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Author:



Eric S. Goldstein
(860) 251-5059
egoldstein@goodwin.com

Private Schools Defeat Clawback Claim by Chapter 7 Trustee

Over the last few years, Chapter 7 Trustees have aggressively sought to clawback tuition payments made to colleges and universities by parents on behalf of their children after the parents filed for Chapter 7 bankruptcy. These efforts have met with mixed success.¹ Now, it appears that Chapter 7 Trustees are setting their sights on private secondary and elementary schools to clawback tuition payments. However, in two recent opinions, the U.S. Bankruptcy Court for the Eastern District of New York has dismissed fraudulent transfer and unjust enrichments claims against private schools seeking to recover tuition payments made in the years before the debtor's bankruptcy case.

In these cases, the debtor, Judith Michel, filed for Chapter 7 bankruptcy on July 4, 2014. In the six years before she filed for bankruptcy, Ms. Michel made tuition payments to two private schools, Trey Whitfield School and Lawrence Woodmere Academy, on behalf of her two minor children in the total amount of \$115,200. The Chapter 7 Trustee appointed to her case later sued both schools to recover these tuition payments under three theories: constructive fraudulent transfers under New York law and the Bankruptcy Code; unjust enrichment under New York law; and intentional fraudulent transfers under New York Law and the Bankruptcy Code.² In response to these claims, the schools moved to dismiss the complaints. On September 18, 2017, the Bankruptcy Court granted the motions to dismiss.

To establish a constructive fraudulent transfer under New York Law and the Bankruptcy Code, a trustee generally has to establish that the transfer was made at a time the transferor was insolvent (or the transfer would have rendered her insolvent) and the transferor did not receive reasonably equivalent value in exchange for the transfer. Here, the Bankruptcy Court ruled that the Trustee's constructive fraudulent transfer claim failed because he failed to allege that Ms. Michel did not receive reasonably equivalent value. The Trustee argued that the satisfaction of Ms. Michel's legal obligation to provide an education for her children was not reasonably equivalent value for the transfers because satisfying this obligation did not yield her a concrete economic benefit. The Bankruptcy Court rejected this argument and held that Ms. Michel's satisfaction of her obligation under New York law to educate her children, the failure of which could have subjected her to a loss of custody or other sanctions, provides sufficient value in this context. Moreover, the Court rejected the Trustee's argument that the transfers lacked value because this obligation could have been satisfied for free by sending the children to public school. The Bankruptcy Court explained that a Trustee cannot scrutinize a debtor's expenditures and seek to recover any expenditures that the Trustee concludes could have been achieved at a lower cost.

1 *Compare DeGiacomo v. Sacred Heart Univ. Inc. (In re Palladino)*, Adv. No. 15-01126, 556 B.R. 10 (Bank. D. Mass. 2016) (rejecting fraudulent transfer claim to recover college tuition); with *Gold v. Marquette Univ. (In Re Leonard)*, 454 B.R. 444 (Bankr. E.D. Mich. 2011) (holding that college tuition can be clawed back as fraudulent transfer). Notably, Connecticut recently amended its Fraudulent Transfer Act to exclude claims against colleges and universities to recover tuition paid by a parent or guardian of a child. Conn. Gen. Stat. 52-552i(f).

2 The fraudulent transfers claims were asserted under 11 U.S.C. §§ 544 and 548, as well as New York Debtor and Creditor Law §§ 273, 274, 275, and 278.



Turning to the unjust enrichment claim, the Bankruptcy Court observed that to succeed on such a claim, the Trustee had to allege that the schools unfairly benefited from receipt of the transfers. The Bankruptcy Court held that the Trustee did not do so because he failed to allege that the transfers were anything other than ordinary tuition payments or that the schools did not provide an adequate education in exchange for the transfers.

Finally, the Bankruptcy Court rejected the Trustee's intentional fraudulent transfer claim because the Trustee failed to allege adequately that Ms. Michel made these transfers with the intent to hinder, delay, or defraud her creditors. The Court reasoned that the Trustee's complaint had no allegations that Ms. Michel made these payments with an ulterior motive. To the contrary, the Court noted that the allegations showed that the tuition payments conferred a tangible benefit on Ms. Michel by satisfying her legal obligation to educate her children. The Court also held that the mere allegation that Ms. Michel had applied for financial aid from the schools did not show that she made the tuition payments with the intent of defrauding her creditors.

While this decision is a complete victory for the schools, the Trustee may still appeal it in the coming days. Moreover, since it is not binding precedent, Chapter 7 Trustees may continue to press these types of clawback claims on the hope of reaching a quick settlement. Schools should consult with counsel to determine the validity and risks that such claims pose, particularly, as this area of the law develops over time.

The cases are captioned *Geltzer v. Lawrence Woodmere Academy*, Adv. Pro. No. 16-01121-ess (Bankr. E.D.N.Y.) and *Geltzer v. Trey Whitfield School*, Adv. Pro. No. 16-01122-ess (Bankr. E.D.N.Y.). The Bankruptcy Court's decisions can be found at http://www.nyeb.uscourts.gov/sites/nyeb/files/opinions/opinion_ess_17-09-18.pdf and http://www.nyeb.uscourts.gov/sites/nyeb/files/opinions/opinion_ess_17-09-18%202.pdf.

Questions or Assistance:

For questions about this alert, please contact Eric Goldstein at (860) 251-5059 or egoldstein@goodwin.com.

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289 Greenwich Avenue
Greenwich, CT 06830-6595
203-869-5600

One Constitution Plaza
Hartford, CT 06103-1919
860-251-5000

265 Church Street - Suite 1207
New Haven, CT 06510-7013
203-836-2801

400 Park Avenue - Fifth Floor
New York, NY 10022-4406
212-376-3010

300 Atlantic Street
Stamford, CT 06901-3522
203-324-8100

1875 K St., NW - Suite 600
Washington, DC 20006-1251
202-469-7750

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