An Economic Unit Approach to Evaluating the Payment of Undergraduate Educational Expenses as Fraudulent Transfers

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INTRODUCTION

The fraudulent transfer is an early concept in the law regulating debtor-creditor relations. Under this body of jurisprudence, dating back to the 1500s, debtors are forbidden from transferring their assets away for the purpose of moving those assets beyond the reach of their creditors. This doctrine has expanded to include the concept of constructive fraud. The doctrine of constructive fraud prohibits a debtor who is in a financially precarious position from engaging in a transfer, or incurring an obligation, for which the debtor does not receive “reasonably equivalent value” in exchange.

Because intent to defraud is not a required element of constructive fraud, third parties who receive transfers from the debtor, even when the subject transactions involve no intent to frustrate creditor collection efforts, may find themselves the target of constructive fraudulent conveyance lawsuits. Indeed, fraudulent transfer law has been used to challenge a variety of transactions. Many of these transactions bear no resemblance to the archetypal tale of the devious debtor who secretly transfers the debtor’s assets away so creditors are unable to take them to satisfy the debts owed to them.¹ Most recently, the doctrine of constructive fraud has

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been used to upend a type of transaction that is generally expected by many in U.S. society – the payment by parents, at least in part, of the undergraduate educational expenses of their children.

This issue came to the fore in the bankruptcy case of Lori and Steven Palladino. When their multimillion-dollar Ponzi scheme began to crumble, the Palladinos filed for bankruptcy relief under Chapter 7 of the Bankruptcy Code. Shortly after their bankruptcy filing, the Palladinos each pled guilty to charges of investment fraud for operating the Ponzi scheme.

Steven Palladino was sentenced to ten years in state prison. Lori Palladino was sentenced to five years of probation. As is the case with all bankruptcy proceedings under Chapter 7 of the Bankruptcy Code, a Chapter 7 trustee was appointed and charged with marshalling and liquidating nonexempt assets of the debtor to satisfy, to the extent possible, debts owed to creditors.

In addition to operating a Ponzi scheme in the years leading up to their bankruptcy filing, the Palladinos were also parents to a daughter who was attending college at Sacred Heart University (“SHU”). In the four years prior to their bankruptcy filing, the Palladinos paid a total of approximately $65,000.00 to SHU to cover the cost of their daughter’s college education. The trustee for the Palladinos’ bankruptcy estate sued SHU, seeking to set aside as constructive

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3 Under the Bankruptcy Code, consumer debtors are permitted to protect some of their assets from the claims of creditors because they are “exempt” under federal bankruptcy law or under the laws of the debtor's home state. 11 U.S.C. § 522(b) (2018). The Bankruptcy Code contains designated exemptions. It also permits each state to adopt its own exemption law in place of the federal exemptions. Some states give consumer debtors the option of choosing between a federal exemption law or the exemptions available under state law. Thus, whether certain property is exempt and may be kept by the debtor is often a question of state law.
fraudulent transfers the $65,000.00 in payments and to recover those payments from SHU. The trustee argued, among other things, that the payments were constructively fraudulent, because the debtors had not received “reasonably equivalent value” in exchange for the payments. Any value given, the trustee argued, was given by SHU (in the form of an education) to the Pallandinos’ daughter, and not to the Pallandinos.

The bankruptcy court rejected this contention, finding the trustee’s, “approach to valuing the Palladinos’ payments to SHU overly rigid.” Holding that reasonably equivalent value had been given to the Palladinos, the court explained that, in making the payments to SHU, the debtors, “believed that a financially self-sufficient daughter offered them an economic benefit and that a college degree would directly contribute to financial self-sufficiency” and that such motivation was, “concrete and quantifiable enough” to establish “reasonably equivalent value.”

The payment of undergraduate educational expenses by a debtor on behalf of the debtor’s child was also attacked as constructively fraudulent in connection with the bankruptcy case of Dr. Leslie Dunston – albeit with an outcome different than the outcome in *Palladino*. Dr. Dunston operated a medical practice for nearly two decades. Dr. Dunston’s practice began to suffer from severe cash flow shortages when it experienced difficulties collecting reimbursements from medical insurance companies. Finally, in October of 2014, Dr. Dunston filed for Chapter 7 bankruptcy relief. As was the case with the Palladinos, Dr. Dunston also had a daughter in college during the years immediately preceding Dr. Dunston’s bankruptcy filing. In the two years prior to the bankruptcy filing, Dr. Dunston paid approximately $87,000.00 to Skidmore College (“Skidmore”) to cover Dr. Dunston’s daughter’s tuition and other costs of

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7 Id. at 16.
attendance. The trustee for Dr. Dunston’s bankruptcy estate sued Skidmore, seeking to avoid as constructive fraudulent transfers the payments made by Dr. Dunston to Skidmore and to recover those payments from Skidmore. Just as the trustee in the Pallandinos’ case had argued, the trustee for Dr. Dunston’s bankruptcy estate argued that Skidmore had not given Dr. Dunston reasonably equivalent value in exchange for the payments. In stark contrast to the decision reached by the bankruptcy court in Pallandino, the bankruptcy court in Dunston agreed with the trustee, holding that, “[f]or constructively fraudulent transfer avoidance purposes, a debtor does not receive ‘reasonably equivalent value’ in exchange for the payment of an adult child’s college tuition.”\(^9\) The Dunston court reached this conclusion because it determined that, “[w]hile the debtor may feel a moral obligation to pay for the debtor’s child's college education and help the child achieve financial independence, the satisfaction of such a moral obligation does not provide an ‘economic’ benefit to the debtor.”\(^10\)

The defendant educational institutions are, of course, the immediate losers in cases such as Dunston. In conjunction with finding that such tuition payments are fraudulent transfers, the defendant college or university may be ordered to then turnover (refund) the subject tuition payments to the trustee.\(^11\) Tuition is an important component of revenues for colleges and universities.\(^12\) As such, forced disgorgement of tuition payments could have a destabilizing effect on the target colleges and universities. In addition, as the direct beneficiary of such payments, the student who received the education at the center of such disputes may find themselves responsible for repaying the subject payments to the defendant college or university,

\(^9\) Id.
\(^10\) Id.
or even directly to the trustee. Alternatively, these students might themselves be sued by the trustee for the recovery of monies used to pay for their tuition or other educational expenses. This fact is particularly problematic, given the drastic rise in tuition costs over the last several years and the increase in student loan debt many students now face.

For many years, the payment of educational expenses as the subject of fraudulent transfer actions by bankruptcy trustees against colleges and universities was largely unheard of. In recent years, however, several colleges and universities have been the target of these claims.

An initial transferee of a fraudulent transfer is strictly liable for recovery of an avoidable transfer. Transferees that are not the initial transferees (i.e. transferees that are subsequent transferees), however, are afforded a “good faith” defense to the trustee’s recovery under 11 U.S.C. § 550(b). Some colleges and universities have successfully argued that they are subsequent transferees of payments by debtor-parents (with the initial transferee of these transfers being the student). As such, they may be entitled to a good faith defense against the recovery of these payments. Pergament v. Hofstra University (In re Adamo), 595 B.R. 6 (E.D.N.Y. 2019). This Article focuses on the evaluation of the reasonably equivalent value requirement. It does not address the good faith transferee defense that subsequent transferees may assert after a given transfer has been deemed to be fraudulent.

Instances of bankruptcy trustees seeking the return of educational payments made by debtors for their adult children has sparked interest and even outrage. Given the skyrocketing costs of tuition, it is reasonable to assume that trustees will bring these claims with greater frequency in the coming years. When tuition was relatively low, trustees likely considered the prospect of pursuing those payments, along with the associated costs and risks, and perhaps surmised that pursing those payments was not worth the trouble. As tuition costs have risen, the dollar value of the pre-bankruptcy tuition payments made by parents has likely risen concomitantly, undoubtedly making the recovery of those payments a more enticing opportunity to trustees.

How should courts evaluate “reasonably equivalent value” for purposes of constructive fraudulent transfer law in the context of the payment of undergraduate educational expenses by debtor-parents for their adult children? The Dunston and Palladino decisions illustrate that this

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In response to these actions by trustees, a group of representatives in Congress introduced the Protecting All College Tuition Act of 2015, H.R. 2267, 114th Cong. (2015) (“PACT”). PACT proposes to protect tuition payments by debtor-parents by excluding those payments from the reach of Section 548 of the Bankruptcy Code, the provision of the Bankruptcy Code that provides a federal cause of action for fraudulent transfer. Accordingly, PACT provides that Section 548 is to be, “amended by adding at the end the following: ‘(f) A payment of tuition by a parent to an institution of higher education (as defined in either section 101 or 102 of Higher Education Act) for the education of that parent's child is not a transfer covered under paragraph (1)(B).’” Id. Progress on the potential passage of PACT has stalled in the House of Representatives. Pursuant to Section 544 of the Bankruptcy Code, however, trustees may also bring claims of fraudulent transfer under state law. Thus, even were Congress to sign PACT into law, it would not prevent trustees from acting under applicable state fraudulent conveyance law.


21 It should be noted that issues also arise with respect to the payment by debtor-parents of tuition to private schools for their children in grades K-12 and with respect to payments made by debtor-parents for the graduate school expenses of their adult children. Further, the payments made by debtor-parents to cover undergraduate educational
issue is often central to the resolution of these claims. They also illustrate the lack of consistency in the courts’ assessment of whether reasonable equivalent value will be seen has having been given to the debtor-parents, such that the defendant college or university will not have to disgorge these payments.

Although relatively few courts have analyzed reasonably equivalent value in the attempted claw-back of tuition payments, numerous courts and commentators have struggled with the application of the reasonably equivalent value requirement in various other contexts. The traditional paradigm of the fraudulent transfer has proven inadequate to address a variety of transactions, including both consumer transactions and commercial transactions. One example

expenses of their adult children may also be subject to scrutiny under other provisions of the Bankruptcy Code - such as in connection with considering whether a debtor’s proposed plan of repayment in a Chapter 13 case should be confirmed, see 11. U.S.C. § 1325(b)(2018), or whether the debtor’s bankruptcy case should be dismissed as an abuse of the bankruptcy process, see 11 U.S.C. § 707(b). These issues, while important and certainly worthy of consideration, are beyond the scope of this Article.

22 See discussion infra Part II.

23 In the 1990s, trustees waged a similar attack against churches and charitable organizations that had received donations from debtors in the months and even years leading up to the debtors’ bankruptcy filing. In that context, trustees argued that donations to religious institutions and charitable organizations did not result in a cognizable value to the debtor for purposes of the requirement in fraudulent conveyance law that the debtor receive “reasonably equivalent value” in exchange for such transfers by the debtor (i.e. the debtor’s donations).

In response to these actions, Congress passed the Religious Liberty and Charitable Donation Protection Act of 1998 (the “Donation Protection Act”). Pub. L. No. 105-183, 112 Stat. 517 (1998). The Donation Protection Act amended several provisions of the Bankruptcy Code, including § 544(b), § 548(a)(2), § 707(b), and § 1325(b)(2)(A). These revisions are aimed at protecting the debtor’s ability to make donations to religious institutions and charitable organizations without the risk that such donations might compromise the debtor’s ability to seek bankruptcy relief or subject the recipients of those donations to potential fraudulent conveyance litigation. Specifically with respect to fraudulent transfer actions, the Donation Protection Act modified the Bankruptcy Code to protect certain contributions to qualified religious or charitable organizations by debtors under Chapters 7, 11, 12, and 13. More particularly, § 548(a)(2)(A) prevents the trustee from avoiding as a constructively fraudulent transfer a charitable contribution to a qualified religious or charitable organization if the amount of the contribution was not more than fifteen percent of the debtor's gross annual income. If a charitable contribution to a qualified religious or charitable organization exceeded fifteen percent of the debtor's gross annual income, § 548(a)(2)(B) prevents the trustee from avoiding that contribution “if the transfer was consistent with the practices of the debtor in making charitable contributions.” § 548(a)(2)(B). In addition, because § 544 of the Bankruptcy Code permits the trustee to bring these claims under state fraudulent transfer law, the Donation Protection Act adds an exception to § 544(b) to exclude from the reach of state fraudulent transfer law transfers to qualified religious or charitable organizations to the same extent those transfers are protected from attack under § 548. § 544(b).
of this failing in the commercial context is illustrated in the application of constructive fraudulent transfer law to intercorporate guarantees. In response to the inadequacy of the prototypical vision of fraudulent transfer law, courts have developed various doctrines, designed to compensate for the shortcomings stemming from the traditional model. The traditional fraudulent transfer model is similarly ill equipped to address the question of whether a debtor-parent receives reasonably equivalent value in exchange for paying the undergraduate educational expenses of the debtor’s adult child.

The purpose of this Article is to offer a new framework for analyzing reasonably equivalent value in constructive fraudulent transfer law as applied to undergraduate educational expenses paid by debtor-parents on behalf of their adult children. The proposed approach aims to create greater consistency and efficiency in the resolution of these claims, while also having the treatment of these claims better promote the “fresh-start” policy of bankruptcy and more faithfully reflect the original purpose of fraudulent transfer law.

Part I of this Article frames the discussion by presenting the origins and purpose of fraudulent transfer law. Part II discusses the constructive fraudulent transfer, focusing on the doctrine courts have employed to assess whether reasonably equivalent value has been given to

As noted supra note 21, in addition to claims of fraudulent transfer, issues related to Chapter 13 plan confirmation and dismissal of purportedly “abusive” Chapter 7 filings may be raised in the context of the payment of educational expenses by debtor-parents.

To address these issues in a comprehensive manner, an approach akin to the approach taken in the Donation Protection Act is likely necessary. This more comprehensive approach to protecting the payment of educational expenses by debtor-parents is likely warranted based, in part, on some of the same considerations underpinning the passage of the Donation Protection Act. A discussion of these analogies and their potential implications is beyond the scope of this Article. To be clear, however, there are significant, relevant distinctions between religious and charitable donations, on the one hand, and the payment of the tuition of an adult child, on the other. Both the varied and widespread economic benefits of obtaining a college degree and the interconnected nature of the economic lives of debtors and their children support that a finding of reasonable equivalent value in the context of the payment of educational expenses by debtor-parents may be warranted, even absent a comprehensive legislative approach to addressing the problem.
the debtor transferor. Part III provides an overview of individuals in bankruptcy, including presenting key underlying policies and goals of bankruptcy for individuals. Part IV provides context for considering the payment of educational expenses as constructive fraudulent transfers by examining the interconnected nature of the family generally, analyzing the relationship between parents and their adult children, and considering its economic ramifications. Part IV also discusses the perceived and actual benefits of a college education and how the responsibility for paying for such education is treated in the United States. Part V examines the assessment of reasonably equivalent value in the context of the payment by debtor parents of undergraduate educational expenses for their adult children. Part VI proposes a new approach to assessing the reasonably equivalent value requirement in the context of these payments based on an assessment of reasonable value to the debtor’s economic unit. This test would assess the economic relationship between the debtor-parent and the adult child to determine whether the debtor-parent and adult child should be taken as a single economic unit for purposes of constructive fraudulent transfer law. It would also ask whether value, in the form of an education, was in fact provided to the debtor’s adult child in exchange for the subject payments. Finally, it would consider whether the expenses paid were necessary for the adult child to receive the education provided. The Article concludes that such a test for reasonably equivalent value in this context will result in a more standardized and efficient approach to the courts’ consideration of such claims and, moreover, that the proposed test would more accurately reflect the economic realities of the family. As such, the proposed test will more faithfully advance the overarching purposes of both bankruptcy and fraudulent transfer law.
I. THE HISTORY AND PURPOSE OF FRAUDULENT TRANSFER LAW

A. The Origins of Fraudulent Transfer Law

Fraudulent transfer law was originally developed to remedy actions taken by a debtor that were aimed at impeding the creditor’s ability to collect on the debt owed to the creditor.\(^{24}\) The prohibition against such transfers was first codified in the Statute of Elizabeth, 13 Eliz., c.5. This statute invalidated transfers that were designed, “‘to delay, hinder or defraud creditors and others.’”\(^{25}\) A deliberate attempt by the debtor to move assets beyond the reach of the debtor’s creditors has come to be known as “actual fraud.”\(^{26}\)

Determining whether a given transfer was in fact, “a device to ‘hinder, delay or defraud’ creditors while reserving some benefit for the debtor” is often difficult.\(^{27}\) In response to this challenge, English courts developed the doctrine of “badges of fraud.” Under this doctrine, the courts could consider circumstantial evidence in determining whether a subject transfer was intended to impede the collection efforts.\(^{28}\) This doctrine required, “proof by a creditor of certain objective facts (for example, a transfer to a close relative, a secret transfer, a transfer of title without transfer of possession, or grossly inadequate consideration).”\(^{29}\) The existence of sufficient badges

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\(^{24}\) Bonded Fin. Servs. v. European Am. Bank., 838 F.2d 890, 892 (7th Cir. 1988) (noting that fraudulent transfer law was originally designed to address “debtors who transferred property to their relatives, while the debtors themselves sought sanctuary from creditors” allowing the debtor’s family to enjoy “the value of the assets, which the debtor might reclaim if the creditors stopped pursuing him”). For a detailed discussion of the history of fraudulent transfer law see Kenneth C. Kettering, The Uniform Voidable Transactions Act; or, the 2014 Amendments to the Uniform Fraudulent Transfer Act, 70 BUS. LAW. 777, 778-79 (2015). For a history of fraudulent transfer its interaction with bankruptcy, see Husky Int’l Electronics, Inc. v. Ritz, 136 S.Ct. 1581, 1587 (2016).


\(^{26}\) For a detailed discussion of fraudulent transfers that are “actually” fraudulent, see Jack F. Williams, Revisiting the Proper Limits of Fraudulent Transfer Laws., 8 BANKR. DEV. J. 55 (1991).

\(^{27}\) Boston Trading Groups, Inc. v. Burnazos, 835 F.2d 1504, 1509 (1st Cir. 1987).

\(^{28}\) Id.; BFP v. Resolution Trust Corp., 511 U.S. at 540.

of fraud, “would raise a rebuttable presumption of actual fraudulent intent.” Fraudulent transfer law based on the “badges of fraud” doctrine, however, has been plagued with, “considerable uncertainty regarding the precise combination of badges of fraud that constituted fraudulent intent.”

The objective of undoing of transfers made by the debtor with the intent to delay, hinder or defraud creditors was incorporated into both the federal Bankruptcy Code and the various state laws that are modeled on the Uniform Fraudulent Conveyance Acts (“UFCA”) and its successor, the Uniform Fraudulent Transfer Acts (“UFTA”), recently amended to be called the Uniform Voidable Transactions Act (“UVTA”). In addition, some of the commonly accepted badges of fraud have been codified in the various state fraudulent transfer laws and the Bankruptcy Code, creating a separate cause of action based on “constructive fraud.”

30 BFP v. Resolution Trust Corp., 511 U.S. at 541.
32 See 11 U.S.C. § 548(a)(1) (2018) (permitting trustee to avoid any transfer made “with actual intent to hinder, delay or defraud”); UNIF. FRAUDULENT TRANSFER ACT § 4(a)(1) (declaring transfers made or obligations incurred to be fraudulent if made “with actual intent to hinder, delay, or defraud”); UNIF. FRAUDULENT CONVEYANCE ACT § 7, 7A (“[Conveying] with actual intent ... to hinder, delay, or defraud either present or future creditors ... is fraudulent as to both present and future creditors.”). The Bankruptcy Act of 1898 “specifically adopted the language of the Statute of 13 Elizabeth” and “[e]very American bankruptcy law has incorporated a fraudulent transfer provision.” BFP v. Resolution Trust Corp., 511 U.S. at 541; see also Simkovic & Kaminetzky, supra note 31, at 135.
33 The UVTA was adopted by the Uniform Law Commission in 2014 as the successor to the UFTA. UNIF. VOIDABLE TRANSACTIONS ACT (UNIF. LAW COMM’N 2014). The UVTA amendments to the UFTA have since been adopted by twenty states. UNIF. LAW Comm’n, Voidable Transactions Act Amendments - Formerly Fraudulent Transfer Act, (last visited April 8, 2019), https://www.uniformlaws.org/committees/community-home?communitykey=64ee1ccc-a3ae-4a5e-a18f-a5ba8206bf49&tab=groupdetails.
34 Boston Trading Groups, Inc. v. Burnazos, 835 F.2d 1504, 1509 (1st Cir. 1987); see also Barry L. Zaretsky, Fraudulent Transfer Law as the Arbiter of Unreasonable Risk, 46 S. C. L. REV. 1165, 1165 (1995) (observing that,
courts to void certain transfers that deplete the debtor's estate to the detriment of its creditors, even when it is not shown that a transfer was designed to delay, hinder or defraud creditors. This type of transfer occurs when a financially unstable debtor transfers an asset or incurs an obligation without receiving a reasonable equivalent value in return.

B. Fraudulent Transfer Law in Bankruptcy

In bankruptcy, fraudulent transfer law is a powerful tool because it permits the trustee to void certain payments or other transfers that were made by the debtor prior to the debtor’s bankruptcy filing.35 Under Section 548 of the Bankruptcy Code, the trustee may make a claim of “actual fraud”36 or “constructive fraud.”37 Section 548 permits a trustee to avoid fraudulent transfers made by a debtor within the two years prior to the debtor’s bankruptcy filing date (known as the “petition date”). This two-year period is colloquially referred to as the “look-back” period because the trustee “looks-back” to examine payments made or obligations incurred during the applicable time period.

Under Section 544(b) of the Bankruptcy Code, the trustee also has the authority to avoid any transfers by the debtor that an unsecured creditor with an allowable claim38 could avoid under applicable state fraudulent transfer law.39 As noted, most state laws are fashioned after either the UFCA or the UFTA.40 These acts both generally provide that a transfer is avoidable if it is either: (a) actually fraudulent, or (b) constructively fraudulent – the same causes of action

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that are recognized by Section 548 of the Bankruptcy Code. Importantly, however, state law fraudulent transfer statutory schemes typically provide for a look-back period ranging from three to six years, potentially giving the trustee the authority to question payments made by the debtor as much as six years prior to the debtor’s bankruptcy filing. 41

Fraudulent transfer law has been used to challenge transfers made and obligations incurred in a variety of scenarios – including transactions involving leveraged buyouts, 42 corporate spin-offs, 43 dividend recapitalizations, 44 real property foreclosures, 45 and intercorporate guaranty obligations. 46 Because an intent to hinder, delay, or defraud creditors is not a required element for constructive fraud, third parties who receive transfers from the debtor or who are the beneficiaries of obligations assumed by the debtor, even when the subject transactions involve no intent to take actions that impede the collections efforts of creditors, are often the target of constructive fraud claims.

C. The Search for Purpose in Fraudulent Transfer Law

Following a borrower’s default, an unsecured creditor generally has the authority to seek a judgment against the borrower. Upon obtaining a judgment, the unsecured creditor may, subject to applicable exceptions, 47 pursue the assets of the borrower to satisfy its judgment. The archetypal tale of a fraudulent transfer consists of a borrower engaging in clandestine

41 These look back periods are codified by state statutes of limitations. For example, New York generally recognizes a six year look back period, codified by the statute of limitations set forth in section 213(1) of the New York Civil Practice Law and Rules.
43 See, e.g., In re VFB v. Campbell Soup. 482 F.3d 624 (3d Cir. 2007).
44 See, e.g., Simkovic & Kaminetzky, supra note 31, 128-30 (noting challenges faced by these transactions).
47 An exempt asset is protected from collection actions by creditors. Each state has a set of exemptions that apply in bankruptcy. Most states require a debtor to use those state exemptions. Seventeen states allow debtors to choose between the state exemption system and another set of exemptions contained in the Bankruptcy Code. 11 U.S.C. §522 (2018) (listing federal exemptions).
transactions that result in “last-minute diminutions in the pool of assets” and are taken in an effort to move property beyond the reach of the debtor’s creditors.48 “Most of us envision a debtor bogusly selling property to a friend or relative for much less than its worth.”49 With this backdrop, the fraudulent transfer can be understood as a contravention of the creditor’s right to recover from the available assets of the creditor’s debtor.50 Fraudulent transfer law protects the rights of the unsecured creditor by prohibiting the debtor from transferring the debtor’s assets with the intent, either actual or implied through the doctrine of constructive fraud, of diminishing the assets available to the debtor’s creditors.51

Many authorities assert that the purpose of fraudulent transfer law is the preservation of the debtor’s assets for the benefit of the debtor’s unsecured creditors.52 With this understanding of the purpose of fraudulent transfer law, courts are compelled to determine what constitutes a reasonably equivalent value – and thus whether a transfer is constructively fraudulent – from the standpoint of a debtor’s creditors.53 From the standpoint of the creditors of a debtor, a transfer that does not benefit the creditors of the debtor does not provide value.54 Professor Jack

49 Williams, Fallacies, supra note 40, at 1421.
50 See also Thomas H. Jackson, Avoiding Powers in Bankruptcy, 36 Stan. L. Rev. 725, 725 n.1 (1984); Williams, Fallacies, supra note 40, at 1421.
52 See, e.g., DeGiacomo v. Sacred Heart University (In re Palladino), 942 F.3d 55, 59 (1st Cir 2019) (“Because fraudulent transfer law’s purpose is to preserve the debtor’s estate for the benefit of unsecured creditors, courts evaluate transfers from the creditors’ perspective”) (citing Riley v. Countrywide Home Loans, Inc. (In re Duplication Mgmt., Inc.), 501 B.R. 462, 483 (Bankr. D. Mass. 2013)); Bundles v. Baker (In re Bundles), 856 F.2d 815, 825 (7th Cir.1988); In re Chase & Sanborn Corp., 813 F.2d 1177, 1181 (11th Cir. 1987); Rubin v. Manufacturers Hanover Trust Co., 661 F.2d 979, 992 (2d Cir.1981); In re Butcher, 58 B.R. 128, 130 (Bankr. E.D. Tenn. 1996); see also, Williams, Fallacies, supra note 40, at 1413 (observing that, “preservation of the estate for the benefit of one’s creditors is a core element of fraudulent transfer jurisprudence. But just as there is more to the apple than its core, so too there is more to fraudulent transfer jurisprudence than the preservation of the estate for one’s unsecured creditors”).
54 Id.
Williams has observed that this view of the purpose of fraudulent transfer law is the, “confounding of purpose with effect” and that it has, “led many a court astray in assessing fraudulent transfer liability.”\textsuperscript{55} A benefits-to-the-creditors requirement for a finding of value in constructive fraudulent conveyance law has implicated many transactions that, “[do] not seem at all like the Elizabethan deadbeat who sells his sheep to his brother for a pittance.”\textsuperscript{56}

A view of fraudulent transfer law that would declare any transfer that results in a net loss to the debtor’s estate to be constructively fraudulent ultimately turns on itself. From a practical perspective (setting aside any challenges that may be faced in its implementation\textsuperscript{57}) a retrospective, balance-sheet test of “value” would likely have a negative economic impact at the macro-level. Such a narrow understanding of value would permit – and perhaps even incentivize – creditors of the debtor to simply sit back and wait to see whether financial decisions made by the debtor are ultimately economically beneficial, challenging only those decisions that do not ultimately “pay off” with a net positive gain to the debtor (and the debtor’s creditors).\textsuperscript{58} Similarly, the debtor may be hesitant to take risks that creditors might otherwise want the debtor to take, fearing that these transactions may later be subject to attack.\textsuperscript{59} Moreover, the third party to the fraudulent transfer triangle – the would-be counter-party to a proposed transaction with the debtor – may also adjust the third party’s behavior to account for the perceived risk that the transaction at issue may later be undone by an unhappy creditor to the debtor. It is, after-all, the transferee who will likely be left “holding the bag” if a transfer is successfully challenged as a

\textsuperscript{55} Williams, Fallacies, supra note 40, at 1421.
\textsuperscript{56} See Baird & Jackson, supra note 25, at 852.
\textsuperscript{57} See, e.g., Simkovic & Kaminetzky, supra note 31, passim (discussing challenges inherent in the process of valuation, particularly as done in hindsight to a given transaction).
\textsuperscript{58} Baird & Jackson, supra note 25, at 852.
\textsuperscript{59} Id. at 853.
voidable transfer. Ultimately, the increased risk associated with transactions should lead to increased transaction costs and may result in missed financial opportunities.

Although preservation of the debtor’s estate for the benefit of unsecured debtors may be the effect of the undoing of a transaction as fraudulent, the fact that a subject transaction may not have resulted in a net financial benefit to the debtor’s estate has not proven sufficient, standing alone, to warrant its undoing. In fact, when courts have been faced with factual scenarios that do not neatly fit the paradigmatic fraudulent transfer, they have crafted doctrines and shifted their frame of reference away from the benefits-to-creditors requirement, adjusting the lens to see a different picture, often resulting in the preservation of the transaction being subjected to scrutiny.60 Thus, the unifying purpose of fraudulent transfer law generally, and constructive fraudulent transfer law specifically, must be something more than the preservation of the debtor’s estate for the debtor’s unsecured creditors.

In the article Is Fraudulent Conveyance Law Efficient, Professor David Carlson describes the purpose of fraudulent transfer law as the redistribution of power. According to Professor Carlson, “[f]raudulent conveyance law redistributes power from positionally strong debtors to positionally weak creditors on the principle that repayment of debt is privileged over the debtor’s freedom to alienate his property.”61 When a debtor is on shaky financial footing, the debtor is, in some ways, at an advantage over the debtor’s creditors. First, the debtor knows the circumstances of the debtor’s finances. The debtor’s creditors often lag on this knowledge. Second, when a debtor is overleveraged, the debtor’s unencumbered assets essentially belong to the debtor’s unsecured creditors, to the extent they are not protected by an exemption. As such,
any financial risk the debtor may take are risks the debtor is imposing on the debtor’s creditors. Professor Carlson observes that fraudulent transfer law intercedes to, \textit{ex post}, balance the power between insolvent debtors and their unsecured creditors.

Professor Williams accepts Professor Carlson’s description of fraudulent transfer law as the \textit{ex post} redistribution of power from positionally strong debtors to positionally weak creditors. In addition, Professor Williams observes that fraudulent transfer law is, “also designed to remedy the risk inherent in time itself.”\textsuperscript{62} A creditor enters a legal relationship with a debtor at a specific point in time and under the circumstances that exist at that time. Upon entering that legal relationship, however, the debtor does not slip into a Rip Van Winkle state of suspended animation. Rather, both debtors and creditors, “continue with their respective affairs long after the events that gave significance to their legal relationship have passed.”\textsuperscript{63} Fraudulent transfer law is designed to account for the fact that, “creditors expect their debtors to continue conducting their affairs in a manner consistent with their past practices.”\textsuperscript{64} Thus, the doctrine of fraudulent transfer, whether actual or constructive, “provides a creditor’s remedy, nothing more or less, when debtors veer from the ordinary course of their affairs at the expense of their unsecured creditors.”\textsuperscript{65} Stated differently, fraudulent transfer law imposes an, “ordinary course of affairs requirement on virtually all transfers and obligations where the debtor is insolvent.”\textsuperscript{66} As such, fraudulent transfer law gives the creditor power retroactively by permitting the creditor to challenge transactions that the creditor had no reason to expect might occur.

\textsuperscript{62} Williams, \textit{Fallacies, supra} note 40, at 1414.
\textsuperscript{63} Id.
\textsuperscript{64} Id.
\textsuperscript{65} Id.
\textsuperscript{66} Id.
II. **Reflecting Purpose in the Reasonably Equivalent Value Requirement**

To avoid a transfer based on a theory of constructive fraud, the trustee must establish that the debtor received, “less than a reasonably equivalent value in exchange for such transfer.”

The Bankruptcy Code defines value as, “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.” The Bankruptcy Code, however, does not provide a definition of “reasonably equivalent value.” As such, courts have employed a case-by-case assessment of whether “reasonably equivalent value” has been given to the debtor in the transaction that is being challenged as constructively fraudulent.

Whether reasonably equivalent value has been given in exchange for a payment is largely a question of fact. Courts have considerable discretion in making this assessment. Courts do not employ a fixed mathematical formula for making this determination. Rather, the determination depends on all the facts of each case. Further, the concept of “reasonably

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67 11 U.S.C. § 548(a)(1)(B) (2018). The trustee must also show that the transfer was made while the debtor was either: (1) insolvent or on the brink of insolvency; (2) engaged in a business with unreasonably small capital; or (3) incurring debts that the debtor did not believe it could pay. *Id.* Similar provisions are contained in both the UFTA and the UFCA. Section 4(a)(2) of the UFTA provides for constructive fraud if the debtor made the transfer or incurred the obligation without receiving reasonably equivalent value in exchange for the transfer or obligation, and the debtor: (1) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business; or (2) intended to incur, believed that the debtor would incur, or reasonably should have believed that the debtor would incur debts beyond the debtor’s ability to pay as they became due. UNIF. FRAUDULENT TRANSFER ACT § 4(a)(2). Sections 4-6 of the UFCA state that a conveyance made or an obligation incurred may be voidable if it is made without fair consideration and: (1) by a person who is thereby rendered insolvent without regard to such person’s actual intent; (2) when the person making it is engaged or is about to engage in a business or transaction for which the property remaining in the person’s hands after the conveyance is an unreasonably small capital, without regard to actual intent; and (3) when the person making the conveyance or entering into the obligation intends to incur or believes that the person will incur debts beyond the person’s ability to pay as they mature. UNIF. FRAUDULENT CONVEYANCE ACT §§ 4-6, §7A.


70 Nordberg v. Arab Banking Corp. (*In re Chase & Sanborn Corp.*), 904 F.2d 588, 593 (11th Cir.1990) (**quoting Mayo v. Pioneer Bank & Trust Co.**, 270 F.2d 823, 829–30 (5th Cir.1959)).

71 *Id.*

72 Peltz v. Hatten, 279 B.R. 710, 736 (D. Del. 2002); Barber v. Golden Seed Co., 129 F.3d 382, 387 (7th Cir.1997).
equivalent value” does not demand a precise dollar-for-dollar exchange. Reasonably equivalent value will generally be said to have been given when the value given is not, “so far short of the real value of the property as to startle a correct mind or shock the moral sense.”

“As long as the unsecured creditors are no worse off because the debtor, and consequently the estate, has received an amount reasonably equivalent to what it paid, no fraudulent transfer occurred.” Ultimately, the determination of reasonably equivalent value has been recognized as “fundamentally one of common sense, measured against market reality.”

Commentators and the courts have struggled to define the proper limits of the doctrine of constructive fraud. In assessing the limits of the doctrine, “[i]t is the reasonably equivalent value requirement that presents hard problems of proof and challenges our understanding of the underlying norms of fraudulent transfer law.” Linking reasonably equivalent value to benefit from a creditor’s perspective is consistent with the classic model of a fraudulent transfer – the malicious transfer of assets by the debtor in exchange for little or no value. Scholars have criticized the benefits-to-the-creditor requirement, however, for failing to adequately address many situations that do not fit the traditional paradigm.

A. Transactions that Do Not Result in a Cognizable Benefit to Creditors of the Debtor.

76 In re Schultz, 368 B.R. 832, 836 (Bankr. D. Minn. 2007).
78 Williams, Fallacies, supra note 40, at 1420.
79 See, e.g., Williams, Fallacies, supra note 40, passim; see also Lipson, supra note 77, at 260-65.
Transactions constituting property-for-services exchanges have been highlighted as a type of exchange that the benefits-to-the-creditor requirement cannot address.\textsuperscript{80} For example, if an insolvent debtor hires a company to provide lawn care services, should payments the debtor makes to this company for lawn care services be subject to attack as constructively fraudulent? This service does not obviously benefit the creditors of the debtor. The payments deplete the debtor’s assets without a clear financial benefit in exchange. Under the traditional benefits-to-the-creditor requirement, these payments should be labeled fraudulent transfers. Often, however, payment-for-services exchanges are found to not constitute constructive fraudulent conveyances.\textsuperscript{81} This is so because, in property-for-services cases, the courts generally shift the value inquiry away from looking at value from the creditor’s perspective to focus on an analysis of the value of the services provided to the debtor and to the price paid by the debtor for those services.

A second scenario that has presented challenges for the benefits-to-creditor test for evaluating the “reasonably equivalent value” requirement is the situation involving a transaction that is unwise from the perspective of utility, whether at the outset or in retrospect. If the debtor makes a foolish investment of the debtor’s assets, or otherwise makes a bad financial decision, should that transfer be deemed fraudulent because it does not result in value from the creditor’s perspective? If value is viewed solely from the perspective of net benefit to the creditor, every unwise transaction that ultimately fails would be deemed a fraudulent transfer. Very often

\textsuperscript{80} See Shupack, supra note 77, at 832-33 (criticizing the issue in the context of the UFTA); but see Frank R. Kennedy, Reception of the Uniform Fraudulent Transfer Act, 43 S.C. L. REV. 655, 661 (1992) (casting fraudulent transfer law as flexible enough to permit the judge to account for property-for-services exchanges).

though, even in the case of a risky investment, these transactions are not deemed to be fraudulent transfers. In the case of an unwise transaction, the inquiry again shifts away from the net value of the transaction to creditors. In those cases, the value inquiry is generally focused on the circumstances surrounding the transaction at issue, including, in the case of a failed investment, the potential for a positive return on the investment. The analysis tends to center on ferreting out indicia of bad faith or collusion, although intent is ostensibly not relevant to the question of whether a transfer was constructively fraudulent.

The case of *In re Chomakos* is illustrative. The trustee brought an action against the Flamingo casino to recover the losses the debtor suffered at the slot machines over a period of several months while the debtor was insolvent. Although the debtor had won on occasion, the debtor’s overall losses were greater than the amounts the debtor had won. In considering whether the debtor had received reasonably equivalent value in exchange for the money the debtor had lost, the court rejected the contentions that “value” must be viewed from the perspective of the creditor and that the subject transfer must result in a net benefit. Rather, the *Chomakos* court applied a totality of the circumstances test to determine whether reasonably equivalent value had been given.

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83 *In re Morris Communications NC, Inc.*, 914 F.2d at 467 (stating that, in determining whether reasonably equivalent value has been given, the, “[f]actors to be considered include the good faith of the transferee, the relation differences in the amount paid compared to the fair market value, and the percentage of the amount paid is of the fair market value ... [and] whether the sale was an arm’s length transaction between a willing buyer and a willing seller”).
85 Id. at 592-93.
86 Some courts have held that the totality of the circumstances test is the test for value that should be applied in all circumstances involving the purchase by consumers of services or intangible or consumable goods. See, e.g., *In re Grigonis*, 208 B.R. 950, 955–56 (Bankr.D.Mont.1997) (stating that consideration that is immediately and completely consumed, such as a service, has “a liquidation or ‘second-hand’ value of zero” and “by definition, always results in asset depletion,” but it is “nonsense” to conclude that such transfers are fraudulent merely because “transfers of funds to secure such enjoyments can by definition be of no value” from the viewpoint of creditors).
The court first considered whether the transactions were conducted at arms-length. The court found that the transactions at issue – the bets placed by the debtor – did appear to be arm’s length, noting that no evidence had been offered to suggest that they were made under compulsion or duress.\textsuperscript{87} The court next considered whether value had been transferred to the debtors. It found value had been transferred because the debtors had the chance to win more money than they wagered. There was value in that opportunity.\textsuperscript{88} In addition, the court found that the debtors, “also received whatever psychic and other intangible values are attendant to being at the Flamingo Establishment and gambling,”\textsuperscript{89} making it clear that, in the court’s view, “value” for purposes of reasonably equivalent value does not mean the debtor must have received something tangible and leviable in exchange.\textsuperscript{90} Finally, the court considered whether “good faith” existed in the subject transactions. In considering this factor, the court examined whether the transferee of the transfer, the casino, had acted in good faith in receiving the transfers. The court concluded that the casino had acted in good faith, observing that there was no proof that the casino had knowledge of the debtors’ precarious financial situation. The court also observed that the transfers the casino received, “was not measurably beyond the consequences of the Debtors’ natural relationship with the Flamingo nor did Flamingo receive or obtain some greater advantage for itself, above and beyond that which naturally results from that relationship.”\textsuperscript{91} With respect to its interaction with the debtors, the Flamingo was simply, “acting in its customary way consistent with the business it was in.”\textsuperscript{92} The court suggested that,

\textsuperscript{87} \textit{In re} Chomakos, 170 B.R. at 593.
\textsuperscript{88} \textit{Id.}
\textsuperscript{89} \textit{Id.}
\textsuperscript{90} \textit{Id.; see also}, DAVID G. EPSTEIN, et al., BANKRUPTCY 375 (1993) (“the requirement of economic benefit to the debtor does not demand consideration that replaces the transferred property with money or something else tangible or leviable that can be sold to satisfy the debtor's creditor's claims”).
\textsuperscript{91} \textit{In re} Chomakos, 170 B.R. at 594-95.
\textsuperscript{92} \textit{Id.}
under certain circumstances, a casino might be said to be acting in bad faith in taking bets, observing that, in the case before the court there was, “insufficient evidence that the Debtors gambling activities involved such amounts or were engaged in with such frequency as would support a conclusion that Flamingo was acting in bad faith.”

**B. Transactions Undertaken on Behalf of a Non-Debtor Third Party.**

Transactions in which a debtor transfers an asset to another, or incurs an obligation in favor of another, in exchange for a benefit that is given to a third-party is yet another type of transaction that has faced considerable challenges under the traditional paradigm of fraudulent transfer law. These transactions are susceptible to a constructive fraud challenge because the debtor often receives no direct benefit from the transaction – thus the debtor, arguably, does not receive, “reasonably equivalent value.” A common example of such a transaction is the intercorporate guaranty.

A guaranty is an agreement by a party to repay the debt of another. There are three common structures for intercorporate guaranties. These structures include the downstream guaranty, the upstream guaranty, and the cross-stream guaranty.

In a downstream guaranty, a parent entity guarantees an obligation of its subsidiary. A downstream guaranty does not generally raise fraudulent transfer concerns. Because the parent company that acts as the guarantor owns some or all of the stock of the subsidiary-borrower, the benefits of the transaction that the borrower receives should flow to the parent-guarantor through

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93 *Id.*
94 For a detailed discussion of the problem of the application of constructive fraudulent transfer law to intercorporate guarantees see Williams, *Fallacies, supra* note 40.
95 Williams, *supra* note 40, at 1417-18.
96 *Id.*
its stock ownership in the borrower.97 A loan to the subsidiary should strengthen the subsidiary’s operations and increase the value of the stock in the subsidiary.98 As a result, the debtor-guarantor receives value in a downstream guaranty sufficient to satisfy the benefits-to-the-creditor requirement.

Both the upstream guaranty and the cross-stream guaranty, however, have faced challenges under traditional fraudulent transfer jurisprudence. Under an upstream guaranty, a subsidiary guarantees the debt of its parent company.99 Under a cross-stream guaranty, one subsidiary guarantees an obligation owed by another subsidiary. A cross-stream guaranty is often used when the two subsidiaries are owned by a common parent entity. In addition, the business operations of the two subsidiaries are often intertwined.

In transactions involving either upstream or cross-stream guaranty transactions, the guarantor generally does not receive any of the loan proceeds from the lender. Rather, those proceeds are given to the borrower entity. Further, because the guarantor does not own the stock in the borrower entity, the guarantor does not clearly benefit from the transaction in the way that the parent-guarantor in a down-stream guaranty transaction benefits from a loan made to its subsidiary. As such, both the upstream guaranty and the cross-stream guaranty transactions would fail the value requirement when viewed through the traditional benefits-to-the-creditor lens.100 Rather than finding all such obligations to be void as constructively fraudulent, however,

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98 Williams, Fallacies, supra note 40, at 1419.
100 3V Capital Master Fund Ltd. v. Official Comm. of Unsecured Creditors of TOUSA, Inc. (In re TOUSA Inc.), 444 B.R. 613, 655–56 (S.D. Fla. 2011); see also, Meeks v. Don Howard Charitable Remainder Trust (In re Southern
some courts have developed doctrines such as the indirect benefits and identity of interests
doctrines to analyze the value in these transactions and uphold the guaranty obligation.

Under the indirect benefits doctrine, a court may find that the debtor received reasonably
equivalent value in exchange for a transfer made by the debtor even when the value the debtor
receives does not come directly to the debtor from the third party to which the debtor made the
transfer that is being attacked as constructively fraudulent. The indirect benefits doctrine
provides significant flexibility as compared to the traditional test that requires an immediate
benefit to the debtor from the transferee, it is not without its limitations. To be recognized by the
court, the indirect benefit received by the debtor must be, “‘fairly concrete.’” Further, courts
have applied the doctrine inconsistently, resulting in no clear understanding of exactly the type
of indirect benefits that will be perceived as providing sufficient “value.” In some instances,
courts have found an asserted indirect benefit to be insufficient because it was not, according to
the court, sufficiently quantified. In other instances, however, courts have recognized less
tangible indirect benefits, such as the enhanced ability to obtain credit, the strengthening of the

Health Care of Ark., Inc.), 309 B.R. 314, 320 (B.A.P. 8th Cir. 2004) (finding no reasonably equivalent benefit to
debtor for paying non-debtor’s mortgage expenses); Braunstein v. Walsh (In re Rowanak Corp.), 344 F.3d 126,
132–33 (1st Cir. 2003); Leonard v. Mountainwest Fin. Corp. (In re Whaley), 229 B.R. 767, 775 (Bankr. D. Minn.
1999) (finding no reasonably equivalent benefit for paying live-in-companion’s credit card expenses).
101 See Leibowitz v. Parkway Bank & Trust Co. (In re Image Worldwide, Ltd.), 139 F.3d 574, 578 (7th Cir. 1998).
102 Id. Once the plaintiff demonstrates that the purported benefit received by the debtor passed through a third party,
many courts place the burden on the defendant to demonstrate that the benefit to the debtor was concrete and
reasonably identifiable. See, e.g., Lisle v. John Wiley & Sons, Inc. (In re Wilkinson), 196 F. App’x 337, 341 (6th
Cir. 2006); see also In re Image Worldwide, Ltd., 139 F.3d at 578.
103 For a discussion of the inconsistency and confusion surrounding the implementation of the indirect benefits
doctrine see Williams, Fallacies, supra note 40.
104 Leibowitz v. Parkway Bank & Trust Co., 210 B.R. 298, 301 (Bankr. N.D. Ill. 1997)(finding the fact, “that Debtor
was permitted to ‘continue in business,’” insufficient because “such consideration does not constitute ‘reasonably
equivalent value’ for purposes of fraudulent transfer law”).
viability of the corporate group, and corporate goodwill. Because the appropriate application of the indirect benefits doctrine is not clearly delineated, it does not provide a viable approach for efficiently and reliably addressing instances in which debtor-parents pay educational expenses on behalf of their adult children.

Under the identity of interests doctrine, a court might find that reasonably equivalent value has been given, “where the debtor and the third party [the party who directly received the benefit of the subject transaction] are so related or situated that they share an identity of interests because what benefits one will, in such case, benefit the other to some degree.” In determining whether this doctrine should apply to a given situation, some courts consider whether a corporate group has purposely availed itself of the benefits of operating as an enterprise such that it should be treated as one borrowing unit, even though each member of the enterprise is a separate legal entity under applicable state law. Similarly, the creditors of the corporate group often benefited from the group functioning as a single enterprise. Some courts have determined that, under the identity of interests doctrine, where the debtor receives an indirect benefit because it is part of a common enterprise, that type of economic benefit can be reasonably equivalent value, based on the theory that the guaranty strengthens the corporate

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105 See In re Image Worldwide, Ltd., F.3d at 581; see also Mellon Bank, N.A. v. Metro Communications, Inc., 945 F.2d 635, 647 (3d Cir. 1991).
106 See, e.g., Consove v. Cohen (In re Roco Corp.), 701 F.2d 978, 983-84 (1st Cir. 1983); Colfax, Inc. v. D'Agostino (In re J.K. Chens., Inc.), 7 B.R. 897, 898 (Bankr. D.R.I. 1981); see also In re Jumer's Castle Lodge, Inc., 338 B.R. 344, 356 (Bankr. C.D. Ill. 2006) (“indirect benefits” constitute “value” and can include a wide range of intangibles such as: corporation's goodwill or increased ability to borrow working capital; the general relationship between affiliates or “synergy” within a corporate group as a whole; and a corporation's ability to retain an important source of supply or an important customer”).
group. Thus, in the commercial context, some courts have recognized that entities that may be separate legal entities under applicable state law may, nonetheless, be treated as a single corporate enterprise under fraudulent transfer law.

The identity of interests approach to analyzing the reasonably equivalent value requirement provides further flexibility as compared to the indirect benefits doctrine because it permits the recognition of value that accrues to the corporate group as a whole. Significantly, given the interconnected nature of the entities being subjected to scrutiny, the fact that the subject transactions occurred would not likely have come as an unexpected development to the creditors. Still, as with the indirect benefits doctrine, this approach is plagued with inconsistency in application, leaving no clear understanding of the type of value that will be recognized as sufficient to defend against claims of constructive fraud.

C. Summary Observations.

Courts often shift the focus of the value inquiry away from the benefits-to-the-creditor test when a given situation does not fit the traditional paradigm of a fraudulent transfer. This change in focus demonstrates that the *purpose* of the reasonably equivalent value requirement is not the preservation of value for the debtor’s unsecured creditors, although it may be the *effect* when a given transfer is voided as constructively fraudulent. As illustrated, the diminution of the debtor’s estate under certain scenarios is acceptable. Instead, the unifying purpose of the value

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110 See *In re* Chase & Sanborn Corp., 904 F.2d 588 (11th Cir. 1990) (holding that chapter 11 debtor received reasonably equivalent value for its guaranty of owner’s loan which was totally secured and co-guaranteed by other entities); *In re* Xonics Photochemical, Inc., 841 F.2d 198 (7th Cir. 1988) (holding that, where affiliates operate as a common enterprise and have intertwined financial affairs, a guaranty of one affiliate’s debts by the other provides benefit and is for reasonably equivalent value); *In re* Agriprocessors, Inc., 490 B.R. 374 (Bankr. N.D. Iowa 2013) (holding that the debtor’s issuance of checks as remuneration for labor that benefited affiliate entity constituted reasonably equivalent value); *In re* Martin, 205 B.R. 646 (Bankr. M.D. Ala. 1993) (holding that the debtor received reasonably equivalent value from its payment to the creditor on a note executed by a corporation of which debtor was the sole shareholder and, thus, payment was not fraudulent conveyance, where debtor guaranteed corporation’s loan).

requirement is to protect creditors from the *unjust* diminution of the debtor’s estate.\(^{112}\) With this understanding, the question then becomes – what makes the diminution of a debtor’s estate “unjust” for purposes of fraudulent transfer law? Considering the historical roots of fraudulent transfer law and the doctrines that have developed to refocus and narrow the scope of constructive fraud, unjust diminution to the debtor’s estate, “means that the diminution, that is, the damage to creditors, arises from a transaction or event outside the ordinary course of affairs of a debtor – an unexpected harm.”\(^{113}\) This ordinary course reading of reasonably equivalent value strives to protect the expectations of the creditors as they existed when the creditors chose to enter into a legal relationship with the debtor. It also strives to protect innocent third-party transferees that may have no reason to suspect that the debtor (the transferor from the perspective of the third-party) is in a financially precarious position. This understanding of the value requirement lends stability to market transactions, leaving third parties freer to engage in ordinary course transactions with potential debtors.

### III. THE FUNCTION OF CONSUMER BANKRUPTCY

#### A. Introduction to Consumer Bankruptcy

To fully appreciate the challenge of certain payments made by the debtor as constructively fraudulent, it is critical to understand the basic mechanics and functions of consumer bankruptcy. Each year, hundreds of thousands of individuals seek bankruptcy protection in the United States.\(^{114}\) Subject to certain restrictions, individuals may seek bankruptcy relief under various

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\(^{112}\) Williams, *Fallacies*, supra note 40, at 1438.

\(^{113}\) *Id.*

Chapters of the Bankruptcy Code. Individuals generally file bankruptcy under either Chapter 13, known as individual reorganization or debt adjustment bankruptcy, or under Chapter 7, known as liquidation bankruptcy. Bankruptcy under Chapter 7 is the most common type of bankruptcy protection sought.

In a Chapter 13 bankruptcy case, the debtor is obligated to commit a portion of the debtor’s future income to paying some or all the debtor’s debts over a period of time. That period of time is typically three to five-years in length. In exchange, the debtor is permitted to keep assets that the debtor might otherwise lose to creditors in bankruptcy under Chapter 7, such as a home or other valuable assets. In contrast, a Chapter 7 bankruptcy case does not require the debtor to commit future income to the payment of debts. Instead, a Chapter 7 trustee is appointed. The trustee is charged with marshalling the debtor’s assets, to the extent those assets are not protected from liquidation by an exemption. The trustee liquidates these nonexempt assets. The trustee then uses the proceeds from the sale of such assets to pay the debtor’s debts, to the extent possible, in accordance with the priority provisions of the Bankruptcy Code. General unsecured creditors, the creditors on the lowest rung of the priority ladder, are often paid nothing or pennies on the dollar in Chapter 7 cases. Aside from a few

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117 Of the 753,333 nonbusiness bankruptcy filings in the twelve-month period ending June 30, 2018, 61.9% of those cases were filed under Chapter 7. Id.
121 11 U.S.C. § 704 (2018). The Bankruptcy Code allows a debtor to protect from the collection efforts of creditors some or all of the debtor’s equity in certain property. The amount the debtor is allowed to protect varies, depending on the state in which the debtor resides. 11 U.S.C. § 522 (2018).
narrowly defined exceptions, debts that the trustee is unable to pay with proceeds from the liquidation of the debtor’s non-exempt assets are discharged and the debtor is no longer liable for them.

B. Screening and Sorting - Eligibility to be a Consumer Debtor Bankruptcy

The Bankruptcy Code contains various requirements and restrictions that serve to either sort a debtor into a particular Chapter of the Bankruptcy Code or screen a potential debtor out of obtaining bankruptcy relief altogether. As noted, most individuals file petitions for relief under either Chapter 7 or Chapter 13. Whether an individual seeks protection under Chapter 7 or Chapter 13, the individual must face what is known as the “means test.”

The means test provides a method of analyzing the debtor’s financial circumstances and determining the debtor’s ability to repay debt. If the debtor is deemed to have the ability to repay a portion of the debtor’s debts, the debtor will be unable to obtain relief under Chapter 7. In order to obtain a discharge of some of the debtor’s debts in bankruptcy, this debtor would likely file bankruptcy under Chapter 13. Under Chapter 13, the debtor would be required to

124 Generally, an individual may be eligible for bankruptcy relief under Chapter 7, 11, 12, or 13 of the Bankruptcy Code. As an initial matter, Section 109 of the Bankruptcy Code – entitled “Who May be a Debtor” – specifies who qualifies to be a debtor under each of the various Chapters of the Bankruptcy Code. 11 U.S.C. § 109 (2018). Chapter 12 is limited to debtors who qualify as family farmers or family fisherman, resulting in few petitions each year being filed under Chapter 12 of the Code. In 2017, only 501 bankruptcy petitions were filed under Chapter 12 of the Bankruptcy Code. Report F-5A. U.S. Bankruptcy Courts Business and Nonbusiness Bankruptcy Filings 2017. This number is dwarfed by the 472,190 non-business cases that were filed under Chapter 7 in 2017. Id. Similarly, comparatively speaking, few individuals seek bankruptcy protection under Chapter 11 of the Bankruptcy Code, perhaps because, as compared to Chapter 13, the Chapter 11 process is costlier and may be more difficult to navigate. In 2017, 7,442 petitions were filed under Chapter 11. Id. It is likely that only a small percentage of these cases were filed by individuals. Richard M. Hynes, Anne Lawton & Margaret Howard, National Study of Individual Chapter 11 Bankruptcies, 25 Am. Bankr. Inst. L. Rev. 61 (2017).
125 The means test is perhaps the most widely discussed of the numerous changes to the Bankruptcy Code that were brought about by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”).
repay that portion of the debtor’s debt that it is determined the debtor is financially able to pay.

As one Senator explained when the means test was enacted:

If repayment is possible, then he or she will be channeled into chapter 13 of the Bankruptcy Code which requires people to repay a portion of their debt as a precondition for limited debt cancellation .... This bill does this by providing for a means-tested way of steering people ... who can repay a portion of their debts, away from chapter 7 bankruptcy.\textsuperscript{127}

A central component to evaluating the financial wherewithal of the individual debtor is the concept of the debtor’s “household.”\textsuperscript{128} A threshold determination in an individual’s bankruptcy case is whether the debtor is categorized as an above-median income debtor or a below-median income debtor. This question is answered by comparing the debtor’s annualized “current monthly income”\textsuperscript{129} to the “median family income”\textsuperscript{130} in the debtor’s state of residence for a family of the same size as the debtor’s “household.” The answer to this critical question impacts several key issues for the individual debtor.

The income of the debtor under the means test calculation includes, among other amounts, amounts paid by a third party “on a regular basis” for the household expenses of the debtor or the debtor’s dependents.\textsuperscript{131} The amounts include, “payments from roommate, partner, parents or relative, regardless of whether living with the debtor”\textsuperscript{132} and, “payments made directly to creditors on behalf of debtor, e.g., rent, car, or insurance.”\textsuperscript{133}

\textsuperscript{127} Id. Whether and to what extent the means test accomplishes its stated purpose is the subject of much discussion. See, e.g., Hon. Eugene R. Wedoff, \textit{Means Testing in the New World}, 79 AM. BANKR.L.J. 231, 254 (Spring 2006).

\textsuperscript{128} An analysis of the debtor’s financial circumstances as a member of a household is central to both Chapter 7 and Chapter 13 bankruptcy. With respect to Chapter 7 bankruptcy, see 11 U.S.C. §707(b). With respect to Chapter 13 bankruptcy, see 11 U.S.C. §1325(b).


\textsuperscript{130} The “median family income” is determined by using Census Bureau data, adjusted annually to reflect the change in the Consumer Price Index. 11 U.S.C.A. § 101(39A) (2018).


\textsuperscript{133} Id.
When a debtor has income that is below the median family income when compared to other households of comparable size in the debtor’s state, the analysis under the means test stops. In such circumstances, the debtor is deemed to have satisfied the means test. Satisfaction of the means test means that a presumption that the debtor’s Chapter 7 filing is abusive does not arise and the debtor will not be barred from obtaining relief under Chapter 7 on this basis. In addition, in such a debtor’s bankruptcy case, only judges, U.S. trustees, and bankruptcy administrators will have standing to challenge the debtor’s Chapter 7 filing as abusive on other grounds – individual creditors of the debtor will not have standing.

In contrast, if a debtor is determined to have income that is above the median family income when compared to other households of comparable size in the debtor’s state, the debtor will be required to complete the entirety of the means test calculations. These calculations require an analysis of detailed and extensive income and expense information. This calculation is aimed at determining whether and to what extent the debtor has “disposable income.”

Upon completion of this analysis, if the debtor’s calculated “disposable income” is above the specified permissible threshold, then the debtor’s Chapter 7 bankruptcy filing is presumptively deemed to be abusive. This presumption of abuse can be “rebutted,” but only by showing the requisite “special circumstances.” In most instances, a debtor with “disposable income” that is above the permissible amount for a household the size of the debtor’s household will be unable to obtain bankruptcy relief under Chapter 7. When a debtor is

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135 Id.
136 11 U.S.C. § 707(b)(6)(2018). Even in circumstances in which a debtor “passes” the means test because that debtor is determined to have income below the median income in the debtor’s state, the debtor’s Chapter 7 filing might nonetheless be attacked as abusive under § 707(b)(3) as a bad faith filing, or as abusive under the “totality of the circumstances.” 11 U.S.C. § 707(b)(3)(2018). Under Section 707(b)(3), courts have broad discretion to find that debtor’s filing to be abusive.
unable to seek relief under Chapter 7, the debtor is generally faced with a choice – either make do without obtaining relief in bankruptcy or seek relief under Chapter 13, thus making it necessary for the debtor to commit certain future earnings towards paying back the debtor’s creditors, to the extent required under the Bankruptcy Code.

The size of the debtor’s household and its impact on the means test calculations also plays a critical role in a debtor’s case under Chapter 13. If a debtor files under Chapter 13, the debtor’s Chapter 13 plan must provide that all the debtor’s “projected disposable income” that will be received by the debtor “in the applicable commitment period” will be used to make payments to the debtor’s unsecured creditors.139 “Disposable income” is defined as “current monthly income received by the debtor less amounts reasonably necessary to be expended … for the maintenance or support of the debtor or a dependent of the debtor.”140 The means by which the “amounts reasonably necessary to be expended” is calculated differs significantly, depending on whether a debtor is determined to have income that is below or above the median family income when compared to other households of comparable size in the debtor’s state. For a debtor with income that is below the median family income, the debtor’s actual expenses are utilized in the calculation.141 For a debtor with income that is above the applicable median


Both before and after the enactment of BAPCPA, courts have struggled with the question of whether debtors in bankruptcy should be permitted to pay the college tuition and expenses of their children who are eighteen or older, rather than directing those funds to the payment of creditors. See In re Goins, 372 B.R. 824 (Bankr. D.S.C. 2007)(discussing this issue as it existed both before BAPCPA and after BAPCPA); see also Dominick Capotosto, Educational Expense Deductions from the Chapter 13 Plan: Creating a “Reasonably Necessary” Standard, 29 EMORY BANKR. DEV. J. 195 (2012). Following the enactment of BAPCPA, some courts have held that the question of whether debtor parents in bankruptcy may pay the educational expenses of their adult age children to be settled in the negative. The Goins court provides a clear discussion of this view. It looked to subsection 707(b)(2)(A)(ii)(IV), which specifically allows a means test deduction of the reasonable and necessary “actual expenses for each dependent child less than eighteen years of age, not to exceed $1,500 per year per child, to attend a private or public elementary or secondary school.” The Goins court reasoned that by expressly including a deduction for pre-college students under the age of eighteen, Congress specifically excluded educational expenses for students over the age of
family income, the debtor is required to utilize Internal Revenue Service ("IRS") standardized expenses in deducting most of the debtor’s expenses. The amount of these standardized IRS expenses depend on the size of the debtor’s family. These standardized expenses may or may not adequately account for the actual expenses of the debtor. The above-median income debtor may also deduct from the debtor’s income, “the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service …. for the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case, if the spouse is not otherwise a dependent.”

Whether the Chapter 13 debtor is a debtor with above median income also impacts the length of time during which the debtor must commit the debtor’s future income to repaying the debtor’s creditors. The “applicable commitment period,” addressed in Section 1325(b)(4) of the Bankruptcy Code, is the period of time the debtor is required to commit future income to the debtor’s repayment plan. For a debtor with income below the applicable median income level, the applicable commitment period is three years. For a debtor with income equal to or greater than the median income of comparably sized households in the debtor’s state, the applicable commitment period must be five years.

Even though the size of the debtor’s household is a critical component to analyzing the debtor’s financial wherewithal in bankruptcy and determining how much, if anything, the debtor will be required to pay to the debtor’s unsecured creditors, the term “household” is not defined in

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142 11 U.S.C. § 1325(b)(3)(2018) (referring to subparagraphs (A) and (B) of section 707(b)(2)).
the Code. In response, courts have developed various approaches to determine a debtor's household size. Most courts to consider the issue have adopted a variation of an approach known as the economic unit approach.

Under the economic unit approach, the court considers the, “financial interdependence of individuals to determine whether someone is an economic part of the debtor’s household”\(^ {144} \) and includes in the debtor’s “household” individuals who “directly impact the debtor’s financial situation.”\(^ {145} \) Under this approach, a “household” includes, “‘individuals who are financially dependent on a debtor, individuals who financially support a debtor, and individuals whose income or expenses are intermingled or interdependent with a debtor.’”\(^ {146} \) Thus, the economic unit approach attempts to, “measure[,] the size of the debtor's household by the number of individuals in the home who act as a single economic unit.”\(^ {147} \) In adopting this approach, one court explained, “the entire purpose of identifying a debtor’s household size is to use that number to determine the debtor’s financial obligations and ability to pay. A definition of ‘household’ that is also tailored to reflect a debtor’s financial situation focuses directly upon the ultimate purpose of the Code.”\(^ {148} \)

Another approach utilized by some court to determine the number of individuals in the debtor’s household is the “heads on beds” approach. This approach utilizes the United States Census Bureau definition of “‘all of the people, related and unrelated, who occupy a housing unit.’”\(^ {149} \) A third approach to defining the debtor’s household that is least commonly adopted by

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\(^{145}\) Id.


\(^{148}\) In re Skiles, 504 B.R. 871, 880–81 (Bankr. N.D. Ohio 2014) (citing Johnson v. Zimmer, 686 F.3d 224, 237 (4th Cir. 2012)). “Courts adopting the “economic unit” definition do so because they believe it most closely aligns with the purpose of the Code, while also comporting with the statutory text.” Id. at 879.

\(^{149}\) In re Ellringer, 370 B.R. 905, 911 (Bankr. D. Minn. 2007).
the courts is known as the IRS dependents approach. This approach relies on the “Internal Revenue Manual (“IRM”) which states that the number of household members allowed for purposes of determining the applicable National Standards should generally be the same as those allowed as dependents on the taxpayer's tax returns.”

Regardless of the approach utilized by the courts to define “household” for purposes of determining the number of individuals in the debtor’s household, one point remains clear – central to the relief provided to consumers under the Bankruptcy Code is the understanding that the debtor’s economic life does not exist in solitude, void of any connectedness to others. Rather, as the Code recognizes, the debtor’s financial wherewithal should be scrutinized by acknowledging and considering the debtor’s economic interconnectedness with others in the debtor’s household.

C. What’s the Point of it all Anyway? – The Goals of Bankruptcy

Bankruptcy law exists in response to our credit economy. At the center of the body of laws that regulate debtor-creditor relations is the tension that exists between the interests of debtors and the interests of creditors. The Bankruptcy Code seeks to navigate and manage these conflicting interests, guided by two overarching goals – providing a fresh financial start to

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150 In re Robinson, 449 B.R. at 479.
151 In re Skiles, 504 B.R. at 880–81 (Bankr. N.D. Ohio 2014) (citing Johnson v. Zimmer, 686 F.3d 224, 237 (4th Cir. 2012) (“[T]he entire purpose of identifying a debtor's household size is to use that number to determine his or her financial obligations and ability to pay. A definition of ‘household’ that is also tailored to reflect a debtor's financial situation focuses directly upon the ultimate purpose of the Code.”)).
153 See Wenmore v. Markoe, 196 U.S. 68, 77 (1904). One of the primary purposes of bankruptcy law is to give, “the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt.” Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) (quoting Williams v. U.S. Fid. & Guar. Co., 236 U.S. 549, 554-55 (1915)).
over-burdened debtors, on the one hand, and treating creditors in a fair and even-handed manner, on the other.\textsuperscript{154}

The Bankruptcy Code embodies the goal of fair and even-handed treatment of creditors by offering a comprehensive system, designed to bring together and address in a collective manner the interests of all creditors of a debtor.\textsuperscript{155} This system is comprised of various provisions regarding the stay of collection actions, priorities of claims, exceptions to the reduction or elimination of debtor’s debts,\textsuperscript{156} and various controls on debtor actions, among other provisions.\textsuperscript{157}

Similarly, bankruptcy accomplishes its “fresh start” function through myriad rules and provisions that allow debtors to “reorder their affairs” and “make peace with their creditors.”\textsuperscript{158} A key component to the bankruptcy fresh start is the shedding of certain debts owed by the debtor.\textsuperscript{159} The discharge granted in bankruptcy operates as an injunction. It protects the debtor from creditor efforts to collect on discharged debts.\textsuperscript{160} This protection, in turn, allows the debtor to “start afresh” with “a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt.”\textsuperscript{161} The Supreme Court has described the fresh-start function of bankruptcy law as having been, “again and again emphasized by the courts


\textsuperscript{155} Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198, 1203 (9th Cir. 2005).

\textsuperscript{156} In bankruptcy parlance, the reduction or elimination of debts of the debtor is referred to as the “discharge” of debts.


\textsuperscript{158} Grogan v. Garner, 498 U.S. at 286.


\textsuperscript{161} Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).
as being of public as well as private interest.” It explained that, “[t]he various provisions of the Bankruptcy Act were adopted in the light of that view and are to be construed when reasonably possible in harmony with it so as to effectuate the general purpose and policy of the act.”

Although scholars disagree as to the proper scope and effect of bankruptcy relief, they generally agree that bankruptcy serves an important social function – serving the public interest, as the Supreme Court has recognized. Commentators suggest that bankruptcy benefits society by influencing debtor-creditor behavior outside of bankruptcy. Bankruptcy is often understood as having a moderating effect on the economy. The specter of bankruptcy is believed to encourage lenders to make more prudent decisions regarding extending credit. If a creditor fears the risk of bankruptcy, the creditor should more carefully scrutinize potential borrowers and adjust the cost of borrowing to more accurately reflect the risk associated with the loan to a particular debtor. Borrowers who are at a greater risk for default pay more for credit, primarily through increased interest rates. A potential borrower who is too risky may be priced out of borrowing. If a potential borrower is essentially destined to default, not having the loan be given in the first instance may be the best result for both the potential borrower and the would-be creditor.

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162 Id.
163 Id.
164 See, e.g., Karen Gross, Taking Community Interests into Account in Bankruptcy: An Essay, 72 WASH. U. L.Q. 1031 (1994) (asserting that community interests are important and must be considered in the bankruptcy process).
165 Local Loan Co. v. Hunt, 292 U.S. at 244.
167 Baird & Jackson, supra note 25, at 852.
168 Id.
169 Id.
Some authorities believe that the existence of the bankruptcy option may also impact debtor behavior by permitting them to take financial risks that might ultimately prove economically beneficial, thereby benefitting not only themselves, but also the creditors of the debtor and the economy generally. In their insightful article, Global Lessons from Consumer Bankruptcy and Healthcare Reforms in the United States: A Struggling Social Safety Net, professors Landry and Yarbrough explained succinctly that

The importance of an effective bankruptcy system is vital to any country, the United States or otherwise, in which the economic structure embraces risk-taking by its citizens in consumer or business financial transactions. Bankruptcy provides an organized mechanism to deal with financial problems. In so doing, the bankruptcy system adds a component of stability to the economic structure of a country. Bankruptcy is a necessary component of our economic system, a fact that the drafters of the Constitution were apparently aware of as they had the foresight to include the “bankruptcy clause” in the Constitution.

In addition to benefits that exist even absent a bankruptcy filing, benefits also flow from the relief granted as a result of the bankruptcy filing. Bankruptcy of course benefits the debtor by allowing the debtor to obtain relief from some or all of the debtor’s debts. The fresh start of bankruptcy, however, also benefits society by allowing the debtor to “begin anew as a productive member of society.” Bankruptcy relief can be understood as serving a rehabilitative function that benefits the public good by allowing “a debtor to retain the basic necessities of life,” and to participate in the economy by earning, consuming, and borrowing. The debtor’s ability to be free from the burden of unmanageable debt “is a matter of great public

170 Id.
171 Landry & Yarbrough, supra note 166, at 349.
concern” because, from a debtor’s perspective, “there is little difference between not earning at all and earning wholly for a creditor.”\textsuperscript{175} Both may prevent the debtor from covering the debtor’s own expenses and from providing for the debtor’s dependents, and poverty “may be the necessary result of either.”\textsuperscript{176}

For individuals overwhelmed by debt, bankruptcy can act as a form of social insurance similar to unemployment insurance, Medicare, disability insurance, or workers’ compensation.\textsuperscript{177} Bankruptcy protection may serve as “a potential substitute” for any of these social insurance programs.\textsuperscript{178} Some experts describe bankruptcy “as an insurer of last resort” that acts to plug the holes in “a social safety net filled with ‘gaps.’”\textsuperscript{179} Given the important role that bankruptcy plays in our society, actors engaged in the bankruptcy process should be particularly careful to avoid promoting policies that ultimately serve to undermine its purposes.

IV. THE INTERRELATED NATURE OF THE FAMILY AND PAYING FOR COLLEGE

A. The Economics of the Family Unit

Before examining how bankruptcy courts have dealt with the treatment of undergraduate educational expenses paid by debtors on behalf of their adult children in the context of constructive fraudulent transfer litigation, it is important to understand the cultural and social context in which such payments are made. Raising a child in the United States is a significant financial undertaking. The U.S. Department of Agriculture estimates that the cost of raising a

\begin{footnotesize}
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\item \textsuperscript{175} Local Loan Co. v. Hunt, 292 U.S. 234, 245 (1934).
\item \textsuperscript{176} Id. at 244.
\item \textsuperscript{177} Feibelman, supra note 172, at 132.
\item \textsuperscript{178} Id.
\item \textsuperscript{179} Id.
\end{itemize}
\end{footnotesize}
child through age seventeen is $233,610.10. This amount is primarily attributable to housing, food, clothing and childcare. Having a child is one of the best predictors of bankruptcy.

The economic relationship between parents and their children, however, does not abruptly end at age eighteen. In fact, prior to the 1970s, the legal age of majority in many states was twenty-one. Moreover, the economic upheaval since the recession of 2008, “appears to be giving rise to a protracted set of economic ties between parents and their adult children.”

Young adults today must contend with high rates of unemployment, the shrinking middle class, and stagnant wages. All of these factors “mean that economic uncertainty is high.” Many young adults remain economically dependent on their parents, to some degree, well into their twenties. In fact, more than a third of young adults ages eighteen through twenty-four regularly receive money or other financial assistance from their family.

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181 Id.
182 See ELIZABETH WARREN & AMELIA WARREN TYAGI, TWO-INCOME TRAP: WHY MIDDLE-CLASS MOTHERS AND FATHERS ARE GOING BROKE 6 (2003). Several provisions of the Bankruptcy Code address debt related to raising children. See, e.g., 11 U.S.C. § 507(a)(1)(2018)(providing for priority treatment for “unsecured claims for domestic-support obligations that … are owed to or recoverable by … [the] child of the debtor, or such child’s parent”); § 522(f) (4) (providing that “household goods” that may be exempted by debtor include educational materials, furniture, toys and hobby equipment that are used by or for use of debtor’s minor dependent children); and § 523 (a) (5) (providing that domestic-support obligations may not be dischared).
183 The American and English Encyclopedia of Law, Garland and McGeehee, 1900B (“By the common law the age of majority is fixed at twenty-one years for both sexes, and, in the absence of any statute to the contrary, every person under that age, whether male or female, is an infant”). The legal age of majority continues to be twenty-one in some states, provided the child is in school. See, e.g., New York Family Court §413(1)a; Or. Rev. Stat. §109.510; Or. Rev. Stat. §107.108.
187 Id.
188 Id. at 61.
189 Parker, supra note 184.
Many young adults live in the home of a parent. Importantly, the level of education attained by an adult child is a key indicator of whether that adult child is likely to live at home with a parent. Forty percent of young adults ages eighteen through thirty-one with a high school degree or less education live in a parent’s home.¹⁹⁰ For college graduates in that same age group, only eighteen percent live at home with their parents.¹⁹¹ When young adults live with their parents, they tend to contribute to the household. Many of them share in household expenses.¹⁹² Some of them pay rent.¹⁹³ Almost half of young adults living at home with their parents contribute through non-monetary assistance like cooking, cleaning, or childcare.¹⁹⁴

B. Interconnected Nature of the Family Beyond Finances

In addition to having finances that are often intertwined, parents and their children often otherwise share a symbiotic relationship. In fact, numerous studies support that the emotional, psychological, and even physical well-being of parents is linked to the well-being or perceived well-being of their children.

Parents view the accomplishments and challenges of their children as indicative of their own success or failure.¹⁹⁵ Parents remain heavily invested in their children’s well-being throughout their lives.¹⁹⁶ Some social scientists have dubbed the parents’ interest in the successes and challenges of their children a “developmental stake.”¹⁹⁷ Because parents feel like

¹⁹¹ Id.
¹⁹² Parker, supra note 184.
¹⁹³ Id.
¹⁹⁶ Id.
¹⁹⁷ Id.
they hold a stake in the personal and professional development of their children, it is not surprising that they experience psychological distress and other problems when they are worried about the well-being of their children. Parents who do not believe their child is “on schedule” to becoming an independent member of society experience strain and a sense of personal failure.\textsuperscript{198} To some extent, parents may feel like they cannot carry on with progressing in their own lives until they believes their children have progressed successfully.\textsuperscript{199}

The success of grown children also impacts the parent-child relationship. “Ambivalence theory” in psychology posits that individuals experience ambivalence “when there are incompatible norms or expectations that cause contradictory emotions or beliefs.”\textsuperscript{200} A parent may experience ambivalence as a result of competing desires to launch their children into adulthood and to support children in need.\textsuperscript{201} Feelings of ambivalence regarding their children is associated with greater depression, lower quality of life, and poorer health among parents.\textsuperscript{202} Parents feel more ambivalent towards children with personal or financial problems. A parent tends to experience more ambivalence for adult children who are less successful professionally and children who attain less education.\textsuperscript{203}

C. The Benefits of College to Students and Their Parents

In today’s economy, both parents and young adults view obtaining a college degree as necessary to financial security.\textsuperscript{204} That belief is reflected in the increasing number of individuals obtaining a college degree. In 2016, forty percent of employed adults ages twenty-five to

\textsuperscript{198} Id.
\textsuperscript{199} Id.
\textsuperscript{200} Id.
\textsuperscript{201} Id.
\textsuperscript{202} Id.
\textsuperscript{203} Id.
twenty-nine had obtained an educational level of at least a bachelor’s degree, compared to only thirty-two percent in the prior generation.\textsuperscript{205} Enrollment in college is expected hit a record high from fall 2020 through fall 2026.\textsuperscript{206} Between fall 2015 and fall 2026, enrollment in college is projected to increase thirteen percent.\textsuperscript{207}

The economic benefits of obtaining a college degree are well-established. College educated young adults are less likely to be unemployed, as compared to young adults without a college education.\textsuperscript{208} They are also more likely to be employed full-time.\textsuperscript{209} In addition, the average college graduate earns twice as much as the average high-school graduate.\textsuperscript{210} This difference totals more than $1 million over a lifetime.\textsuperscript{211} When comparing today’s generation of young adults with prior generations, the disparity in economic outcomes between college graduates, on the one hand, and those with a high school diploma or less formal schooling, on the other, “has never been greater in the modern era.”\textsuperscript{212}

In addition to the financial benefits realized by the college graduate, parents may also benefit financially from their children’s education. Not surprisingly, young adults with a college degree are less likely to be economically dependent on their parents.\textsuperscript{213} Moreover, parents often

\textsuperscript{205} Nikki Graf, \textit{Today’s young workers are more likely than ever to have a bachelor’s degree}, \textit{Pew Res. Ctr.} (May 16, 2017), http://www.pewresearch.org/fact-tank/2017/05/16/todays-young-workers-are-more-likely-than-ever-to-have-a-bachelors-degree/.


\textsuperscript{207} \textit{Id.}

\textsuperscript{208} \textit{Id.}

\textsuperscript{209} Graf, \textit{supra} note 205.


\textsuperscript{211} \textit{Id.} Millennial college graduates ages twenty-five to thirty-two who are working full time earn more annually—about $17,500 more—than employed young adults holding only a high school diploma. \textit{Rising Costs}, supra note 19.

\textsuperscript{212} \textit{Rising Costs}, supra note 19.

\textsuperscript{213} \textit{See} Holmstrom et al., \textit{supra} note 204, at 285.
receive some assistance from an adult child when the parents become elderly, “especially if the parent-child relationship is an agreeable one.” 214 Given their greater earning potential, adult children with college degrees are more likely to be able to help elderly parents financially.

The economic benefit of a college education is reflected in the Bankruptcy Code. Specifically, some debts are very difficult, if not impossible, to eliminate or reduce through bankruptcy. 215 Student loan debt is a type of debt for which relief in bankruptcy is available only in limited circumstances. Student loan debt may only be discharged in bankruptcy if the debtor proves that the repayment of the debt would impose an undue hardship on the debtor. 216 One of the policy considerations behind the legislature’s decision to make student loan debt difficult to discharge in bankruptcy was its desire to prevent students from incurring debt to obtain an education, a thing that may generate substantial financial returns, and then shedding that debt before they have begun to utilize that education for its expected economic gains and repay their student loan debt. 217

214 See Holmstrom et al., supra note 204, at 285.
216 11 U.S.C. § 523(a)(8)(2018). The Bankruptcy Code was amended in 1998 to provide that student loans that are federally guaranteed could not be discharged unless the debtor could prove the debt was an undue hardship. See Higher Education Amendments Act of 1998, § 971, Pub. L. No. 105-244, 112 Stat. 1581, 1837 (1998). The Bankruptcy Code was again amended in 2005 to extend this discharge exemption to all student loan debt.

The economic landscape has changed significantly since Section 523(a)(8) of the Bankruptcy Code was enacted. Student loan debt has ballooned as the cost of education has risen. As student loan debt has continued to rise, some commentators have observed what appears to be a trend in the courts towards relaxing the standard required for student loan debt to be deemed dischargeable. In fact, some courts state expressly that the standard should be revised to a standard that allows the court to consider the totality of the circumstances surrounding the debtor’s particular situation in determining whether student loan debt should be discharged in bankruptcy. In re Roth, 490 B.R. 908, 920 (B.A.P. 9th Cir. 2013)(Pappas, Bankruptcy Judge, Concurring) (“the analysis required by [the current test] to determine the existence of an undue hardship [sufficient to allow discharge] is too narrow, no longer reflects reality, and should be revised by the Ninth Circuit when it has the opportunity to do so. Put simply, in this era, bankruptcy courts should be free to consider the totality of a debtor’s circumstances in deciding whether a discharge of student loan debt for undue hardship is warranted”).
Having a college degree also correlates with benefits that are not directly financial in nature. Since the late 1990s, mortality rates for individuals who have less than a college degree have been steadily increasing in various age-groups. During this same period, longevity has continued to improve for individuals who hold a college degree. For example, the mortality rate for men age fifty to fifty-four who do not hold a bachelor’s degree is 867 per 100,000, while the mortality rate for men of the same age group who hold a bachelor’s degree is just 243 per 100,000.\footnote{Anne Case & Angus Deaton, \textit{Mortality and Morbidity in the 21st Century}, BROOKINGS PAPERS ON ECONOMIC ACTIVITY, Spring 2017, at 397, 417, https://www.brookings.edu/wp-content/uploads/2017/08/casetextsp17bpea.pdf.}

\section{D. Societal Benefits of College}

Society also benefits from having a population that is more highly educated. On average, college graduates earn more money. As a result, they also pay more in taxes. Individuals who hold a college degree pay an average of ninety-one percent more in taxes each year, as compared to individuals who have not obtained an education past high school.\footnote{Jennifer Ma, et al., \textit{Education Pays 2016: The Benefits of Higher Education for Individuals and Society} 3 (2016), (https://trends.collegeboard.org/sites/default/files/education-pays-2016-full-report.pdf.)}

Individuals who hold a college degree are also much less likely to be dependent on taxpayer funded benefit programs, as compared to individuals who do not hold a college degree. Amounts expended on social welfare programs, such as Medicaid, housing assistance, unemployment compensation, and the Supplemental Nutrition Assistance Program (“SNAP”), are significantly lower for individuals with higher levels of education.\footnote{\textit{Id.}} Further, individuals without a college degree are much more likely to experience living in poverty. In 2015, only four percent of individuals age twenty-five who held a college degree lived in poverty, compared to thirteen percent of individuals who held only a high school diploma.\footnote{\textit{Id.}}
E. Paying for College – What is Ordinary Course?

The majority of families in the United States believe that both parents and students should contribute to paying for college.\textsuperscript{222} In sixty-nine percent of families, parents contribute to the college educational expenses of their children.\textsuperscript{223} These parents pay an average of thirty-seven percent of the total cost of attendance for their children.\textsuperscript{224} In fact, the view that college is a necessary investment and the expectation that parents will contribute to that investment has become so engrained in our society, that, “[t]he notion that parents will do whatever is required - including taking out loans and remortgaging homes - to ensure their children’s education has simply become part of the ‘world as taken-for-granted’ ....”\textsuperscript{225}

The expectation that parents will contribute to the costs of their children’s undergraduate education is reflected in the calculation of student need by educational institutions. To be considered for federal financial assistance with educational expenses, the student must complete the Free Application for Federal Student Aid (“FAFSA”). As a part of this application, students who are under the age of twenty-four and financially dependent on their parents must provide their parents’ financial information, in addition to providing their own financial information.\textsuperscript{226} The information provided is used to determine the “expected family contribution.”\textsuperscript{227} The expected family contribution is the amount the family will be expected to contribute to the educational expenses of the student in the upcoming school year.\textsuperscript{228} It is used to determine

\textsuperscript{222} Three in five families believe that paying for college is a shared responsibility between the parent and student. SALLIE MAE BANK, HOW AMERICA PAYS FOR COLLEGE 11 (2014), http://news.salliemae.com/files/doc_library/file/HowAmericaPaysforCollege2014FNL.pdf.
\textsuperscript{223} Id.
\textsuperscript{224} Id.
\textsuperscript{225} Holmstrom et al., supra note 204, at 266.
\textsuperscript{228} 20 U.S.C. § 1087mm (2018).
whether and to what extent the student will be eligible for federal financial assistance.\textsuperscript{229} It is also often used to determine eligibility for grants and loans from states and educational institutions.\textsuperscript{230} Thus, the expectation that parents will contribute to the costs of their child’s college education is so engrained in our society that it is taken as presumed by the federal government, state governments, and educational institutions.

Certain tax incentives further underscore the importance of a college education and the expectation that parents will contribute to the costs of their children’s undergraduate education. For example, if a child is a student, a parent may claim that child as a dependent up to age twenty-four.\textsuperscript{231} Conversely, if a child is not a student, the parent may only claim the child as a dependent up to age nineteen.\textsuperscript{232} Other programs encourage parental contributions to undergraduate education.\textsuperscript{233} These incentives include tax savings on certain funds contributed to accounts established under a qualified state tuition program pursuant to Section 529 of the Internal Revenue Code, known as “529 accounts” or “529 plans”\textsuperscript{234} and tax savings on certain savings trusts known as Coverdell Education Savings Accounts (“Coverdell Accounts”).\textsuperscript{235}

Subject to certain limitations, the Bankruptcy Code expressly excludes from the bankruptcy estate – and thus distribution to creditors — funds used to purchase tuition credit and

\textsuperscript{231} 26 U.S.C. § 152(c) (2018).
\textsuperscript{232} Id.; see also, I.R.S., Qualifying Child Rules, CREDITS & DEDUCTIONS, https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/qualifying-child-rules (last visited April 8, 2019).
funds contributed to 529 accounts.\textsuperscript{236} Similarly, the Bankruptcy Code excludes from the property of the bankruptcy estate funds deposited into Coverdell Accounts, provided certain requirements are met.\textsuperscript{237} The exclusion from property of the estate of funds deposited into 529 plans or Coverdell Accounts is permitted on a sliding scale. Provided the conditions set forth in the Bankruptcy Code are met, all funds deposited into 529 plans or Coverdell Accounts more than 720 days (just under two years) prior to the date the debtor filed for bankruptcy protection are excluded from the property of the bankruptcy estate.\textsuperscript{238}

Further demonstrating the expectation that parents will contribute to the costs of the undergraduate educational expenses of their children is the fact that these payments are very often stipulated to, or even mandated, in the context of the divorce or legal separation of parents. Many states give courts the power to impose support orders on parents for the support of their adult children who are enrolled in undergraduate degree programs.\textsuperscript{239} Even in circumstances where such payments are not be mandated by the courts, however, the payment of these expenses are often included in separation agreements and divorce settlement agreements.\textsuperscript{240}

\textsuperscript{238} 11 U.S.C. § 541(b)(5)(2018); 11 U.S.C. § 541(b)(6) (2018). Funds deposited between 365 and 720 days prior to the debtor’s bankruptcy filing are excluded from property of the bankruptcy estate up to the amount of $6,425.00. § 541 (b)(5)(C); § 541 (b)(6)(C). This amount is adjusted on April 1 every three years. It will again be adjusted on April 1, 2019. 11 U.S.C. § 104 (2018). No funds contributed to these education savings accounts during this period of time that exceed the amount of $6,425.00 are excluded from the property of the bankruptcy estate — i.e. they remain property of the bankruptcy estate and thus are available for potential distribution to creditors. § 541 (b)(5)(C); § 541(b)(6)(C). Finally, no such contributions made within the year prior to the bankruptcy are excluded from the property of the bankruptcy estate. § 541 (b)(5)(C); § 541(b)(6)(C).
\textsuperscript{239} See, e.g., Con. Gen. Stat. § 46b–56c (2016)(giving Connecticut courts the power to issue support orders for children enrolled in undergraduate education programs until they reach age twenty-three); Mass. Gen. Laws ch. 208 § 28 (2016) (giving Massachusetts courts the power to issue support orders for children enrolled in undergraduate education programs until they reach age twenty-three); N.Y. Fam. Ct. Act §413; N.Y. Dom. Rel. Law §240 1-b (giving New York courts the power to issue support orders for children enrolled in undergraduate education programs until they reach age twenty-one).
\textsuperscript{240} Ruth N. López Turley, Matthew Desmond, Contributions to College Costs by Married, Divorced, and Remarried Parents, 32(6) J. OF FAM. ISSUES, 767 (2010). In addition to being expected, however, parental contributions play a key role in helping to ensure that the student’s educational goals are in fact achieved. Studies show that parental
V. UNDERGRADUATE EDUCATIONAL EXPENSES AND THE SEARCH FOR VALUE

Relatively few courts have assessed reasonably equivalent value in the context of the payment of undergraduate educational expenses by debtor-parents on behalf of their adult children.\(^{241}\) As of the writing of this Article, the opinion entered in the *Palladino* case, discussed in the introduction to this Article, is the only opinion to date to have been taken to a federal circuit court for review.\(^ {242}\) On November 12, 2019, the First Circuit Court of Appeals entered an order in the case, reversing the bankruptcy court’s decision in favor of SHU and remanding the matter back to the bankruptcy court. In reversing the bankruptcy court’s decision, the First Circuit found that the payments were constructively fraudulent because, “[t]he tuition payments here depleted the estate and furnished nothing of direct value to the creditors.”\(^{243}\)

The divergence between the decision in the bankruptcy court in *Palladino*, on the one hand, and the decisions entered by the First Circuit in *Palladino* and the *Dunston* court, on the other, illustrate that, of those courts to have addressed the question of whether tuition payments made by debtor-parents on behalf of their adult children should be treated as fraudulent transfers, they have assessed the issue in two very conflicting manners.\(^{244}\) Under one approach, the courts

\(^{241}\) Mackenzie, *supra* note 19, *passim* (collecting cases). Although relatively few courts have been asked to rule on the question of whether tuition payments made by a debtor-parent on behalf of the debtor’s adult-child should be construed as constructively fraudulent, in recent years, a number of plaintiffs have claimed that such payments are constructively fraudulent. 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 (2019) (collecting cases, including cases that were settled or dropped without judgment by the relevant court).

\(^{242}\) DeGiacomo *v.* Sacred Heart University (*In re Palladino*), 942 F.3d 55 (1st Cir 2019).

\(^{243}\) *Id.* at 59.

\(^{244}\) The payment of undergraduate educational expenses is often addressed, either by settlement or by mandated court order, in the context of the divorce or legal separation of parents. Given that these payments arise as a result of a prior adjudication or prior stipulated resolution, they are generally treated differently as compared to payments by parents that are not paid pursuant to a prior agreement or court order. The unique treatment of these payments is beyond the scope of this Article. It is worth noting, however, that courts presented with challenges to payments that
conclude that, while the payment by the debtor-parent of educational expenses for the debtor’s adult child may result in value to the adult child (in the form of an education), no value is given to the debtor and, as such, the value is not reasonably equivalent. Because, according to this view, the debtor did not receive reasonably equivalent value, the transfer may be deemed constructively fraudulent and, accordingly, the payments may be recovered from the educational institution that received the subject payments or from the student who received the education.

In another case in point, Gold v. Marquette Univ. (In re Leonard), the Chapter 7 Trustee sought to recover payments made by the debtors to Marquette University for the debtors’ eighteen-year-old son’s tuition and other expenses related to his education at Marquette. Falling in line with the benefits-to-the-creditors approach to the value analysis, the court held that, in analyzing the value given by a transferee, “the focus should be on the overall effect on the debtor’s net worth after the transfer.” Consequently, the court concluded, the benefit given to the debtor must be an “economic” benefit that is “concrete” and “quantifiable.” In considering the benefits the debtors may have received as a result of the payment of their son’s educational expenses, the court found that any benefit they received “did not increase their ‘net worth,’ nor

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are mandated by prior agreement or a divorce decree may take the position that such payments are beyond the reach of fraudulent transfer laws or may permit the defense of issue preclusion to protect such payments. Mimi Faller, Separation Agreements: Could They Be Considered Constructively Fraudulent?, 25(1) NORTON J. BANKR. L. & PRAC. Art. 5 (2016). In fact, payments that are mandated by a divorce decree may be permitted to continue even after a debtor files for bankruptcy protection. In re Smith, No. 15 B 36486, 2016 WL 7441605 (Bankr. N.D. Ill. Dec. 27, 2016).


Id. at 457.

Id.
did such benefits increase the Debtors’ assets in any way that could be used to pay their creditors.\textsuperscript{250} Accordingly, reasonably equivalent value was lacking.

In assessing reasonably equivalent value, courts have drawn a distinction between payments made on behalf of minor children and payments made on behalf of adult children. In \textit{In re Sterman},\textsuperscript{251} the trustee sued the daughters of the debtors, seeking to recover education-related payments the debtors made on behalf of their daughters. With respect to the payments made on behalf of one of the daughters, some of these payments were made before the daughter reached the age of majority and others were made after the daughter reached the age of majority.\textsuperscript{252} Regarding the payments that had been made when the daughters were adults, the court found that the debtors had not received reasonably equivalent value in exchange for the payments. The court recognized that making these payments might be “economically prudent.”\textsuperscript{253} Nonetheless, the court found that, although these payments purportedly benefited the debtor by increasing the likelihood that their daughters would become self-sufficient, and also provided “psychic assurance and other intangible benefits” to debtors in guaranteeing, in connection with room and board and other payments, that their daughters would have a place to live and food to eat, these benefits did not constitute “value” under the Bankruptcy Code. With respect to payments the debtor made while their daughter was a minor, however, the court held that the debtors had received reasonably equivalent value because the payments had satisfied the debtors’ obligation to provide their minor daughter with an education.\textsuperscript{254}

\textsuperscript{250} \textit{Id.} at 457-58.
\textsuperscript{252} \textit{Id.} at 235-36. The age of majority in New York, the applicable jurisdiction in \textit{Sterman}, is twenty-one. \textit{Id.} at n.8.
\textsuperscript{253} \textit{Id.}
\textsuperscript{254} \textit{Id.}
Courts espousing the view that the payment of educational expenses for an adult child does not result in value to a debtor-parent appear to accept that the value received by the debtor may be indirect (i.e. that it need not flow directly to the debtor from the transferee), but they nonetheless generally adopt an overly narrow view of value as something that must be immediately and unquestionably leviable on behalf of the creditors, thereby failing to recognize in the calculation of value the benefits that accrue to the debtor as a member of the family economic unit with the child who is receiving the education.\textsuperscript{255} Similar to the entity whose credit worthiness and financial stability may be enhanced by monies and other benefits that flow to a close affiliate entity, the credit worthiness and financial stability of the debtor-parent is almost certainly enhanced by the debtor’s child receiving a college education. Additionally, while they are living with their parents, adult children generally contribute financially or otherwise to the maintenance of the debtor’s household.\textsuperscript{256} Further, parents generally provide their young adult children with most or all of the essentials for living – housing, clothing, food, utilities, and the like, regardless of whether those adult children are receiving an education at that same time. In fact, if children are living with their parents at the time the parents file for bankruptcy protection, this financial reality is accepted by most bankruptcy courts in determining whether and to what extent the debtors will be able to repay their creditors in bankruptcy.\textsuperscript{257}

Although a trustee might pursue either the adult child or the educational institution for the payments made by debtor-parents, in situations where it is the college or university that is

\textsuperscript{255} This analysis of value is, of course, akin to the narrow value analysis employed by some courts in the context of intercorporate guarantee obligations which lead these courts to fail to recognize value obtained by the corporate enterprise in conjunction with intercorporate guarantees or other intercorporate transfers. \textit{See, e.g.}, 3V Capital Master Fund Ltd. v. Official Comm. Of Unsecured Creditors of TOUSA, Inc. (\textit{In re TOUSA}), 444 B.R. 613, 659 (S.D. Fla. 2011).

\textsuperscript{256} \textit{Supra} notes 192-197 and related text.

\textsuperscript{257} \textit{Supra} Part III.B.
required to return tuition payments to a trustee, there are, nonetheless, potential consequences for the adult children who received the education. For example, when an adult child has not yet graduated, the school may place a “hold” on the student’s degree – meaning the student will not graduate until the debt is paid.258 Even when a student has already received a diploma, the school may nonetheless pursue the former student for the amounts the college or university was required to pay to the trustee. Under such circumstances, a debtor-parent may voluntarily take on the debt, thereby undermining the fresh start the debtor was supposed to receive.259 As society has come to see college as a necessity, it should not be surprising that a debtor-parent would give up the fresh start bankruptcy offers to ensure the debtor’s child is permitted to graduate and is not retrospectively saddled with unexpected debt.

As compared to those courts that have permitted the recovery of such payments, courts that reject attempts by trustees to recover from colleges and universities payments that were made by a debtor-parent on behalf of the debtor’s adult child take a radically different view of whether value was given to the debtor-parent. In Palladino, discussed in the introduction to this


259 In one case, a university allowed the adult child to graduate, but only after the debtor-parent signed an installment agreement to pay $250 a month to settle the debt. Katy Stech, Bankruptcy Trustees Claw Back College Tuition Paid for Filers’ Kids, WALL ST. J. (May 5, 2015, 7:50 PM), https://www.wsj.com/articles/bankruptcy-trustees-claw-back-college-tuition-paid-for-filers-kids-1430869820?mod=rss_Education; see also, Derek A. Huish, Clawing Back Tuition Payments in Bankruptcy: Looking to Ancient and Recent History to Define the Future, 104 IOWA L. REV. 2151, Appendix (2019)(noting several cases that were resolved by settlements agreements that included payments to the trustee by the debtor).

In the Chapter 13 case of In re Riegodedios, 146 B.R. 691 (Bankr. E.D. Va. 1992), the court recognized the connection between the fresh start objective of bankruptcy and the payment of college tuition by debtor-parents. In that case, the court considered a creditor’s objection to the debtors’ proposed plan in a Chapter 13 case because the debtors proposed in their plan that they be permitted to pay $614 a month to cover tuition and rent for their daughter’s last year of college. In approving the debtors’ plan, the court determined that the proposed expenditure of $614 per month for tuition and rent was “reasonably necessary” because a college education that would make their daughter a more productive and useful citizen and this goal was part of the “fresh start” envisioned by the Bankruptcy Code. Id. at 693. The court also took notice that the proposed payment was, “not a new expense of the debtors” and that the “debtors are not expending unreasonable amounts of money in sending their daughter to an expensive private school.” Id.
Article, the court rejected as “overly ridged” the trustee’s contention that the only value in the transaction that should be considered was the education given to the debtors’ daughter by the university.\textsuperscript{260} In rejecting this narrow view of value, the court explained that, in making the payments to SHU, the debtors, “believed that a financially self-sufficient daughter offered them an economic benefit and that a college degree would directly contribute to financial self-sufficiency” and that such motivation was, “concrete and quantifiable enough” to establish “reasonably equivalent value”.\textsuperscript{261}

Similarly, \textit{In re Cohen}, the trustee challenged $102,573.00 in payments that the debtor-parents made for their son and daughter's post-secondary educations, including $46,059.97 for their son's undergraduate education, $7,562.00 for their daughter's undergraduate education and $39,205.00 for their daughter's graduate education.\textsuperscript{262} In rejecting the trustee’s contention that the payments related to undergraduate expenses were constructively fraudulent, the court held that, “such expenses are reasonable and necessary for the maintenance of the Debtor's family” and, thus, such payments were not constructively fraudulent.\textsuperscript{263} The court, however, limited its holding only to the payments made by the parents to cover undergraduate educational expenses, stating that, “children in graduate school are well into adulthood.”\textsuperscript{264} Because the \textit{Cohen} court found that the undergraduate expenses paid by the debtor-parents were “reasonable and necessary for the maintenance of the Debtor's family,” the court held that the trustee failed to

\begin{flushright}
\textsuperscript{261} Id.
\textsuperscript{263} Id. at *10.
\textsuperscript{264} Id.
\end{flushright}
meet the trustee’s burden to show that the parents did not receive reasonably equivalent value in exchange for these payments.\textsuperscript{265}

Likewise, in \textit{In re Oberdick},\textsuperscript{266} the trustee challenged $82,536.22 worth of expenditures that were used to pay for the undergraduate tuition and living expenses of the debtor’s adult children. The \textit{Oberdick} court agreed with the reasoning of the \textit{Cohen} court, finding that the payment of the subject educational expenses was necessary for the maintenance of the debtor’s family and, as such, were not constructively fraudulent.\textsuperscript{267} In reaching this conclusion the court stated, “Even though there may not strictly be a legal obligation for parents to assist in financing their children's undergraduate college education …. this Court has little hesitation in recognizing that there is something of a societal expectation that parents will assist with such expense if they are able to do so.”\textsuperscript{268}

As in the case of intercorporate guarantees, courts that employ a narrow benefits-to-the-creditor analysis of the value that is required under the reasonable equivalent value requirement, focusing narrowly on the immediate net benefit to the creditor, fail to account for the larger context in which the subject payments are made and the larger impact of the education received by the adult children. Further, with this overly narrow view of value, we are confronted squarely with the problem of the “confounding of purpose with effect” that has, “led many a court astray in assessing fraudulent transfer liability.”\textsuperscript{269} Conversely, courts that have found these payments

\textsuperscript{265} \textit{Id.}
\textsuperscript{267} \textit{Id.} at 712.
\textsuperscript{268} \textit{Id.} The \textit{Oberdick} court, however, distinguished expenses not directly related to the education of the debtor’s children, such as those related to the debtor’s son’s school trip to Italy and contributions to a fraternity, finding that those expenses were not necessities and were subject to recovery as fraudulent transfers. \textit{See also} Eisenberg v. Penn. State Univ. (\textit{In re Lewis}), Adv. Pro. No. 16–0282, 2017 WL 1344622 (Bankr. E.D. Pa. April 7, 2017) (holding that a parent’s payment of a child's undergraduate college expenses is a reasonable and necessary expense for maintenance of the family and for preparing family members for the future, and therefore, the parent receives reasonably equivalent value in exchange for the tuition payment.).
\textsuperscript{269} Williams, \textit{Fallacies, supra} note 40, at 1421; \textit{see also} discussion \textit{supra} Part I C.
to not be constructively fraudulent recognize and account for the practical, cultural, and societal context in which these payments are made. Decisions that protect these payments underscore the reasonably equivalent value requirement as a doctrine that is aimed at protecting creditors from transfers that are outside the ordinary course of affairs of a debtor.270

VI. ASSESSMENT OF REASONABLY EQUIVALENT VALUE TO THE FAMILY ECONOMIC UNIT

This Article proposes a model of fraudulent transfer law as applied to undergraduate educational expenses paid by debtor-parents that is true to the historical roots of fraudulent transfer law and in line with the fresh start and fair treatment goals of bankruptcy. The proposed model rejects the traditional view reflected in fraudulent transfer jurisprudence that the reasonably equivalent value analysis must focus on direct value to the debtor as an isolated unit, viewed from the standpoint of the creditors of the debtor. As discussed, a benefits-to-the-creditor requirement approach is overly narrow. This approach has threatened many transactions never intended by the drafters of the statutes to be subject to undoing under fraudulent transfer law.271 Where the elements of a constructive fraudulent transfer claim are otherwise satisfied, a narrow understanding of value would likely result in the avoidance of most payments to educational institutions made by debtor-parents on behalf of their adult children. This result does not comport with the notion of fraudulent transfer law as a tool to protect creditors against unexpected risks272 and undermines the fresh start objective of bankruptcy. The indirect benefits approach and the identity of interests doctrines are similarly unsatisfactory because there is no consistent understanding of what constitutes a cognizable benefit, or the amount of benefit

270 See discussion supra Part II C.
271 See discussion supra Part II.
272 Williams, *Fallacies*, supra note 40.
required to satisfy the reasonably equivalent value requirement.\textsuperscript{273} Such unclear standards result in uncertainty and inefficiency in the resolution of these disputes.

Acknowledging that consumer bankruptcy law considers the financial wherewithal of the debtor as a member of a household and recognizing fraudulent transfer law as a tool to protect a debtor’s creditors from unexpected harm that results when a transaction is outside the ordinary course of affairs for the debtor,\textsuperscript{274} this Article advocates for a pragmatic and contextual assessment of reasonably equivalent value. The proposed test asks whether the payment of the educational expenses by the debtor-parent provided value— including the reasonable anticipation of value— to the debtor’s household, looking to the economic unit approach utilized by many bankruptcy courts for purposes of understanding the term household.

\textbf{A. The Proposed Test}

Under the proposed test, the analysis of reasonably equivalent value rests on three factors: (1) whether reasonably equivalent value has been given to the adult child of the debtor in exchange for payments made by the debtor-parent; (2) whether the expenses paid by the debtor-parent were necessary for the adult child to receive the education provided; and (3) whether, at the time the payments were made, the debtor-parent and adult child should be deemed a member of the same economic unit, such that they should be viewed as a single unit for fraudulent transfer purposes—\textit{i.e.} were the economic lives of the debtor-parent and the debtor’s adult child intertwined such that the payment of the educational expenses by the debtor-parent would be expected and such that the child’s circumstances, “directly impact[ed] the debtor’s financial situation.”\textsuperscript{275}

\textsuperscript{273} For a thorough discussion of the inadequacies of the indirect benefits doctrine, see Williams, \textit{Fallacies}, supra note 40.
\textsuperscript{274} \textit{Id.} at 1414.
The first factor of the test would be met where the adult child indeed receives an education from the college or university that received the payments. In situations in which the child did not actually receive the full benefits of the education\textsuperscript{276} – for example, if the student stopped attending classes mid-way through the semester – the value given might be challenged. Similarly, where the educational institution in question might be shown to essentially be a sham, the value given might be challenged.

The second factor focuses on the nature of the expenses paid by the debtor-parent. It focuses on how closely that expense was tied to the education received by the adult child and whether the expense could be taken as necessary for the adult child to obtain the education provided. An expense like tuition would easily satisfy the requirement that the expense be necessary for the education provided. Similarly, expenses such as the cost of textbooks and lab fees would also seem to easily qualify as necessary expenses. Expenses less clearly necessary for the education attained by the adult child would be subject to more scrutiny. For example, overseas travel and fraternity fees might not be deemed necessary for the adult child to obtain the education provided.\textsuperscript{277}

The third factor of the proposed test requires an assessment of the relationship between the debtor-parent and the adult child, examining the interrelated nature of their economic lives.\textsuperscript{278}

\textsuperscript{276} The fact that this Article focuses on undergraduate educational expenses is not intended to suggest that a similar argument could not be made in the context of the payment by parents of tuition and fees for their adult children to attend a vocational school.

\textsuperscript{277} The court in \textit{In re Oberdick} made this distinction, finding that expenses not directly related to the education of the debtor’s children, such as those related to the debtor’s son’s school trip to Italy and contributions to a fraternity, were not necessary expenses and were subject to recovery as fraudulent transfers. \textit{In re Oberdick}, 490 B.R. at 712.

\textsuperscript{278} It should be noted that, as discussed above, the Bankruptcy Code expressly permits debtors to move certain funds into tax savings accounts and outside the reach of creditors for the purpose of covering the educational expenses of qualified beneficiaries. \textit{Supra} Part IV. E. Importantly, qualified beneficiaries are not required to be members of the debtor’s household and, in fact, may have no impact at all on the debtor’s economic life. Moreover, all funds deposited in these plans more than two years prior to the debtor’s bankruptcy filing are excluded from inclusion in the bankruptcy estate.
It is important to recognize that the individual who would have the most direct and accurate knowledge of the debtor’s living situation and economic ties – the debtor – is not likely to be a party to a fraudulent conveyance actions. Moreover, the make-up of a debtor’s economic unit may change over time. For these reasons, to make the inquiry more efficient, the test would operate with presumptions and burden shifting.279

Under this third factor, if a debtor’s adult-child was listed as a dependent280 on the debtor or the debtor’s non-filing spouse’s income tax return for the period of time during which the subject payments were made, that adult child will be rebuttably presumed to be a member of the debtor’s economic unit, such that the value received by the adult child may be taken as value received by the debtor-parent. The trustee, however, might successfully rebut this presumption by providing documentation or other evidence that supports that the adult child’s financial life is not in fact intertwined with the financial life of the debtor-parent. If the trustee were to provide evidence to successfully rebut the presumption, the burden would shift to the target of the fraudulent conveyance action to provide countervailing evidence supporting that the adult child should be construed as having been part of the debtor’s economic unit at the time the subject payments were made.

279 See In re Skiles, 504 B.R. 871 (Bankr. N.D. Ohio 2014)(adopting rebuttable presumptions and burden shifting in the context of determining whether a child will be deemed a member of the debtor’s “household” under the economic unit test for household).

280 A factor to which bankruptcy courts look in determining whether a child should be deemed a member of the debtor’s “household” under the economic unit approach is whether the debtor claimed the child as a dependent on the debtor’s tax returns during the period of time in question. I.R.S. Publication 501 sets forth a five-factor test for determining whether a child is the debtor’s “dependent”: (1) a relationship test, which requires that the potential dependent be “son, daughter, stepchild, foster child, or a descendant of any of them ...”;(2) an age test, which requires that the person be under 19 years of age, under 24 years of age and a full-time student, or any age if permanently disabled; (3) a residency test, which would require that the person lived with the debtor for more than half of the year; (4) a financial support test, which would require that the child not “have provided more than half of his or her own support for the year”; and (5) a joint return test, which generally disallows anyone filing a joint return from being declared as a dependent on another person’s tax return. I.R.S., DEPENDENTS, STANDARD DEDUCTION, AND FILING INFORMATION 10 (2018). https://www.irs.gov/pub/irs-pdf/p501.pdf. There are certain modified tests for a dependent child of more than one person, such as in the case of divorce or separation. Id. at 13.
Conversely, if a debtor’s adult child was not listed as a dependent on the debtor or debtor’s non-filing spouse’s income tax return that covers the period of time when the subject payments were made, that adult child is rebuttably presumed to not be a part of the debtor’s economic unit. The target of the constructive fraudulent conveyance claim would have the initial burden to rebut this presumption by providing evidence showing that the adult child should be construed as part of the debtor’s economic unit during the applicable period. If that party can provide satisfactory evidence, the burden would shift to the trustee to provide countervailing evidence.

With respect to evidence that might be used by either the trustee or the target of a claim of constructive fraud to rebut an applicable presumption regarding whether an adult child was a member of the debtor’s economic unit at the applicable period of time, the body of jurisprudence analyzing the term “household” under the economic unit approach provides an abundance of guidance. Evidence that might be considered include, for example, (1) documentation completed during the period of time when the subject payments were made that identify members of the debtor’s household – such as applications for government assistance, real property leases and rental applications, loan applications, or credit card applications, (2) bank statements, credit cards statements, or receipts, (3) domestic support orders or divorce orders, (4) evidence as to whether the adult child had ever lived independently, (5) evidence regarding the adult child’s employment history, (6) the age of the adult child, (7) whether and to what extent the adult child shared a residence with the debtor, and (8) whether the debtor-parent and the adult child are or could be treated as a single unit for other purposes, such as insurance coverage, federal or state student aid or student loans, or other federal or state aid programs.
B. Illustrating the Benefits of the Proposed Test

Examining the application of the proposed test to a typical factual scenario from which a claim of constructive fraud may arise should illustrate the benefits of the proposed test as compared to the current doctrines.

Debbie and Dan have one child, twenty-year-old Sam. Sam is a junior at State University. Over the last two years, Debbie and Dan have made approximately $40,000.00 in payments to State University for Sam’s tuition, books, and room and board. Sam lives at school during the school year. During holidays and over the summer, Sam lives back at home with Debbie and Dan. Debbie and Dan claim Sam as a dependent on their jointly filed tax returns. Debbie and Dan own a small shop in which they sell hand-made crafts and other goods. A fire in the shop destroys most of their inventory and badly damages the building. While battling with their insurance provider over coverage for the damage, they are forced to close the shop and have lost their primary source of income. They begin to default on loan payments and other bills. They eventually file for relief under Chapter 7 of the Bankruptcy Code. The Chapter 7 trustee sues State University, seeking to recover the $40,000.00 in payments made by Debbie and Dan to the University. The trustee asserts that the payments were constructively fraudulent because, the trustee argues, any value given in exchange for the payments was given to Sam and not to Debbie and Dan.

Under the direct value requirement, only Sam received value from State University in exchange for the payments made by Sam’s parents. As such, assuming the other elements of constructive fraud are met, the payments made by Debbie and Dan to State University would be recoverable as constructively fraudulent.

Under the totality of the circumstances, indirect benefits, and identity of interests
doctrines, however, an argument can be made that value was provided to the debtors. The University could attempt to gather evidence of the indirect benefits that may have flowed to the debtors. When Sam was away at school, Sam was not consuming food or using the utilities at Sam’s parents’ home, thereby arguably benefitting the debtors by reducing their bills. The debtors may attest that they felt peace of mind by helping Sam obtain a college education, thereby permitting them to focus on running their business. When Sam was home, Sam may have added value to the household by doing chores at home and perhaps by working in the debtors’ shop. Arguably, Sam provided this assistance, at least in part, in response to the financial support and educational opportunities provided to Sam by Sam’s parents.

Of course, the trustee could question any benefits that arguably flowed to the debtor-parents. Moreover, even if benefits are shown to have flowed to the debtor-parents, the trustee could question whether those indirect benefits constitute a reasonably equivalent value in exchange for the payments made by Debbie and Dan to State University. As existing caselaw illustrates, authorities would apply incoherent tests to the value requirement and may ultimately disagree on the result.

The proposed test addresses the value requirement in a manner that is coherent and principled, looking to the policies and goals underpinning both fraudulent transfer law and bankruptcy. Under the proposed test, we would ask: (1) whether reasonably equivalent value was given to Sam in exchange for the payments made by Sam’s parents; (2) whether the expenses paid by Sam’s parents were necessary for Sam to receive the education provided; and (3) whether, at the time the payments were made, Sam should be deemed a member of the same
economic unit with Sam’s parents,\textsuperscript{281} such that they should be viewed as a single unit for fraudulent transfer purposes.

The first requirement of the test would be met here. In exchange for the payments made by Sam’s parents, Sam received an education and room and board at the University. The second requirement likewise would be easily met here. The payment of tuition would certainly be necessary for Sam to receive the education Sam received. Similarly, Sam would need room and board while Sam obtains an education.

Finally, the third requirement would be satisfied here. Sam’s parents claimed Sam as a dependent on their tax returns for the time period during which the payments to the University were made. Based on the facts given, the trustee would be unable to rebut the presumption that Sam was a part of the same economic unit with the debtors at the time the debtors made the payments to the University on Sam’s behalf. As such, Sam and Sam’s parents should be treated as one economic unit for purposes of the constructive fraud claim against the University. Thus, under the proposed test, the debtors have received a reasonably equivalent value in exchange for the payments they made to the University.

Creditors to a consumer borrower understand that the borrower’s financial life is not entirely independent of the members of the borrower’s household. In fact, this reality is reflected in bankruptcy law. Moreover, the expectation that parents will help to pay for the undergraduate educational expenses of their children is deeply engrained in our society. Creditors of Debbie and Dan would not be unfairly prejudiced by viewing Sam as part of one economic unit with Debbie and Dan for purposes of fraudulent transfer law with respect to the claims against the

\textsuperscript{281} It should be noted that the answer to this question may have already been resolved in connection with determining the size of the debtors’ household for other relevant purposes. \textit{Supra} Part III. B.
University.

VII. CONCLUSION

The proposed assessment for value advocates a practical approach to the reasonably equivalent value requirement in the context of the payment by debtor-parents of educational expenses for their adult children. It is based on the economic, cultural, and societal realities that provide the context in which the payments at issue are made, while staying true to the equitable roots of fraudulent transfer law. The proposed assessment protects the legitimate expectations of the debtor (including the debtor’s children), the debtor’s creditors, and the colleges and universities that receive payments from the debtor. It does not prohibit the avoidance of transfers generally understood as “true” fraudulent transfers – those transfers that “unacceptably contravene norms of creditors’ rights.” A showing of actual fraud could nonetheless be used to void the rare instance in which a debtor-parent might intentionally make such payments to move assets beyond the reach of its creditors. Similarly, it does not prohibit the appropriate party from challenging the debtor’s bankruptcy case as having been filed in bad faith. As the same time, however, the proposed assessment stays true to the historical underpinnings of fraudulent transfer law and to the fresh start goal of bankruptcy by properly aiming the reasonably equivalent value requirement at protecting creditors from transactions that would be not be expected.