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Student Loan Update and the State of Higher Education Across Jurisdictions

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STUDENT LOAN UPDATE AND THE STATE OF HIGHER EDUCATION ACROSS
JURISDICTIONS

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Introduction¹

Student loan debt is one of the most pernicious problems in the United States. “[O]utstanding student loan debt has tripled since 2006, from under \$500 billion to over \$1.5 trillion today[.]” and now exceeds both credit card and auto loan indebtedness.² Equally troubling is the rate of delinquency: “[a]mong all types of household debt, student loans have the highest delinquency rate.”³ Ineluctably, not only does student loan debt cause mental stress in the borrower and the borrower’s dependents, but socially, those holding crushing student loan debt will be unable to save for homes and retirement, will delay life events such as marriage, and may forgo choosing public-service careers.⁴ And while the discussion of student loan debt centers on the so-called “millennial,” older Americans also struggle with student loan debt; whether incurred themselves or as a co-signed debt for their children’s tuition.⁵ “Student loan debt thus affects not only those who owe the loans but also has consequences that ripple through our communities and our nation.”⁶

¹ Prepared by Kristi Sutton, Law Clerk to the Hon. Cynthia A. Norton, with acknowledgement to Marjorie Kaufman, Managing Director of Getzler Henrich & Associates LLC with respect to her materials on higher education restructuring.

² Final Report of the American Bankruptcy Institute Commission on Consumer Bankruptcy, 2 (2019) *available at* <https://ConsumerCommission.abi.org/commission-report> (citation omitted).

³ *Id.* (citation omitted).

⁴ *See generally id.*, at 3.

⁵ Shannon Najmabadi, *At 69 she’s still paying off \$12,000 of student debt – including out of her Social Security checks. It isn’t just a millennial problem*, Texas Tribune, Oct. 23, 2019, *available at* <https://www.texastribune.org/2019/10/23/student-debt-not-just-millennial-problem/>.

⁶ Final Report, *supra* note 2, at 3.

While student loan issues unquestionably come to the fore given the numerous societal impacts associated with high debt and default, higher education institutions are also at risk. With the expansion and implosion of for-profit colleges and decreasing funding for public higher education institutions, not only will tuition continue to rise, but access to quality education will decrease. Taken together, these influences warrant discussion of possible solutions and an examination into how the bankruptcy code may assist the most vulnerable.

Congressional Intent and Dischargeability

“[P]rior to 1976, student loans were fully dischargeable.”⁷ This changed however, when Congress determined that debtors were allegedly abusing the bankruptcy system through incurring student loan debt and discharging the debt shortly after graduation.⁸ As a result, in 1978, 11 U.S.C. § 523(a)(8) was born and included the following exception from discharge:

“[a] governmental unit, or nonprofit institution of higher education, for an education, for an educational loan, unless⁹

- A. such loan first became due before five years before the date of the filing of the petition; or
- B. excepting such debt from discharge under this paragraph will impose undue hardship on the debtor and the debtor’s dependents.”¹⁰

And while the addition of “undue hardship” appears to have been a mere compromise,¹¹ the statute was further amended to where Congress lengthened the time period for discharge from five to seven years and eliminated the words “from higher education;” effectively opening the door for

⁷ *Legislative Update: Student Loans and Bankruptcy: Recommendations for Reform*, 37 AM. BANKR. INST. J. 3, 8 (March 2018).

⁸ *Id.* (citing Janice E. Kosel, *Running the Gauntlet of “Undue Hardship”: The Discharge of Student Loans in Bankruptcy*, 11 GOLDEN GATE U.L. REV. 457 (1981)).

⁹ *Id.* (citing P.L. No. 95-598 (Nov. 6, 1978)).

¹⁰ *Id.*

¹¹ *Id.* (citing Kosel, *Running the Gauntlet*, *supra* n. 8, at 465).

private loan protection.¹² Later, Congress removed, in its entirety, student loan discharge, absent a showing of “undue hardship” and, in 2005, curiously extended the exception to cover private and for-profit educational loans.¹³ The effect of these amendments enlarged the non-dischargeability provision and “expand[ed] loan servicers’ ability to collect on debt by allowing garnishment of wages and even Social Security benefits.”¹⁴ Given the rather ambiguous and subjective term “undue hardship,” courts nationwide struggle with its applicability and whether the facts before them satisfy the “undue hardship” requirement.

Case Law Examining Legislative Intent

1. Statutory Analysis, not Undue Burden, Justified the Discharge of a Non-Governmental, For-Profit Loan. *In re Crocker*, No. 18-20254, 2019 WL 5304619 (5th Cir. Oct. 21, 2019), as revised (Oct. 22, 2019)

The court analyzed (a) whether a bankruptcy judge may enforce a discharge granted in another district and (b) whether the private loans at issue, loans obtained to pay education expenses, were non-dischargeable. In holding that a bankruptcy judge may not enforce a discharge granted in another district, the court initially analyzed 1970 legislation on registering injunctions. This legislation permitted an order of discharge be registered in another district and be “enforced in like manner.” This legislation was later repealed by the adoption of the bankruptcy code in 1978; specifically deleting the language “may be enforced in like manner.” The court then looked to 28 U.S.C. § 1963, which permits registration, but only for judgments that order the recovery of property or money; injunctive relief is neither. Given that the only authority that the bankruptcy court could enforce another district’s discharge was repealed, the court found that a bankruptcy judge may not enforce another court’s injunctive relief.

Next, the court held that a non-governmental, for-profit loan incurred to fund bar exam preparation was dischargeable. Finding § 523(a)(8)(A)(i) and (B) inapplicable, the court looked to the language of § 523(a)(8)(A)(ii) under the general principle that all exceptions to discharge are to be interpreted narrowly, in favor the debtor. The statutory language of § 523(a)(8)(A)(ii) expresses that

¹² *Id.*

¹³ *Id.* at 8, 76.

¹⁴ *Id.* at 76.

there must be “an obligation to repay funds received as an education benefit, scholarship, or stipend.” The court noted the absence of the term “loans” under this subsection for the premise that educational benefits are not loans. The court applied a *noscitur a sociis* inquiry, to avoid surplusage, and opined, given that stipends and scholarships may not need to be repaid, educational benefits are similarly unconditional. The loan at issue here was thus deemed dischargeable because it did not satisfy § 523(a)(8)(A)(ii) as its repayment was unconditional.

2. A Broad Construction of the Term “Funded” Failed to Adhere to Congressional Intent to Narrowly Construe Exceptions to Discharge. *In re Page*, 592 B.R. 334, 336 (B.A.P. 8th Cir. 2018)

The B.A.P. reversed and remanded the bankruptcy court’s summary judgment order in favor of the student loan creditor. The court did not question that the loan was an “educational loan” as contemplated by § 523(a)(8), however, it questioned whether the bankruptcy court erred in drawing an inference that a non-profit organization (“TERI”) “funded” the loan program in which the debtor applied for loans to attend community college. The specific inquiry centered on whether the court erred in its analysis of whether TERI “funded” the loan program when the only role mentioned by the bankruptcy court was that “TERI served in a plenary or near-plenary capacity as the sole entity to which loan documents were submitted to the Loan Program by regular mail or overnight delivery.” The evidence was sparse; it was unclear whether TERI received all loan applications and it was not evident how the debtor submitted its loan documents. The court held that the evidence failed to reflect that TERI funded the loan program and that the lower court’s broad definition of the term “funded” contradicted the narrow construal of exceptions to discharge.

3. Parents’ Loan to Son’s Ex-Fiancé used to Pay Off her Student Loans was not an “Educational Loan” and was Dischargeable. *In re Conklin*, No. 18-30263, 2019 WL 4023822 (Bankr. W.D.N.C. Aug. 26, 2019)

Parents of soon-to-be-married son loaned his fiancé money to pay off her high-interest student loans. The initial agreement was an oral agreement for repayment, but when the couple broke off the engagement, the debtor signed a promissory note. The note made no reference to the loan as an educational loan, but the parents sought the loan be deemed non-dischargeable pursuant to § 523(a)(8)(B). The parents argued that the debt was an indebtedness to them to refinance indebtedness which qualified as a qualified loan under § 221(d) of the IRS Code. The court analyzed the plain language of

the statute and in this analysis, concluded that a two-part inquiry was necessary to determine what an “educational loan” was: (1) was this a loan and (2) was it an “educational loan?” There was no dispute that this was a loan however, the character of the loan, its nature, was to help the lenders’ son and his future (ex) fiancé with their debts. The purpose was not for the loan to be used for the debtor’s education, housing, or tuition. The court also found that legislative history and public policy favored finding the loan dischargeable. The legislative goal of non-dischargeability and student loans was to protect the financial integrity of educational loan programs, not parent-lenders. Last, the court looked to the “substance of the transaction test” and reasoned that because the parents’ purpose of extending the loan was personal, not educational, the loan was not an “educational loan.”

Undue Hardship

Given the ambiguity of “undue hardship” and Congress’ lack of guidance, Circuit courts apply one of two tests to determine whether re-payment of the student loan debt would pose an “undue hardship” upon the debtor.¹⁵ First, is the *Brunner* test, out of the Second Circuit.¹⁶ This widely-adopted test¹⁷ requires:

“(1) that the debtor cannot maintain, based on current income and expenses, a ‘minimal’ standard of living for herself and her dependents if forced to repay the loans;

(2) that additional circumstances exist indicating 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.”¹⁸

To succeed in showing that re-payment of a student loan would pose an “undue hardship,” the debtor must satisfy all three prongs.¹⁹

¹⁵ *Id.*

¹⁶ *Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F.2d 395, 396 (2d Cir. 1987).

¹⁷ Legislative Update, *supra* note 7, at 76 (stating that nine Circuits apply the *Brunner* test).

¹⁸ *Brunner*, 831 F.2d at 396.

¹⁹ *See generally Brunner*, 831 F.2d 395.

The second test, out of the Eighth Circuit, is the totality-of-the-circumstances test.²⁰ This non-exhaustive test looks to

- “(1) the debtor's past, present, and reasonably reliable future financial resources;
- (2) a calculation of the debtor's and her dependent's reasonable necessary living expenses; and
- (3) any other relevant facts and circumstances surrounding each particular bankruptcy case.”²¹

“Simply put, if the debtor's reasonable future financial resources will sufficiently cover payment of the student loan debt - while still allowing for a minimal standard of living - then the debt should not be discharged.”²² “Because this test allows courts to consider additional circumstances, does not require debtors to show additional circumstances and does not require debtors to show good-faith efforts to repay the loans...[this test]...is generally considered a more lenient test.”²³ Nonetheless, application of the *Brunner* test in the majority of Circuits makes discharging student loan debt near impossible.

Case Law Examining the Brunner Test:

- 1. No Undue Hardship when the Debtor could hold Gainful Employment, would Earn a Pension and Social Security Income in Short Time, and Never Voluntarily Made a Payment Towards his Student Loan. *In re Shenk*, 603 B.R. 671 (Bankr. N.D.N.Y. 2019)**

Fifty-nine-year-old debtor sought his loans discharged pursuant to § 523(a)(8). Prior to attending university, the debtor served in the army. At the time of this proceeding, he was unemployed, however, he previously held and worked “blue-collar” positions. The debtor had four children and owed child support to his ex-wife. The debtor also admitted taking \$10,000 out of his 401(k) to buy a motorcycle

²⁰ *Long v. Educ. Credit Mgmt. (In re Long)*, 322 F.3d 549, 554-55 (8th Cir. 2003).

²¹ *Id.* at 554 (citations omitted).

²² *Id.* at 554-55.

²³ Legislative Update, *supra* note 7, at 76 (citing Sarah Eldstrom Smith, *Should the Eighth Circuit Continue to Be the Lone Ranger? A Look at the Totality-of-the-Circumstances Test for Discharging Student Loans Under the Undue Hardship Exception in Bankruptcy*, 29 *HAMLIN L. REV.* 601, 633 (2006) (describing totality-of-the-circumstances test as a more lenient test)).

and musical instruments. Pursuant to the *Brunner* test, to hold a student loan non-dischargeable, it must be shown “(1) that the debtor cannot maintain, based on current income and expenses, a ‘minimal’ standard of living for [him]self and [his] dependents if forced to repay the loans; (2) that additional circumstances exist indicating 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.” The court held that the debtor satisfied the first prong because he was unemployed and was not yet receiving his pension and social security benefits. As to the second prong however, the court reasoned that the debtor could obtain gainful employment and that he was actively pursuing this goal. The debtor would also soon earn additional income from his pension and Social Security. There was no evidence that the debtor’s current financial status and unemployment would endure. Last, the debtor failed to show that he made a good faith effort to repay his student loan debts given that he never made a voluntary payment. As such, the loan was non-dischargeable.

2. No Undue Hardship when the Debtor Qualified for Income-Based Monthly Student Loan Payments Between \$63-\$94 and Spent Between \$290-\$550 a Month on Non-Essentials. *In re Murrell*, 605 B.R. 464 (Bankr. N.D. Ohio 2019)

The creditor, a student loan lender, filed a motion for summary judgment on the grounds that the debtor failed to satisfy the *Brunner* “undue burden” test to have his student loans discharged. Due to an alleged injury, the debtor was unemployed for nine years. Following his injuries, the debtor incurred student loan debt and enrolled in numerous educational institutions. The debtor completed one of three programs he enrolled in and argued that the one program he did complete did not provide him with the skills needed to succeed in the workforce. While the debtor stated that finding employment was challenging due to his injuries, a physician’s examination indicated that he could hold a sedentary level of work for eight hours. As to income, the debtor earned Social Security income and his wife worked. Together, they earned an adjusted gross income of \$32,893. While the debtor never made a student loan payment, he qualified for an income-based repayment option of \$63-\$94 per month. Further, the debtor’s expenses showed that he paid between \$290-\$550 a month for tv, internet, and phone. The court applied the first element of the *Brunner* test: that the debtor could not maintain, based on current income and expenses, a “minimal” standard of living. This prong entitles a debtor to maintain a minimal standard of living, permitting payments for food, shelter, medical care and transportation before being required to repay student loan debt.

Applying the debtor's income and expenses to the first prong, the court found (a) that the debtor's household income was well above the 2018 poverty guidelines, (b) the debtor could feasibly pay a monthly payment to the student loan lender based on an income-based repayment plan, and (c) that the debtor could adjust his recreational expenses to have funds available for the loan repayment. Given that the debtor could not satisfy the first prong of the three-prong *Brunner* test, the court granted the summary judgment motion.

3. Partial Discharge of the Debtor's Private Student Loans was Warranted when the Debtor could not Maintain a Minimal Standard of Living if Required to Re-Pay the Loan in Full, when the Debtor could Afford a Partial Payment if she Eliminated or Lowered her Unnecessary Expenses, when the Debtor's Future Financial Affairs would Persist for a Significant Period of the Repayment Period, and when the Debtor made Good Faith Efforts to Repay the Student Loan Debt. *In re Nitchev*, No. AP 18-03090-PCM, 2019 WL 4010810 (Bankr. D. Or. Aug. 23, 2019)

The debtor incurred significant government and private student loans to attend law school. Prior to this proceeding, the debtor agreed to repay her federal debt in an income-based repayment plan. At issue here were three private loans held by "NC." The debtor, a thirty-eight-year-old woman with no dependents struggled to find employment after graduation and eventually found steady employment in a small criminal defense firm. The debtor's wages steadily increased from 2010 to the sum of \$69,398 in 2018. The debtor had no nonexempt assets, owned no real estate, and drove an old car. The court applied the "undue hardship" *Brunner* test to determine whether the private student loans were dischargeable in full or in part pursuant to § 523(a)(8). First, the court looked to whether the debtor would have an ability to maintain a minimal standard of living if required to repay this debt. The court analyzed the debtor's income and expenses and concluded that even if the debtor eliminated or lowered two of her non-essential expenses, she could not maintain a minimal standard of living if required to repay the loans. The court noted the private nature of the loans and that any repayment or restructuring would be subject to the unilateral discretion of NC. The court also showed concern that the loans had all matured or were accelerated; indicating that NC could garnish 25% of the debtor's net income. The debtor's budget could not withstand this garnishment. The court found the first prong satisfied.

As to the second prong, whether the debtor's finances would persist for a significant portion of the repayment period, the court noted that the debtor had no medical issues, no dependents, was well-educated, and was young. Nonetheless, the court acknowledged market

conditions, the debtor's heavy work-week hours, and that working in a small criminal firm did not set the debtor up for higher pay. Further, looking to the repayment period, the court reasoned that the term of the loans was seven years and that five years constituted a significant portion. Given that the debtor's financial circumstances were unlikely to change in five years, the court found the second prong satisfied. And last, as to the debtor's good faith efforts to repay the debt, the court noted that she incurred significant credit card debt to pay her loans and that she voluntarily entered a twenty-five-year repayment plan on her federal loan. The court held the last prong satisfied. The court did not hold that full discharge was warranted however, given that the debtor would likely earn slightly more income and that she could minimize two unnecessary expenses. The court thus ordered the debtor to pay \$150 towards the private loan for 110 months and ordered any amount over \$16,500 be discharged.

Case Law Examining the Totality-of-the-Circumstances Test:

- 1. Discharge of Wife's Student Loan and Some of Husband's Student Loans was Warranted when the Wife Had Little Ability to Earn Enough Income to Repay her Loan, when the Husband Worked a Low-Paying Job, and when their Budget Showed Expenses could be Minimized with Excess Funds Being Available to Repay some of the Loans. *In re Swafford*, 604 B.R. 46 (Bankr. N.D. Iowa 2019)**

Co-debtors, Joshua and Krystal, argued that their student loan debt posed an undue hardship. Krystal had one student loan and Joshua owed eight separate loans to three different lenders. Both debtors were in their mid-thirties, lived with their three children, and all lived on Joshua's income of \$49,500 before taxes. Krystal occasionally worked as a waitress but was unemployed at the time of this proceeding. Joshua incurred some student loan debt to obtain his psychology degree and both Joshua and Krystal incurred student loan debt to enroll in a nursing program in which they both failed. Krystal also owed domestic support obligations for children she had before marrying Joshua and any paycheck she earned was subject to garnishment. In the Eighth Circuit, the totality-of-the-circumstances test applied and pursuant to this test, a court looks to (1) the debtor's past, present, and reasonably reliable future financial resources; (2) the debtor's reasonable and necessary living expenses; and (3) any other relevant facts and circumstances. And while partial discharge is not permitted, the court may look to each individual loan to find whether repayment of that loan would pose an undue hardship.

The court first analyzed the debtors' income separately. As for Joshua, the court noted his steady employment and while he

received minimal promotions, no promotion was foreseeable. As for Krystal, her on and off employment would likely not result in obtaining a well-paying job and any income earned, would be garnished. As to the second element, the debtors did not live unreasonably, but some recreational and food expenses could be minimized. Last, the court looked to whether the debtors could make any significant contribution under a \$0 income-based repayment plan and found that, not only could they not make meaningful contribution, but that the debt would increase. The court ordered Krystal's loan discharged and ordered all but three of Joshua's loans discharged. The court found that some of the debtors' expenses could be minimized and that the extra savings could be applied to Joshua's three smallest loans.

2. A Debtor's Poor Health and Yearly Income at or below \$25,000 Warranted Discharge of Student Loans under a Totality-of-the-Circumstances Analysis. *In re Schatz*, No. 14-30835-EDK, 2019 WL 5106434 (Bankr. D. Mass. Oct. 2, 2019)

On remand from the First Circuit B.A.P., the bankruptcy court applied a totality-of-the-circumstances test to hold that because (a) the debtor's income, post-law-school never exceeded \$25,000, (b) the debtor lived a "spartan lifestyle not susceptible to further reduction of necessary expenses," and (c) the debtor had extensive medical and dental problems, excepting the student loans from discharge would pose an undue hardship. If the loan were except from discharge, the debtor would be required to pay \$1,000 towards the loan. The court found, based on the debtor's work and health problems, she could not afford this payment. The debt was thus discharged pursuant to § 523(a)(8).

Recommendations

Absent Congressional Amendment:

Given the "up-hill battle" debtors face under the *Brunner* test, the ABI Commission on Consumer Bankruptcy issued a Final Report suggesting that, absent congressional amendment, the *Brunner* test should solely require the debtor to establish:

"(i) the debtor cannot pay the student loan sought to be discharged according to its standard ten-year contractual schedule while maintaining a reasonable standard of living,

(ii) the debtor will not be able to pay the loan in full within its initial contractual payment period...during the balance of the contractual term, while maintaining a reasonable standard of living, and

(iii) the debtor has not acted in bad faith in failing to pay the loan prior to the bankruptcy filing.”²⁴

Recommendations for Amendment:

- (1) Amendment to 11 U.S.C. § 523(a)(8) to “except from discharge only student loans that (A) were made, insured, or guaranteed by a governmental unit, (B) were incurred for the debtor’s own education, and (C) absent a showing of undue hardship, first became payable less than seven years before the bankruptcy case was filed, regardless of any suspension of payments.”²⁵
- (2) Congress could further amend 11 U.S.C. § 507(a) to add an “eleventh priority for claims excepted from discharge under § 523(a)(8).”²⁶

Chapter 13 and Separate Classification

Once a bankruptcy case is filed, if the debtor is not in default on student loan payments, the Department of Education (“DOE”) and the student loan servicer will place the debtor’s loan into “administrative forbearance” status to comply with the automatic stay.²⁷ The DOE will then suspend collection efforts and will not send any communication to the debtor until a discharge is entered or the case is dismissed.²⁸ Interest continues to accrue on non-dischargeable loans in “administrative forbearance.”²⁹ And while the student loan creditor may receive small sums from the plan’s distribution to unsecured creditors, if the sum is not sufficient to cover the monthly amount due, the loan may go into default status.³⁰ Because the debtor will not know about the

²⁴ Final Report, *supra* note 2, at 2.

²⁵ *Id.* at 1.

²⁶ *Id.*

²⁷ Amanda L. Anderson & Mark A. Redmiles, *Federal Student Loan debt in Bankruptcy: Recent Movement Towards Income-Driven Repayment Plans in Chapter 13*, 66 U.S. Attorney’s Bulletin, at 62 (March 2018).

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

default as a result of the “administrative forbearance,” once the case is closed, the debtor may soon find that the student loan debt is even higher than it was prior to the bankruptcy filing.³¹

“Debtors who propose a repayment plan under chapter 13 find it very difficult to repay meaningful distributions to student loan creditors during the course of a chapter 13 plan.”³²

Pursuant to 11 U.S.C. § 1322(b)(1), a debtor’s chapter 13 plan may

“designate a class or classes of unsecured claims, as provided in section 1122...but may not discriminate unfairly against any class so designated; however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims.”³³

Section 1122(a) “requires that all claims within a class (1) be ‘substantially similar,’ (2) either secured or unsecured, and (3) share the same priority.”³⁴

Thus, “[d]istinguishing differences between creditors’ claims and treating some better than others is acceptable in bankruptcy if it is ‘not unfair.’”³⁵ “Unfair means not just or impartial; biased; inequitable.”³⁶ As it relates to student loans and separate classification, debtors face a “hard sell” and it is their burden of proof at confirmation to show that the plan does not unfairly discriminate.³⁷ “Unless the chapter 13 debtor can show that discriminatory treatment between similarly situated creditors is necessary for the debtor to successfully complete his chapter 13 plan, separate classification of student loans and other general unsecured claims is seldom permitted.”³⁸

³¹ *Id.*

³² Legislative Update, *supra* note 7, at 76.

³³ 11 U.S.C. § 1322(b)(1).

³⁴ Hon. Robert E. Nugent III, *Dicta: Creative Classification in Plans*, 37 AM. BANKR. INST. J. 6, 30 (June 2018) (citing 11 U.S.C. § 1122(a)).

³⁵ *Id.*

³⁶ *Id.* (citing Webster’s New American Dictionary, 2d College Ed. (1970), p. 1550).

³⁷ *Id.* at 31.

³⁸ Legislative Update, *supra* note 7, at 77 (citing *Groves v. LaBarge (In re Groves)*, 39 F.3d 212, 215 (8th Cir. 1994)).

Case Law Examining Separate Classification of Student Loans in Chapter 13 Plans

1. Separate Classification of a Student Loan Co-Signed with the Debtor's Daughter Unfairly Discriminated Other General, Unsecured Creditors. *In re Morrison*, No. 18-05791-5-DMW, 2019 WL 4732375 (Bankr. E.D.N.C. Sept. 26, 2019)

The debtor's chapter 13 plan proposed to pay Wells Fargo, holder of a co-signed loan, in full, as a separately classified, unsecured claim. Prior to this case, the debtor co-signed a loan with her daughter to pay for university tuition. Per the terms of the loan, the loan would remain in deferment, albeit accruing high interest, until the daughter graduated. Under the debtor's proposed plan, all other general unsecured claims would receive 13% dividend over the life of the plan. However, if Wells Fargo's claim was not separately treated, all unsecured creditors, including Wells Fargo, would receive 25%. In support of her argument that the co-signed debt could be treated separately, the debtor cited 11 U.S.C. § 1322(b)(1) and argued that unfair discrimination is not prohibited if the separate classification is the debtor's consumer debt for which another person is liable. The court found fault with this argument because the daughter, not the debtor, received the benefit of the debt. The court looked to legislative history which made clear that when a debtor extended his credit to help a co-signer, there was no moral obligation to repay the debt. However, if the debt was incurred for the benefit of the debtor, there was such a moral obligation to repay. Here, the court opined that, not only would the debtor not benefit from the debt, but also reasoned that no payments were due under the terms of the loan. Simply, there was no default. As a result, the court found the plan unconfirmable because its treatment of Wells Fargo was unfairly prejudicial.

2. Unfair Discrimination is Present when a Chapter 13 Plan Proposed Discrimination that "Alters the Allocation of Benefits and Burdens to the Detriment of One Class." *In re Kane*, 603 B.R. 491 (Bankr. D. Kan. 2019)

Sixty-six percent of the debtor's unsecured debt was student loan debt. The debtor proposed a plan which altered the priority of payment so that the student loan debt would be paid after administrative expenses and secured and priority creditors, but before other unsecured creditors. The trustee objected pursuant to § 1322(b)(1). The trustee argued that if the debtor's student loan claims were paid pro rata with the other unsecured debts, the pro rata share to all creditors would be 71.03%. If, however, the student loan was paid 100% from the net pool before funds went to the other unsecured creditors, the unsecured creditors would only receive 13.84%. To find whether this discrimination was unfair, the court

looked to how other courts in the district analyzed unfair discrimination and separate classification and weighed four factors: (1) equality of distribution; (2) nonpriority of student loans; (3) mandatory versus optional contributions; and (4) the debtor's fresh start. As to factors (1) and (3), the court noted that there obviously was no equality of distribution and there were no additional funds contributed beyond what the bankruptcy code required. As to factor (2), the court reasoned that there was no reason to treat the student loan debt more favorably than other general, unsecured debt, as student loans are also nonpriority. And last, as to factor (4), the court found this factor to weigh in favor of the debtor's plan because the debtor's fresh start would be hampered by disallowing separate classification. Nonetheless, given that three factors weighed in favor of disallowing separate classification due to unfair discrimination, the court did not approve the debtor's plan.

3. When a Chapter 13 Plan does not Propose Separate Classification of a Student Loan from other Nonpriority, Unsecured Debt, there can be no Unfair Discrimination. *In re Wood*, No. 18-31268-BPC, 2018 WL 6060305 (Bankr. M.D. Ala. Nov. 19, 2018)

The trustee objected to debtor's proposed plan and argued unfair discrimination existed because the plan did not separately classify a student loan. The trustee argued that failure to separately classify the student loan would result in the general, unsecured creditors receiving less than 10%. The court analyzed § 1322(b)(1) and § 1122(a) and noted the permissive language of both statutes. The court reasoned that nothing in the code required a debtor to discriminate between unsecured creditors even if failing to do so resulted in a smaller return to the unsecured creditors. Further, the court reasoned that discrimination meant that a distinction was made between two things and here, the debtor did not make any distinction. The court held that the trustee's argument failed as there was no separate classification and nothing in the code required the debtor to discriminate her student loan debt from the other unsecured, nonpriority debts.

Recommendations

Absent Congressional Amendment:

Recommended by the ABI Commission:

“Section 1322(b)(1) should be interpreted to allow separate classification and payment of nondischargeable student loans at a higher dividend than other general unsecured claims as long as the other unsecured claims are paid at least as much as is required under

the best interest test of § 1325(a)(4), including cases where the best interest test would not require any payment.”³⁹

Concerned that precedent may prohibit such an interpretation of current law, the ABI Commission also suggests the following interpretations:

- “(i) If another person is liable for payment of a nondischargeable student loan, § 1322(b)(1) should be interpreted to allow a plan to provide for its payment at a higher rate than other general unsecured claims, as long as the other unsecured claims are paid at least as much as is required under the best interest test of § 1325(a)(4), including cases where the best interest test would not require any payment;
- (ii) Section 1322(b)(5), providing for the cure and maintenance of long-term unsecured claims, should be interpreted to apply to student loans; and
- (iii) Section 1322(b)(10), disallowing payment of interest on nondischargeable debts, should be interpreted as not applying to claims being treated under § 1322(b)(5).”⁴⁰

Recommendations for Amendment:

- Congressional revision to § 1322(a) “to allow the plan to provide for less than full payment of all amounts owed for a claim entitled to the student loan priority only if the plan provides that all of the debtor’s projected disposable income for a five-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.”⁴¹
- Amendment to § 1322(b)(10) to “provide that it does not apply to priority unsecured debts.”⁴²

Higher Educational Institutions

The Three Providers:

³⁹ Final Report, *supra* note 2, at 2.

⁴⁰ *Id.*

⁴¹ *Id.* at 1.

⁴² *Id.*

The structure of higher education can be separated into three providers: private, not-for-profit schools (e.g. Yale or Columbia), public schools (e.g. Pennsylvania State University or Rutgers, the State University of New Jersey), and private, for-profit schools, (e.g. the University of Phoenix).

“[P]rivate not-for-profit schools are the most common type of higher education schools in the country.”⁴³ They typically have one or two campuses and the organizational structure is generally uniform: while these schools are run by a CEO in the form of a president or chancellor, the board of trustees holds the legal authority.⁴⁴ A charter granted by the state in which the school operates controls and it is state law which vests authority in the board.⁴⁵ Trustees cannot be removed by “outsiders” and while they may have term limits, the trustees choose their successors.⁴⁶ Hence, “[w]hile trustees take their jobs seriously, they do not have to worry about removal by an outside group that believes the organization needs to rethink its current operating plans.”⁴⁷

While the number of private schools is higher than public institutions, about four times as many students attend public school than private, not-for-profit institutions.⁴⁸ Further, while public schools are similar to private, not-for-profit schools, in that they are led by a president or chancellor, have layers of internal organization, and are under the authority of a board, public schools receive funding from the public fisc and the board “make-up” is significantly different.⁴⁹

⁴³ Robert K. Rasmussen, *Lessons for Academic Leaders from Modern Restructuring Practice*, 92 AM. BANKR. L.J. 233, 237 (2018) (citing *Characteristics of Degree-Granting Postsecondary Institutions*, National Center for Education Statistics (May 2017), https://nces.ed.gov/programs/coe/indicator_csa.asp).

⁴⁴ *Id.* at 237-39.

⁴⁵ *Id.* at 237.

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.* at 238 (citing National Student Clearinghouse Research Center, Term Enrollment Estimates: Spring 2017 4, <https://nscresearchcenter.org/wp-content/uploads/CurrentTermEnrollment-Spring2017.pdf>).

⁴⁹ *Id.* at 238-39.

For the majority of states, an elected official appoints the board of a public school; however, in a minority of states, voters directly elect the members.⁵⁰ Either way, the board is connected to state voters and the threat of removal lingers.⁵¹ Additionally, public universities, some with campuses state-wide, tend to be more diverse than private, not-for-profit institutions.⁵²

Private, for-profit schools are organized akin to private, not-for-profit institutions in that they are led by a CEO who answers to the authority of the board.⁵³ The company's shareholders may nominate and remove the board's directors.⁵⁴ Notably different from private, not-for-profit institutions, investors fund for-profit schools and expect returns on their investments:

“[t]he motivations of those who enter this investment arena may be laudable - providing education to more people at a lower price - but the returns they seek are financial as well. The cheerleaders for these schools embrace the profit motive. For them, it is market discipline spurred by potential financial rewards that emboldens the risk taking that will lead to new, innovative, and disruptive ways of delivering education.”⁵⁵

Also dissimilar from private, not-for-profit schools, for-profit schools operate either on a single-campus basis or on a multi-state level.⁵⁶ For example, the University of Phoenix has numerous campuses across several states and where “the University of Phoenix has closed over one hundred of its campuses with a single decision to streamline its operations[,]” only “three to five private, not-for-profit schools have closed on an annual basis in recent years. . . .”⁵⁷

⁵⁰ *Id.* at 239.

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.* at 239-40.

⁵⁶ *Id.* at 240.

⁵⁷ *Id.* (citing Joseph Flaherty, *University of Phoenix Phasing Out Campuses; Current Students Not Affected, School Says*, Phoenix New Times, Sept. 25, 2017, <http://www.phoenixnewtimes.com/news/university-of-phoenix-phasing-out-more-campuses-9722920>).

Interplay Between the Bankruptcy Code and the Higher Education Act

While the bankruptcy code does not prohibit colleges from reorganizing in bankruptcy, “colleges face ‘an effective death sentence’⁵⁸ if they file bankruptcy because doing so renders an institution ‘ineligible to participate in the federal financial aid programs.’”⁵⁹ As it stands, the code provides no meaningful relief for higher educational institutions looking to restructure debts and continue to educate.⁶⁰

Pursuant to 20 U.S.C. § 1002(a)(4)(A) of the Higher Education Act, “[a]n institution shall not be considered to meet the definition of an institution of higher education...if the institution...has filed for bankruptcy. . . .”⁶¹ “Given that financial aid is the lifeblood of nearly all colleges, terminating a college’s eligibility to participate in the federal financial aid programs effectively precludes colleges from reorganizing under federal bankruptcy law.”⁶² To illustrate, ITT Educational Services, a fifty-year-old, for-profit education provider lost federal financial aid funding and within two weeks, closed its doors.⁶³

An unrectified tension exists between the Higher Education Act and the bankruptcy code. At first blush, 11 U.S.C. § 525(a) appears to protect higher education institutions from losing Title IV eligibility if a bankruptcy petition is filed. Section 525(a) provides:

“a governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to, condition such a grant to, discriminate with respect to such a grant

⁵⁸ Matthew Adam Bruckner, *Bankrupting Higher Education*, 91 AM. BANKR. L.J. 697, 698 (2017) (citing Joseph H. Smolinsky, *For-Profit Education Institutions Face a Volatile and Uncertain Future*, Weil Bankruptcy Blog (Jan. 8, 2016), <http://business-finance-restructuring.weil.com/uncategorized/forprofiteducation-institutions-face-a-volatile-and-uncertain-future-2/> (discussing for-profit colleges)).

⁵⁹ *Id.* (citing 20 U.S.C. § 1002(a)(4)(A)) (further citations omitted).

⁶⁰ Rasmussen, *supra* note 43, at 233.

⁶¹ 20 U.S.C. § 1002(a)(4)(A).

⁶² Bruckner, *supra* note 58, at 698 (citing Scott Norberg, *Bankruptcy and Higher Education*, 23 AM. BANKR. INST. L. REV. 385, 387 (2015)).

⁶³ Rasmussen, *supra* note 43, at 234 (citing Danielle Douglas-Gabriel, *ITT Technical Institutes Shut Down After 50 Years in Operation*, WASH. POST, Sept. 6, 2016, https://www.washingtonpost.com/news/grade-point/wp/2016/09/06/itt-technical-institutes-shut-down-after-50-years-in-operations/?utm_term=.5440745c095c).

against, deny employment to, terminate the employment of, or discriminate with respect to employment against, a person that is or has been a debtor under this title or a bankrupt or a debtor under the Bankruptcy Act, or another person with whom such bankrupt or debtor has been associated, solely because such bankrupt or debtor is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, has been insolvent before the commencement of the case under this title, or during the case but before the debtor is granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act.”⁶⁴

“Section 525(a) was enacted to protect debtors from discriminatory treatment by the government because of the bankruptcy filing.”⁶⁵ Notwithstanding the code’s “fresh start” policy, two courts⁶⁶ have held this policy overridden by Congress’ decision to deny a higher education institution access to Title IV programs if it files bankruptcy.⁶⁷ It is the Higher Education Act, not the bankruptcy code, that requires amendment to permit a higher education institution to maintain Title IV access while in bankruptcy.⁶⁸

America’s higher education institutions, confronted with greater competition to attract students and reacclimate to accommodate expensive technological advances, are facing greater financial strain.⁶⁹ To illustrate, 763 institutions of higher education closed in 2016 alone.⁷⁰ Also plaguing colleges and universities are unsustainably high fixed costs.⁷¹ Prior to its abrupt closure in 2015, Corinthian Colleges, Inc. rapidly expanded from 49 campuses and 20,000 students to 100

⁶⁴ 11 U.S.C. § 525(a).

⁶⁵ Bruckner, *supra* note 58, at 714 (citing 11 U.S.C. § 525(a)).

⁶⁶ *In re Betty Owen Schools, Inc.*, 195 B.R. 23, 31 (Bankr. S.D.N.Y. 1996); *In re Lon Morris College*, Case No. 12-60557 (Bankr. E.D. Tex. filed July 2, 2012).

⁶⁷ Bruckner, *supra* note 58, at 714-15.

⁶⁸ Matthew Adam Bruckner, *Terminating Tenure: Rejecting Tenure Contracts in Bankruptcy*, 92 AM. BANKR. L.J. 255, 260 (2018).

⁶⁹ Bruckner, *supra* note 58, at 701 (citations omitted).

⁷⁰ *Id.* at 700 (citing Kate Smith, *Here's What Happens to Endowments When Colleges Close*, Bloomberg, Mar. 6, 2017, available at <https://www.bloomberg.com/news/articles/2017-03-06/orphan-endowments-of-dead-schools-bedevil-states-across-america> (citing figures from the U.S. Department of Education)).

⁷¹ *Id.* at 701-02.

campuses and enrollment of 74,000 students.⁷² Implosion of colleges like Corinthian and Anthem Education Group (both for-profit colleges), impacted, “more than one hundred thousand students, the U.S. Department of Education, every American taxpayer, bondholders, other creditors, employees, and communities.”⁷³

While private, for-profit colleges tend to be the focus of discussion when exploring unsustainable growth, public colleges and universities are also at risk, albeit for different reasons. Specifically, public higher education institutions are facing greater financial strain from budget cuts. To illustrate, in 2015, Louisiana State University prepared a financial exigency plan after the state’s governor proposed an 82% cut of the state’s contribution to the school.⁷⁴ Louisiana State University is not alone; in the wake of a 41% drop in state funding, the University of Alaska also declared a financial exigency declaration.⁷⁵

Financial strains are not likely to lessen given that there are limits as to how much tuition a student is willing to pay and how much budget trimming a college can do before sacrificing quality. It is expected that many colleges and universities in financial plight will either close or merge.⁷⁶

The problems students face when colleges and universities close are severe. When Shepherd University, a California non-profit corporation, closed its doors, thirty nurses, all near program completion, were unable to complete their degree.⁷⁷ Additionally, the school’s closure

⁷² *Id.* at 702 (citing See Sophia Yan, *Corinthian Colleges to Close All Remaining Campuses*, CNN, Apr. 27, 2015, available at <http://money.cnn.com/2015/04/26/news/corinthian-colleges-close/>).

⁷³ *Id.* at 704 (citations omitted).

⁷⁴ *Id.* at 705 (citing R. Kyle Alagood, *LSU's Possible 'Bankruptcy': The Bell Tolls for Louisiana Higher Education*, Huffington Post Blog (Apr. 27, 2015), http://www.huffingtonpost.com/r-kyle-alagood/lsus-possible-bankruptcy-b_7149140.html).

⁷⁵ Susan Svriuga, *University of Alaska declares financial emergency in face of deep budget cuts*, WASH. POST., July 23, 2019, available at <https://www.washingtonpost.com/education/2019/07/23/university-alaska-declares-financial-emergency-face-deep-budget-cuts/>.

⁷⁶ Bruckner, *supra* note 58, at 705 (citations omitted).

⁷⁷ Bruckner, *supra* note 68, at 260.

threatened the visa status of one hundred foreign students who, by their visa's requirements, were required to study at Shepherd University.⁷⁸ Transferring credits and discharging student loans are also hurdles for students when higher education institutions close. "Approximately forty-seven percent of students at closed colleges never transfer their credits to a new college nor receive a 'closed-school discharge' of their federal educational debt."⁷⁹ Simply, students once-enrolled in closed schools continue to carry the burden of debt without the reward of graduation. Unsurprisingly, students who shoulder student loan debt and fail to graduate are more likely to file bankruptcy.⁸⁰

Case Law Examining the Higher Education Act and the Bankruptcy Code

1. The General Provisions of 11 U.S.C. § 525(a) do not Override Congress' Unequivocal Exclusion of Schools that File for Bankruptcy from Participating in Federal Student Loan Programs. *In re Betty Owen Schools Inc.*, 195 B.R. 23 (Bankr. S.D.N.Y. 1996)

The debtor, a vocational school, filed for chapter 11 relief. Nearly all students enrolled in the school received federal funding. When the bankruptcy case was filed, the DOE informed the debtor that it would no longer receive federal funding; the debtor argued this action violated § 525(a). The court acknowledged that, on its face, this discrimination indeed violated the bankruptcy code, but that Congress "acted unequivocally to exclude schools which have filed bankruptcy from participating in federal student loan and grant programs." Analyzing legislative history, the court also reasoned that the policy favoring a "fresh start" was curtailed for debtor schools relying on federal funding. Per the court, this policy conserved resources for fiscally-healthy institutions. Simply, the express language of the Higher Education Act and the legislative history evidenced that debtor schools were not as entitled to a "fresh start" as other debtors.

⁷⁸ *Id.*

⁷⁹ *Id.* at 261 (2018) (citing Letter from Pauline Abernathy & Jennifer Wang, The Institute for College Access & Success, to the U.S. Department of Education (Aug. 1, 2016), available at ticas.org/sites/default/files/pub_files/ticas_detailed_bd_nprm_comments.pdf).

⁸⁰ *Id.* (citing Katherine M. Porter, *College Lessons: The Financial Risks of Dropping Out*, in *Broke: How Debt Bankrupts the Middle Class* 85-100 (Katherine M. Porter ed., 2012) (further citation omitted)).

The Liquidation of Corinthian Colleges, Inc.

Founded in 1995, Corinthian Colleges, Inc. was a California-based, for-profit higher education company.⁸¹ At the peak of its expansion, Corinthian enrolled 74,000 students, hired over 10,000 employees, and operated over 100 campuses in 25 states and Canada.⁸² When the company faced allegations of consumer fraud, predatory lending practices and falsification of grades, attendance, and job placement however, it was sued by the government, students, and shareholders.⁸³ “The company also faced state attorney general investigations, a United States Attorney criminal investigation, a Securities and Exchange Commission (SEC) investigation, a Congressional investigation, a forced sell-off, bankruptcy, and heavy fines from the [DOE].”⁸⁴ For example, the Consumer Financial Protection Bureau, in September 2014, sued Corinthian for \$500 million for its participation in an “illegal predatory lending scheme.”⁸⁵ In 2015, the DOE itself fined Corinthian Colleges \$30 million for “substantial misrepresentations” of job placement rates.⁸⁶

As a result of the numerous lawsuits and findings of misrepresentations and fraud, Corinthian eventually sold or closed all campuses and ceased student enrollment.⁸⁷ The abrupt

⁸¹ C. Tyler Flores, *Unprecedented Uncertainty: The Corinthian Colleges Debacle, the Department of Education's Response, and the Bankruptcy Practitioner's Dilemma*, 39 AM. J. TRIAL ADVOC. 651 (2016) (citing *Corinthian Colleges*, U.S. Senate Comm. on Health, Educ., Labor & Pensions at 379, http://www.help.senate.gov/imo/media/for_profit_report/PartII/Corinthian.pdf).

⁸² *Id.* at 651-52 (citing *Corinthian Colleges*, *supra* note 81).

⁸³ *Id.* at 652 (citations omitted).

⁸⁴ *Id.* at 652-53 (citations omitted).

⁸⁵ *Id.* (citing *CFPB Sues For-Profit Corinthian Colleges for Predatory Lending Scheme*, Consumer Fin. Prot. Bureau (Sep. 16, 2014), <http://www.consumerfinance.gov/newsroom/cfpb-sues-for-profit-corinthian-colleges-for-predatory-lending-scheme>).

⁸⁶ Michael Hiltzik, *In Corinthian Colleges fiasco, Education Secretary Betsy DeVos defines 'contempt of court,'* L.A. TIMES, Oct. 31, 2019, available at <https://www.latimes.com/business/story/2019-10-31/devos-contempt-of-court>.

⁸⁷ Flores, *supra* note 81 at 652-54 (citations omitted).

closure displaced 16,000 students.⁸⁸ Unable to find buyers for remaining un-sold campuses, the company filed bankruptcy.⁸⁹ Prior to approval of a liquidation plan, the DOE, encouraged by the Attorneys General of multiple states and numerous senators, “unveiled an ‘unprecedented,’ two-tiered, debt-relief program to forgive Corinthian students’ student loan debt.”⁹⁰ Once approved, the liquidation plan also included a \$2.5 billion claim from a private group of Corinthian students, a claim disputed by the DOE on the grounds it interfered with its debt forgiveness plan.⁹¹

For many for-profit colleges, including Corinthian, the target student population includes underprivileged and minority students:⁹²

“[Corinthian's] advertisements targeted poor and minority students, capitalizing on their desperation for jobs to get them on the phone with admissions representatives. Those salespeople used classic high-pressure tactics to sign them up for programs that were up to five times the price of similar offerings at a community college, and twice as much as a state university. One former employee called the tactics she had been taught ‘beyond deceptive and immoral.’ For many students, a major life decision that was meant to lift them out of poverty has left them more deeply entrenched in it.”⁹³

The high-pressure sales strategy employed by admissions representatives at Corinthian, included misrepresenting future job placements and salaries, telling students they would lose their “spot” in classes unless they immediately enrolled, and failing to fully explain how much debt they would incur.⁹⁴ The tactics perpetuated by for-profit schools such as Corinthian Colleges, contribute

⁸⁸ *Id.* at 655 (citing *Corinthian Announces Cessation of Effectively All Operations*, Corinthian Colleges, Inc. (Apr. 26, 2015), <http://www.cci.edu/update.php>).

⁸⁹ *Id.* (citing Dawn McCarty, *Corinthian Bankruptcy Caps Biggest U.S. Education Meltdown*, Bloomberg Bus. (May 4, 2015, 6:10 PM), <http://www.bloomberg.com/news/articles/2015-05-04/corinthian-colleges-files-for-bankruptcy-after-closing-schools>).

⁹⁰ *Id.* at 653-56 (citations omitted).

⁹¹ *Id.* at 656 (2016) (citing Matt Chiappardi, *Feds Slam Corinthian Students' Bid to Halt Collection Efforts*, Law 360 (June 23, 2015, 9:59 PM), <http://www.law360.com/articles/671594/feds-slam-corinthian-students-bid-to-halt-collection-efforts>).

⁹² *Id.* at 663.

⁹³ *Id.* at 664 (citations omitted).

⁹⁴ *Id.* at 665 (citations omitted).

to the high loan default rate of minorities. In a recent study performed by the Federal Reserve Bank of New York, student loan borrowers from predominately black neighborhoods are nearly twice as likely to default on their student loan debt as borrowers from predominately white neighborhoods.⁹⁵ The destructive strategy in charging exorbitant tuition, when combined with low graduation rates, perpetuates the racial wealth gap and prevents these students from escaping poverty.

The predatory strategy employed by Corinthian spurred the DOE to revisit the “defense to repayment” provision of the Higher Education Act and to take “unprecedented action to create a streamlined process that is fair to students who may have been victims of fraud and...holds colleges accountable to taxpayers.”⁹⁶ Whether this action indeed resulted in clear-cut, streamlined relief for Corinthian students is up for debate. For the 16,000 students who attended closed Corinthian schools, the DOE applied the “closed school discharge” provision, which would permit 100% discharge of the student loan debt.⁹⁷ For students to benefit from this provision, they must complete paperwork and await approval by the DOE.⁹⁸ Students of the closed schools also may transfer their earned credit, however, finding institutions to accept Corinthian credits is no easy task.⁹⁹ Pointedly, the DOE faced backlash and criticism when it released a list of schools willing to accept the credits and among the list were numerous for-profit schools under investigation by state or federal agencies.¹⁰⁰

⁹⁵ Jonnelle Marte, *Black student loan borrowers are defaulting at nearly twice the rate of whites: NY Fed*, Reuters, Nov. 13, 2019, available at <https://www.reuters.com/article/us-usa-fed-debt-race-idUSKBN1XN25M>.

⁹⁶ Flores, *supra* note 81 at 666 (citing *Fact Sheet: Protecting Students from Abusive Career Colleges*, U.S. Dep't of Educ. (June 8, 2015), <http://www.ed.gov/news/press-releases/fact-sheet-protecting-students-abusive-career-colleges>).

⁹⁷ *Id.* at 668 (citations omitted).

⁹⁸ *Id.* (citations omitted).

⁹⁹ *Id.* (citations omitted).

¹⁰⁰ *Id.* at 669-70 (2016) (citing Ashley A. Smith, *After the Collapse*, [redacted] Inside Higher Ed (Apr. 29, 2015) <https://www.insidehighered.com/news/2015/04/29/colleges-and-education-department-scramble-help-former-corinthian-students-amid>).

For students who remained in operable Corinthian Colleges, the DOE applied the “defense to repayment” provision and the results are even more murky, particularly for students outside of California.¹⁰¹ For this provision to apply, the student must assert that a college’s actions violated state law; in California, applicable to students who attended Heald College (a Corinthian College entity), the DOE found evidence of misrepresentation and that Heald violated California law.¹⁰² In response, the DOE developed an online form for these students to fill out; as such, Heald’s students, were not required to prove that they were defrauded.¹⁰³ Similarly, students in California who attended WyoTech, Everest College, or an Everest online program (in California) must only prove that “they attended a program covered by the agencies’ investigation” to be eligible for borrower defense relief.¹⁰⁴

While some students indeed received relief, student loan forgiveness for many Corinthian students remains uncertain. Recent changes in the DOE’s regulation of student loan forgiveness further complicate matters.

Amendments to the Protection of Student Borrowers and Taxpayers

In the wake of the closure of Corinthian Colleges, the DOE began the negotiation to enhance borrower protections, defend taxpayer dollars, and deter harmful practices by institutions. On October 28, 2016, the DOE announced the final regulations to protect borrowers and hold institutions accountable.¹⁰⁵ To achieve these goals, the new regulations:

¹⁰¹ *Id.* at 671.

¹⁰² *Id.* at 668 (2016) (citing *Fact Sheet supra* note 95).

¹⁰³ *Id.* (citing *Attestation for Certain Heald College Students Application Application for Borrower Defense to Repayment Loan Discharge*, U.S. Dep’t of Educ., <https://borrowerdischarge.ed.gov/FormWizard/RLD/RLDStep1.aspx?lang=en>).

¹⁰⁴ *Id.* at 672 (citing Kelly Field, *Agencies’ Finding Eases Path to Debt Relief for Some Corinthian College Students*, *The Chron. of Higher Educ.* (Nov. 17, 2015), <http://chronicle.com/article/Agencies-Finding-Eases-Path/234243>).

¹⁰⁵ Press Release, *U.S. Department of Education Announces Final regulations to Protect Students and Taxpayers from Predatory Institutions* (Oct. 28, 2016), available at <https://www.ed.gov/news/press-releases/us-department-education-announces-final-regulations-protect-students-and-taxpayers-predatory-institutions>.

- [Gave] borrowers access to consistent, clear, fair, and transparent processes to file claims;
- Empower[ed] the Secretary to provide debt relief to borrowers without requiring individual applications in instances of widespread misrepresentations;
- Protect[ed] taxpayers by ensuring that financially troubled institutions provide the government with protection against the risks they create and that institutions whose actions lead to discharges of Federal student loans are held responsible;
- Help[ed] students make more informed decisions by requiring proprietary schools with poor loan repayment outcomes to include a plain-language warning in their advertising and promotional materials;
- Ensured affected borrowers have information about loan discharge when schools close and access to an automated process; and
- Banned schools from inducing students to sign pre-dispute arbitration agreements that waive their rights to go to court and bring class action lawsuits based on borrower defense claims.¹⁰⁶

Among the most notable changes of the 2016 regulations was, for students who attended a school closed on or after November 1, 2013 and did not re-enroll in another Title IV institution within three years, the student loans were automatically discharged.¹⁰⁷ This regulation provided streamlined relief for eligible Corinthian students.¹⁰⁸ The regulations also banned all pre-dispute arbitration agreements (effectively prohibiting institutions from banning student class action suits) and protected taxpayer dollars by requiring institutions to “put up” collateral if at risk of closure.¹⁰⁹

¹⁰⁶ *Id.* (direct quotation).

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

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However, on August 30, 2019, the DOE announced new finalized regulations to protect student borrowers and hold higher education institutions accountable.¹¹⁰ Applicable to all federal student loans made on or after July 1, 2020, Betsy Devos, U.S. Secretary of Education, called for regulatory reform “as it became clear the old rules just weren’t working.”¹¹¹ The new regulations will:

- Grant borrowers the right to assert borrower defense to repayment claims against institutions, regardless of whether the loan is in default or in collection proceedings.
- Maintain the current rule's preponderance of the evidence standard for all borrower defense to repayment claims.
- Allow borrowers ample opportunity to file defense to repayment claims – three years from either the student's date of graduation or withdrawal from the institution.
- Create streamlined and fair procedures, regardless of the borrower's current repayment status, that ensure basic due process for all parties.
- Give students the ability to allege a specific amount of financial harm and to obtain relief in an amount determined by the Department, which may be greater or lesser than their original claim amount.
- Extend the closed school discharge window from 120 days to 180 days, ensuring that students have a meaningful opportunity to obtain relief if they cannot complete their programs due to school closures.
- Reduce precipitous closures by encouraging institutions to close only after the completion of well-planned teach-outs that allow students a reasonable opportunity to finish their programs.

¹¹⁰ Press Release: *U.S. Department of Education Finalizes Regulations to Protect Student Borrowers, Hold Higher Education Institutions Accountable and Save Taxpayers \$11.1 Billion Over 10 Years* (Aug. 30, 2019), available at <https://www.ed.gov/news/press-releases/us-department-education-finalizes-regulations-protect-student-borrowers-hold-higher-education-institutions-accountable-and-save-taxpayers-111-billion-over-10-years>.

¹¹¹ *Id.* (quoting U.S. Secretary Betsy Devos).

- Allow students to choose between accepting an institution's offer of a teach-out opportunity or submitting a closed school discharge to the Department.
- Provide fair, clear and verifiable financial triggers for recalculating an institution's financial responsibility composite score and triggering additional security to protect taxpayers.
- Update composite score calculations to reflect changes to Financial Accounting Standards Board (FASB) accounting standards.
- Provide taxpayers with a net federal budget savings over the 2020-2029 loan cohorts of \$11.1 billion, including \$9.8 billion for changes to the defense to repayment provisions and \$1.3 billion for changes related to closed school discharges.¹¹²

While the new regulations are touted to enhance borrower protections, the regulations are expected to make it more challenging for students who were harmed by institutional misconduct or closures to find student loan relief and to hold schools accountable.¹¹³ The DOE predicts that when implemented, the new regulations will reduce the student loan relief caused by school malfeasance and closure by \$512.5 million per year.¹¹⁴ Arguably, this will incentivize the predatory practices the 2016 regulations sought to end. To illustrate the consequences of the 2019 Rule, the SLBA (Student Loan Borrower Assistance), the Institute for College Access & Success (TICAS) and the Century Foundation, together, summarized ten ways the new regulations will hurt borrowers:

- (1) Relating to the time limit to file a borrower defense claim, where the 2016 Rule allots six years from discovery (or reasonably could have discovered) of the misrepresentation, the 2019 Rule generally requires all borrowers to file a claim within three years from when they left school.¹¹⁵

¹¹² *Id.* (direct quotation).

¹¹³ *Top 10 Ways New Rules on Borrower Defense, School Closures, and Arbitration are Worse for Borrowers*, Student Loan Borrower Assistance, Sept. 23, 2019, <https://www.studentloanborrowerassistance.org/top-10-ways-new-rules-on-borrower-defense-school-closures-and-arbitration-are-worse-for-borrowers/>.

¹¹⁴ *Id.*

¹¹⁵ *Id.*

- (2) Where the 2016 Rule permits automatic discharge of student loans for groups of borrowers when there is evidence of widespread malfeasance, the 2019 Rule requires each borrower to apply individually and prove the claim, regardless of evidence of widespread mistreatment.¹¹⁶
- (3) To qualify for loan discharge caused by misrepresentation, Rule 2016 requires a showing of substantial misrepresentation on which the borrower relied. Pursuant to Rule 2019 however, the borrower must satisfy the requirement of Rule 2016 *and also* show that “the school made the misrepresentation with knowledge that it was false, misleading or deceptive; or [t]hat the school acted with reckless disregard to the accuracy of the information; and [t]hat the borrower suffered specific types of financial harm.”¹¹⁷
- (4) To qualify for loan discharge, where the 2016 Rule did not require a showing of financial harm as a result of the misrepresentation, the 2019 Rule requires documents be provided to prove the borrower was financially harmed beyond the obligation to repay the debt and that the harm was not caused by the economy.¹¹⁸
- (5) Under the 2016 Rule, a judgment against the school or a breach of contract are both grounds for a borrower defense loan discharge. Under the 2019 Rule however, while judgments and breach of contract may be used as evidence to support a claim, neither are sufficient to receive a discharge.¹¹⁹
- (6) Where the 2016 Rule permits a borrower to seek reconsideration of a denied defense claim based upon new evidence not previously considered, denials under the 2019 Rule are final.¹²⁰
- (7) If a borrower has an approved defense to repayment claim, Rule 2016 provides no basis for the school to punish students. Rule 2019 permits schools to deny transcripts to and refuse to verify earned credits of students with successful claims.¹²¹
- (8) If a student attended a closed school, Rule 2016 explains that the student could complete a “teach-out” plan, transfer (if possible),

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ *Id.*

or have the student loans discharged. Automatic discharge without application by the borrower is performed if the student does not re-enroll in another school within three years. In contrast, Rule 2019 prohibits automatic discharge if the school closed on or after July 1, 2020. All students must file applications. Further, if the school “convinces” a borrower to participate in a “teach-out” plan, the borrower becomes ineligible for a closed school discharge.¹²²

- (9) Relating to whether a harmed borrower may go to court, where Rule 2016 expressly prohibits pre-dispute arbitration agreements or class-action waivers, it is unlikely, under Rule 2019 that a borrower may go to court. Rule 2019 reversed 2016 and allows schools, as a pre-condition for enrollment, to require students to sign mandatory pre-arbitration dispute arbitration agreements and class-action waivers.¹²³
- (10) Last, as to the question “how much will borrowers be helped?”, in 2016, the DOE estimated that \$17 billion in relief would be provided under the Rule to student harmed by closures and school misconduct. The DOE estimates that, under the 2019 Rule, 3% of the loans associated with misconduct will be cancelled.¹²⁴

Summarily, while the new regulations espouse a new wave of efficiency and protection, the 2019 Rule is not only less borrower-friendly, but it empowers misconduct and bestows unequal bargaining power upon educational institutions.

The 2019 Rule is just the latest hurdle for Corinthian students. In 2017, Secretary DeVos sought to limit the recovery of these borrowers by comparing the average earnings of students in similar vocational programs.¹²⁵ After denial of 8,600 claims of Corinthian students, DeVos reasoned that “applicants would receive full loan forgiveness if their earnings are less than 50

¹²² *Id.*

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ Danielle Douglas-Gabriel, *DeVos violated a court order to stop collecting on the debts of Corinthian College students. Now, they want her held in contempt*, WASH. POST., October 4, 2019, available at <https://www.washingtonpost.com/education/2019/10/04/devos-violated-court-order-stop-collecting-debts-corinthian-college-students-now-they-want-her-held-contempt/>.

percent of those of their peers. If their pay is at or above that threshold, the department would provide relief on a sliding scale.”¹²⁶ While Judge Kim of the U.S. District Court in San Francisco refrained from declaring the partial relief illegal, she held that using Social Security Administration data to calculate loan forgiveness was illegal and banned the DOE from this practice.¹²⁷ The DOE appealed and while awaiting the decision of the Court of Appeals for the Ninth Circuit, the DOE ceased processing debt relief claims; as of June, 2019, more than 210,000 applications for debt relief await decision.¹²⁸

Further exacerbating the plight of Corinthian’s former students, on October 24, 2019, Judge Kim found Secretary DeVos in contempt of court and fined the DOE \$100,000 for violating the court’s order to stop collecting on loans owed by Corinthian students.¹²⁹ The DOE billed 16,000 students and parents for payments they did not owe and in so doing, tarnished credit reports, garnished wages, and seized tax refunds.¹³⁰

A Brief Glance into the Financial Stability of the University of Puerto Rico

Puerto Rico’s financial stability was in flux long before 2017 Hurricanes Irma and Maria. The commonwealth’s economic history, intertwined with various congressional enactments, contributed to its present fiscal turmoil.¹³¹ As a recent illustration, following a ten-year phase-out of corporate tax benefits, manufacturers left the island and by the mid 2000’s, recession and

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ *Id.*

¹²⁹ Erica L. Green & Stacy Cowley, *Betsy DeVos is Held in Contempt Over Judge’s Order on Loan Collection*, N.Y. TIMES, Oct. 24, 2019, available at <https://www.nytimes.com/2019/10/24/us/politics/education-dept-loan-repayments-corinthian.html>.

¹³⁰ *Id.*

¹³¹ See Jill Dolan, *After the Storm: Hurricanes Irma and Maria and Puerto Rico’s Debt Restructuring*, 43 DEL. J. CORP. L. 347, 351-52 (2019) (for an in-depth discussion into numerous congressional influences and actions that influenced Puerto Rico’s economy) (citations omitted).

accumulated debt took hold.¹³² The manufacturer departure took with it well-paying jobs and when combined with other factors, roughly 10% of Puerto Rico’s population relocated to the mainland United States from 2007 to 2017.¹³³ Contributing to the financial crisis, are the commonwealth’s high poverty rate and its aging and costly infrastructure.¹³⁴

Ineligible to elect chapter 9 bankruptcy to permit restructuring of its publicly-owned utility companies,¹³⁵ Puerto Rico’s only option to improve its fiscal situation was to “enroll” in the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA), a congressional legislative solution.¹³⁶ Included in this legislation was the creation of a “Financial Management and Oversight Board” (Board), consisting of seven president-appointed members, who “provide a method for a covered territory to achieve fiscal responsibility and access to the capital markets.”¹³⁷ The Board’s powers are broad and include authority such as budget approval, access to official data from the federal government and Puerto Rico’s government, ability to bring civil actions to enforce its authority, enter into contracts, and access creditor and claim information.¹³⁸ Board members may also accept gifts and property, both real and personal, for performing their official duties.¹³⁹

As it relates to the University of Puerto Rico, the public institution is at the mercy of the Board’s fiscal decisions. To illustrate, under the Board’s oversight, “[t]he appropriation for the University of Puerto Rico’s operating expenses was slashed by \$86 million [in 2019], to about

¹³² *Id.* at 349 (citing Puerto Rico In Crisis Timeline, 1, 3-5, Centro--The Center for Puerto Rican Studies, Hunter College, City University of New York, https://centropr.hunter.cuny.edu/sites/default/files/PDF_Publications/Puerto-Rico-Crisis-Timeline-2017.pdf).

¹³³ *Id.* at 349-50.

¹³⁴ *Id.* (citations omitted).

¹³⁵ See *Puerto Rico v. Franklin California Tax-Free Tr.*, 136 S. Ct. 1938, 1949 (2016).

¹³⁶ Dolan, *supra* note 131, at 357-58 (citations omitted).

¹³⁷ *Id.* at 358 (citing 48 U.S.C. § 2121(a) (2016)).

¹³⁸ *Id.* at 358-59 (2019) (citations omitted).

¹³⁹ *Id.* at 359 (2019) (citing 48 U.S.C. § 2121(e) (2016)).

\$501 million, following on a \$44 million cut the year before that and a \$203 million cut the year before that.”¹⁴⁰ While nationally, disinvestment from public higher education is becoming more prevalent, for the University of Puerto Rico, the numbers are staggering: by 2022, state funding will be under \$400 million or 56% lower than historically funded.¹⁴¹ Hoping to ease the pressure caused by these cuts, the university’s tuition is going up.¹⁴²

Given the commonwealth’s poverty level of 44.4%, tuition hikes will place students and their families, who are already struggling financially, into deeper debt.¹⁴³ The University of Puerto Rico is recognized as the island’s “main vehicle of upward social mobility.”¹⁴⁴ With the raise in tuition however, access to quality education will be uncertain for many Puerto Rican students.

Further exacerbating Puerto Rico’s social and economic plight post-Hurricane Maria, when numerous United States colleges and universities offered guest programs for Puerto Rican students affected by the storm, federal aid that would normally go to schools in Puerto Rico, went to schools in the United States.¹⁴⁵ Specifically, the host schools received large portions of federal aid allocated for hurricane victims; out of \$41 million in emergency relief funds paid out by the DOE, only \$8.9 million benefitted higher education in Puerto Rico.¹⁴⁶ Money that could have gone towards rebuilding the University of Puerto Rico, went to other schools.¹⁴⁷ And while the president of the University of Puerto Rico, Jorge Haddock, expressly discounted that the cuts in funding negatively impact(ed) the quality or access to the school, professors and staff at the school are not

¹⁴⁰ Elizabeth Redden, *Deep Cuts in Puerto Rico*, Inside Higher Ed., July 11, 2019, available at <https://www.insidehighered.com/news/2019/07/11/university-puerto-rico-faces-deep-cuts-appropriations>.

¹⁴¹ *Id.*

¹⁴² *Id.*

¹⁴³ *Id.*

¹⁴⁴ Lisa Bartfai, *Puerto Rico’s public university system is in disarray. But it’s not just because of Hurricane Maria*, Public Radio International, June 11, 2018, available at <https://www.pri.org/stories/2018-06-11/puerto-ricos-public-university-system-disarray-its-not-just-because-hurricane>.

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ *Id.*

so optimistic.¹⁴⁸ Regardless, given that Puerto Rico's debt is more than 100% of its gross domestic product, and given the tight reins now controlled by the Oversight Board, the financial stability of the university will remain uncertain.¹⁴⁹

Case Law Establishing that Puerto Rico, While Not a "State" Under Chapter 9, is a "State" for Purposes of Pre-emption.

1. While Puerto Rico May Not Authorize its Municipalities to Seek Chapter 9 Relief, the Commonwealth is Still Subject to the Scope of Chapter 9's Pre-Emption Provision. *Puerto Rico v. Franklin California Tax-Free Tr.*, 136 S. Ct. 1938 (2016)

Puerto Rico, embroiled in financial crisis, enacted the Recovery Act to enable its financially underwater public utility companies to implement restructuring plans. At issue was whether the federal bankruptcy code prohibited Puerto Rico from implementing its own municipal bankruptcy scheme. The Court held that, while the 1984 amendment to the code, which included Puerto Rico as a "State" for purposes of the code, except for the purpose of defining who may be a debtor under chapter 9, the commonwealth was still a "State" for purposes of pre-emption. The Court found that the exception only excluded Puerto Rico for purposes of *who may be a debtor* under chapter 9 and that if Congress intended to exclude Puerto Rico as a "State" for purposes of the pre-emption provision, it would have said so. As a result, the Court, finding the pre-emption provision applicable, found that federal law pre-empted the Recovery Act.

Hampshire College: A Success Story?

While the future of higher education institutions appears grim, the strategy of a private, not-for-profit Massachusetts college evidences the necessity (and hopeful success) of adaptability.¹⁵⁰ When Hampshire College, an experimental school that encourages students to develop their own curricula, announced an unavoidable merger, alarm surged among prospective

¹⁴⁸ Redden, *supra* note 140.

¹⁴⁹ Elizabeth Whiting, *Puerto Rico Debt Restructuring: Origins of A Constitutional and Humanitarian Crisis*, 50 U. MIAMI INTER-AM. L. REV. 237, 238-39 (2019).

¹⁵⁰ Eliza Gray, *Are Liberal Arts Colleges Doomed?*, WASH. POST, Oct. 21, 2019, available at <https://www.washingtonpost.com/magazine/2019/10/21/downfall-hampshire-college-broken-business-model-american-higher-education/>.

students, current students, and alumni.¹⁵¹ Undeterred by the possible merger, thirteen freshmen enrolled in the Fall 2019 semester, comprising the college’s smallest freshman class.¹⁵² For these students, Hampshire College provided a flexible course of study that promoted open-ended thinking and project-based learning for a reasonable tuition.¹⁵³

Hampshire College, like other private colleges, relies on tuition and fees for its revenue. Accepting an incoming class of thirteen students, many of whom rely on financial aid, was financially, unsustainable.¹⁵⁴ Nonetheless, when the school’s then-president, Miriam Nelson, announced her resignation, the college charted a different strategy: one that did not involve a merger.¹⁵⁵ Rather, under the leadership of current president, Ed Wingenbach, the strategy turned to stabilizing cash flow, managing resources, fundraising, budget-cutting, and reducing faculty.¹⁵⁶ In hopes of “luring” students interested in unique and specialized programs, the college developed curricula focused on “questions of our time,” such as climate change, migration, and artificial intelligence.¹⁵⁷

Thus far, these strategies are proving fruitful. As of October 2019, the college raised \$9 million from fundraisers and student applications for 2020 are being accepted.¹⁵⁸ Critically, in November 2019, the New England Commission of Higher Education, specifically noting improvements such as the hiring of a new president, achievements of the school’s governing boards, and realistic planning for future enrollment, fund-raising, and finances, voted to continue

¹⁵¹ *Id.*
¹⁵² *Id.*
¹⁵³ *Id.*
¹⁵⁴ *Id.*
¹⁵⁵ *Id.*
¹⁵⁶ *Id.*
¹⁵⁷ *Id.*
¹⁵⁸ *Id.*

accreditation of Hampshire College.¹⁵⁹ Without this accreditation, the college would unquestionably be “dead-in-the-water,” as accreditation permits Hampshire College to grant degrees and accept federal student financial aid.¹⁶⁰ Enhancing the likelihood of its fiscal success, the college is willing to make additional changes to its structure through partnership with community colleges, developing one-year certificate programs, and integrating departments to reduce costs.¹⁶¹

The success of Hampshire College remains tenuous and uncertain. Its progression towards fiscal health however, evidences hope for other residential liberal arts schools. Perhaps Hampshire College’s near collapse and its remodeled fiscal strategy evidence that the current higher education institution model adopted by many colleges and universities, while successful ten years ago, may no longer be tenable in an era of lower birth rates, heightened competition, and skyrocketing tuition.

New Oversight in Massachusetts

While Hampshire College may prove a success story, the growing number of private colleges in financial distress has garnered the attention of state and federal government agencies. Specifically, in Massachusetts, prior to Hampshire College publicizing its financial woes, Mount Ida College, another private liberal arts college, abruptly closed its doors in 2018 and left 1,500 students scrambling to transfer to other schools.¹⁶² So significant was the impact of Mount Ida’s closure, the state’s legislature passed a law designed to monitor private colleges’ financial health.¹⁶³ The law is designed with transparency in mind: the law authorizes the state’s Board of

¹⁵⁹ Ray Kelly, Hampshire College retains accreditation following key review, Mass Live, Nov. 24, 2019, available at <https://www.masslive.com/news/2019/11/hampshire-college-maintains-accreditation-following-key-review.html>.

¹⁶⁰ *Id.*

¹⁶¹ Gray, *supra* note 150.

¹⁶² Jeremy Bauer-Wolf, *When should a college say it might close?*, Educationdive, Nov. 22, 2019, available at <https://www.educationdive.com/news/when-should-a-college-say-it-might-close/567864/>.

¹⁶³ *Id.*

Higher Education to develop a means to screen private colleges annually to determine fiscal health.¹⁶⁴ While designed to prevent abrupt school closures, this law has met significant push-back from college administrators who propound that sharing details of financial problems will “sound[] the death knell for their institutions.”¹⁶⁵

To assuage the fears of publicity, the law (while not final as of the date of these materials), will require colleges to submit plans showing what steps will be taken if the institution were in financial distress.¹⁶⁶ And while neither the details of these plans, nor the college’s finances will be made public,¹⁶⁷ the new law will require public notification of institutions that are “at risk.”¹⁶⁸ This disclosure will likely be challenged, particularly as it relates to small private colleges, where no standard requirements exist to disclose finances.¹⁶⁹ To assure compliance however, the law expresses that a college’s failure to comply with the rules may result in revocation of state aid and the ability to grant degrees.¹⁷⁰ While this law may become a model for other states to follow, there is unquestionably a delicate balance of public disclosure and regulatory overreach.

Strategies for Restructuring

Because “[f]ederal law prohibits the disbursement of federal loans to an institution that has filed for relief under the Code[,]” filing bankruptcy is simply not a viable option for colleges and universities wishing to continue educating students.¹⁷¹ Given the complexity of even a small

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*

¹⁶⁸ Scott Cohn, *The other college debt crisis: Schools are going broke*, CNBC, Dec. 3, 2019, available at <https://www.cnbc.com/2019/12/03/the-other-college-debt-crisis-schools-are-going-broke.html>.

¹⁶⁹ *Id.*

¹⁷⁰ Bauer-Wolf, *supra* note 162.

¹⁷¹ Rasmussen, *supra* note 43, at 233 (citing Matthew A. Bruckner, *Bankrupting Higher Education*, 91 AM. BANKR. L.J. 697 (2017) and Scott F. Norberg, *Bankruptcy and Higher Education Institutions*, 23 AM. BANKR. INST. L. REV. 385 (2015)).

school's capital structure, leaders of higher education may find guidance in the restructuring practices employed by companies that restructured outside of bankruptcy.¹⁷² From a creditor's point of view, restructuring outside the code's parameters may provide power to dictate the course of restructuring.¹⁷³ While sometimes beneficial, this may lead to power struggles and an inability to reach agreements. Thus, just as chapter 11 is not a panacea, debt restructuring is not a cure-all for financially distressed higher education institutions. Specifically, for many colleges, "the problems lie more on the operational side rather than having a capital structure that needs adjustment."¹⁷⁴ Still, one strategy that may be performed outside bankruptcy, is to restructure any outstanding debt.¹⁷⁵

To illustrate, Thomas Jefferson School of Law, a not-for-profit school, borrowed \$90 million in bonds and built a state-of-the-art law school just as the "bottom fell out of the law school market."¹⁷⁶ While the bondholders were entitled to foreclose, it was apparent that the new law school could not be easily repurposed for other uses.¹⁷⁷ The bondholders agreed to restructure the debt and a deal was reached in which the creditors would receive title to the school and lease it back to the borrower, effectively reducing the school's debt service by half.¹⁷⁸

Also, out of the "insolvency community's playbook," higher institutions in distress may turn to financial restructuring and turnaround experts.¹⁷⁹ Financial experts are not a common player on a school's board of trustees. Rather, board members tend to be "prominent alumni and other

¹⁷² *Id.* at 234.

¹⁷³ *Id.* (citing Robert K. Rasmussen & Douglas G. Baird, *PRIVATE DEBT AND THE MISSING LEVER OF CORPORATE GOVERNANCE*, 154 U. PA. L. REV. 1209 (2006); Harvey R. Miller & Shai Y. Waisman, *The Creditor in Possession: Creditor Control of Chapter 11 Reorganization Cases*, 21 Bankr. Strategist 1 (2003)).

¹⁷⁴ *Id.* at 235.

¹⁷⁵ *Id.* at 247.

¹⁷⁶ *Id.* at 250.

¹⁷⁷ *Id.*

¹⁷⁸ *Id.*

¹⁷⁹ *Id.* at 251.

notables.”¹⁸⁰ However, “when in step with the CEO [financial experts] can be helpful allies in navigating financial distress.”¹⁸¹ Because businesses are continually exploring ways to lower costs, “[b]oard members who have operated in this environment could generate new ideas for the college or university leadership to consider.”¹⁸² In consonance with greater flexibility in board membership, schools may benefit from relaxing the requirement that a president must be a faculty member.¹⁸³ Rather, emphasis should be placed on a leader with a financial and business background who has the experience and the knowledge to guide the university toward fiscal success.¹⁸⁴

Hiring a turnaround consultant may also behoove the school.¹⁸⁵ An outsider may find things missed by a university’s insiders, find opportunities to constructively change, and add skills needed for any necessary changes.¹⁸⁶ For example, “[e]nhancing the financial acumen of boards and finding new presidents skilled at turnaround situations is a process that can take years. A consultant can be hired much more quickly.”¹⁸⁷

Last, obviously integral to financial restructuring success, is the contribution of faculty. Because colleges and universities are not accustomed to drastic changes and because faculty expect to be consulted about issues facing the school, the president must consult faculty, articulate the school’s challenges, keep faculty well-informed, and welcome constructive feedback.¹⁸⁸

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² *Id.*

¹⁸³ *Id.* at 252.

¹⁸⁴ *Id.*

¹⁸⁵ *Id.*

¹⁸⁶ *Id.* at 253.

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*