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Connecticut Bankruptcy Court Rejects Claw Back of Parent Plus Loan Proceeds

Back in December 2017, we wrote about Chapter 7 bankruptcy trustees' attempts to claw back the distribution of Parent Plus loan proceeds to college and universities when the parent that obtained the loan for their child's education later files for bankruptcy [<http://www.shipmangoodwin.com/claw-back-of-parent-plus-loan-proceeds-to-pay-college-tuition-hits-a-roadblock>]. We explained that such efforts had so far been rejected by bankruptcy courts in Pennsylvania and Michigan. In a pair of recent decisions, the Bankruptcy Court for the District of Connecticut has joined the fray and similarly rejected these claims. If this trend holds, this will be good news for colleges and universities because trustees may no longer feel obligated, as a fiduciary for creditors, to bring such claims in Connecticut and potentially in jurisdictions across the country.

As discussed in our prior article, the Department of Education makes Parent Plus loans to parents to pay for tuition and related costs for their dependents' attendance at a participating undergraduate institution. The Department of Education pays the loan proceeds directly to the school, and if the student withdraws from school, the unused loan proceeds are paid back to the Department of Education.¹

The only two courts to have previously considered whether the distribution of Parent Plus loan proceeds could be recovered as fraudulent transfers rejected such a claim. The courts held that fraudulent transfer claims can only recover property that was the property of the debtor and Parent Plus loan proceeds were never the debtor's property because the proceeds were paid directly to the university. In addition, the courts found that the debtor could not have used the loan proceeds to pay his or her creditors because the pertinent statutes and regulations required that the proceeds be used solely to pay the dependent's tuition costs.

In decisions issued on February 27, 2018, in *Novak v. University of Miami*, Adv. Pro. No. 17-02036 and *Boscarino v. Ithaca College*, Adv. Pro. No. 16-02002, the Connecticut Bankruptcy Court (Tancredi, J.) agreed with those prior decisions and rejected Chapter 7 trustees' attempts to recover the proceeds of Parent Plus loans paid to University of Miami and Ithaca College, respectively. The Court explained its reasoning in a Memorandum of Decision entered in the *University of Miami* case, which was adopted in the *Ithaca College* case.²

In *Novak v. University of Miami*, the trustee sought to recover the distribution of the loan proceeds under both the Connecticut Uniform Fraudulent Transfer Act ("CUFTA") and Section

¹ You can read more about the background on Parent Plus loans in our prior article available here: <http://www.shipmangoodwin.com/claw-back-of-parent-plus-loan-proceeds-to-pay-college-tuition-hits-a-roadblock>.

² *Boscarino v. Ithaca College*, Adv. Pro. No. 16-02002, Memorandum of Decision on Defendant's Motion for Summary Judgment, ECF No. 63, p. 4 (Bankr. D. Conn. filed Feb. 27, 2018).



548 of the Bankruptcy Code.³ The Court observed that both CUFTA and the Bankruptcy Code's fraudulent transfer provision require that the challenged transfer must have been of the debtor's property or assets.⁴ The Court reviewed in detail the statutes and regulations governing Parent Plus loans. The Court agreed with the prior decisions that under the statutes and regulations governing Parent Plus loans, Parent Plus loan proceeds could never have been the debtor's property.⁵ As a result, the Court dismissed the trustee's complaint.⁶ The Court observed that this result is consistent with the purposes of fraudulent transfer laws – to recover property that would have been available to creditors had it not been transferred – because Parent Plus loan proceeds could never have been available to the debtor's creditors under the governing statutes and regulations.⁷

As the Connecticut Bankruptcy Court acknowledged,⁸ there now appears to be an emerging consensus in the case law that Parent Plus loan proceeds are not subject to fraudulent transfer recovery. However, no appellate level court has yet ruled on the viability of these claims. Nonetheless, the series of adverse rulings may have now reached the level that trustees will no longer feel a fiduciary duty to bring such claims – at least in Connecticut and perhaps nationwide.

Questions or Assistance

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3 *Novak v. University of Miami*, Adv. Pro. No. 17-02036, Memorandum of Decision on Defendant's Motion to

4 Dismiss, ECF No. 32, pp. 5-9 (Bankr. D. Conn. filed Feb. 27, 2018) (hereinafter, the "MOD").

5 MOD, at p. 4.

6 MOD, at pp. 5-9.

7 MOD, at p. 9.

8 MOD, at pp. 8-9.

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