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BANKRUPTCY AND EDUCATION

KEITH SHARFMAN*

Bankruptcy law interacts with education law in a number of respects. A bankrupt educational institution loses access to student financial aid,[1] and its accreditation status is excluded from the bankruptcy estate.[2] Actions by accreditation agencies against bankrupt educational institutions are not subject to the automatic stay.[3] And absent a showing of undue hardship, student loans are not dischargeable in bankruptcy.[4]

The exceptional treatment of educational institutions and their students in bankruptcy reflects a fundamental tension between the goals of bankruptcy law on the one hand and education policy on the other. While bankruptcy law generally seeks to maximize value for creditors and afford a fresh start to individual debtors,[5] it balances these objectives with the goals of education policy, which include assuring educational quality, access, and affordability, as well as protecting the investment of public funds in the educational sector.[6]

Whether current law achieves the correct balance or ought to be rethought and reformed was the subject of a symposium that the *American Bankruptcy Institute Law Review* hosted at St. John's School of Law on October 24, 2014. The event brought together distinguished experts in the fields of bankruptcy and education law, and their contributions are published here in this symposium issue. These papers are especially timely in light of recent news events concerning high profile insolvencies in the higher education sector and pending legislation to reauthorize the Higher Education Act. And they will be of particular interest, given how little attention the intersection between these two subject areas has received until now.

The six symposium contributions cover various topics that fall within the broader conference theme. Some of them focus on issues that primarily affect institutions. Others emphasize issues of concern to students and to society more broadly. Each contribution is unique in content and offers a diverse perspective.

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* Professor of Law & Associate Director of Bankruptcy Studies, St. John's University School of Law. Many thanks to all of the symposium participants for their participation, their efforts, and their insights, to Terry Hartle and Robert Witwer for some very helpful suggestions, to Sam Gerdano, Andrew Simons, and Michael Simons for supporting this event, and to Kelly Porcelli and the other editors and staff of the *American Bankruptcy Institute Law Review* for their hard work.

[1] 20 U.S.C. § 1002(a)(4).

[2] 11 U.S.C. § 541(b)(3).

[3] 11 U.S.C. § 362(b)(14).

[4] 11 U.S.C. § 523(a)(8).

[5] Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE. L.J. 857 (1982); Jackson, *The Fresh-Start Policy in Bankruptcy*, 98 HARV. L. REV. 1393 (1985).

[6] See generally the various provisions concerning access, affordability, quality, and the protection of federal funds contained in the Higher Education Act, which is codified at 20 U.S.C. § 1001 et seq.

Mike O'Neal, a former university president, offers a witty keynote address[7] focusing on the dangers that U.S. institutions of higher learning are now facing, including the dangers of insolvency and financial failure that the current "bubble" in higher education may well foretell. In response to these dangers, O'Neal recommends that higher education institutions shore up their balance sheets to prepare for financial challenges and he further suggests that consolidation through mergers may be a sensible response to anticipated contraction within the higher education sector. Given the current inaccessibility of bankruptcy to higher education institutions, O'Neal's grim predictions and prescriptions may well become reality, and they set the stage for a discussion about whether anything constructive may be done through changes in bankruptcy policy to address the dangers that he identifies.

One such policy idea suggested for consideration by Scott Norberg, a respected bankruptcy scholar who has played a leading role in the accreditation of American law schools by the American Bar Association, is to amend the Higher Education Act and the Bankruptcy Code to allow institutions of higher learning to continue to operate, remain accredited, and receive Title IV funding while in bankruptcy under the watchful eye of both a bankruptcy judge and the U.S. Department of Education.[8] A major advantage of this suggested mechanism would be to allow a school in financial distress to restructure its non-Title IV obligations, such as mortgage and pension debts, in the same efficient way that other corporate entities do when they find themselves in financial distress. Another advantage is to enable a school's creditors to recover more fully through the facilitation of a reorganization, rather than receive a smaller recovery in a non-bankruptcy shutdown or liquidation (at least in some range of cases, where reorganization would be from a financial standpoint the more viable option). All of this could be accomplished, Norberg notes, without compromising the government's and society's understandable interest in protecting Title IV funds and recovering Title IV obligations, whose protection could be achieved by elevating the priority of such claims under section 507 of the Bankruptcy Code. Given the Department's recent experiences with large failures such as Corinthian and with the prospect of more such failures on the horizon, Norberg's thought experiment is well worth considering.

Another alternative for higher education institutions in financial distress is to place them (either voluntarily or, more likely, involuntarily) into receivership. Discussed in the contribution of Randel Lewis,[9] one of the country's leading experts on receiverships, the receivership alternative (unlike Norberg's idea) is already feasible under existing law and does not require any changes to the Bankruptcy Code or the Higher Education Act. A major advantage of this approach, Lewis notes, is that a higher learning institution in receivership may continue to receive Title IV funds. A further advantage may be that a receiver has broader powers to turn an institution around and maximize its value for stakeholders than perhaps may be granted to a monitor chosen by

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[7] Mike E. O'Neal, *Is Higher Education Learning Anything?: The Dangers to U.S. Institutions of Higher Learning from the Disruptive Challenges in the Twenty-first Century*, 23 AM. BANKR. INST. L. REV. 401 (2015).

[8] Scott F. Norberg, *Bankruptcy and Higher Education Institutions*, 23 AM. BANKR. INST. L. REV. 385 (2015).

[9] C. Randel Lewis, *Managing a Safe Landing: Dealing with Distressed Universities and Colleges*, 23 AM. BANKR. INST. L. REV. 367 (2015).

the U.S. Department of Education, such as was recently appointed in the Corinthian matter. If a "safe landing" is or should be the goal when a higher education institution gets into financial difficulty, receiverships may well be the best option in at least some cases.

Turning from institutions to students, Steven Harper, formerly a partner at Kirkland & Ellis and now a professor at Northwestern as well as a celebrated blogger with a number of books to his credit, offers a contribution[10] that analyzes the moral hazard associated with federally-guaranteed student loans, focusing particularly on those used to finance legal education. He posits that the availability of such loans to all law students at accredited law schools—even to students without a strong expectation of sufficient earnings post-graduation to repay their loans—has led to dysfunction in the market for legal education. But Harper is not merely a critic of the status quo. He offers an intriguing solution to the moral hazard problem: to limit access to federally guaranteed student loans to amounts that students who receive them will likely be able to repay based on expected outcomes at the time of enrollment. Harper's novel approach to the problem of student debt may well be a sensible way to address the elevated risk of default that is particularly associated with high cost educational programs, and his approach may well generalize to other educational contexts beyond law school.

Another contribution related to student debt is by economist Meta Brown and several co-author colleagues from the Federal Reserve Bank of New York.[11] In this paper, Brown and her co-authors report on a new data set concerning educational debt. The authors find that nearly one third of student loans are in delinquency – a rather high figure that is somewhat masked by deferment and grace periods. They further find that the currently high student loan burden (relative to historical figures) is apparently correlated with (if not a cause of) reduced access to credit, difficulties with debt payments, and lower rates of car and home purchases. While these descriptive figures concerning student debt do not suggest anything definitive as to normative bankruptcy and/or education policy, and while they may well be offset or explained by concomitant increases in the value of the degrees that are financed through such debt, the statistics that Brown and her colleagues describe and report are sure to be important considerations in future policy discussions.

Finally, combining the various student and institutional issues is an important contribution from Ada Meloy, who until her recent, tragic passing was general counsel at the American Council on Education and formerly counsel at New York University. On the issue of student loans, Meloy offers some anecdotal evidence from an earlier time of abusive and egregious defaults on student debt that (in contrast to the views expressed by Harper) supports to some extent the non-dischargeability of student loans that is now reflected in current law. At the same time, she contends that non-dischargeability should not have been extended in 2005 to cover all private label educational loans and not just those that are federally guaranteed, and she predicts that

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[10] Steven J. Harper, *Bankruptcy and Bad Behavior - The Real Moral Hazard: Law Schools Exploiting Market Dysfunction*, 23 AM. BANKR. INST. L. REV. 347 (2015).

[11] Meta Brown et al., *Student Debt Growth and the Repayment Progress of Recent Cohorts*, 23 AM. BANKR. INST. L. REV. 331 (2015).

this extension may be scaled back in a future reauthorization of the Higher Education Act. A final point she makes, with great skill, is the surprising and "troubling" position that bankruptcy courts now take with respect to the clawback (as avoidable fraudulent transfers) of tuition payments made by soon-to-be bankrupt parents on behalf of their college-age children on the theory that the parents have not received reasonably equivalent value. Because the college has clearly transferred value to the student in exchange for tuition, it is easy to sympathize with Meloy's perspective. And overall, the breadth and depth of Meloy's experience in the field of higher education law and policy adds an irreplaceably valuable perspective on these important issues. Her voice will be missed.

In sum, we who edit this journal are grateful to the distinguished participants for their important contributions. We thank and commend them for their efforts. And we look forward to the ongoing policy dialogue in the bankruptcy and education communities that the research published here is sure to stimulate.