Summary of the Forthcoming Seminar Introduction for ABLJ and Key Points to be Raised at the Seminar in Las Vegas

Karen Gross

My forthcoming Introduction to the articles accompanying this Seminar will provide the larger context for these excellent articles. I will focus most particularly on why this particular topic – the intersection of higher education and bankruptcy -- should be of interest to both those involved in insolvency work and those involved in work in higher education. To be sure, it is of keen interest to those involved in both arenas. And, it is a topic that is keenly timely.

As the articles written by the panelists will indicate, higher education and bankruptcy intersect in a myriad of ways that have not been fully explored and implicate vastly more than the Bankruptcy Code itself. The Higher Education Act and its accompanying regulations, governance laws and debt collection are all a large part of the story and how these bodies of law intertwine with the Code is a topic of considerable confusion and debate.

The initial issues surround the limitations placed on institutions of higher education (IHEs) accessing the federal bankruptcy laws. Indeed, I suspect few are even aware of these limitations and their rationale. Understanding these limitations and overcoming what I term the "access obstacle" – apart from legislative change – is another question. The benefits to institutions of IHE access to bankruptcy relief, assuming it can be achieved, is yet another question still.

I am not alone in seeing the need for change in this arena. Part of the reason for the absence of robust discussion is, I suspect, that this problem implicates distinct bodies of knowledge that are in different silos: higher education law and policy and bankruptcy law and policy among them. And, who wants to admit that higher education institutions are failing and/or closing – which they are and this is a trend that is not abating. Closure of educational institutions may seem counter-intuitive in a nation that prizes (one hopes) diverse quality post-secondary education.

I believe many educators are unaware of the bankruptcy constraints on institutions; they are also unaware of the benefits such laws would provide. Conversely, many bankruptcy experts may be unaware of the constraints in the laws relative to education and the complexity of higher education in terms of institutional and financial structures and governance. As someone who ostensibly is familiar with both bodies of knowledge, I count myself as one of the people who was largely unaware – until relatively recently – of the nuanced arguments, the laws and regulations implicated and the unintended consequences we have created regarding access of IHEs to bankruptcy relief.

To be cynical, perhaps some of the suboptimal (in my view) outcomes were intended; in other words, the aim of the legal regime was intended because of a strong dislike for for-profit schools. I, on the other hand, suspect that the legal regimes reflect a failure to understand the complexity of and the "in the trenches" experiences undergirding higher education today. The law was and is, in other words, crafted in a way that is delinked from the reality of post-secondary education in America.

For all of this to make sense, then, we need to begin with a description of the state of higher education in the US, a topic I will raise and discuss in some detail at the NCBJ conference symposia. This is because this information provides critical and important context for the suggestions the panelists and I are making.

In my published Introduction and at the symposium, rather than detailing the legal regime, I will focus on policy and why changes are needed and why the need is now. I will also address a sad but real aspect of higher education: leadership failure and moral collapse of leaders and then why the bankruptcy laws are uniquely suited to right such wrongs through a myriad of approaches. Add protests and campus dissent into the mix and we have even greater complexity and need for resolution. Equity has a role – not just in the courts but in education as well.

My writing and remarks will also be grounded in my own in the trenches experiences as a college president and as a senior policy advisor to the US Department of Education in the Obama Administration. And, I now work as a senior fellow with College Promise, part of Civic Nation, a non-profit that is trying to carry out the education legacy of the former President amidst a sea of opposition. The point is that the discussion isn't theory; it is grounded in practice.

As the moderator of the panel, I hope to engage these experienced panelists in discussions that allow the audience not only to reflect on the issues but also to question, to ask, to probe, to explore solutions. After all, quality education requires engagement.

Finally, it is not without some irony that this panel is occurring amidst a host of natural and unnatural disasters – hurricanes and shootings, including most recently here in Las Vegas. These events all have serious financial implications in addition to implications for individuals and families. And, for educators, these types of disasters present remarkable challenges not only in reopening schools but also in enabling and creating a comfortable, safe and stable environment in which learning can occur. Post-disaster, we don't just reopen the book to where we last left off. How we, as educators, enable bad moments to become teachable moments is something to be shared too – and the bankruptcy laws, with their fresh start policy, can provide useful guidance.

Student Loan Reform through Bankruptcy

Dalié Jiménez[1]

Most commentators agree: with $1.4 trillion in outstanding loans and rising defaults, we have a student loan problem. Could bankruptcy help solve this problem? A popular proposal is to make student loans more easily dischargeable in bankruptcy. The immediate response to this proposal is to argue that it would encourage debtors to incur more (and perhaps riskier) student loan debt and would open up the floodgates to non-deserving debtors. Often forgotten from the discussion, however, is the moral hazard effects of the current bankruptcy regime on institutions whose students receive student loans.

This Article argues that there are three primary problems with the current structure of our student loan program, all of which increase school moral hazard. First, federal policies make it too easy for post-secondary programs to receive federal student loan funds. Second, poor supervision of institutions receiving such funds means that many have received them for far longer than warranted. Finally, this system of financing post-secondary education places most of the risk of failure squarely on students and their families. Repayment and forgiveness programs serve to somewhat ameliorate these concerns, but these programs only apply to some federal loans, do not go far enough, and often involve an overwhelming amount of paperwork.

The current administration and Congress do not appear to want to move forward in offering any relief to distressed debtors; if anything, their moves have been in the contrary direction. The Bankruptcy Code, as it currently stands, can and does provide relief for a few, but it poses significant access hurdles for student loan debtors in bankruptcy. The high costs of hiring an attorney and procedural difficulty of bringing an adversary proceeding to discharge student loans keep the neediest debtors away from bankruptcy relief. Legislative action is needed, but it does not appear to be forthcoming. This article posits that the Bankruptcy Code has tools to help solve part of the student loan problem—even without any legislative change.

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The most obvious way in which bankruptcy can help solve the student loan problem is at the individual level. We know that only a handful of debtors attempt to discharge their student loans in bankruptcy. In large part, this is due to an access to civil justice problem. Few lawyers do this work, fewer still are willing to take it on without an upfront fee, something that is difficult for debtors for whom it is an undue hardship to repay the loans. These debtors should have relief, but they are currently not receiving it. Presuming that federal law is unlikely to change, this article suggests moves that courts, attorneys, and consumer groups can implement now, without legislative action. Many of these moves are ongoing. I first catalog the positive changes that some courts have made to the way they treat student loans in bankruptcy such as allowing partial discharge and enforcing loan compromises that end in discharge. I then propose a set of procedural and case management tools that aim to increase the accessibility of the discharge to student loan debtors: focusing on how courts can encourage (and appropriately support) pro se debtors to adjudicate the dischargeability of their loans. Envisioning partnerships between bankruptcy courts and legal aid groups, the article describes how self-help materials for pro se debtors might help them bring their student loan issues to the court and at the same time bring creditors to the table to work out a solution.

Individual relief is important, but it is necessarily incremental. The larger problem is that programs that provide little benefit to students are allowed federal funds in the form of student loans. I do not argue that that bankruptcy can entirely solve this problem: but instead sketch out ways in which decisions and opinions in bankruptcy court may influence legislators and regulators in ways that would further encourage the federal government to change their federal aid policies. Bankruptcy alone will not solve this problem. The hope is that an increase in student loan discharges will spur legislative action sooner rather than later while helping individual debtors along the way.

Lessons for Academic Leaders from Modern Restructuring Practice

Robert K. Rasmussen[1]

Colleges and universities have a complicated relationship with Chapter 11. Those institutions that operate on a not-for-profit basis cannot be forced into bankruptcy via an involuntary petition. The Bankruptcy Code prohibits such filings against corporations that are not "moneyed, business, or commercial" in nature, and thus not-for-profit schools are immune.[2] The Code itself, however, does not put any further restrictions on the ability of institutions of higher education to use the Bankruptcy Code to address issues of financial distress. That said, it is common knowledge that Chapter 11 provides no relief to an institution seeking to restructure its debts and remain viable as a going concern.

The de facto restrictions on access to Chapter 11 lie elsewhere. Federal law prohibits the disbursement of federal loans to an institution that has filed for relief under the Code.[3] Changes in the student lending market in recent years have led to an environment where the majority of students from virtually all colleges and universities who borrow money to finance their studies do so from the federal government. The federal government stepped into the funding gap that arose at the onset of the Great Recession, and it continues to be the primary funding of higher

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[2] 11 U.S.C. § 303(a).
[3] For a description of this limitation as well as an argument questioning its merits, see Matthew A. Bruckner, *Bankrupting Higher Education,* __ Am. Bankr. L.J. __ (2017 forthcoming); Scott F. Norberg, *Bankruptcy and Higher Education Institutions,* 23 Amer. Bankr. Inst. L. Rev. 385 (2015)

education. This reliance on federal funds means that, for any given college, if federal loans are not available, students by and large will choose to go elsewhere. The upshot of this is that a college or university that has decided to close its doors can use the Code to assist its winding down. It can use Chapter 11 to monetize its physical plant, endowment and intellectual property, and then to sort out which creditors get which proceeds. What cannot be done, however, is to file a petition under Chapter 11 as part of an attempt to rehabilitate the school.

It is far from clear that such limitation is wise public policy.[4] For the purposes of this paper, I want to put this issue to one side. Rather, the focus here is that, even assuming that Chapter 11 remains unavailable as a practical matter for schools facing financial distress, I want to consider what lessons leaders of higher education can learn from restructuring practice in general. Recent years have seen a transformation of how businesses deal with financial distress. Creditors, especially senior creditors, often can dictate the course that a business takes.[5] An entire profession of turnaround managers has been created. These professionals parachute into a company in order to tackle its problems. Boards of directors have become increasingly attuned to the strategies available. Prearranged deals have become commonplace.[6] Devices such as restructuring support agreements have allowed affected

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[4] For what it is worth, I find the arguments put forward by Professors Buckner and Norberg persuasive.

[5] See 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)

[6] See Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight,* 56 Stan. L. Rev. 673 (2003).

parties to craft solutions in advance of a bankruptcy filing.[7] The tools described here can well be deployed to combat financial distress, even without access to Chapter 11.

One note of caution, however, needs to be sounded at the outset. It is true that private restructuring practices can provide models and lessons for leaders in higher education; such tools, however, are no panacea. Bankruptcy law by and large exists to solve a collective action problem.[8] Disparate creditors pursuing their collection rights could force a viable concern to liquidate, and Chapter 11 provides a forum to prevent such action. The problem of uncoordinated creditors, however, is not coextensive with the problems of financial distress that many schools are facing. For many institutions, the problems lie more on the operational side rather than having a capital structure that needs adjustment. To the extent that there are fewer (and poorer) students seeking a four-year degree, and if colleges and universities cannot repackage their product to expand the market, there will be fewer students. The decrease in students will put financial pressure on a number of schools, and it may well be that some schools will not be make a go of it in the new competitive landscape. Restructuring tools can undoubtedly aid many schools as they confront turbulent times; they will not ensure that all schools currently operating remain in business.

[7] See Douglas G. Baird, *Bankruptcy's Quiet Revolution,* working paper

[8] The canonical work remains Thomas H. Jackson, The Logic and Limits of Bankruptcy Law (Harvard 1986).

Bankruptcy: Tenure Killer?

Matthew Bruckner[1]

The ability to reject unprofitable contracts and pay creditors in "tiny bankruptcy dollars" is one of the most powerful tools available to a bankruptcy enterprise. It is likely to be critically important to a college's ability to reorganize, if the financial penalties for reorganizing are lifted. Rejection is simply another way to say that the DIP will not perform its obligations under the contract. In other words, that the DIP will breach. The Bankruptcy Code does not seek to impose an obligation on debtors to perform their contractual duties. Instead, it offers debtors a choice, they can choose either to perform or to breach.

The effect of the DIP's breach is the same in bankruptcy as it is outside of bankruptcy. The DIP's breach entitles its non-breaching counterparty to receive damages for the DIP's breach. An important difference is that a DIP's decision to reject is treated as a pre-petition breach, giving rise to "an unsecured claim against the assets of the debtor." The non-breaching counterparty, holding only a general unsecured claim, will—in most cases—be paid only in "tiny bankruptcy dollars."

As noted above, at private colleges tenure is a contractual arrangement, normally indicating that the college "will grant certain rights and be bound by the 1940 Statement" by the AAUP. In other words, tenure grants a professor the right to receive certain due process protections before being deprived of their academic appointment. As such, there does not seem to be any limitation present in section 365 that would restrict a college's ability to reject its tenure contracts with one or more professors. Assuming the college breached its obligation to provide the appropriate pre-termination process, such as notice and the opportunity to be heard, those professors would become general unsecured creditors.

Of course, it's entirely possible that a bankruptcy hearing would itself constitute appropriate pre-termination process and therefore that a fired tenured professor would not even have a claim against the estate.

One restriction on the debtor's ability to reject a tenure (or other) contract is that the "debtor's decision [to reject an executory contract] is subject to court approval." Some courts have taken the view that they should weight the benefit to the debtor from rejection "against the consequent harm suffered by the [non-breaching] party." But these courts would appear to be a minority. In general, courts defer to the debtor's business judgment, absent evidence of the debtor's

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bad faith, abuse of discretion or if the decision is manifestly unreasonable. As long as the debtor can articulate a reason for rejecting a contract, such as because a particular professor is no longer needed, and that rejection is likely to save the debtor money, the court is likely to approve the decision to reject.

Outside of bankruptcy, it's common for a tenured faculty member at a public college to seek reinstatement where they have been inappropriately terminated. In bankruptcy, they are unlikely to receive such a remedy. In bankruptcy, contract obligations are usually not specifically enforced. Instead, "equitable remedies are translated into monetary bankruptcy claims."

There are two potentially interesting caveats to the analysis just provided. First, the foregoing assumes that tenure is a primarily contractual arrangement. But in some cases—particularly at public colleges—tenure has a constitutional dimension. In a recent string of municipal bankruptcy cases, parties have been actively litigating whether bankruptcy courts can allow debtors to discharge claims arising under the constitution. For example, in the Detroit bankruptcy, Judge Rhodes drew a distinction between Fourteenth Amendment violations brought pursuant to 42 U.S.C. § 1983, which are dischargeable, and violations of the Fifth Amendment's Takings Clause, which are not dischargeable.

<u>Constitutional claims</u>

In San Bernardino's bankruptcy case, the city's chapter 9 bankruptcy plan, which proposed paying victims of police brutality 1/100th of the value of their claims, was approved by the bankruptcy court. One of those injured by police, Rovinski Renter, alleged that a San Bernardino police officer broke her arm, then handcuffed her and left her "without medical care for 30 minutes." As a result, Renter has needed more than a half a dozen surgeries and yet still remains "at risk of losing her arm or at least elbow because of what happened," according to her attorney. Renter's one percent payout is the same as that received by others injured by the city's actions, even where those claims do not have a constitutional basis. Two victims are appealing that decision, but there is contrary Ninth Circuit precedent allowing cities to discharge civil rights claims against a reorganized municipal debtor.

By contrast, in Detroit's bankruptcy case, Judge Rhodes drew a distinction between Fourteenth Amendment violations brought pursuant to 42 U.S.C. § 1983—like those raised in San Bernardino—which are dischargeable, and violations of the Fifth Amendment's Takings Clause, which are not dischargeable. In the Detroit case, there were two distinct groups of credits asserting constitutional claims against the city.[2] The first group were referred to as the "§1983 Creditors." They alleged that Detroit police officers violated their "constitutional rights, including those guaranteed by the First, Fourth, Fifth, Sixth, Seventh, and Fourteenth Amendments." The §1983 Creditors asserted that treating their constitutional claims as unsecured claims (and receiving between ten and 13 percent payouts) violated "their Fourteenth Amendment right to receive compensation for the violations of their constitutional rights."

By contrast, the second group—referred to as the "Takings Creditors"—had either "obtained a liquidated final judgment against the City for an ongoing Fifth Amendment Takings violation due to certain land use restrictions," or had pending suits against the City for just compensation. The Takings Creditors asserted that treating their constitutional claims as unsecured claims violated their Fifth Amendment rights to receive "their just compensation awards in full".

Judge Rhodes distinguished between the Takings Creditors asserting Fifth Amendment "just compensation" claims and § 1983 Creditors demanding compensation under § 1983 for other constitutional violations. This distinction allegedly arose because the basis for asserting claims for compensation differ for the two types of creditors. The Fifth Amendment itself establishes the right to compensation, whereas the right to compensation for violations of the Fourteenth Amendment arises under §1983 and not under the Fourteenth Amendment itself. Thus, there is no constitutional violation when §1983 claims are paid in tiny bankruptcy dollars because Congress is free to restrict or expand §1983 relief as it sees fit. By contrast, Congress may not alter the right to compensation for Takings Claims violations.

While Judge Rhodes' distinction draws some support from Supreme Court precedent, it is not free from doubt. Professor Charles Tabb has cogently argued that Congress may restrict the substantive rights of constitutional creditors in bankruptcy because the Takings Clause does not independently limit Congress' authority to modify the substantive rights of creditors through the Bankruptcy Clause. Nevertheless, even Professor Tabb notes in the first paragraph of his article that it is the "gospel truth", "the received wisdom" and "an article of faith," that "the Fifth Amendment Takings Clause independently limits the exercise of the bankruptcy power under the Bankruptcy Clause." So while it is plausible that Judge Rhodes got it wrong, it seems worthwhile to consider whether the constitutional claims of tenured faculty are more plausibly analogized to Takings Clause claims or to § 1983 claims. If the claims of tenured faculty may plausibly arise under the Takings Clause, it could seriously complicate any attempt for colleges to reorganize in bankruptcy.

Tenured faculty may well be able to complicate college reorganizations in just this manner. To establish a Fifth Amendment takings claim, a plaintiff must allege that there has been a taking of private property for public use without just compensation. In contrast to untenured professors, a tenured professor has a property interest in his or her continued employment. And if that property is taken and the tenured professor receives only an unsecured claim against a bankrupt college, that professor would likely have been denied "just compensation."

On its face, the question of whether the taking is for a public use appears more difficult. But Professor Tabb has argued that it is not. In a different context, he has argued that even the taking of a contractual (rather than a constitutional) claim is for a public use, citing Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) for the proposition that paying creditors a fraction of what's owed them and discharging the remainder is "of public as well as private interest." This would seem even more true when a public college discharges its debts than when an individual (or a business enterprise) does so because the state treasury (and indirectly the taxpaying public) is liable for the undischarged debts of public colleges.

As a result of the foregoing, a few things now seem clear. First, if Judge Rhodes' has correctly read the relevant Supreme Court then public colleges would not be able to reject their contracts with tenured professors and pay those professors as unsecured creditors. Instead, tenured professors at public colleges would be entitled to full repayment of their claims, which may be a substantial sum indeed. As a result, bankruptcy reorganization would likely remain functionally unavailable for public colleges that need to restructure their obligations to tenured professors. But this only applies to public colleges. Private colleges—both nonprofits that have tenured faculty and for-profits that likely do not—would be able to restructure their contracts with faculty. By contrast, if Professor Tabb is correct, all types of colleges would be able to restructure their contracts with tenured professors and reorganize in bankruptcy.

However, it's not only the case that a public college cannot effectively restructure its contracts with tenured professors, but all colleges may find their restructurings complicated when they try to assume their existing contracts. More on that in the following section.