

THE COLLEGE CONUNDRUM – STUDENT LOANS, TUITION AND BANKRUPTCY

(by Deborah A. Notinger)

Two Hot Topics in Bankruptcy

This is a brief overview of two “hot topics” in the bankruptcy world (and in the world in general, with the skyrocketing costs of college in the US) related to the payment of tuition for college:

- 1) What happens when you’ve paid for your (or your child’s) college education with student loans, but end up in bankruptcy?
- 2) What happens when you pay for your child’s college education (with cash or loans) and end up in Chapter 7 bankruptcy shortly thereafter – can your bankruptcy trustee recover the payments you’ve made to the college, as either actual fraudulent transfers or as constructive fraudulent transfers?

1. Discharge of Student Loans in Bankruptcy.

Surprise! Did you know that because most student loans are guaranteed in some way by the federal government, they are generally not dischargeable for an individual in bankruptcy like other debts such as credit cards and medical bills? This is what the Bankruptcy Code (Title 11 of the U.S. Code, et seq.) has to say about the discharge (or lack thereof) of student loan obligations (emphasis added):

11 U.S.C. §523

(a) A discharge under section [727](#), [1141](#), [1228\(a\)](#), [1228\(b\)](#), or [1328\(b\)](#) of this title does not discharge an individual debtor from any debt—

(8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor’s dependents, for—

(A) (i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or

(ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or

(B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual;

Most debts are automatically discharged (i.e. the Debtor no longer has any personal liability for same) about 90 days after filing for an individual who (in Chapter 7¹) files for bankruptcy listing all of his/her assets and liabilities, attends a Section 341 Meeting of the Creditors and answers any questions from the Trustee satisfactorily. If the Debtor wants to discharge any student

¹ In Chapter 13 the Debtor’s discharge is issued at the end of a successful partial repayment plan.

loan(s) (as defined in 11 U.S.C. §523(a)(8)(A) or (B)) as part of the bankruptcy process, however, the Debtor **must file a separate law suit** (called an Adversary Proceeding) against the student loan provider(s), within the bankruptcy case, and prove by a preponderance of the evidence to the Bankruptcy Judge that repayment of the student loan(s) “would impose an undue hardship on the debtor and the debtor’s dependents.” See 11 U.S.C. §523(a)(8). Only after the Debtor proves his/her case under 11 U.S.C. §523(a)(8) would a student loan obligation be discharged as part of the bankruptcy process.

As you can imagine, proving that a student loan would impose an undue hardship on the Debtor and his/her dependents is very fact specific, and done on a case-by-case basis. However, the general test that has been adopted in New Hampshire (and by the First Circuit Bankruptcy Appellate Panel) for determining whether a student loan debt can be discharged is the “totality of the circumstances test.” “Under the totality of the circumstances test, the Court will examine the Debtor’s past, present, and future financial resources and necessary living expenses and whether, taken together with other factors, the Debtor has the ability to repay the loans at issue while maintaining a minimal standard of living.” See Blanchard v. N.H. Higher Education Assistance Foundation (In Re Blanchard) 2014 BNH 008, 8/14/2014 (Adv. Pro. No. 13-1038-JMD) (Comprehensive Opinion, attached); Bronsdon v. Educational Credit Management Corp., (In Re Bronsdon) 435 B.R. 791,798 (1st Cir. BAP 2013).

Both the Blanchard and Bronsdon Courts go on to define the totality of circumstances test further as:

“The totality of the circumstances analysis requires a debtor to prove by a preponderance of evidence that (1) his past, present, and reasonably reliable future financial resources; (2) his and his dependents’ reasonably necessary living expenses; and (3) other relevant facts or circumstances unique to the case, prevent him from paying the student loans in question while still maintaining a minimal standard of living, even when aided by a discharge of other prepetition debts. Courts should consider all relevant evidence – the debtor’s income and expenses, the debtor’s health, age, education, number of dependents and other personal or family circumstances, the amount of the monthly payment required, the impact of the general discharge under chapter 7 and the debtor’s ability to find a higher-paying job, move or cut living expenses.”

Even though it is not listed specifically in the above analysis, the Debtor’s efforts to repay the loan(s) prepetition are also a factor (albeit not a deciding factor as under the rejected Brunner test from the 2nd Circuit) for the court to consider when deciding whether a student loan debt should be discharged as an undue hardship. Blanchard, supra at Op. p. 15.

Below is a (non-exhaustive) list of “undue hardship” cases from New Hampshire and the results thereof. Two things stand out to the author: 1) the Debtor has to gather and provide to the Court a lot of evidence of his/her undue hardship to be successful, a big task for a financially, and sometimes mentally and/or physically stressed or disabled person; and 2) if you are gainfully employed, do not have too many dependents and have not really tried to repay your student loans, you are not going to be able to discharge them in bankruptcy.

Undue Hardship Cases – NH Examples (unreported opinions can be accessed through the New Hampshire Bankruptcy Court’s website www.uscourts.nhb.gov or through ECF by researching the Adv. Pro. Docket No.)

Abdinoor v. Navient Solutions, Inc., et al. (2015 BNH 006), Adv. Pro. No. 14-1048-BAH, Opinion dated 09/03/2015 (27- year-old debtor in good health with no dependents who worked full-time in her chose field as a legal assistant not entitled to discharge over \$105,000.00 in student loan debt three and ½ years after graduating, when she had disposable income each month and her current and future employment prospects were good and/or improving [even though the Debtor did not have permanent housing at the time of trial], thus she could maintain a minimum standard of living while repaying her student loans).

Blanchard v. N.H. Higher Education Assistance Foundation (In Re Blanchard) 2014 BNH 008, 8/14/2014 (Adv. Pro. No. 13-1038-JMD) (In re Blanchard) (2014) (student loans of \$52,902.65 discharged as undue hardship for married debtor, father of five minor children, whose wife was a stay-at-home mom and homeschooler for 3 of the parties’ children, even though debtor worked full time in his field of study as a nurse; family lived very modestly, could not readily improve their financial circumstances, and debtor had not been able to reduce the balance owed on his loans over a long period of time (14 years), despite compliance with various deferment and repayment plans).

Narayanan v. NHHEAF, et al. (In re Narayanan) (2009 BNH 021), Adv. Pro. No. 08-1073-JMD, Opinion dated 8/3/09 (debtor who guaranteed student loans for his adult children [whom the debtor continued to support even though they were not minors] not entitled to discharge \$212,798 [!!] in student loans in bankruptcy where debtor (even though recently laid off, 61 years old, with no retirement savings) showed no effort to repay loans in the last few years, had been able to acquire and maintain savings in excess of \$10,000.00, owned a home with substantial equity, and had shown a history of being able to become re-employed after short periods of unemployment in the information technology field). This case was decided under the now-rejected Brunner test, which focused more on the debtor’s efforts to repay the student loans pre-bankruptcy-petition, but it still hit all the “highlights” of the “totality of the circumstances” test and provides a contrast to the Blanchard case.

Tucker v. Sallie Mae, Inc., et al. (In Re Tucker) (2009 BNH 024), Adv. Pro. No. 08-1159-JMD, Opinion dated 9/3/09 (debtor (with no dependents living alone in a modest apartment) with long history of depression who had been able to get off social security, obtain a bachelor’s degree and work for some time in her chosen field, but ultimately had to stop working and go back on social security disability due to her depressive illness, allowed to discharge approximately \$58,000 in student loan debt as an undue hardship, even though she did not present any expert medical testimony on the future of her illness, only testimony of the debtor and her close friend.). Also decided under Brunner, but again discusses “totality of the circumstances” factors.

First Circuit Bankruptcy Appellate Panel

Bronsdon v. Educational Credit Management Corp., 435 B.R. 791 (1st Cir. BAP 2013) (In Re Bronsdon) (healthy 65-year-old woman living temporarily with her father who went to law

school on student loans but then could not pass the bar exam in three tries (or even come close), or get a job in any field despite multiple attempts, who was now on social security, entitled to discharge her student loans (\$82,000) as an undue hardship under the “totality of the circumstances” test, even though she did not apply for the federal William D. Ford Federal Direct Loan Program, an income-based repayment plan that would have required monthly payments of zero and led to forgiveness (but not discharge – write-off of interest is taxable!) of the loans after 25 years or sooner if the Debtor’s circumstances did not improve). (See also Dufresne v. NHHEAF (In re Dufresne) 341 B.R. 391 (Bankr.D.Mass. 2006) (unemployed debtor [living with various health problems temporarily in a room in her ex-husband’s home] who failed the bar nine times and thus could not fully utilize the law degree for which she owed over \$106,000.00 in student loans entitled to discharge of student loans for undue hardship.)

2. Fraudulent Transfer Actions Against Colleges/Universities to “Claw Back” Tuition Payments made to the school within 2 years (11 U.S.C. §548 – the federal fraudulent transfer statute) or 4 years (11 U.S.C. §544 and NH RSA 545-A – the state fraudulent transfer statute made applicable in bankruptcy).

Another “hot” topic in bankruptcy spawned by the high cost of college (which perhaps just became less hot in the First Circuit – see below), is whether a Chapter 7 trustee can “claw back” as an intentional or constructive fraudulent transfer, tuition payments made by a debtor within two years (federal) or four years (New Hampshire) of his/her bankruptcy filing to a college, university or other private school (“college” or “colleges”) on behalf of the debtor’s child. Fraudulent transfer actions (and other so-called Chapter 5 claims, preference actions and post-petition transfer actions) are important to Chapter 7 bankruptcy trustees because they allow a trustee to bring back into a bankrupt debtor’s estate certain transfers of money or property made by the debtor (mostly pre-petition), to be shared amongst all of the debtor’s creditors. Often times the Trustee’s recoveries of fraudulent transfers (or other Chapter 5 claims) are the only substantial assets that exist in the estate at the end of the day to be paid to a debtor’s many creditors.

A trustee can bring a fraudulent transfer action one of two ways (four ways, actually) under the Bankruptcy Code, either under 11 U.S.C. §548, which reads as follows (emphasis added):

§548(a)

(1) **The trustee may avoid any transfer** (including any transfer to or for the benefit of an insider under an employment contract) **of an interest of the debtor in property**, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, **that was made or incurred on or within 2 years before the date of the filing of the [bankruptcy] petition**, if the debtor voluntarily or involuntarily—

(A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted **[the so-called “intentional fraudulent transfer”]**; or

(B) [the so-called “constructive fraudulent transfer”]
(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
(ii)
(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation...;

Or the Trustee can bring a fraudulent transfer action under state law, if the statute of limitations is longer than that under the Bankruptcy Code (in New Hampshire, the statute of limitations under our fraudulent transfer statute, N.H. RSA 545-A, is four years) under 11 U.S.C. §544, which reads in pertinent part (emphasis added):

§544

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—

(1) a creditor... or (3) a bona fide purchaser of real estate...

(b)

(1) Except as provided in paragraph (2)², **the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law [i.e. N.H. RSA 545-A]** by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

N.H. RSA 545-A also allows actions for either intentional fraudulent transfer, or constructive fraudulent transfer, with similar (but not identical) proof as required by the federal fraudulent transfer statute, 11 U.S.C. §548 (“FFTS”) quoted above.

For simplicity’s sake this discussion only deals with the FFTS, but bear in mind the issues are similar for state law claims. Trustees are always looking for ways to bring funds back into the bankruptcy estate, and bringing back a large tuition payment or payments made to colleges by certain debtor/parents within a few years of filing for bankruptcy has become a “thing” in bankruptcy. Colleges are understandably upset with this development, as they are not used to having to return tuition payments, particularly where the student actually attended, and/or graduated from the college with a degree. The simplest argument here for a fraudulent transfer is, however, that while the student may have benefitted from the payment of the tuition bills, the insolvent debtor/parent did not. Hence the Chapter 7 Trustee, provided he/she can prove the debtor/parent was already insolvent or about to become insolvent when the tuition bill was paid (usually not a very difficult exercise for the trustee – a review of the debtor’s bankruptcy schedules will often reveal creditors owed more than the tuition payment(s) plus the debtor’s remaining assets on the date the tuition payment was made), can theoretically recover the tuition payment under 11 U.S.C. §548(a)(1)(B) because the debtor/parent received “less than a reasonably

² Certain charitable contributions, not relevant here.

equivalent value” (some would argue no value at all as the parent/debtor was not the one in college) in exchange for the tuition payment. Easy right?

Not so fast. While we have not had a case on this issue yet in New Hampshire, the issue was recently ruled on in Massachusetts by Judge Hoffman in the case styled DeGiacomo v. Sacred Heart University, Inc. (In Re Palladino), U.S. Bankruptcy Court for the District of Massachusetts Adv. Pro. No. 15-01126-MSH (Opinion dated 8/10/2016, attached) (“the SHU Case”). The SHU Case (over approximately \$65,000.00 in tuition paid) is interesting because it decides issues on both intentional fraudulent transfer of college tuition payments for the Palladinos’ adult daughter (but on the narrow issue of whether the so-called “Ponzi Scheme Presumption” applies to tuition payments made to a college that did not participate in the Ponzi scheme, but received those payments from the debtors while the debtors were running a Ponzi scheme), and on constructive fraudulent transfer under the FFTS and the Massachusetts equivalent.

Surprisingly (at least to this frequent counsel for the Trustee), the Trustee lost the SHU Case on summary judgment on all counts. In the not terribly surprising category, Judge Hoffman ruled that the Ponzi Scheme Presumption (i.e. that payments made in the two years (FFTS) or four years (MA law) prior to bankruptcy by the principals running a Ponzi scheme are presumptively intentional fraudulent transfers because they are made with funds obtained through the Ponzi scheme and/or are made in furtherance of the Ponzi scheme) did not apply to college tuition payments made to SHU, which had no knowledge of the Ponzi scheme being run by the Palladinos, and which payments were not in furtherance of the Ponzi scheme itself, but for the sole purpose of allowing the debtors’ daughter to receive a college education (Op. p. 5-6). This is the general consensus of the law on this issue, as discussed by Judge Hoffman. It is surprising, however, to the author that the Trustee did not press a general intentional fraudulent transfer claim. It is the debtor’s fraudulent intent (not SHU’s) that matters. Many debtors (particularly those engaged in a Ponzi scheme) would have multiple creditors whose claims or lawsuits were being ignored (i.e. “hindered, delayed or defrauded”) while the insolvent debtors paid \$65,000 to their daughter’s college for the benefit of an insider (the daughter).

Much more surprising in the SHU Case is Judge Hoffman’s reasoning for granting summary judgment in favor of SHU on the constructive fraudulent transfer claim under the FFTS and related MA law. Judge Hoffman ruled that there was no doubt that the debtors were insolvent at the time they made the tuition payments to SHU (thus satisfying 11 U.S.C. §548(b)(ii)(I)), but he went on to rule that the debtors received “a reasonably equivalent value” for the tuition payments to SHU that was “concrete and quantifiable enough” because a financially self-sufficient daughter was an economic benefit to the debtors. Op. p. 8. Things that make you go “hmmm.” Perhaps Judge Hoffman is also questioning the strength of this reasoning as he recently certified the questions raised in the SHU Case for direct appeal to the First Circuit Court of Appeals, indicating that there was a no controlling authority on these issues and that the issues have public importance (see Certification, attached). Hopefully the 1st Circuit will accept the SHU Case appeal so that practitioners in New Hampshire will have some controlling law on these issues, one way or another.

There is clearly an “uncomfortableness” in forcing colleges to repay tuition to a bankruptcy trustee and perhaps the SHU Case is just a means to an end. In fact, two members of Congress

have introduced a bill called PACT (Protecting All College Tuition) Act of 2015 (H.R. 2267) to prevent Trustees from bringing certain fraudulent transfer actions. This bill amends the federal bankruptcy code (11 U.S.C. Sec. 548(b) – the so-called constructive fraudulent transfer statute), with respect to transfers of interests that may be avoided by a bankruptcy trustee, to except tuition payments by a parent to an institution of higher education for the education of that parent's child. It appears that the bill is stuck in committee and will not become law (if at all) any time soon. Also, the bill apparently does not address whether the Trustee can still bring an intentional fraudulent transfer action against a tuition-receiving-school under 11 U.S.C. §548, nor does it address what happens if the Trustee brings a state-law fraudulent transfer claim (pursuant to 11 U.S.C. §544), based either on actual or constructive fraud.

If you would like to discuss any of these issues or receive copies of any of the documents discussed herein, please feel free to give me a call or shoot me an e-mail.

Deb Notinger
(603) 417-2158
debbie@notingerlaw.com

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW HAMPSHIRE**

In re:

Bk. No. 13-11016-JMD
Chapter 7

William J. Blanchard,
Debtor

William J. Blanchard,
Plaintiff,

v.

Adv. No. 13-1038-JMD

New Hampshire Higher Education Assistance Foundation,
Defendant

*Alice C. Ranson
Elliott, Jasper, Auten & Shklar, LLP
35 Main Street
Newport, NH
Attorney for Plaintiff-Debtor*

*Clifford Gallant, Jr.
Beliveau, Fradette, Doyle & Gallant, PA
91 Bay Street
Manchester, NH
Attorney for Defendant*

MEMORANDUM OPINION

I. INTRODUCTION

This matter is before the Court on the Amended Complaint (Doc. No. 17) (the “Complaint”) of William J. Blanchard (the “Debtor” or “Plaintiff”) against New Hampshire Higher Education Assistance Foundation (the “Defendant”). The Complaint requests that the

Court enter relief in favor of the Plaintiff, pursuant to § 523(a)(8) of the Bankruptcy Code, and declare that the Defendant's claims – which are on account of educational loans – are dischargeable. The Court held a trial on the matter on February 6, 2014. At the end of the trial, the Court ordered the Plaintiff and Defendant to submit written closing arguments. The parties did so, and the Court took the matter under submission.

This Court has authority to exercise jurisdiction over the subject matter and the parties pursuant to 28 U.S.C. §§ 1334, 157(a), and U.S. District Court for the District of New Hampshire Local Rule 77.4(a). This is a core proceeding in accordance with 28 U.S.C. § 157(b)(2)(I).

II. FACTS

At the outset of the trial, the parties admitted Plaintiff's Exhibits 1 – 22 and Defendant's Exhibits 101 – 117 by agreement. The parties' Agreed Statement of Facts (Doc. No. 33) (the "ASF") was also admitted into evidence. The Debtor was the only witness who testified at the trial.

A. The Debtor's Personal Background

The Debtor is a 45 year old married man with five children, ranging in age from six to sixteen.

Prior to taking out the educational loans at issue in this case, the Debtor had a "GED." The Debtor first used educational loans to finance a general associate's degree in science. That degree was required before the Debtor could pursue his nursing degrees. The Debtor then used loans to obtain his Licensed Practical Nurse degree ("LPN"), and later his Registered Nurse

degree (“RN”). The Debtor used the loans to pay for tuition, as well as his room and board. The Debtor was in school for a total of five years to obtain his RN. Currently, the Debtor is employed as an emergency room RN at Springfield Hospital in Vermont. Specifically, the Debtor is a triage charge nurse. In addition to his employment at Springfield Hospital, the Debtor works on a part-time on-call basis for Maplewood Nursing Home. The Debtor’s testimony indicated that he has worked only two shifts at the nursing home in the past eight or nine months.

The Debtor filed a chapter 7 bankruptcy petition on April 18, 2013 (the “Petition Date”).

B. The Educational Loans

As a preliminary matter, the parties agree that the loans at issue in this case are the type of loans normally excepted from discharge pursuant to § 523(a)(8) of the Bankruptcy Code.

The ASF lays out a lengthy and detailed history of all the loans the Debtor received from the Defendant or its predecessors-in-interest,¹ including original disbursement amounts, dates and terms of forbearance agreements and deferments, and dates and amounts of all payments. See ASF ¶¶ 2-55. For the present purpose, it is sufficient to describe the loans as follows:

Between September 18, 1995 and July 6, 1999, the Debtor received a total of twelve Federal Stafford Loans: six subsidized and six unsubsidized (collectively the “Group C & D Loans”). The total amount disbursed on the Group C & D loans was \$27,622.50. In March and April of 2000, the Debtor applied for and received a Federal Consolidation Loan covering the Group C & D Loans. The consolidation loan included an \$11,292.60 subsidized portion and a

¹ For the sake of simplicity, the term “Defendant” will include NHHEAF, its predecessors-in-interest, and whatever lender or servicer the Debtor dealt with in connection with the educational loans at issue in this case.

\$19,870.87 unsubsidized portion. Both portions bore interest at a fixed 7.5%.

In October of 2001, the Debtor applied for and received one final Subsidized Stafford Loan, in the original amount of \$1,697.50 (the “Group B Loan”).² Accordingly, taking into account the consolidation loan, the total original balance of all of the loans was \$32,860.97.

From 2000 to 2013, the Defendant granted the Debtor numerous deferments and forbearances. While the ASF provides a complete payment history, it does not include the total amount the Debtor has paid on account of the loans. The payment history indicates that between forbearances and deferments, the Debtor made consistent payments of the monthly amount due, for periods ranging from a few months to over a year. This applies to both the Group B and Group C & D Loans. The Debtor testified that he has paid a total of “about \$20,000.” The Defendant did not dispute that testimony, so for the present purpose, the Court finds that the Debtor paid \$20,000 on account of the loans.

As of January 14, 2014, the total outstanding balance of the Group B and Group C & D Loans was \$52,902.65. ASF ¶75 This is consistent with the Debtor’s testimony that the outstanding balance was “about \$50,000.” Accordingly, over the life of the loans, the Debtor has paid approximately \$20,000, but the balance due on the loans has *increased* by approximately \$20,000.

According to the Defendant’s Exhibit 117, the minimum amount the Debtor could be required to pay each month towards all of the loans, under income based repayment (“IBR”), is \$177.23. This is consistent with the Debtor’s testimony that he believed the minimum monthly

² The Debtor used the Group B Loan to obtain his RN, after having worked for a year with his LPN.

payment under IBR would be approximately \$175. The Debtor also explained his understanding that he would have to “re-qualify” for IBR on an annual basis, and assuming he did so, the repayment term would be 25 years. At that time the loans would be deemed paid in full regardless of any then outstanding balance.³

The Debtor borrowed a modest amount of money to pursue a degree in nursing. He obtained a nursing degree and is successfully employed in that field. He is married and has struggled to support his family for thirteen years while employed full time as a nurse. During that thirteen year period he has paid what he was able on his student loans and received temporary payment relief under applicable law. At the end of thirteen years his efforts have appeared to accomplish little beyond the passage of time, as the balance due on his student loans has not decreased in any material way. The circumstances of this case remind the Court of the chorus to the well known folk song “Sixteen Tons”:

*You load sixteen tons and what do you get?
Another day older and deeper in debt.
Saint Peter don't you call me, 'cause I can't go.
I owe my soul to the company store.*

C. The Debtor's Financial Condition and Affairs

1. The Debtor's wife and children

The Debtor and his family live in Claremont, New Hampshire in a 1972 mobile home. The Debtor owns the mobile home and the land upon which it sits. The Debtor testified that he has expanded the mobile home over time to accommodate his family. The Debtor is the only income-earner for his family of seven. The Debtor's wife, has been a stay-at-home mother for

³ Neither party appears to have considered what federal income tax consequences might result from any such loan forgiveness.

the last fifteen years. Prior to that, she worked as a bank teller and as a waitress. Mrs. Blanchard home-schools the family's three youngest children. She had previously home-schooled the family's two oldest children as well, but they now attend Claremont Christian Academy, a private school.

According to the Debtor's Schedule J, he pays \$200 per month for the two oldest children to attend private school. The Debtor and his wife made the decision to enroll the children in private school one to two years prior to the Petition Date, and the children began attending the private school approximately six months prior to the Petition Date. The Debtor testified that he and the two children split the cost of tuition. The children qualified for some scholarships, but not enough to completely cover tuition. To make up the shortfall, the children work as janitors for the school for an hour each day. According to the Debtor's testimony, the school pays the children, who then pay the money back to the school. At this point, the children are paying more towards their tuition – through their work arrangement with the school – than the Debtor. The Debtor testified that he believes home-schooling the children at this point would be more expensive than sending them to the private school.

According to the Debtor's testimony, the cost of home-schooling the family's three youngest children includes an average of \$50 to \$75 per month for supplies. That range appears to include both traditional school supplies, as well as educational materials from online publishers.

The Debtor testified that his wife cannot work outside the home because she home-schools the three youngest children. The Debtor further testified that it would actually cost more to send the three youngest children to public school, with the additional costs including school

lunches, transportation costs (e.g., additional gas to drive them to and from school), and required school supplies (e.g., calculators). The Debtor explained his belief that the net financial effect of Mrs. Blanchard returning to work would be negative, in that her earning potential is low, and the additional costs involved in her working outside the home would be more than offset by the increased expenses (e.g., transportation to and from her work, childcare expenses, etc.).

2. The Debtor's work history and income

The Debtor testified that he can only “count on” 36 hours of work each week at Springfield Hospital, corresponding to a bi-weekly paycheck of \$1,700. The Debtor's Schedule I indicated that he had monthly gross wages of \$5,429.67 and monthly income (after payroll deductions) of \$3,907.93. Ex. 110. In connection with this adversary proceeding, Debtor's counsel prepared a more detailed analysis of his monthly income, which was admitted as Exhibit 111. The Debtor testified that the exhibit lists his net monthly income. The exhibit covers October 2012 to June 2013, and provides an average monthly income for that period of \$4,941.51.

The Debtor's tax returns for 2009, 2010, 2011, and 2012 were admitted as Exhibits 105, 106, 107, and 108, respectively. Those exhibits indicate that the Debtor had adjusted gross income of \$71,213 for 2009; \$69,599 for 2010; \$72,064 for 2011; and \$67,594 for 2012. The Defendant cross-examined the Debtor extensively on the contents of his tax returns and bank statements (Ex. 109). The Debtor's testimony indicated that he works at a job whose pace, hours, and hourly wage vary, but there was no missing or phantom income that did not appear on

the Debtor's tax returns or bank statements.⁴ The Debtor's testimony further indicated that he works additional shifts and outside nursing jobs. Accordingly, the Debtor consistently earns more than the \$1,700 bi-weekly, the minimum amount that he can ensure he earns.

3. The Debtor's expenses and assets

The Debtor's Schedule J indicated that he had average monthly expenses of \$4,081.00, resulting in a monthly net loss of \$173.07. Ex. 112. In connection with this adversary proceeding, Debtor's counsel prepared a more detailed analysis of his monthly expenses, which was admitted as Exhibit 115. The exhibit includes an explanation of the various expenses. The exhibit provides that the Debtor's average monthly expenses are \$5,209. Comparing Exhibit 111 to Exhibit 115, the Debtor would have an "updated" monthly net loss of \$267.49.

The Debtor's testimony indicated numerous areas in which he and his wife work to minimize expenses. Apart from the fact that the Debtor and his family live in an expanded mobile home, whose monthly mortgage payment totals \$787, the Debtor's expenses include the following:

The Debtor owns three vehicles, a 2002 Dodge van, a 2000 Saturn station-wagon with 182,000 miles, and a 1994 Chevy Corsica with 224,000 miles. The van is not currently on the road because it needs a muffler and did not pass inspection. The Debtor purchased the station-wagon for \$2,500 and it is his wife's vehicle. The Debtor's testimony indicated that he financed

⁴ The Defendant's cross examination of the Debtor identified several items in the Debtor's primary bank account (Ex. 109) that did not appear to be deposits from wages or payments of routine expenses. The Debtor testified that the deposits and withdrawals were from a mission trip to Africa that the two oldest children did. Each child had to raise \$3,000 for the trip, and it appeared that some or all of the money flowed through the Debtor's primary bank account.

\$1,800 of the purchase price of the station-wagon, with a monthly payment of \$150. The Chevy was intended for the Debtor's son, but he does not have his license yet, so the Debtor drives it to work. The Debtor's Exhibits 12, 13, 14, and 15 include receipts for annual vehicle registration, car payments, vehicle repairs, and gasoline.

The Debtor testified that his family shops at three different stores to save money. The Debtor's Exhibit 19 includes receipts for the month of December 2013 for food, groceries, and home supplies. The total of those receipts is \$1,788.98, according to a summary at the beginning of the exhibit. The Debtor testified that he drives to Lebanon, New Hampshire to buy "animal feed," which consists of stacks of old bread that the Debtor and his family eat. The Debtor buys his lunches at the subsidized cafeteria at Springfield Hospital, because, according to the Debtor, that is the cheapest option. The Debtor explained numerous other expenses that his family incurs, including clothing, shoes, and sports equipment for his children,⁵ as well as heating and utility costs. To save money, the Debtor buys the wood he uses to heat his home directly from a logging truck, and then cuts and splits the wood himself. The Debtor pays a \$50 monthly tithe to the family's church, and has done so for 17 years. The Debtor testified that he used to pay a \$200 monthly tithe, but reduced the amount when he filed his bankruptcy.

Upon cross-examination from the Defendant, the Debtor explained his expenses in detail. With the exception of a few expenses, the Debtor's testimony indicated that the expenses listed on his Schedule J and documented in his trial exhibits were reasonably accurate. The Court is satisfied that variations between the Debtor's Schedule J and his trial exhibits are due to the

⁵ The Debtor testified that his children participate in karate classes and tournaments, and the Debtor's testimony indicated that these activities have somewhat variable costs.

variability of some of the Debtor's expenses (e.g., heating, auto gas). The Debtor's testimony indicated that he did not "pad" his expenses or "stock-up" in advance of the Petition Date or during the adversary proceeding. The Defendant indicated a few items on the Debtor's Schedule J that were overstated and adjusted on Exhibit 115, including electricity and heating fuel. The Defendant also indicated items that had increased dramatically between Schedule J and Exhibit 115, including food, which increased from \$850 on Schedule J to \$1,600 on Exhibit 115. The Debtor provided a satisfactory explanation for the discrepancies, and explained that the understated original amount for "food" was due to the fact that the amount did not reflect what the family terms "dry goods" (e.g., toilet paper and similar non-food items).

4. The Debtor's prospect for increased income or decreased expenses

The Debtor testified that he is at the highest level he can achieve in nursing without a bachelor's degree, which he does not have. He has worked at Springfield Hospital for six years and did not receive a raise this year. He expects to earn about the same amount he is earning now for the foreseeable future. The Debtor's testimony indicated that his work is physically demanding. According to the Debtor's testimony, he had back surgery a few years ago and has or had a problem with his right ulnar nerve. The Debtor testified that if he became physically unable to perform his duties as an emergency room nurse, he would have few other options for work and does not know what he would do to earn money.

The Debtor's testimony was somewhat unclear, but he may have resigned as a charge nurse recently because he felt he was losing his critical thinking skills. The Debtor explained his opinion that while being a charge nurse is a good "resume booster," it can cause a person to lose his critical care skills.

D. The Parties' Positions

The Debtor argues that he is maximizing his income and minimizing his expenses, but will be unable to maintain a minimal standard of living for himself and his dependents if he is forced to repay his educational loans.

The Defendant argues that the Debtor has understated his income and overstated his expenses. The Defendant identifies several expenses that the Debtor can reduce or eliminate, including the children's private school and the church tithe, and identifies ways for the Debtor to maximize his income, including having his wife return to work instead of home-schooling the family's children. Additionally, the Defendant argues that two of the Debtor's expenses appearing on Exhibit 115, specifically a \$100 monthly payment on account of "Claremont Welfare" and a \$200 monthly payment on account of "Family Debts (Wife's Name)," unfairly favor payments to other long-term creditors⁶ at the Defendant's expense. Under the Defendant's revised expenses, the Debtor will have ample money to maintain a minimal standard of living while repaying his loans in full.

⁶ The Debtor's testimony indicated that the welfare expense is actually a loan. At the time the Debtor received the loan he did not believe it was a debt, but apparently something akin to a grant or an assistance payment. The Debtor testified that the welfare debt is approximately \$2,400 and is secured by a lien in the Debtor's home. According to the Debtor's testimony, interest is compounding on the debt, and while the Debtor has not yet made any payments toward it, he needs to do so some day. With regards to the Debtor's wife's debts, the Debtor testified that they were on account of family expenses the wife incurred on credit cards in her own name. According to the Debtor's testimony, the family is trying to maintain Mrs. Blanchard's credit (this is apparently the reason she was not included in the Debtor's bankruptcy).

III. DISCUSSION

A. Section 523(a)(8) and the Applicable Standard

Under § 523(a)(8) of the Bankruptcy Code, a debtor cannot discharge educational loans unless excepting the loans from discharge “would impose an undue hardship on the debtor and the debtor’s dependents.” The statute does not define “undue hardship,” and this Court has generally followed the three-part test for undue hardship set forth in Brunner v. New York State Higher Educ. Servs. Corp., 831 F.2d 395 (2d Cir. 1987). See, e.g., McClain v. Am. Student Assistance (In re McClain), 272 B.R. 42, 47 (Bankr. D.N.H. 2002); Grigas v. Sallie Mae Servicing Corp. (In re Grigas), 252 B.R. 866, 874 (Bankr. D.N.H. 2000). Under Brunner, student loan obligations impose an undue hardship within the meaning of the statute and can be discharged, if:

- A. The debtor cannot maintain, based on current income and expenses, a minimal standard of living for himself and his dependents if forced to repay the loan;
- B. Additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loan; and
- C. The debtor has made good faith efforts to repay the loan.

Brunner, 831 F.2d at 396; McClain, 272 B.R. at 47; Grigas, 252 B.R. at 874; Garrett v. New Hampshire Higher Educ. Assistance Found. (In re Garrett), 180 B.R. 358, 362 (Bankr. D.N.H. 1995).

Notwithstanding the above cases, this Court has never been fully satisfied with the Brunner standard. As one bankruptcy court put it, when examining the various prevailing standards for undue hardship, Brunner “test[s] too much.” Kopf v. U.S. Dept. of Educ. (In re

Kopf), 245 B.R. 731, 741 (Bankr. D. Me. 2000).

In Kopf, Judge Haines provides a detailed analysis of what he determined were the three prevailing views. See id. at 737-745. Incorporating that analysis will streamline this Court’s analysis in this case.

1. The Three Prevailing Standards as Explained in Kopf

Kopf identifies three primary “tests” for undue hardship: 1) the In re Johnson test⁷; 2) the In re Brunner test; and 3) the “totality of the circumstances” test. Id. at 736-37.

According to Kopf, the In re Johnson test examines a number of facts and circumstances and was designed “to determine whether the debtor’s ‘future financial resources for the longest foreseeable period of time allowed for repayment of the loan, [would] be sufficient to support the debtor and his dependent[s] at a subsistence or poverty standard of living, as well as to fund repayment of the student loan.’ If not, loan repayment would impose an ‘undue hardship’ on the debtor.” Id. at 737-38 (citations omitted). The In re Johnson test adds two other tests, one examining “good faith,” and one making a “policy” inquiry. Id. at 738. “To pass the ‘good faith test’ the debtor must show that he or she had made a ‘bona fide attempt to repay the loan.’” Id. (citations omitted). To determine the policy test, a court “must examine the pros and cons of discharging the student loan(s) in light of the policy behind § 523(a)(8) and repealed 20 U.S.C. § 1087-3 (1978): ‘to combat the abuse of the bankruptcy laws by recently-graduated students.’” Id. (citations omitted).

This Court will not belabor its analysis of the In re Johnson test. The bankruptcy court in

⁷ Pa. Higher Educ. Assist. Agency v. Johnson (In re Johnson), 5 Bankr. Ct. Dec. 532 (E.D. Penn. 1979).

Kopf rejected it, and even the Third Circuit Court of Appeals stated that it “appears to be both unnecessarily complicated and unduly cumbersome.” Pa. Higher Educ. Assist. Agency v. Faish (In re Faish), 72 F.3d 298, 303 (3d Cir. 1995).

Similarly, this Court will not belabor its analysis of the In re Brunner test. That test has been the prevailing standard in the District of New Hampshire, and the cases cited above provide ample analysis and application of the standard.

In Bronsdon v. Educ. Credit Mgmt. Corp. (In re Bronsdon), 435 B.R. 791, 798-99 (B.A.P. 1st Cir. 2010), a case decided after Kopf, the First Circuit Bankruptcy Appellate Panel explained the totality of the circumstances test, and compared it to the In re Brunner test.

The totality of the circumstances analysis requires a debtor to prove by a preponderance of evidence that (1) his past, present, and reasonably reliable future financial resources; (2) his and his dependents’ reasonably necessary living expenses; and (3) other relevant facts or circumstances unique to the case, prevent him from paying the student loans in question while still maintaining a minimal standard of living, even when aided by a discharge of other prepetition debts. Courts should consider all relevant evidence – the debtor’s income and expenses, the debtor’s health, age, education, number of dependents and other personal or family circumstances, the amount of the monthly payment required, the impact of the general discharge under chapter 7 and the debtor’s ability to find a higher-paying job, move or cut living expenses.

The Brunner test differs, albeit modestly. Brunner requires a three-part showing (1) that the debtor cannot, based on current income and expenses, maintain a minimal standard of living for herself or her dependants if forced to repay the loans; (2) that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor has made good faith efforts to repay the loans.

One can see readily that insofar as income and expenses are concerned, the tests take converging tacks. The totality test looks to past, present, and future financial resources and necessary living expenses and whether, taken together with other factors, the debtor has the ability to repay while maintaining a minimal standard of living. Brunner asks the same question looking to current income and expenses, then considers whether circumstances inhibiting repayment will endure.

Id. (citations and quotations omitted).

The Bronsdon court explains that some courts applying Brunner's second prong (that the state of the debtor's affairs is likely to persist) have unnecessarily inserted a requirement of "unique" or "extraordinary" circumstances (e.g., "debtor's advanced age, illness or disability, psychiatric problems, lack of usable job skills, large number of dependents or severely limited education.") See id. at 800. In the absence of those circumstances, a "court may conclude that the debtor has failed the second Brunner prong and the student loans will not be discharged." Id. Bronsdon concludes that "the totality of the circumstances test best effectuates the determination of undue hardship while adhering to the plain text of § 523(a)(8)." Id. at 801. In support of this result, the Bankruptcy Appellate Panel notes that the First Circuit Court of Appeals "has endorsed the totality of the circumstances approach in related bankruptcy settings." Id. at 801 n.15.

In the present case, this Court does not think the result would be different between the totality of the circumstances test and the Brunner test. However, to the extent the Brunner test has been read to require some "certainty of hopelessness," the Court agrees with Bronsdon that such a requirement is not supported by the text of the Bankruptcy Code. See id. at 801. Moreover, as explained below, the Debtor has made a good faith effort to repay the loans, and while this satisfies the third prong of Brunner, it is also certainly a relevant factor in a totality of the circumstances inquiry. Accordingly, the Court finds this is an appropriate juncture to adopt the totality of the circumstances test.

B. The Burdens of Proof and Production

The creditor bears the initial burden of proving the existence of the debt and that the debt is of the type excepted from discharge under § 523(a)(8). Educ. Credit Mgmt. Corp. v. Savage

(In re Savage), 311 B.R. 835, 839 (B.A.P. 1st Cir. 2004) (citation omitted). Once the creditor satisfies that burden, the burden shifts to the debtor to prove undue hardship by a preponderance of the evidence. Id.; see also Grogan v. Garner, 498 U.S. 279 (1991). After the debtor makes a showing that would support an undue hardship determination, the burden of production – the duty of going forward with evidence – shifts to the creditor to present some evidence to rebut the debtor’s prima facie case. Votruba v. Florida Dep’t of Educ. (In re Votruba), 310 B.R. 698, 704 (Bankr. N.D. Ohio 2004).

Here, the parties do not dispute the existence of Group B and Group C & D loans or that the loans fall under § 523(a)(8). Accordingly, the Debtor has the burden to prove undue hardship by a preponderance of the evidence.

C. Analysis

Under the totality of the circumstances test, the Court will examine the Debtor’s past, present, and future financial resources and necessary living expenses and whether, taken together with other factors, the Debtor has the ability to repay the loans at issue while maintaining a minimal standard of living. See Bronsdon, 435 B.R. at 798.

Viewing the Debtor’s family’s income and expenses as a whole, it is nearly impossible to identify any area where the Debtor could significantly increase his income or decrease his expenses.

1. The Debtor’s Family’s Income

The Debtor’s testimony indicated that his income has reached something of a ceiling.

Without a bachelor's degree,⁸ and given that the Debtor did not receive a raise in the past year, it does not appear that the Debtor can reasonably expect significant raises in the future. In the absence of any evidence to the contrary, the Court accepts the Debtor's contention that he will earn about the same amount he is earning now for the foreseeable future. By all accounts, the Debtor is hard working, and seeks to maximize his income through additional shifts and outside work, to the extent he is able.

Moreover, there is no evidence to refute the Debtor's testimony that the net financial effect of his wife returning to work would be negative. The Debtor and his family live in a relatively rural area. His wife has not worked outside the home for fifteen years. There is no evidence before the Court regarding Mrs. Blanchard's qualifications for any particular field or role, and no evidence regarding what salary Mrs. Blanchard could expect to earn if she were able to secure work. In light of the above, the Court concludes that Mrs. Blanchard's election not to work, and to instead home-school the family's younger children, does not have a significant effect on the family's net income, and likely helps to minimize the family's expenses.

The Debtor's tax returns indicate that his income has been relatively steady in the recent past, and the Debtor's testimony indicates that state of affairs is unlikely to change at any time in the foreseeable future. The Debtor is 45 years old, works in a physically demanding field, and has had injuries or physical overuse issues in the past that hampered his ability to work. There is nothing in the evidentiary record to support a finding that the Debtor will be able to work at his current physically demanding job, plus part time work, at his current pace for the indefinite

⁸ It is ironic that the Debtor's income might be higher if he had obtained a bachelor's degree, but that result would likely have involved additional educational debt.

future. Similarly, no evidence supports any finding that the Debtor's income is likely to increase in any material way in the foreseeable future.

2. The Debtor's Family's Expenses

Viewed in light of the Debtor's specific personal and professional circumstances, and viewed as a whole, the Debtor appears to have pared his expenses to a minimum. Some of the Debtor's expenses are exceptionally low. For example, \$787 per month for a mortgage payment for a family of seven is among the lowest values the Court has seen. Similarly, the Debtor's budget of \$1,600 per month for food and home supplies for a family of seven is quite modest. Moreover, the Debtor's election to purchase old bread labeled "animal feed" indicates to the Court that the Debtor has gone to great lengths to minimize his expenses.

The Debtor's two oldest children attend private school. The cost to the Debtor of \$200 per month is low in the context of public education, and very low in the context of private education. The fact that the Debtor's children contribute more to their tuition than the Debtor does further indicates that the Debtor (and his family) have made and continue to make efforts to keep the family's expenses as low as possible.

With regard to the Debtor's welfare debt, the Debtor's testimony indicated that he is not currently making payments toward this debt but needs to in the future. Because the amount of the debt is increasing and the debt is secured by a lien in the Debtor and his family's home, eventually paying this debt appears to be a matter of necessity, or the Debtor might risk losing his home.⁹ With regard to payments on account of the Debtor's wife's debts, these are almost

⁹ The parties did not address whether the welfare debt would be discharged in the Debtor's bankruptcy. Even if the Debtor's personal obligation of the debt is discharged, it appears almost certain that the lien in the Debtor's home would "ride-through," and the creditor

certainly unaffected by the Debtor's bankruptcy. Accordingly, they will remain due and owing, and are a family expense. Failing to service these debts might result in collection actions against the Debtor's wife or the family's property. Accordingly, the Court does not find that payments on account of the welfare debt and the wife's debts are unreasonable, and for the reasons just stated, appear to be necessary to maintaining a minimal standard of living for the Debtor's family.

Thus, viewed as a whole, the Court is unable to identify any expenses that are excessive or could be significantly reduced. In addition, several categories of expense are *below* a minimal standard of living. There is no evidentiary basis for the Court to find that the Debtor's expenses will decrease in the foreseeable future. While some hypothetical future circumstances (e.g., the Debtor's oldest children graduating from high school and moving out of the family home) might decrease some of the Debtor's expenses, other hypothetical future circumstances (e.g., the Debtor requiring additional medical care as he ages, the Debtor's aging mobile home needing expensive repairs or upgrades, the Debtor's older, high-mileage cars needing repairs or replacement) would do the opposite.

3. The Debtor's Efforts to Repay the Loans

The payment history provided in the ASF, along with the Debtor's testimony, indicates that the Debtor has made a good faith effort to repay loans over a period in excess of ten years. While the Debtor has applied for and been granted deferrals and forbearances, he appears to have made payments of the amounts due on a timely basis. However, in spite of his efforts, the balance of the loans has not materially decreased.

would thus maintain its *in rem* rights against the Debtor's home.

None of the testimony or evidence suggests that the Debtor has attempted to shirk his obligations to the Defendant or that the Debtor has sought an easy way out. To the contrary, it appears that the Debtor has attempted to repay the loans to the extent he was able, but he has been unsuccessful in substantially reducing the balance due on the loans.

IV. CONCLUSION

Under the totality of the circumstances, the Court finds that the Debtor does not have the ability to repay the loans at issue in this case while maintaining a minimal standard of living. Accordingly, judgment shall enter for the Debtor discharging his student loans.

This opinion constitutes the Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052. A separate order and judgment shall be entered.

ENTERED at Manchester, New Hampshire.

Date: August 14, 2014

/s/ J. Michael Deasy
J. Michael Deasy
Bankruptcy Judge

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS
EASTERN DIVISION**

1

Here are the undisputed facts and background surrounding this dispute. At all times relevant to this proceeding, Nicole Palladino was enrolled as an undergraduate accounting major at SHU in Fairfield, Connecticut. She began her freshman year in the fall of 2012 with an expected graduation date in the spring of 2016. While Nicole was an undergraduate she spent summers and other time away from school living at home with one or both of the Palladinos.¹ During her time as a student at SHU Nicole was at least 18 years of age. Even though Nicole was considered an adult under Massachusetts law, she was a dependent student for college financial aid purposes. This meant that whenever Nicole sought financial aid from SHU, the Palladinos were required to submit financial aid forms and other personal financial information as part of the school's evaluation of Nicole's eligibility. The Palladinos did so on multiple occasions. In addition, the Palladinos consistently declared Nicole as a dependent on their income tax returns. The Palladinos also submitted multiple applications for parental loans to help fund Nicole's college costs. In addition to attempting to assist Nicole through scholarships and loans, the Palladinos paid a portion of her tuition and charges directly to SHU. Between March 1, 2012 and March 31, 2014, the Palladinos paid SHU a total of \$64,696.22 to cover these costs. This figure does not include additional expenditures by the Palladinos to support Nicole during her college years such as feeding her whenever she spent time at home.

On July 21, 2014, Steven and Lori Palladino each pled guilty to charges of investment fraud for operating a Ponzi scheme through their company, Viking Financial Group, Inc. Steven was sentenced to ten years in state prison and Lori to five years' probation. On April 1, 2014, the Palladinos filed joint voluntary petitions for relief under chapter 7 of the Bankruptcy Code (11

¹ For ease of reference I will refer to Steven and Lori as the Palladinos and to their daughter as Nicole.

U.S.C. § 701 *et seq.*) commencing the main case.² Mr. DeGiacomo was appointed chapter 7 trustee.

Mr. DeGiacomo initiated this adversary proceeding with a four count complaint against SHU seeking to set aside as fraudulent transfers the \$64,696.22 in payments made by the Palladinos on theories of actual and constructive fraud under both Bankruptcy Code § 548 and the Massachusetts Uniform Fraudulent Transfer Act (UFTA), Mass. Gen. Laws ch. 109A, and to recover that sum from SHU for the benefit of the bankruptcy estate.

Mr. DeGiacomo maintains that during the period between 2012 and 2014, the Palladinos were actively engaged in the Ponzi scheme for which they were ultimately convicted. As a result, he invokes the so-called “Ponzi scheme presumption” that all payments by the Palladinos to SHU were made with actual intent to hinder, delay, or defraud creditors. In the alternative, Mr. DeGiacomo urges that the payments were constructively fraudulent because the Palladinos received no reasonably equivalent value from SHU in exchange for the payments and the Palladinos were insolvent at the time the payments were made.

SHU retorts that the Ponzi scheme presumption is inapplicable to the payments in question, and in any event, SHU believes it has rebutted that presumption with undisputed evidence of its good faith and lack of knowledge as to the Palladinos’ fraudulent conduct. As for Mr. DeGiacomo’s assertion of constructive fraud, SHU acknowledges the Palladinos’ insolvency but maintains that the Palladinos did receive reasonably equivalent value in return for their payments.

² Viking too filed a chapter 7 petition, case no. 14-12116, and its case has been substantively consolidated with the Palladinos’ case.

Claiming there are no material facts in dispute here, each party seeks summary judgment in its favor. Fed. R. Civ. P. 56 governs motions for summary judgment in bankruptcy proceedings, per Fed. R. Bank. P. 7056. *McCrory v. Spiegel (In re Spiegel)*, 260 F.3d 27, 31 (1st Cir. 2001). “The court shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law.” Fed. R. Civ. P. 56(a). “Only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment.” *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). “[S]ummary judgment will not lie if the dispute about a material fact is ‘genuine,’ that is, if the evidence is such that a reasonable jury could return a verdict for the nonmoving party. *Id.*

In counts I and III of his complaint, Mr. DeGiacomo asserts that the payments to SHU were actually (as opposed to constructively) fraudulent under Bankruptcy Code § 548(a)(1)(A) and Mass. Gen. Laws ch. 109A § 5(a)(1). He bases his assertion on the Ponzi scheme presumption. This legal construct stands for the proposition that “the existence of a Ponzi scheme establishes that transfers were made with the intent to hinder, delay and defraud creditors.” *Picard v. Merkin (In re Bernard L. Madoff Inv. Sec., LLC)*, 440 B.R. 243, 255 (Bankr. S.D.N.Y. 2010).

Mr. DeGiacomo urges the broadest possible application of the Ponzi scheme presumption so that every transfer of property by a Ponzi scheme perpetrator regardless of its purpose would be presumed fraudulent. SHU advocates a narrower application of the presumption, limiting it to transfers in furtherance of the scheme, which it asserts would eliminate the Palladinos’ college payments on Nicole’s behalf from the presumption.

I adopt SHU's interpretation of the Ponzi scheme presumption as more reflective of the policies and objectives the presumption is intended to address. "All transfers made *in furtherance of that Ponzi scheme* are presumed to have been made with fraudulent intent." *Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 531 B.R. 439, 471 (Bankr. S.D.N.Y. 2015) (emphasis added). "[A] generalized intent to defraud," while certainly present in a Ponzi scheme case, "is not sufficient, by itself, to show that the transfers in question were made with fraudulent intent." *Welt v. Publix Super Markets, Inc. (In re Phoenix Diversified Inv. Corp.)*, Adversary No. 10-03005-EPK, 2011 WL 2182881, at *3 (Bankr. S.D. Fla. June 2, 2011). Transfers that "perpetuate" or "are necessary to the continuance of the fraudulent scheme" are subject to the presumption because they relate directly to the intent to defraud. *Id.* Extending the scope of the Ponzi scheme presumption as broadly as Mr. DeGiacomo advocates would ensnare transferees indiscriminately when the scheme inevitably implodes:

By definition, a Ponzi scheme is driven further into insolvency with each transaction. Therefore, by the trustee's reasoning, no one who in any way dealt with, worked for, or provided services to the debtors could prevent avoidance of any transfers they received. The debtors' landlord, salaried employees, accountants and attorneys, and utility companies that provided services to the debtors all assisted the debtors in the furtherance of their fraudulent scheme. In spite of this fact, we do not think that the goods and services that these persons and entities provided were without value or that transfers to them could be set aside as fraudulent conveyances. We see no material distinction between such persons or entities and appellants. All were necessary to the success of the debtors' scheme.

Merrill v. Allen (In re Universal Clearing House Co.), 60 B.R. 985, 999 (D. Utah 1986) (footnotes omitted). See also *Balaber-Strauss v. Sixty-Five Brokers (In re Churchill Mortgage Inv. Corp.)*, 256 B.R. 664, 681 (Bankr. S.D.N.Y. 2000) (quoting *In re Universal Clearing House Co.* with approval), *aff'd sub nom. Balaber-Strauss v. Lawrence*, 264 B.R. 303 (S.D.N.Y. 2001). Allowing Mr. DeGiacomo to prevail under an actual fraud theory here would mean ignoring the nature of the transactions engaged in by the Palladinos in their day to day affairs (morally

culpable as they may have been in relation to the scheme itself), like buying groceries, paying medical bills, and supporting their child. “The Ponzi scheme presumption must have some limitations, lest it swallow every transfer made by a debtor, whether or not such transfer has anything to do with the debtor’s Ponzi scheme.” *Kapila v. Phillips Buick-Pontiac-GMC Truck, Inc. (In re ATM Fin. Servs., LLC)*, Adversary No. 6:10-ap-44, 2011 WL 2580763, at *5 (Bankr. M.D. Fla. June 24, 2011).

Absent the Ponzi scheme presumption, Mr. DeGiacomo does not press the argument that the Palladinos paid SHU with actual intent to defraud their creditors. He does not quarrel with SHU’s position that it had no knowledge of the Palladinos’ fraudulent activity and that it received their payments in good faith. The facts agreed to by the parties establish that the Palladinos made the payments for one reason only, to enable their daughter, Nicole, to receive a college education. Summary judgment shall enter in favor of SHU on counts I and III of the complaint.

As indicated at the outset, this litigation is really about value. Were the Palladinos’ payments to SHU constructively fraudulent under Bankruptcy Code § 548(a)(1)(B) and Mass. Gen. Laws ch. 109A § 5(a)(2), as alleged in counts II and IV of Mr. DeGiacomo’s complaint, because the Palladinos did not receive reasonably equivalent value from SHU in exchange for the payments? There is no dispute that but for the question of value, the Palladinos’ payments would qualify as constructively fraudulent. The funds transferred belonged to the Palladinos, the transfers were made within the two and four year statutory lookback periods under the Bankruptcy Code and the UFTA, and the Palladinos were insolvent when the transfers were made.

This is not the first lawsuit brought by a bankruptcy trustee to recover college tuition payments made by a parent for a child. Prior decisions offer conflicting guidance. Courts that have rejected trustees' efforts to claw back tuition payments view such payments as essential to maintaining the family unit. *Sikirica v. Cohen (In re Cohen)*, Adversary No. 07-02517-JAD, 2012 WL 5360956 at *10 (Bankr. W.D. Pa. Oct. 31, 2012), *rev'd on other grounds*, 487 B.R. 615 (W.D. Pa. 2013). "[T]here is something of a societal expectation that parents will assist with such expense if they are able to do so." *Trizechahn Gateway, LLC v. Oberdick (In re Oberdick)*, 490 B.R. 687, 712 (Bankr. W.D. Pa. 2013). Other courts have found that tuition payments for children were avoidable because the benefits parents received in exchange were not "concrete" or "quantifiable." *Gold v. Marquette Univ. (In re Leonard)*, 454 B.R. 444, 457 (Bank. E.D. Mich. 2011); *see also Banner v Lindsay (In re Lindsay)*, Adversary No. 08-9091 (CGM), 2010 WL 1780065, at *9 (Bankr. S.D.N.Y. May 4, 2010) (holding that college tuition payments were avoidable because the parents were under no legal obligation to pay).

Ethereal or emotional rewards, such as love and affection, do not qualify as value for purposes of defeating a constructive fraudulent conveyance claim. *Pereira v. Wells Fargo Bank, N.A. (In re Gonzalez)*, 342 B.R. 165, 169 (Bankr. S.D.N.Y. 2006); *see also Tavenner v. Smoot*, 257 F.3d 401, 408-09 (4th Cir. 2001). Mr. DeGiacomo correctly points out that under Massachusetts law a parent has no legal obligation to support an adult child and so, he suggests, the only possible justification the Palladinos could have had for paying Nicole's college costs were of a recondite variety.

Like his position on the Ponzi scheme presumption, I find Mr. DeGiacomo's approach to valuing the Palladinos' payments to SHU overly rigid. In separate affidavits filed in support of SHU's motion for summary judgment the Palladinos offer consistent explanations as to why they

made the payments to SHU. As stated by Lori Palladino, for example, in her affidavit, Docket Entry 40-3, at ¶¶ 16-17:

As Nicole's mother, I feel obligated to pay Nicole's tuition because I am her mother and she shouldn't have to come out of SHU saddled with thousands of dollars in loans. Assisting Nicole with her loans gives her the best chance of graduating from SHU. Upon graduating, Nicole will be in the best position to go to graduate school, secure a job and become financially self-sufficient by finding her own place to live, paying her own bills and paying for her own food... If Nicole is unable to graduate from SHU, she will either move back home with me, or she will obtain her own place to live in which case I will have to pay for her housing, bills and food costs. Either of these options result [sic] in a financial burden on me. The value to my husband and I [sic] in exchange for paying the tuition to SHU is a financially self-sufficient daughter resulting in an economic break to us.

Mr. DeGiacomo does not dispute that the Palladinos' statements represent their views as to why they paid Nicole's college costs, but he asserts that those views are irrelevant because they do not establish "concrete" and "quantifiable" value.

I find that the Palladinos paid SHU because they believed that a financially self-sufficient daughter offered them an economic benefit and that a college degree would directly contribute to financial self-sufficiency. I find that motivation to be concrete and quantifiable enough. The operative standard used in both the Bankruptcy Code and the UFTA is "reasonably equivalent value." The emphasis should be on "reasonably." Often a parent will not know at the time she pays a bill, whether for herself or for her child, if the medical procedure, the music lesson, or the college fee will turn out to have been "worth it." But future outcome cannot be the standard for determining whether one receives reasonably equivalent value at the time of a payment. A parent can reasonably assume that paying for a child to obtain an undergraduate degree will enhance the financial well-being of the child which in turn will confer an economic benefit on the parent. This, it seems to me, constitutes a *quid pro quo* that is reasonable and reasonable equivalence is all that is required.

Summary judgment shall enter in favor of SHU on counts II and IV of the complaint.

Dated: August 10,
2016

By the Court,



Melvin S. Hoffman
U.S. Bankruptcy Judge

Counsel Appearing: Mark G. DeGiacomo, Esq.
Ashley S. Whyman, Esq.
Murtha Cullina LLP
Boston, MA
for the plaintiff Chapter 7 Trustee

Elizabeth J. Austin, Esq.
Pullman & Comley, LLC
Bridgeport, CT
for the defendant, Sacred Heart University, Inc.

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS
EASTERN DIVISION**

In re:

STEVEN PALLADINO AND LORI
PALLADINO

Debtors

MARK G. DEGIACOMO, CHAPTER 7
TRUSTEE

Plaintiff

V.

SACRED HEART UNIVERSITY, INC.
Defendant

Chapter 7

Case No. 14-11482-MSH

Adversary Proceeding
No. 15-1126

**CERTIFICATION FOR DIRECT APPEAL TO THE UNITED STATES COURT OF
APPEALS FOR THE FIRST CIRCUIT UNDER 28 U.S.C. § 158(d)(2)**

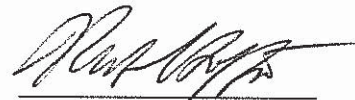
In accordance with the accompanying Memorandum, I certify for direct appeal to the United States Court of Appeals for the First Circuit, pursuant to 28 U.S.C. § 158(d)(2), the Notice of Appeal dated August 15, 2016, from the Judgment and Orders of this Court dated August 10, 2016. Copies of the Judgment, Orders and Memorandum of Decision, issued in connection with the Judgment and Orders, are attached. I further certify that:

- (i) The Judgment and Orders involve questions of law as to which there is no controlling decision in the Court of Appeals for the First Circuit or of the Supreme Court of the United States, and involve matters of public importance;

- (ii) The Judgment and Orders involve questions of law that have resulted in conflicting decisions among lower courts around the country; and
- (iii) A direct appeal from the Judgment and Orders will materially advance the progress of the adversary proceeding in which the appeal is taken and in turn, the efficient and cost-effective administration of the main bankruptcy case.

At Boston, Massachusetts this 18th day of August, 2016.

By the Court,



Melvin S. Hoffman
U.S. Bankruptcy Judge

behalf of their adult daughter \$64,696.22. At the times the Palladinos paid SHU they were insolvent. Also at those times, the Palladinos were actively engaged in operating a Ponzi scheme through their company, Viking Financial Group, Inc. On July 21, 2014, the Palladinos pled guilty to charges of investment fraud by operation of a Ponzi scheme through Viking Financial Group.

2. Rule 8006(f)(2)(B): The Questions.

There are two issues of law raised in this appeal: (i) whether the so-called “Ponzi scheme presumption” applies to the Palladinos’ payments to SHU so as to render those payments actual fraudulent transfers under Bankruptcy Code § 548(a)(1)(A) and Mass. Gen. Laws ch. 109A, § 5(a)(1) and (ii) whether the Palladinos did not receive reasonably equivalent value in exchange for their payments to SHU so as to render those payments constructive fraudulent transfers under Bankruptcy Code § 548(a)(1)(B) and Mass. Gen. Laws ch. 109A, § 5(a)(2).

3. Rule 8006(f)(2)(C): The Relief Sought.

In his complaint against SHU in the adversary proceeding the trustee sought to set aside and recover the payments to SHU as actual fraudulent transfers under 11 U.S.C. § 548(a)(1)(A) and Mass. Gen. Laws ch. 109A, § 5(a)(1) and constructive fraudulent transfers under 11 U.S.C. § 548(b) and Mass. Gen. Laws ch. 109A, § (5)(a)(2). The trustee based the actual fraudulent transfer claims on the Ponzi scheme presumption and the constructive fraudulent transfer claims on the premise that a parent does not receive reasonably equivalent value for tuition paid on behalf of an adult child. The trustee moved for summary judgment on his claims. In its cross motion for summary judgment SHU argued that the Ponzi scheme presumption should be

narrowly construed by limiting it only to transfers made in furtherance of the Ponzi scheme, which would exclude the Palladinos' tuition payments, and that in any event SHU could rebut the presumption because it had acted in good faith as it was unaware of the Palladinos' fraudulent or criminal behavior. SHU also opposed the trustee's constructive fraudulent transfer claim arguing that a parent who pays for an adult child's college education does receive economic value.

4. Rule 8006(f)(2)(D): The Reasons Why the Direct Appeal should be Allowed, including which Circumstances Specified in 28 U.S.C. § (d)(2)(A)(i)-(iii) Applies

The adversary proceeding raises two questions of law, neither of which is addressed by any controlling legal authority from the Court of Appeals for the First Circuit or the Supreme Court of the United States.¹

With respect to the Ponzi scheme presumption, while other courts of appeals have addressed the presumption, they have done so only in order to establish or affirm its existence and not to define its application to specific transfers. *See, e.g., Johnson v. Nelson (In re Slatkin)*, 525 F.3d 805, 814 (9th Cir. 2008) ("We hold that once the existence of a Ponzi scheme is established, payments received by investors as purported profits—i.e., funds transferred to the investor that exceed that investor's initial 'investment'—are deemed to be fraudulent transfers as a matter of law.); and *Janvey v. Alguire*, 647 F.3d 585, 598 (5th Cir. 2011) (In affirming the grant of a preliminary injunction freezing commissions, bonuses of employees and the quarterly

¹ A case's legal novelty makes it a "prime candidate" for review under 28 U.S.C. § 158(d)(2).

compensation of the “branch managing director,” the court stated: “In this circuit, proving that [a transferor] operated as a Ponzi scheme establishes the fraudulent intent behind the transfers it made.”) (Internal quotation marks and citations omitted). There are no reported circuit court decisions addressing the question does the Ponzi scheme presumption apply only to a transfer directly facilitating the scheme.

The law outside this circuit as articulated by lower courts supports a conclusion that in cases involving Ponzi schemes, the transfers sought to be recovered must have been made “in furtherance of that Ponzi scheme” in order for the Ponzi scheme presumption to arise. *Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 531 B.R. 439, 471 (Bankr. S.D.N.Y. 2015). *See also Kapila v. Phillips Buick-Pontiac-GMC Truck, Inc. (In re ATM Fin. Servs., LLC)*, Adversary No. 6:10-ap-44, 2011 WL 2580763, at *5 (Bankr. M.D. Fla. June 24, 2011); *Welt v. Publix Super Markets, Inc. (In re Phoenix Diversified Inv. Corp.)*, Adversary No. 10-03005-EPK, 2011 WL 2182881, at *3 (Bankr. S.D. Fla. June 2, 2011); *Balaber-Strauss v. Sixty-Five Brokers (In re Churchill Mortg. Inv. Corp.)*, 256 B.R. 664, 681 (Bankr. S.D.N.Y. 2000) (quoting *In re Universal Clearing House Co.* with approval), *aff'd sub nom. Balaber-Strauss v. Lawrence*, 264 B.R. 303 (S.D.N.Y. 2001); and *Merrill v. Allen (In re Universal Clearing House Co.)*, 60 B.R. 985, 999 (D. Utah 1986).

As to the constructively fraudulent nature of tuition paid on behalf of an adult child, the reported decisions on this issue are evenly divided. *Compare Trizechahn Gateway, LLC v. Oberdick (In re Oberdick)*, 490 B.R. 687, 712 (Bankr. W.D. Pa. 2013) (“[T]here is something of a societal expectation that parents will assist with such expense if they are able to do so.”);

Sikirica v. Cohen (In re Cohen), Adversary No. 07-02517-JAD, 2012 WL 5360956 at *10 (Bankr. W.D. Pa. Oct. 31, 2012), *rev'd on other grounds*, 487 B.R. 615 (W.D. Pa. 2013) with *Gold v. Marquette Univ. (In re Leonard)*, 454 B.R. 444, 457 (Bank. E.D. Mich. 2011); *see also Banner v Lindsay (In re Lindsay)*, Adversary No. 08-9091 (CGM), 2010 WL 1780065, at *9 (Bankr. S.D.N.Y. 2010) (holding that college tuition payments were avoidable because the parents were under no legal obligation to pay).

Both questions at issue in this appeal are of national significance. The ubiquity of electronic platforms for all manner of communications and business transactions, has had the unfortunate side-effect of enabling fraudsters to develop ever more sophisticated and devious ways to swindle the general public. Use of the internet has led to the proliferation of scams worldwide. *See* <http://www.bloomberg.com/news/articles/2016-02-03/china-s-biggest-ponzi-scheme-shows-rot-in-internet-financing> (last visited August 17, 2016) (“Ezubo defrauded more than 900,000 people out of the equivalent of \$7.6 billion by promising them returns as much as 10 times higher than the official deposit rate... More than 1,000 of these so-called P2P firms are “problematic,” the China Banking Regulatory Commission said in December.”). The Great Recession also has been identified as a factor leading to an unprecedented surge in Ponzi scheme discoveries. Between 2008 and 2013 at least 500 Ponzi schemes involving over 500 billion dollars have been exposed. *See*, <http://www.ponzitracker.com> (last visited August 18, 2016). When the schemes inevitably collapse, bankruptcy typically ensues. The Ponzi scheme presumption has become one of the mainstays in the arsenal of weapons deployed by bankruptcy trustees in administering Ponzi scheme cases. Circuit level authority delineating the contours of

the presumption would greatly assist parties and lower courts in the First Circuit and elsewhere facing this issue.

The question of whether tuition payments are constructively fraudulent if made by an insolvent parent for the benefit of an adult child is of significance to colleges and universities nationally as well as to bankruptcy trustees around the country who are charged with the responsibility of recovering assets for the benefit of unsecured creditors. Reported decisions by lower courts reach differing conclusions. No court of appeals has ruled on this question. A number of targeted institutions of higher education have chosen to settle with trustees rather than litigate because of the ambiguous state of the law on this issue. *See Katy Stech, Tuition Refund Denied in Bankruptcy Case*, WALL ST. J., Aug. 12, 2016. A circuit level ruling on this issue would significantly enhance our understanding of the concept of “reasonably equivalent value” as used in the Bankruptcy Code and Uniform Fraudulent Transfer Act and add certainty to the debate over tuition payments.

5. Rule 8006(f)(2)(E): Copies of Relevant Pleadings

Copies of the Judgment, Orders and Memorandum of Decision dated August 10, 2016, are attached to the Certification for Direct Appeal filed herewith.

At Boston, Massachusetts this 18th day of August, 2016.

By the Court,



Melvin S. Hoffman
U.S. Bankruptcy Judge

Counsel Appearing: Mark G. DeGiacomo, Esq.
Ashley S. Whyman, Esq.
Murtha Cullina LLP
Boston, MA
for Mark G. DeGiacomo, Chapter 7 Trustee

Elizabeth J. Austin, Esq.
Pullman & Comley LLC
Bridgeport, CT
for Sacred Heart University