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Claw Back of Parent PLUS Loan Proceeds to Pay College Tuition Hits a Roadblock

Over the last few years, Chapter 7 trustees of the bankruptcy estates of parents that paid college tuition for their children in the years before their bankruptcy filings have actively pursued the recovery of those tuition payments as constructively fraudulent transfers. While the case law on the viability of these claims is mixed, the success of some of these claims has appeared to set a new standard of care for trustees. Trustees likely will continue to feel compelled by their fiduciary duty to creditors to assert these fraudulent transfer claims for the foreseeable future.

Trustees now appear to be pushing the boundary of these claims by pursuing the recovery from colleges and universities of the distribution of the proceeds of federal education loans (the so-called "Parent PLUS loans") made to parents for the educational expenses of their dependent children. There are some key differences between the typical case of a parent paying tuition directly to the undergraduate institution and a distribution of Parent PLUS loan proceeds. Unlike the direct payment of tuition from the parent to the child's undergraduate institution, Parent PLUS loan proceeds are paid directly from the lender to the school. Moreover, federal law governing these loans prohibits the use of loan proceeds for anything other than the student's educational expenses. In the few decided cases to date, these distinguishing factors have so far stymied trustees' attempts to avoid and recover the distribution of these loan proceeds.

Claw Back of Parents' Direct Tuition Payments

The Bankruptcy Code provides that a trustee can avoid and recover transfers of property of the debtor in the two years before the bankruptcy filing if the debtor received less than reasonably equivalent value in return and the transfer was made at a time when the debtor was insolvent or became insolvent as a result of transfer.[1] A trustee can also take advantage of state fraudulent transfer law, which generally allows the trustee to avoid and recover transfers that were made four or more years (depending on the state) before the bankruptcy filing.[2]

The courts that have sustained these claims have held that the parents did not receive reasonably equivalent value in exchange for the tuition payments because there was no legal obligation to make such payments.[3] These courts have rejected that the satisfaction of the

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1 11 U.S.C. § 548(a)(1)(B). Transfers also may be subject to avoidance if debtor "intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured . . . ." *Id.*

2 11 U.S.C. § 544(b)(1). Most states that have adopted the Uniform Fraudulent Transfer Act have a four year statute of limitations. However, some states have longer statute of limitations for fraudulent transfer claims. *e.g.,* NY CPLR § 213(8) (six year statute of limitation under NY law). Notably though, Connecticut has recently amended its Uniform Fraudulent Transfer Act to expressly bar "constructive" fraudulent transfer claims against higher education institutions for undergraduate tuition payments by a parent or guardian. *See* Conn. Gen. Stat. § 52-552i(f).

3 *See, e.g., Boscarino v. Board of Trustees of Connecticut State University System (In re Knight)*, Adv. Pro. No. 15-02064, 2017 WL 4410455 at *3-7 (Bankr. D. Conn. Sept. 29, 2017); *Roach v. Skidmore Coll. (Matter of Dunston)*, 566 B.R. 624, 636-37 (Bankr. S.D. Ga. 2017); *Gold v. Marquette Univ. (In re Leonard)*, 454 B.R. 444, 457 (Bankr. E.D. Mich. 2011); *Banner v. Lindsay (In re Lindsay)*, No. 08–9091, 2010 WL 1780065, at *9 (Bankr. S.D.N.Y. May 4, 2010).

moral or familial obligation to provide a post-secondary education for one's child constitutes "value" for purposes of this analysis because "value" in this context focuses on the economic benefit received in exchange for the transfer that would benefit the debtor's creditors. These courts similarly reject the argument that providing a post-secondary education for their child provides "value" by making the child economically self-sufficient because such indirect benefits are not a tangible *quid pro quo* that provides a benefit to the debtor's current creditors.

On the other hand, a number of courts have rejected these claims. These courts have held that the satisfaction of the moral obligation to provide a post-secondary education as well as the economic benefit to parents from making their child economically self-sufficient is sufficient "value" to defeat a fraudulent transfer claim.[4]

Parent PLUS Loans

The Higher Education Act of 1965 (20 U.S.C. § 1001, *et seq.*) (the "HEA") authorizes the Department of Education ("DOE") to make direct loans on behalf of students to certain, participating post-secondary institutions under the William D. Ford Federal Direct Loan Program.[5] One of the authorized loan programs is the Direct PLUS Loan Program, which provides loans to, among others, parents of dependent undergraduate students.[6] When the loans are made directly to parents, it is generally referred to as a "Parent PLUS" loan.

Under the Parent PLUS loan program, eligible parents of students enrolled for an undergraduate degree at a participating college or university may borrow money from the Secretary of the DOE to pay for the student's costs of attending that school.[7] A parent is eligible if he or she is borrowing to pay for the educational costs of a dependent undergraduate student and meets the other applicable disclosure and credit standards.[8] To obtain the loan, the parent, student, and school submit applications to the DOE.[9] The amount of the loans are limited to the cost of attendance minus other estimated financial assistance for the student.[10]

If the loan is approved, the proceeds of the Parent PLUS loan is disbursed by either (1) an electronic transfer of funds directly from the lender to the undergraduate school, or (2) a check copayable to the undergraduate school and parent borrower.[11] Upon a student's withdrawal, any refund or return of funds allocated to the student's direct loan must be paid directly by the participating school to the DOE Secretary.[12] The HEA additionally provides for monetary and criminal penalties against any person who fraudulently obtains Parent PLUS loans or misapplies such funds.[13]

These provisions are reflected in the Model Promissory Note published by the DOE, which is signed by the borrower parent. In particular, the Model Promissory Note provides that: (i) the

4 *Eisenberg v. Penn State Univ. (In re Lewis)*, 574 B.R. 536, 541 (Bankr. E.D. Pa. 2017) ("parent's payment of a child's undergraduate college expenses is reasonable and necessary expense for maintenance of the family and for preparing family members for the future"); *DeGiacomo v. Sacred Heart University, Inc., (In re Palladino)*, 556 B.R. 10, 15-16 (Bankr. D. Mass. 2016) (providing college education to make child financially self-sufficient provides concrete financial benefit to parent who would otherwise continue to support child) [appeal pending]; *Trizechahn Gateway, LLC v. Oberdick (In re Oberdick)*, 490 B.R. 687, 712 (Bankr. W.D. Pa. 2013) ("there is something of a societal expectation that parents will assist with such expense if they are able to do so"); *Sikirica v. Cohen (In re Cohen)*, Adv. Pro. No. 07-02517, 2012 WL 5360956 at *10 (Bankr. W.D. Pa. Oct. 31, 2012) (payment of undergraduate tuition for child is reasonable and necessary for purposes of fraudulent transfer statutes), *rev'd in part on other grounds*, 487 B.R. 615 (W.D. Pa. 2013).
5 20 U.S.C. § 1087a; 34 C.F.R. § 685.101(a).
6 34 C.F.R. § 685.100(a)(3).
7 34 C.F.R. § 685.200(c)(2); *see* 34 C.F.R. §§ 685.100(a)(3), 685.101(b)(3).
8 34 C.F.R. § 685.200(c)(2).
9 34 C.F.R. § 685.201(b).
10 34 C.F.R. §§ 685.203(f) and (g); *see* 34 C.F.R. § 685.101(a).
11 20 U.S.C. § 1078-2(c).
12 34 C.F.R. §§ 685.305, 685.306(a).
13 20 U.S.C. § 1097(a).

the loan proceeds can only be used for the student's authorized educational expenses; (ii) the parent authorizes the school to credit the student's account for the loan proceeds and to pay any refund to the DOE; and (iii) the amount of the loan is limited to the dependent student's estimated costs of attendance.[14]

The *Eisenberg v. Penn State University* Decision

In *Eisenberg v. Penn State Univ. (In re Lewis)*, 574 B.R. 536 (Bankr. E.D. Pa. 2017), the Bankruptcy Court for the Eastern District of Pennsylvania rejected an attempt by a Chapter 7 Trustee to recover from Penn State University funds paid directly by the DOE under a Parent PLUS loan entered into by the debtor for the benefit of his dependent child. After surveying the federal law governing Parent PLUS loans, the court observed that the loan proceeds were never in the debtor's possession or control — a fact that the trustee conceded.[15] Indeed, had the debtor's child withdrawn from school, the court noted that under the regulations the loan proceeds would have to be returned to the DOE — not the debtor.[16]

Because the fraudulent transfer statutes only allow for the avoidance of a transfer of the debtor's property, the fact that the loan proceeds were paid directly to Penn State was fatal to the Trustee's claim.[17] The court concluded that the loan proceeds were never the debtor's property, and federal law precluded the loan proceeds from ever becoming the debtor's property.[18] Moreover, the court observed that allowing the trustee to bring such a claim would be merely a "revenue generating tool" that bore no relation to the purpose of fraudulent transfer laws, which was to recover property that was improperly put out of the reach of the debtor's creditors.[19]

Conclusion

While it appears that claw back claims for tuition payments made directly by parents in the years preceding their bankruptcy cases will continue to be asserted by trustees, the jury is still out on the ability to recover Parent PLUS loan proceeds. However, the limited case law to date indicates that bankruptcy trustees will not be able to maintain these claims because the loan proceeds are never in the parents' custody or control, and federal law places strict restrictions on the use of such proceeds. There are still a number of Parent PLUS loan cases presently winding their way through the courts. The disposition of these cases in the coming months should provide additional guidance on whether trustees have a viable claim to recover the proceeds of such loans from colleges and universities.

Questions or Assistance

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14 *See generally* Master Promissory Note, Direct PLUS Loans, available at https://studentloans.gov/myDirectLoan/mpnPlusHTMLPreview.action (last visited December 18, 2017).
15 *Eisenberg v. Penn State Univ.,* 574 B.R. at 539-40.
16 *Id.,* at 540.
17 *Id.*
18 *Id.*
19 *Id.* Although not published, a similar decision was reached in *Shapiro v. Gideon (In re Gideon),* Adv. Pro. No. 16-04939 (TJT), ECF No. 33 (Bankr. E.D. Mich. April 26, 2017). In that case, the court granted summary judgment to DePaul University on a similar claim to avoid and recover the distributions of a Parent PLUS loan.

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