

## BANKRUPTCY AND HIGHER EDUCATION INSTITUTIONS

SCOTT F. NORBERG\*

### INTRODUCTION

The media coverage of higher education is replete these days with reports of economic challenges faced by higher education institutions, and of colleges and universities that are struggling financially or failing. *Moody's Issues Negative Outlook for Higher Education*,<sup>1</sup> *Rising Tuition Discounts and Flat Tuition Revenues Squeeze Colleges Even Harder*,<sup>2</sup> *Historically Black Colleges Face Uncertain Future*,<sup>3</sup> and *Expect Another Down Year for Tuition Revenue, Moody's Says*,<sup>4</sup> are exemplary of many headlines in recent months. While the outlook is not entirely negative, Moody's reports that one in ten colleges "is suffering 'acute financial distress' because of falling revenues and weak operating performance."<sup>5</sup> Law schools in particular are experiencing historic declines in enrollment.<sup>6</sup>

Whatever the fate of financially distressed colleges and universities, one point is clear: reorganization in bankruptcy is not an option for institutions that receive federal student financial aid funding from the United States Department of Education ("DOE") pursuant to title IV of the Higher Education Act.<sup>7</sup> This is because an institution's eligibility to participate in title IV programs terminates immediately upon filing for bankruptcy,<sup>8</sup> and termination will instantly destroy the institution's financial viability.

---

\* Professor of Law, Florida International University College of Law, Miami, Florida, and Accreditation Project Director of Data Policy and Collection, American Bar Association Section of Legal Education and Admissions to the Bar. The views expressed in this Article are the author's alone and do not necessarily reflect the views of the ABA Section of Legal Education. The author is grateful to the participants in the *American Bankruptcy Institute Law Review's* symposium for their questions and comments on the author's symposium presentation, especially Ray Warner and Keith Sharfman. The Article is much improved as a result.

<sup>1</sup> Don Troop, *Moody's Issues Negative Outlook for Higher Education*, CHRON. HIGHER EDUC. (July 14, 2014), <http://chronicle.com/blogs/bottomline/moodys-issues-negative-outlook-for-higher-education/>.

<sup>2</sup> Scott Carlson, *Rising Tuition Discounts and Flat Tuition Revenues Squeeze Colleges Even Harder*, CHRON. HIGHER EDUC. (July 2, 2014), <http://chronicle.com/article/Rising-Tuition-Discounts-and/147465>.

<sup>3</sup> Jerome Bailey Jr., *Historically Black Colleges Face Uncertain Future*, WASH. TIMES (July 22, 2014), <http://www.washingtontimes.com/news/2014/jul/22/historically-black-colleges-face-uncertain-future/?page=all>.

<sup>4</sup> See *Expect Another Down Year for Tuition Revenue, Moody's Says*, CHRON. HIGHER EDUC. (Nov. 17, 2014), [http://chronicle.com/blogs/ticker/expect-another-down-year-for-tuition-revenue-moodys-says/89791?cid=pm&utm\\_source=pm&utm\\_medium=en](http://chronicle.com/blogs/ticker/expect-another-down-year-for-tuition-revenue-moodys-says/89791?cid=pm&utm_source=pm&utm_medium=en).

<sup>5</sup> Troop, *supra* note 1.

<sup>6</sup> See *infra* notes 51–57 and accompanying text.

<sup>7</sup> See 20 U.S.C. § 1001 et seq. (2012). Title IV of the Higher Education Act governs federally funded student financial aid programs for college and post-secondary vocational training. See 20 U.S.C. § 1070(a). An institution must apply to the DOE for eligibility certification that the school meets the standards for participation in the title IV programs. See 34 C.F.R. §§ 600.20(a)(1)–(2), 668.13(a)(1)–668.16 (2013). To participate in title IV programs, a school must: (1) be an eligible institution of higher education; and (2) meet program and administrative requirements. See 20 U.S.C. §§ 1001(a)–(b), 1002(a)(1)–(6), 1094(a) (providing eligibility requirements for obtaining funding under title IV).

<sup>8</sup> See 20 U.S.C. § 1002(a)(4)(A),(6) (stating an institution that files for bankruptcy will no longer meet the definition of a higher education institution and thus, will be ineligible for title IV funding).

This Article raises the question whether the Higher Education Act ("HEA") provision that effectively precludes bankruptcy reorganization by colleges and universities, which was added to the Act in 1992, is wise policy. Even if it was in 1992, the DOE's regulation of title IV funding and of higher education accreditation has expanded considerably since then, warranting reconsideration of the anti-bankruptcy provision in light of these changes. This Article first details the relevant education and bankruptcy law provisions, and examines the rationale for the HEA anti-bankruptcy provision as found in the legislative history. The Article then considers the merits of the provision using a hypothetical case of a stand-alone law school that cannot meet its debt obligations after paying operating expenses.

I. THE HIGHER EDUCATION ACT AND ACCESS TO TITLE IV FINANCIAL AID PROGRAMS  
BY INSTITUTIONS OF HIGHER EDUCATION FILING FOR BANKRUPTCY

*A. Relevant Higher Education Act Provisions*

Title IV of the Higher Education Act of 1965 establishes various federal student financial aid (grant and loan) programs whereby the government pays eligible higher education institutions funds necessary to provide aid to qualifying students.<sup>9</sup> These programs include: the Federal Pell Grant Program, the Federal Supplemental Educational Opportunity Grant Program, the Federal Stafford Loan Program, the Federal PLUS Program, the Federal Consolidation Loan Program, the Federal Work-Study Program, the Teacher Education Assistance for College and Higher Education Grant Program, the William D. Ford Federal Direct Loan Program, and the Federal Perkins Loan Program.<sup>10</sup>

Eligible institutions are those that meet the HEA title IV definition of "institution of higher education."<sup>11</sup> The definition imposes three primary requirements for eligibility: (1) state licensure, (2) accreditation by a DOE-recognized accrediting agency, and (3) certification by the DOE that the institution is administratively capable and financially responsible.<sup>12</sup> The DOE annually evaluates each title IV institution's financial responsibility using information from the institution's audited financial statement. To demonstrate that it is financially responsible, an institution must meet all of its financial obligations, including return of funds for which it is obligated under title IV (for example, in certain circumstances where a student does not begin attendance or withdraws, or funds are not disbursed to a student); maintain specified equity, reserve, and net income ratios; and have sufficient cash reserves to make required returns of

---

<sup>9</sup> See 20 U.S.C. § 1070(a) (hereafter referred to simply as, title IV). If an institution were not eligible to participate in the title IV student financial aid programs, it would have to finance operations by making its own loans to students and/or requiring payment of tuition and fees up front. Through participation in title IV programs, a higher education institution is virtually guaranteed that all tuition and fee charges are paid, up front and on time. If not for the title IV programs, the institution would need to charge significantly higher tuition to take account of the costs of underwriting and collecting loans, and of borrower defaults.

<sup>10</sup> See 34 C.F.R. § 668.1(c) (2013).

<sup>11</sup> See 20 U.S.C. §§ 1001, 1002.

<sup>12</sup> 20 U.S.C. § 1001(a).

unearned title IV funds.<sup>13</sup> The DOE may require an institution that fails the financial responsibility test to post a letter of credit against potential HEA obligations.<sup>14</sup>

The HEA further provides that where a student is unable to complete a program due to closure of an institution, or if an institution has failed to make a refund of loan proceeds that the institution owed to a student's lender, the DOE shall repay the student's loan, with a right against the institution for any refund amount owed to the student.<sup>15</sup> Where a participating institution decides to cease operations or faces possible loss of state licensure, accreditation, or DOE certification, it must submit a teach-out plan to its accrediting agency specifying how students will be able to complete their degree programs notwithstanding closure of the institution.<sup>16</sup> Thus, where an institution closes and students are unable to complete a program under the institution's teach-out plan (which may provide for completion of the program at another institution), the federal government will incur liability for the students' loan obligations.

As amended in 1992, the definition of "institution of higher education" excludes an "institution . . . that has filed for bankruptcy."<sup>17</sup> As a result, any higher education institution that files for bankruptcy is immediately ineligible for participation in the title IV financial aid programs. This component of the definition contains no exception or allowance for discretion.<sup>18</sup>

#### *B. Relevant Bankruptcy Code Provisions and Case Law*

In 1990, Congress amended the Bankruptcy Code to provide exceptions to the automatic stay and to the definition of property of the bankruptcy estate that apply to higher education institutions. While a higher education institution that participates in title IV student financial aid programs can be a debtor under the Bankruptcy Code,<sup>19</sup>

---

<sup>13</sup> 34 C.F.R. §§ 668.171–668.173 (detailing information an institution must provide and the methodology by which the Secretary considers it).

<sup>14</sup> 34 C.F.R. § 668.173(d).

<sup>15</sup> See 20 U.S.C. § 1087(c).

<sup>16</sup> See 34 C.F.R. § 668.14(b)(31).

<sup>17</sup> 20 U.S.C. § 1002 (a)(4)(A).

<sup>18</sup> See *id.* The provision may not apply, however, to a higher education institution against which creditors have filed an involuntary provision. See 11 U.S.C. § 303 (2012) (governing filing of involuntary petitions). The statute refers only to an "institution . . . that has filed for bankruptcy" and not to an institution against which a petition has been filed. There do not appear to be any reported court decisions addressing the question.

<sup>19</sup> Bankruptcy Code section 109, "Who may be a debtor," provides in relevant part:

(b) A person may be a debtor under chapter 7 of this title only if such person is not—

(1) a railroad;

(2) a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, a New Markets Venture Capital company as defined in section 351 of the Small Business Investment Act of 1958, a small business investment company licensed by the Small Business Administration under section 301 of the Small Business Investment Act of 1958, credit union, or industrial bank or similar institution which is an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act, except that an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor if a petition is filed at the direction of the Board of Governors of the Federal Reserve System; or

property of the estate is defined to exclude a debtor's eligibility to participate in title IV financial aid programs, as well as a debtor's accreditation status and state licensure.<sup>20</sup> Further, the automatic stay provides no relief as against any action by the DOE to terminate eligibility of a debtor to participate in student financial aid programs, or any action by an accrediting agency or state regarding the accreditation status or licensure of a debtor as an educational institution.<sup>21</sup>

Education institution debtors have attempted to escape the operation of these HEA and Bankruptcy Code limitations on bankruptcy relief in two ways, both of which have been rejected by courts. In *Betty Owen Schools, Inc. v. United States Department of Education*,<sup>22</sup> the debtor sought to undo, under Bankruptcy Code section 525, the DOE's revocation of its right to participate in title IV financial aid programs.<sup>23</sup> The DOE terminated the debtor's eligibility pursuant to 20 U.S.C. § 1002(a)(4) (formerly 20 U.S.C. § 1088(a)(4)), which as noted above, provides that an "institution [that] . . . has filed for bankruptcy" is excluded from the definition of "institution of higher education" and as such is not eligible to participate in HEA grant and loan programs.<sup>24</sup> The Department acknowledged that it had terminated the debtor's eligibility to participate in HEA programs solely because the debtor had filed for bankruptcy.<sup>25</sup>

---

(3)(A) a foreign insurance company, engaged in such business in the United States; or  
 (B) a foreign bank, savings bank, cooperative bank, savings and loan association, building and loan association, or credit union, that has a branch or agency (as defined in section 1(b) of the International Banking Act of 1978) in the United States.

....

(d) Only a railroad, a person that may be a debtor under chapter 7 of this title (except a stockbroker or a commodity broker), and an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor under chapter 11 of this title.

11 U.S.C. § 109. Thus, there is no formal bar to an educational institution filing for bankruptcy under chapter 7 or 11.

<sup>20</sup> Section 541(b)(3) of the Bankruptcy Code provides: "Property of the estate does not include— (3) any eligibility of the debtor to participate in programs authorized under the Higher Education Act of 1965 (20 U.S.C. 1001 et seq.; 42 U.S.C. 2751 et seq.), or any accreditation status or State licensure of the debtor as an educational institution[.]" 11 U.S.C. § 541(b)(3).

<sup>21</sup> Section 362(b)(14)–(16) provides:

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970, does not operate as a stay—

....

(14) under subsection (a) of this section, of any action by an accrediting agency regarding the accreditation status of the debtor as an educational institution;

(15) under subsection (a) of this section, of any action by a State licensing body regarding the licensure of the debtor as an educational institution;

(16) under subsection (a) of this section, of any action by a guaranty agency, as defined in section 435(j) of the Higher Education Act of 1965 or the Secretary of Education regarding the eligibility of the debtor to participate in programs authorized under such Act . . .

11 U.S.C. § 362(b)(14)–(16).

<sup>22</sup> *In re Betty Owen Sch.*, 195 B.R. 23 (Bankr. S.D.N.Y. 1996).

<sup>23</sup> *See id.* at 26–27.

<sup>24</sup> *See id.* at 31.

<sup>25</sup> *Id.* at 31.

The bankruptcy court initially observed that, "[o]n its face, the Department appears to have violated section 525 . . . ." <sup>26</sup> The court held, however, that section 525 did not invalidate the HEA provision making bankruptcy debtors ineligible to participate in HEA programs. <sup>27</sup> It reasoned that the general policy goals of the Bankruptcy Code and the HEA eligibility limitation would be furthered by ruling for the Department; and in addition, that conflicting provisions within the Bankruptcy Code would be harmonized. <sup>28</sup> Referring to sections 362(b)(14)–(16) and 541(b)(3), the court explained:

If Congress had amended the Bankruptcy Code to allow the accrediting agencies to take appropriate action free of the protection of the "automatic stay" and "property of the estate", to hold that the Department violated section 525 would only inhibit the agency from taking the very action Congress had, in its wisdom, permitted. <sup>29</sup>

In *Statewide Oilfield Construction, Inc. v. Career Collection Ass'n*, <sup>30</sup> the debtor argued that its relationship with its accrediting agency was an executory contract that could be assumed, thereby allowing it to cure its defaults and precluding termination. <sup>31</sup> The bankruptcy court initially agreed that the relationship was an executory contract, but reconsidered its decision when shortly thereafter sections 362(b)(14)–(16) and 541(b)(3) became part of the Bankruptcy Code. <sup>32</sup> The court reasoned that an assumed contract is regarded as an asset of the bankruptcy estate, and that Congress had made clear in section 541(b)(3) that a debtor's accreditation status cannot be an asset of the estate. <sup>33</sup> The case did not involve an attempt by the debtor to maintain title IV eligibility.

The *Betty Owen Schools* and *Statewide Oilfield Construction* cases appear to have definitively settled the questions they addressed—it does not appear that there are any other reported court decisions considering whether section 525 bars termination of eligibility based on the filing of a bankruptcy petition, <sup>34</sup> or whether the accreditation

---

<sup>26</sup> *Id.*

<sup>27</sup> *See id.* at 34.

<sup>28</sup> *See id.* at 33.

<sup>29</sup> *See id.* The court also reasoned that general bankruptcy policy must yield to more specific policy objectives and that section 1088(a)(4) of HEA was enacted after section 525 of the Bankruptcy Code. *Id.*; *see also* *New York Inst. of Dietetics, Inc. v. Riley*, 966 F. Supp. 1300, 1316 (S.D.N.Y. 1997) (holding that DOE properly terminated plaintiff's eligibility under title IV based on bankruptcy filing by an entity with which plaintiff was associated, notwithstanding that section 525(a) prohibits discrimination against "a person that is or has been a debtor under this title . . . or another person with who such debtor has been associated") (emphasis omitted) (citation omitted). *Cf.* *Fed. Commc'ns. Comm'n v. NextWave Personal Commc'ns.*, 537 U.S. 293, 304 (2003) (holding FCC violated Bankruptcy Code section 525 by cancelling FCC licenses solely for failure to pay debts dischargeable in bankruptcy; case did not involve any conflict between Bankruptcy Code and another federal statute, the Communications Act, which did not require revocation as a sanction for failure to make contractual payments for purchase of licenses).

<sup>30</sup> 134 B.R. 399 (Bankr. E.D. Cal. 1991).

<sup>31</sup> *Id.* at 401.

<sup>32</sup> *Id.* at 401–02 (considering recent Congressional amendment to Bankruptcy Code).

<sup>33</sup> *Id.* at 402.

<sup>34</sup> *See In re Wheeling Coll. of Hair Design*, No. 95-68-ST, 1995 WL 934884 (Dep't of Educ. Nov. 22, 1995) (terminating eligibility to participate in title IV programs where institution had filed for bankruptcy and its

relationship is an executory contract that could be assumed.

## II. THE RATIONALE FOR THE HEA ANTI-BANKRUPTCY PROVISION

As noted above, as part of a comprehensive overhaul of the HEA in 1992, Congress added section 1002(a)(4), making higher education institutions ineligible for title IV funding upon the filing of a petition in bankruptcy.<sup>35</sup> The Senate Report accompanying the HEA amendments<sup>36</sup> contains no specific explanation of the anti-bankruptcy provision. Further, although the Report acknowledged the Bankruptcy Code amendments two years earlier,<sup>37</sup> it does not include any consideration of the efficacy or inefficacy of the amendments in addressing the bankruptcy-related concerns impacting administration of title IV programs.

More broadly, the Senate Report found that serious flaws in each of the three primary title IV program eligibility requirements—state licensure,<sup>38</sup> accreditation by a DOE-recognized accrediting agency,<sup>39</sup> and DOE certification<sup>40</sup>—threatened the "cost-effectiveness and ongoing viability" of the Guaranteed Student Loan Programs (GSLP).<sup>41</sup> In discussing the role and shortcomings of higher education accrediting agencies in assuring the quality of education required for GSLP participation, the Report touched briefly on several points concerning bankruptcy and higher education institutions:

Due process constraints.—Accrediting bodies' ability to respond to problems in schools has been severely limited by due process constraints, i.e., actual and/or threatened lawsuits, recourse to bankruptcy, and mandatory review and appeals procedures in cases involving adverse actions. [According to the Inspector General,] "By securing the protection of the [bankruptcy] court, which has an interest in seeing that the schools survive through reorganization, even a school that cannot make loan refund payments to former students may continue to admit new students who in turn incur student loan obligations [even though that] \* \* \* school may well close or otherwise cut back its educational program."<sup>42</sup>

Further, the Report found that the DOE's certification process was plagued by

---

accreditation had been removed).

<sup>35</sup> See Higher Education Amendments of 1992, Pub. L. No. 102-325, 106 Stat. 448. Section 1002(a)(4) of the HEA was originally numbered 20 U.S.C. § 1088(a)(4). It was renumbered 20 U.S.C. § 1002(a)(4) as part of Pub. L. No. 105-244 in 1998.

<sup>36</sup> S. REP. NO. 102-58 (1991).

<sup>37</sup> *Id.* at 34.

<sup>38</sup> See *id.* at 14–16.

<sup>39</sup> See *id.* at 16–22.

<sup>40</sup> See *id.* at 25–33.

<sup>41</sup> See *id.* at 1.

<sup>42</sup> See *id.* at 19 (second and third alteration in original) (emphasis omitted).

"pervasive and persistent problems,"<sup>43</sup> including its process for certifying institutions for eligibility to participate in title IV loan programs, and for recognizing accrediting agencies.<sup>44</sup> As pertaining specifically to bankruptcy and higher education institutions, the Report found that:

institutions are certified even when there were clear indications of significant administrative deficiencies . . . . Moreover, in the case of surety arrangements, whereby financially weak schools are certified on the basis of posting cash, bonds, or other assets as a guarantee against any potential loss, many were plainly inadequate. In one case, a severely troubled school, whose recertification was based on increasing its surety bond from \$20,000 to \$100,000, declared bankruptcy leaving students with loans worth more than \$700,000 and the Department with about \$1 million in cash advances. The Department failed to collect the \$100,000 bond and was unable to go after the cash advances because the school had no assets.<sup>45</sup>

In its findings, conclusions, and recommendations, the Report concluded:

many of the program's intended beneficiaries—hundreds of thousands of young people, many of whom come from backgrounds with already limited opportunities—have suffered further because of their involvement with the GSLP. Victimized by unscrupulous profiteers and their fraudulent schools, students have received neither the training nor the skills they hoped to acquire and, instead, have been left burdened with debts they cannot repay.

. . . [W]hile students and taxpayers have paid dearly, unscrupulous school owners, accrediting bodies, lenders, loan servicers, guaranty agencies, and secondary market organizations have profited handsomely, and in some cases, unconscionably.

. . . .

. . . [T]he Subcommittee acknowledges that the Congress and the Department have recently instituted a number of important measures, including: . . . eliminating the bankruptcy recourse used by schools trying to escape adverse action by accreditation agencies . . . .<sup>46</sup>

In sum, the Senate Report reflects Congressional concerns that bankruptcy courts had been unduly solicitous of debtors seeking to reorganize, allowing them to continue

---

<sup>43</sup> *Id.* at 25.

<sup>44</sup> *See id.* at 25–26.

<sup>45</sup> *Id.* at 26.

<sup>46</sup> *Id.* at 33–34.

to accept students even though the enterprise was failing and ultimately not able to make loan refund payments and leaving students with student loan debt and without degrees, and that some institutions were unscrupulous and even fraudulent in their use of title IV funds. Although the Report acknowledges that the Bankruptcy Code had been amended to "eliminat[e] the bankruptcy recourse,"<sup>47</sup> it does not explain the rationale for precluding entirely the possibility of bankruptcy reorganization by higher education institutions that participate in title IV programs.

### III. RECONSIDERING THE HEA ANTI-BANKRUPTCY PROVISION

It is debatable whether the rationale for the anti-bankruptcy provision, as found in the Senate Report accompanying the HEA amendments in 1992, was sound at the time the provision was added to the HEA. The Bankruptcy Code amendments made two years earlier in 1990 exempt DOE actions regarding title IV eligibility from the automatic stay,<sup>48</sup> and further exclude accreditation and licensure status from the definition of property of the estate and exempt related actions from the operation of the automatic stay.<sup>49</sup> Thus, apart from the bankruptcy exclusion in HEA section 1002(a)(4), the DOE, state licensing authorities, and accrediting agencies may enforce eligibility, licensing and accreditation standards without creditor or bankruptcy court interference. If the DOE has not terminated an institution's eligibility for title IV funding at the point that it files for bankruptcy relief, there may be grounds (apart from the anti-bankruptcy provision) to terminate eligibility after the filing. If the institution does not meet DOE financial responsibility requirements, its eligibility will be subject to termination without bankruptcy court or creditor interference.

Further, the rationale that unscrupulous or fraudulent institutions found refuge in bankruptcy to the detriment of the DOE and students is misplaced. To the contrary, bankruptcy entails court supervision that guards against fraud and mismanagement, and allows for recovery against owners and others for fraudulent conveyances and preferences. Likewise, the concern that bankruptcy permitted bankrupt higher education institutions to avoid loan refund and security bond obligations is misplaced. These problems arise from the lack of adequate DOE oversight and insufficient debtor assets, not from the act of filing for bankruptcy. Finally, the critique that bankruptcy courts were overly solicitous of debtors seeking to reorganize is moot in light of the absolute exclusion found in section 362(b)(16) relating to DOE actions to enforce its regulations concerning eligibility for title IV funding.<sup>50</sup>

Alternatively, perhaps the rationale for the anti-bankruptcy provision is more simply that, any institution needing to declare bankruptcy is too risky to bet taxpayer dollars on it, and too risky to allow students to enroll in. As discussed above, however,

---

<sup>47</sup> *Id.* at 34.

<sup>48</sup> See 11 U.S.C. § 362(b)(16) (2012).

<sup>49</sup> See 11 U.S.C. §§ 541(b)(3), 362(b)(14)–(16); see also Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 3007, 104 Stat. 1388, 1388-28 (amending sections 362(b) and 541(b), modifying definition of "property of the estate" to exclude eligibility of debtor to participate in programs authorized under Higher Education Act).

<sup>50</sup> See 11 U.S.C. § 362(b)(16).



the counter argument is that filing for bankruptcy does not change the underlying financial condition of the institution, and the Bankruptcy Code exceptions to the automatic stay and property of the estate provisions permit the DOE, accrediting agencies, and state licensing agencies to proceed to enforce their rights outside the purview of the bankruptcy court.

Even if sound at the time, expansion of DOE oversight of its institution certification and accreditation agency recognition processes since 1992 are reason to reconsider the merits of the per se exclusion. Part IV below uses legal education and a hypothetical law school as the context for considering the merits of the exclusion. This discussion posits that the Bankruptcy Code provisions providing special exemptions from the automatic stay and property of the estate remain in place. In addition, it is suggested that the Bankruptcy Code be amended to grant priority to DOE claims over general unsecured claims.

#### IV. THE HEA ANTI-BANKRUPTCY PROVISION RECONSIDERED IN THE CONTEXT OF A LAW SCHOOL IN THE CURRENT LEGAL EDUCATION MARKET AND DOE REGULATORY ENVIRONMENT

##### *A. The Decline of the Legal Education Market*

While higher education institutions in general currently face significant economic challenges,<sup>51</sup> legal education in particular is experiencing historic declines in enrollment. The percentage of law graduates who obtained legal employment within nine months of graduation has been declining since at least 2001, and this decline was significantly aggravated with onset of the Great Recession in 2008.<sup>52</sup> While the legal employment rate for law graduates ticked up slightly for the graduating class of 2013, still only 70.6% of the graduates had obtained full-time legal employment within nine months of graduation, with 57% of the class in full-time bar pass required positions and 13.6% in full-time J.D. advantage jobs nine months after graduation.<sup>53</sup>

The continuing low legal employment rates for law graduates have led to a correction in law school enrollments, which have declined sharply over the past four years. The number of first-year matriculates reached an all-time high in fall 2010, and since then has fallen to a level not seen since the late 1970s (when there were fewer than 170 ABA-approved law schools, compared to 205 today).<sup>54</sup>

---

<sup>51</sup> See *supra* notes 1–6 and accompanying text.

<sup>52</sup> See BRIAN Z. TAMANAHA, *FAILING LAW SCHOOLS* 116–17 (2012) (explaining percentage of graduates who obtained jobs as lawyers declined from 68.3% in 2001 to 62.5% in 2009 and discussing law schools' response).

<sup>53</sup> See *2013 Law Graduate Employment Data*, AM. B. ASS'N SEC. LEGAL EDUC. & ADMISSIONS TO B. 1 (2013), [http://www.americanbar.org/content/dam/aba/administrative/legal\\_education\\_and\\_admissions\\_to\\_the\\_bar/statistics/2013\\_law\\_graduate\\_employment\\_data.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/legal_education_and_admissions_to_the_bar/statistics/2013_law_graduate_employment_data.authcheckdam.pdf).

<sup>54</sup> See *Enrollment and Degrees Awarded 1963-2012*, AM. B. ASS'N SEC. LEGAL EDUC. & ADMISSION TO B. 1 (2013), [http://www.americanbar.org/content/dam/aba/administrative/legal\\_education\\_and\\_admissions\\_to\\_the\\_bar/statistics/enrollment\\_degrees\\_awarded.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/legal_education_and_admissions_to_the_bar/statistics/enrollment_degrees_awarded.authcheckdam.pdf) (providing data for number of first year students enrolled in law schools from 1964-2012).

**First-Year Enrollments at ABA-Approved Law Schools, 2010-2014<sup>55</sup>**

| Year | 1L Matriculates | Percent change since 2010 |
|------|-----------------|---------------------------|
| 2010 | 52,488          | ---                       |
| 2011 | 48,697          | -7.2%                     |
| 2012 | 44,481          | -15.3%                    |
| 2013 | 39,675          | -24.4%                    |
| 2014 | 37,924          | -27.7%                    |

**Total Enrollments at ABA-Approved Law Schools, 2010-2014<sup>56</sup>**

| Year | Total Enrollment | Percent change since 2010 |
|------|------------------|---------------------------|
| 2010 | 147,525          | ---                       |
| 2011 | 146,288          | -0.1%                     |
| 2012 | 139,055          | -5.7%                     |
| 2013 | 128,710          | -12.8%                    |
| 2014 | 119,775          | -18.8%                    |

Moreover, the short-term forecast for law school enrollments remains negative. Law School Admission Council test administrations were down by 9.1% on the June 2014 test, and by 8.1% on the September/October 2014 test.<sup>57</sup>

With declining law school enrollments has come a decrease in the qualifications of entering classes as reflected in 25th, 50th, and 75th percentile LSAT scores. The average LSAT score of the entering classes at ABA-approved law schools fell by about two points at each of the 25th, 50th, and 75th percentiles from 2010 to 2013.<sup>58</sup>

**Average 25/50/75th Percentile LSAT Scores at ABA-Approved Law Schools, 2010 and 2013**

| Year | 25th Percentile | 50th Percentile | 75th Percentile |
|------|-----------------|-----------------|-----------------|
| 2010 | 155.2           | 158.1           | 160.5           |
| 2013 | 152.2           | 156.0           | 158.6           |

<sup>55</sup> See *id.*; see also *ABA Section of Legal Education Reports 2014 Law School Enrollment Data*, ABA NEWS ARCHIVES (Dec. 16, 2014), [http://www.americanbar.org/news/abanews/aba-news-archives/2014/12/aba\\_section\\_of\\_legal.html](http://www.americanbar.org/news/abanews/aba-news-archives/2014/12/aba_section_of_legal.html); *ABA Section of Legal Education Reports 2013 Law School Enrollment Data*, ABA NEWS ARCHIVES (Dec. 17, 2013), [http://www.americanbar.org/news/abanews/aba-news-archives/2013/12/aba\\_section\\_of\\_legal.html](http://www.americanbar.org/news/abanews/aba-news-archives/2013/12/aba_section_of_legal.html).

<sup>56</sup> See *id.*; see also *ABA Section of Legal Education Reports 2014 Law School Enrollment Data*, *supra* note 55; *ABA Section of Legal Education Reports 2013 Law School Enrollment Data*, *supra* note 55.

<sup>57</sup> See *LSATs Administered—Counts and Percent Increases by Admin and Year*, LSAC (2014), <http://lsac.org/lsacresources/data/lsats-administered>.

<sup>58</sup> See Jerry Organ, *Thoughts on Fall 2013 Enrollment and Profile Data Among Law Schools*, LEGAL WHITEBOARD (March 2, 2014), <http://lawprofessors.typepad.com/legalwhiteboard/2014/03/thoughts-on-fall-2013-enrollment-and-profile-data-among-law-schools.html> (noting decline in first year LSAT scores between 2010 to 2013).

At forty schools, the median LSAT score fell by four or more points between 2010 and 2013.<sup>59</sup>

At the same time, bar examination passage rates have declined.<sup>60</sup> The mean scaled Multistate Bar Examination score on the July 2014 bar examination was more than two points lower than the previous year, marking the single largest drop in the mean score in a generation.<sup>61</sup> The National Conference of Bar Examiners has attributed the decline to the weaker entering class credentials of the class that entered in 2011 and graduated in 2014.<sup>62</sup>

*B. Expanded Oversight by the DOE of Accrediting Agencies and in the Certification of Institutions for Title IV Eligibility*

Since 1992, the DOE has added significant oversight in both its process for recognizing accreditation agencies and its process for certifying institutions for title IV eligibility. Indeed, the prevailing criticism today of the DOE's management of the recognition of higher education accrediting agencies is that it is overly regulatory.<sup>63</sup> Several examples drawn from the Accreditation Project of the American Bar Association Section of Legal Education, whose Council and Accreditation Committee are recognized by the DOE as the accrediting agency for the J.D. degree, may illustrate the point. As now required by DOE regulations,<sup>64</sup> while ABA-accredited law schools receive a site visit and top-to-bottom accreditation review every seven years,<sup>65</sup> Rule 6 of the ABA Rules of Procedure for Approval of Law Schools now provides for annual interim monitoring of schools based on financial resources, employment outcomes, bar passage rates, and admissions requirements and enrollment changes.<sup>66</sup> Further, where

---

<sup>59</sup> See *id.* (discussing number of schools experiencing LSAT score declines at each percentile).

<sup>60</sup> See Tamara Tabo, *When Bar Scores Plummet, Who Will Examine The Examiners?*, ABOVE THE LAW (Nov. 7, 2014, 6:01 PM), <http://abovethelaw.com/2014/11/when-bar-scores-plummet-who-will-examine-the-examiners/> (discussing drop in scores for July 2014 bar exam).

<sup>61</sup> See *id.* (reporting national average MBE score lowest in ten years and July 2014 MBE pass rates experienced largest decline since MBE was implemented).

<sup>62</sup> See *id.* (citing Erica Moeser's address to law school deans regarding multi-state bar exam scoring).

<sup>63</sup> See Eric Kelderman, *Public-College Leaders Rail Against Education Dept.'s 'Regulatory Culture'*, CHRON. HIGHER EDUC. (Oct. 20, 2014), [http://chronicle.com/article/Public-College-Leaders-Rail/149535/?cid=pm&utm\\_source=pm&utm\\_medium=en](http://chronicle.com/article/Public-College-Leaders-Rail/149535/?cid=pm&utm_source=pm&utm_medium=en) (citing Thomas Edison State College president, George A. Pruitt, who stated Department of Education's "regulatory culture" impedes innovation and progress in higher education).

<sup>64</sup> See 34 C.F.R. § 602.19 (2013) (providing for monitoring and reevaluating of institutions or programs).

<sup>65</sup> See ABA STANDARDS AND RULES OF PROCEDURE FOR APPROVAL OF LAW SCHOOLS R. 5(b)(1)(2014-2015), available at [http://www.americanbar.org/content/dam/aba/publications/misc/legal\\_education/Standards/2014\\_2015\\_corrected\\_aba\\_rules\\_of\\_procedure.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publications/misc/legal_education/Standards/2014_2015_corrected_aba_rules_of_procedure.authcheckdam.pdf) (stating site evaluation of accredited law school shall be conducted "in the third year following the granting of full approval and very seventh year thereafter").

<sup>66</sup> See *id.* at R. 6. Rule 6 provides in full:

**Rule 6: Interim Monitoring of Accreditation Status**

(a) The Accreditation Committee shall monitor the accreditation status of law schools on an interim basis between site evaluations. In its interim monitoring of a law school's accreditation status, the Committee shall use a law school's annual questionnaire submissions, other information requested by the Committee, and information otherwise deemed reliable by the Committee for its review.

there is a finding of possible non-compliance with any standard, it generally must be resolved by the Accreditation Committee and Council within two years or the school's accreditation is terminated.<sup>67</sup>

The efficacy of accreditation to ensure the quality of accredited programs should not be overstated. Indeed, there are salient critiques that agencies such as the ABA have been "captured" by the schools it is charged with regulating, and that the Standards are not sufficiently rigorous.<sup>68</sup> Under pressure from the DOE to establish an output-based standard for accreditation, the ABA adopted a bar pass standard in 2005 that arguably is set very low. No school has failed it, although it is fair to posit that schools that may be in danger of violating the standard have made the program improvements necessary to comply.<sup>69</sup> Perversely, the bar pass standard arguably eclipses other standards on quality of educational program and governing admission of students with weak performance predictors. As long as the school is meeting the minimum bar pass standard, the thinking goes, it is necessarily in compliance with minimum standards on quality of faculty, academic program, admissions, and so on. The larger point, however, is that the accreditation process now required by the DOE is significantly more rigorous than it was when Congress overhauled the HEA in 1992.

### *C. A Hypothetical Case for Bankruptcy Reorganization*

Consider ABC School of Law, a hypothetical independent law school that is accredited by the American Bar Association Section of Legal Education and Admissions to the Bar. It is a lower-ranked law school in a desirable geographic location. It is tuition-dependent, relying on student tuition dollars for over 90% of its operating budget. Students borrow the vast majority of their tuition and living expenses through title IV programs. The school grants scholarships ranging from 25% to 100% of tuition to about 65% of the student body. These scholarships come very largely from tuition paid by other students. The school has a modest endowment of nearly \$40 million, most of it restricted to professorships and student scholarships. It employs approximately 150 faculty and staff, and is a party to hundreds of contracts for goods and services, some short-term and some longer-term, ranging from library resources to

---

(b) In conducting interim monitoring of law schools, the Committee shall consider at a minimum:

- (1) Resources available to the law school;
- (2) Efforts and effectiveness in facilitating student career placement;
- (3) Bar passage; and
- (4) Student admissions including student credentials, size of enrollment, and academic attrition.

<sup>67</sup> See *id.* at R. 14(b) ("The period of time by which a law school is required to demonstrate compliance with a Standard shall not exceed two years from the date of determination of noncompliance . . ."). This rule is required by DOE regulations, 34 C.F.R. § 602.20(a)(2)(iii).

<sup>68</sup> See, e.g., TAMANAHA, *supra* note 52, at 11 (describing 1995 lawsuit filed against ABA regarding accreditation process).

<sup>69</sup> See David Yellen, *The Dean's Office: Why The ABA Is Resistant To Change*, ABOVE THE LAW (Mar. 7, 2013, 10:11 AM), <http://abovethelaw.com/2013/03/the-deans-office-why-the-aba-is-resistant-to-change/> (noting weak bar passage standard and suggesting it should be strengthened).

copier machines to catering. The school is among the fifteen largest enterprises in terms of its contribution to the local economy.

During the steady law school enrollment increases of 2000–2010, the school expanded its enrollments and built a new, larger, and very expensive state-of-the-art facility that it financed with borrowed funds. Not long after the school occupied the new facility, legal education was hit by the continuing significant declines in enrollment. Tracking national trends, ABC's first-year enrollments have declined by over 25% since 2010. Further, as is the case at many lower-ranked law schools, ABC has seen increasing numbers of students transfer to other, more highly ranked schools. With the decline in enrollments, ABC has also seen a sizable drop in the credentials of its entering classes over the past four years as measured by LSAT score and UGPA. In other words, even as it has had to reduce the size of its first-year classes, the school has lost ground in the credentials of its entering classes. Had it maintained entering class credentials at 2010 levels, it would have experienced even larger declines in enrollment.

**ABC School of Law Enrollments and Entering Class Credentials, 2010-2014**

| Year | 1L Enrollment | Total Enrollment | Median LSAT Score | Median UGPA |
|------|---------------|------------------|-------------------|-------------|
| 2010 | 500           | 1200             | 152               | 3.12        |
| 2011 | 420           | 1100             | 151               | 3.01        |
| 2012 | 390           | 1050             | 148               | 2.93        |
| 2013 | 320           | 910              | 145               | 2.92        |
| 2014 | 250           | 750              | 142               | 2.88        |

The school has trimmed its faculty, staff, library, travel, and other expenses in light of the reduced enrollments (although under the watchful eye of the ABA, it has added resources to its academic support program in order to prepare the larger numbers of students with weaker admissions profiles). The continuing faculty and staff members have agreed to 20% pay cuts. Even so, while revenues significantly exceed expenses, ABC cannot meet its debt service payments on the new building. It is in default on its mortgage, and has been in negotiations with the lender for several months. The building was designed as a law school, and so will not have much of a market for resale if the mortgagee were to foreclose on it.

The ABA has been carefully monitoring the law school's compliance with accreditation standards, including the requirement that the school have adequate financial resources to meet present and anticipated program needs.<sup>70</sup> The lower enrollments, reduced financial resources, and weaker credentials of the entering classes have been the subject of close and continuing interim accreditation monitoring. Bar passage rates continue to meet accreditation standards. Likewise, the DOE is monitoring the school for compliance with DOE financial and administrative regulations. Although the school is in default on its mortgage, the DOE has not

<sup>70</sup> See AMERICAN BAR ASSOCIATION STANDARDS FOR APPROVAL OF LAW SCHOOLS Standard 201 (2014-2015), available at [http://www.americanbar.org/content/dam/aba/publications/misc/legal\\_education/Standards/2014\\_2015\\_aba\\_standards\\_chapter2.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publications/misc/legal_education/Standards/2014_2015_aba_standards_chapter2.authcheckdam.pdf).

decertified the school's eligibility for title IV funding as the school negotiates a possible restructuring of the mortgage debt. Both the ABA and the DOE have followed closely the progress of the negotiations between ABC and the mortgagee.

This hypothetical scenario is not implausible, and ABC School of Law presents a strong profile for chapter 11 reorganization. Like any other overleveraged business that generates income in excess of operating expenses, and going concern value exceeds liquidation value, there are strong incentives for creditors to consensually restructure the debt. However, collective action problems or dysfunction in debtor-creditor negotiations may derail a consensual restructuring. Bankruptcy would provide an opportunity for the school to restructure its debt, preserve going concern value for the benefit of creditors, maintain employment of faculty and staff, continue relationships with suppliers, and help to preserve the local tax base. The threat of bankruptcy provides added incentive for creditors, the mortgagee in particular, to restructure the school's debt.

Under current law, bankruptcy of course is not an option for ABC School of Law (or any other higher education institution that participates to any significant extent in title IV student financial aid programs). What interest is advanced by the rule? And do the benefits outweigh the costs in terms of successful reorganizations that are precluded by the rule? Arguably, the HEA anti-bankruptcy provision gives the DOE a measure of control over a financially distressed institution that it would not otherwise have. Without bankruptcy court interference, the DOE may have enhanced leverage to demand that an institution meet DOE financial and administrative requirements to remain eligible for title IV funding. The recent case involving a for-profit educational institution, Corinthian, may be an example. There, the DOE appointed a monitor to oversee the winding down of the business.<sup>71</sup>

But this leverage very largely exists apart from the HEA anti-bankruptcy provision. Bankruptcy Code section 362(b)(16) provides that the automatic stay does not apply to any action by the DOE regarding a debtor's eligibility to participate in title IV programs for failure to meet administrative capability or financial responsibility requirements.<sup>72</sup> This exception provides nearly the same leverage as the anti-bankruptcy provision without precluding a bankruptcy filing to deal with creditors other than the DOE.<sup>73</sup> In other words, the provision barring eligibility of an institution that files for bankruptcy adds very little to the Code exemption, while altogether precluding a college or university from using bankruptcy to address other debt problems. To further protect title IV programs from loss, the Code could be amended to grant a priority for loan refund obligations over general unsecured debts.

Instead, the anti-bankruptcy provision may give undue leverage to creditors other than the DOE. In the hypothetical case of ABC School of Law, the mortgage holder

---

<sup>71</sup> Katy Murphy, *Corruption-buster to Monitor Sale, Closure of Corinthian Colleges*, SAN JOSE MERCURY NEWS (July 18, 2014, 10:21 AM), [http://www.mercurynews.com/education/ci\\_26173323/corinthian-colleges-former-u-s-attorney-patrick-fitzgerald](http://www.mercurynews.com/education/ci_26173323/corinthian-colleges-former-u-s-attorney-patrick-fitzgerald); Richard Perez-Pena, *College Group Run for Profit Looks to Close or Sell Schools*, N.Y. TIMES, Jul. 4, 2014, at A10, available at <http://www.nytimes.com/2014/07/05/education/corinthian-colleges-to-largely-shut-down.html> (reporting on Corinthian College's agreement with federal Education Department).

<sup>72</sup> See 11 U.S.C. § 362(b)(16) (2012).

<sup>73</sup> *Id.*

and other creditors are in a position to demand changes in the school's operating plan that may be inconsistent with program quality standards. Creditors are less likely than the DOE, the school's accrediting agency, and the school itself to appreciate these requirements. In the hypothetical case, to maintain revenues, the school has significantly lowered admissions criteria, and in order to reduce expenses, has reduced faculty and staff, thereby increasing the student-faculty ratio and eroding the quality of student services. The HEA anti-bankruptcy provision may deprive the debtor of some leverage it may have to hold the line on program quality standards, while enhancing the mortgagee's leverage to improve the bottom line at the likely expense of program quality. The bankruptcy court as a neutral tribunal would be in a position to impartially consider a debtor higher education institution's business plan in light of the competing interests of creditors, on the one hand, and the debtor's interest in maintaining educational program quality, on the other hand. In effect, the DOE and accrediting agencies are allies of an institution that meets program quality standards but is overleveraged with debt.

#### V. CONCLUSION: WHY NOT BANKRUPTCY REORGANIZATION FOR HIGHER EDUCATION INSTITUTIONS?

Why should a higher education institution not have access to bankruptcy reorganization as any other enterprise? The same policies that underlie the reorganization of businesses in general also support reorganization for higher education institutions. Chapter 11 enables preservation of the going concern value of an enterprise and thereby the maximization of recoveries for creditors.<sup>74</sup> In addition, it enables the resolution of creditor versus creditor disputes over entitlements to the debtor's assets; establishes certain preferences in the distribution of value to creditors; and makes possible the preservation of jobs, local tax bases, and supplier relationships.<sup>75</sup>

In the hypothetical case of ABC School of Law, the institution continues to be accredited by the ABA and certified by DOE to participate in title IV programs. The filing of a chapter 11 petition would not in and of itself change these facts, and may allow the school to bring about a restructuring of its mortgage debt that would not otherwise be possible outside of bankruptcy. If the school and mortgagee cannot come to terms, and the school is forced to liquidate, the going concern surplus value of the enterprise may be lost to creditors, the community would lose an important economic asset, and the employment of numerous faculty and staff members would be disrupted.

---

<sup>74</sup> See, e.g., Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97, 109 (1984) (suggesting in bankruptcy a firm should be kept "intact only if it has more value as a going concern than liquidated, because only then will the assets be put to their highest-valued use").

<sup>75</sup> See, e.g., Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 785–88 (1987) (highlighting positive outcomes of bankruptcy on debtors, creditors, and other interested parties).