Education Law/Constitutional Law

Protecting Students and Creditors: Bankruptcy Reform for Colleges and Universities

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Over the past few years, there has been a steady increase in the number of colleges in financial distress that have been forced to either close or merge with a larger institution.[1]

Typically when a business is overwhelmed by debt, it has the option to file for bankruptcy protection. This allows the business to continue to operate while it re-organizes its debt obligations, in the hope or expectation that its future revenue will be greater than the amount it could receive through liquidation.[2]

As a result of a decades-old congressional mandate, however, colleges and universities who file for bankruptcy protection lose their eligibility for federal financial aid programs, including student loan programs. Because most higher education institutions get most of their operating funds from various forms of federal financial aid, their ineligibility for these programs makes it effectively impossible for them to continue to operate after a bankruptcy filing.

The logic for this rule, however, may be now largely outdated and misplaced. In fact, with the proper safeguards in place colleges and universities, as well as their students and faculty, could greatly benefit from being able to file for bankruptcy protection.

Current Laws Effectively Preventing Bankruptcy in Higher Education Institutions

All colleges and universities that meet the definition of an "institution of higher education" are eligible to participate in federal student financial assistance programs outlined in Title IV of the Higher Education Act.[3] These federal programs allow higher education institutions to provide financial aid to qualified students, and consequently are crucial for the financial success of most institutions.

However, in an effort to protect taxpayers and students, the HEA was amended in 1992 to include a provision that makes any college or university that files for bankruptcy immediately ineligible to participate in federal student financial assistance programs. Under 20 U.S.C. §1002(a)(4)(A), "[a]n institutional shall not be considered to meet the definition of an institution of higher education . . . if the institution, or an affiliate of the institution . . . has filed for bankruptcy." The HEA does not provide any exceptions to this rule, however, nor does it allow the Department of Education to grant any exemptions.[4]

As a result, while no law explicitly prevents higher education institutions from filing for bankruptcy, the reality is that filing for bankruptcy protection is a death sentence for colleges and universities. More than once, higher education institutions have looked futilely to different sections of the Bankruptcy Code for protection from this rule when filing for bankruptcy.[5]

For example, in *In re Betty Owen Schools, Inc.*, a not-for-profit vocational school filed for Chapter 11 and was stripped of its eligibility to participate in HEA Title IV programs.[6] The school attempted to argue that the "fresh start" provision contained in Section 525 of the Bankruptcy Code superseded the HEA and protected the institution's eligibility to participate in HEA financial assistance programs during the bankruptcy process.[7] The court ruled, however, that the Bankruptcy Code could not override Congress' clear and specific intent to prevent higher education institutions that have filed for bankruptcy from participating in federal financial assistance programs.[8]

More recently, a bankruptcy court in Texas made a similar ruling when Lon Morris College filed for bankruptcy.[9] As one would expect, shortly thereafter Lon Morris College was liquidated. More recently and more locally, Dowling College on Long Island was forced to close its doors after 48 years when the school was forced to file for bankruptcy due to its financial difficulties.[10]

Congress's Justification for Current Law

The reasoning behind Congress' decision to essentially prevent higher education institutions from filing for bankruptcy is certainly laudable, but due to current economic realities may be now misplaced. The anti-bankruptcy provision was added to the HEA in 1992, but the accompanying Senate Report does not specifically address its addition.[11] The report instead made broad statements about issues with certifying financially weak schools to participate in HEA Title IV programs. The report also noted that many of these schools eventually filed for bankruptcy and left their students with large amounts of student loan debt without obtaining degrees.

Congress was therefore concerned about "unscrupulous profiteers" who would defraud students by establishing higher education institutions without the proper finances or administration and make fraudulent use of the funds they received through Title IV programs. By eliminating bankruptcy as a recourse for these fraudulent institutions, Congress believed it would put an end to these "fly-by-night" colleges, since they would no longer be able to fall back on debt reorganization through bankruptcy to save them from financial ruin.[12]

While this rationale was well-intentioned at the time of its enactment, the

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HEA's strict anti-bankruptcy reorganization provision has negatively affected legitimate, financially struggling institutions and their students than it has prevented fraudulent use of Title IV funds. Neither Betty Owens School nor Lon Morris College were fly-by-night institutions. In fact, Lon Morris College had existed since 1854, and the bankruptcy court specifically noted that the institution was not "unscrupulous" or "dishonest" like the institutions Congress intended to target with the 1992 amendment to the HEA.[13]

Although there is no guarantee that these institutions would have been able to survive if they were permitted to file for reorganization under Chapter 11, there may be no valid justification for preventing legitimate institutions like the ones mentioned above from doing so in an effort to solve their financial problems.

How Struggling Institutions Can Benefit From Bankruptcy

As noted, almost every business in America is able to seek bankruptcy protection. Some of these businesses, like Chrysler, Macy's and Texaco, are very well known and continue to operate years after filing for bankruptcy.[14] Because colleges and universities face many of the same financial difficulties and economic pressures as any other business, allowing these institutions to file for bankruptcy could greatly benefit not just the institutions themselves, but their students and faculty as well.

One of the main benefits to filing for bankruptcy protection is the automatic stay, which occurs upon the filing of a bankruptcy petition. The stay generally prevents creditors from asserting liens and obtaining judgments against a debtor's assets while the bankruptcy case is pending.[15] This effectively gives a debtor time to remain in operation and devise a plan as to how it can restructure its obligations without the threat of litigation, lien executions, or bank levies.[16] For higher education institutions, this time would allow a school to devise ways to increase enrollment, sell off non-critical real estate or other assets, merge or partner with other institutions, or otherwise find alternate methods of funding, all while allowing its students to continue taking classes and obtain their educations.

Another useful aspect of bankruptcy for higher education institutions is the ability to consolidate and re-organize their debt obligations. Because colleges and universities provide a wide range of facilities and services, institutions in financial distress likely have many different contracts and creditors to which they owe money. Negotiating with these parties individually would be nearly impossible, and unlikely to produce a positive result for the institution. In a reorganization under the Bankruptcy Code, however, all creditors will generally have to abide by the terms of the reorganization plan that is ultimately approved by the bankruptcy court.[17]

In addition, in some circumstances, filing for bankruptcy would allow higher education institutions to sell expendable assets without any liens or encumbrances attached.[18] This would enable institutions to exam-

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vant in such searches is whether the search was justified at its inception and reasonably related in scope to the justification. The Court said that the word "reasonable" can be defined in various ways, depending on the context of the search.[17] The Court said that the first search was justified because of the suspicion of smoking, and the second search was justified because marijuana and other suspicious items were found with the cigarettes.

"Special Needs"

Just two years later, however, the U.S. Supreme Court, in deciding a criminal case entitled *Griffin v. Wisconsin*, held that "[a] State's operation of a probation system, like its operation of a school . . . presents 'special needs' beyond normal law enforcement that may justify departures from the usual warrant and probable-cause requirements."[18] In an anticipated move, the Court announced that school searches would not always need to be supported by individual suspicion. In *Vernonia School Dist. 47J v. Acton*, the Court applied the "special needs" doctrine to validate the school district's policy of conducting drug tests on student athletes through random, suspicion-less, drug searches.[19] Sometime later, the Court expanded on that authority to permit such drug testing to be conducted on students participating in other school-sponsored activities, in *Earls*.[20]

In *Earls*, the Court attempted to provide guidance to lower courts across the country by stating that "[i]n certain limited circumstances, the Government's need to discover such latent or hidden conditions, or to prevent their development, is sufficiently compelling to justify the intrusion on privacy entailed by conducting such searches without any measure individualized suspicion."[21] This could provide the justification for requiring clear backpacks that so many students are skeptical of.[22]

The Effectiveness of Clear Backpacks

Many are also skeptical as to whether the new security measures at Stoneman Douglas will be effective.[23] Students and parents point out that the Parkland gunman, Nikolas Cruz, was not a student when the shooting occurred.[24] Even those who believe the clear bags make students safer admit that they impair productivity.[25] While providing a safe environment is a top priority for schools around the country, surveillance precautions have several implications on students' ability to learn. Studies show that students become resentful, and less willing to obey policies when they feel that their privacy rights are unfairly violated.[26] Proof of this phenomenon can be seen in the fact that many students at Stoneman Douglas protest the school-issued backpacks by filling them with tampons and tissue paper, attaching protest pins, or painting them with political statements.[27] These activities, reminiscent of *Tinker v. Des Moines Independent School District*,[28] raise concerns about balancing students' freedom of expression rights with the school's ability to successfully implement the safety precaution and maintain a productive learning environment.

Negative Implications Due to New Safety Measures

Many students feel that the school's security measures have deprived them of a sense of normalcy and individualism in an educational environment.[29] Since the policy has been implemented, there have been floods of social media posts from students who feel their rights have been violated, without an increased feeling of safety.[30]

In addition to the backpack requirement, the increased police presence at Stoneman Douglas has also had negative implications for students' expectation of privacy. Students compare the school's new environment to that of a jail.[31] In particular, black students have voiced their concerns about racial profiling at Stoneman Douglas. One student stated that "'every day, students lose more and more freedoms at MSD. Students of color have become targets and white students have become suspects.'"[32] Black students at Stoneman Douglas fear that they were not taken into consideration when the school heightened its police staffing.[33]

A Work in Progress

Ty Thompson, School Principal of Stoneman Douglas, agrees that the precaution makes it difficult to balance students' convenience and privacy with their safety and security.[34] He asks families to be patient while the school fine-tunes the security procedures.[35] According to Superintendent, Robert Runcie, the clear backpacks are not a permanent measure.[36] However, district officials say that Stoneman Douglas' security protocols may be implemented district-wide.[37]

Despite the criticism, schools around the country have implemented policies similar to Stoneman Douglas's, in the wake of its shooting. A Nassau County middle and high school, for example, recently mandated that students use clear backpacks.[38] These students have voiced similar apprehensions about the policy, namely their concerns about privacy and free expression.[39]

It is questionable whether clear backpack policies are the most effective method of ensuring students' safety. For many, the potential privacy infringements are a small price to pay to avoid another school shooting. However, as surveillance in schools continues to grow, it becomes difficult to discern when the procedures become counterproductive to a conducive and comfortable learning environment.

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ine what assets they could dispose of and still remain in operation, all the while getting the most value in return. Considering the large number of assets held by colleges and universities, this could be an immensely helpful tool in helping institutions generate capital.

These useful tools, however, are generally only available to debtors through bankruptcy and thus depriving colleges and universities from taking advantage of them severely limits their options when faced with financial hardship.

Removing the Anti-Bankruptcy Provision from the Higher Education Act

Because of the clear benefits to higher education institutions, the HEA could be amended to remove the outright prohibition against filing for bankruptcy. This amendment would not require complicated changes to the HEA, but could be accomplished through simple amendments to the HEA that address Congress' original concerns about institutions abusing the bankruptcy system.

One possible way to prevent potential abuses is to create a process by which the United States Department of Education would be closely involved throughout a higher education institution's bankruptcy proceeding. The Department already has the ability to appear in the bankruptcy case as a "party of interest" as a creditor of the filing institution. By appearing as an interested party in the case, the Department could monitor the filing institution's activities.[19]

To ensure proper oversight the Department could assign a specific person to track the case throughout the proceedings. If the Department begins to suspect that the institution is committing some type of fraud in the bankruptcy, the Department could step in and place restrictions on the institution's access to Title IV funds and otherwise notify the court. This is not to suggest that anything about the bankruptcy process itself needs to be changed when a higher education institution is involved. The Department of Education's involvement would only serve as an extra layer of protection and oversight to help quell Congress' concerns.

At a minimum, Congress could add a provision to the HEA that allows the Department to examine the individual situation of an institution and determine if it should be allowed to file for bankruptcy without losing its Title IV funding. The Department could come up with a list of criteria that an institution must meet in order to be exempt from the effective prohibition against bankruptcy to ensure that the institution's bankruptcy filing is not fraudulent. Adding this type of exception would allow higher education institutions that would legitimately benefit from bankruptcy to keep their Title IV funding while still preventing other institutions from abusing the system.

Above all, any amendments to the HEA should be aimed at protecting the interests of students. By not being able to file for bankruptcy, struggling higher education intuitions are often forced to abruptly close their doors which greatly disrupts their students' educations.

For example, this past April, Mount Ida College, a small liberal arts school in Massachusetts, announced it would be closing at the conclusion of the spring semester following numerous failed attempts at correcting its financial difficulties.[20] The news came as a shock to both current and incoming students leaving many to wonder how they would be able to continue their educations going forward.[21] Although the Mount Ida campus was acquired by the University of Massachusetts, many of the majors offered by Mount Ida will no longer be available, leaving students with limited viable options to continue their educations.

Students should be allowed to continue to work towards their degrees while their college or university attempts to resolve their financial issues through bankruptcy. Given the financial state of many higher education institutions around the country, Congress could act on this issue quickly before other long standing institutions are forced to shut down for good.

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