HIGHER ED IN DISTRESS: Is There a Restructuring Solution?

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The financial distress being experienced by many, if not most, colleges and universities—large and small, public and private, for-profit and not-for-profit—was thrust into the public eye by the May 2015 Chapter 11 filing of Corinthian Colleges, which had 107 campuses, employed over 10,000 people, and claimed over 74,000 enrolled students in the United States and Canada.[1] What was not so clear was that, although exacerbated by recent demographic and financial conditions and "gainful employment" regulations adopted by the U.S. Department of Education to protect students, this was not a new phenomenon:

> Resource allocations in American higher education are increasingly governed, on the one hand, by the constraints of a continuing fiscal crisis and, on the other, by pressures from business and political leaders who insist that colleges and universities help meet the challenges of a new economy. The result is a seemingly contradictory imperative that higher education do more with less. Achieving this objective may be impossible for the individual institution or faculty member, but I want to suggest that the contradiction is being resolved at a systemic level, through a combination of institutional responses to market forces and strategic planning at the state, regional, and federal level. These responses and plans — budget cuts, program eliminations, retrenchment, reallocation, curriculum reform, and a plethora of other changes — may seem bewildering and chaotic to individual faculty. It is my contention, however, that these responses are not confused, short-term measures that will go away "once the economy recovers."
> ....
> For better or worse, higher education is suffering from a profound decline of public confidence and when faculty invoke the hackneyed claims that "higher education is different" or that "quality cannot be measured," it will only reinforce public suspicion.

Was this written last month? Last year? Within the last decade? No, it was written in 1996, with an author's postscript from 2000.[2] Since for-profit colleges were largely unknown then, it was aimed at the traditional institutions, but it carries meaning still today.

The Problem

Unlike 1996, today there are two distinct "markets" in higher education served by two different kinds of providers: the traditional nonprofit college and university (NFPs) and the relatively new for-profit model (FPs), which came into existence to address the market of students who might not qualify for admission to traditional college programs. NFPs divide into roughly defined submarkets of the elite, heavily—or at least adequately—endowed institutions, and "everyone else," institutions that rely largely on enrollments and tuition to cover expenses. While NFPs on the whole are by no means thriving or financially healthy, they are in the main surviving, if not prospering, and doing much better than the FPs as a whole, of which only one or two "chains," if not wildly successful, are doing relatively well.

According to its first day declaration filed in its bankruptcy case, Corinthian was founded in 1995, and:

> [T]hrough acquisitions [it] became one of the largest for-profit post-secondary education companies in the United States and Canada. The Company offered career-oriented diploma and degree programs in diverse fields such as health care, business, criminal justice, transportation technology and maintenance, construction trades, and information technology. As of March 31, 2014, the Company operated over 100 campuses and provided educational opportunities to more than 74,000 students and had more than 10,000 employees. It also offered degrees online.[3]

There are now many FPs, the largest being Corinthian, University of Phoenix, Kaplan Higher Education, Capella University, ITT Educational Services, DeVry, Inc., and several others. It is likely that with the exception of ubiquitous University of Phoenix, most people not involved in the industry do not recognize those names.

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The companies face the same problems, and since they all depend upon enrollments and tuitions to fund the ventures and cover costs, in addition to large amounts of Department of Education funding—90 percent of revenue in Corinthian's case[4]—declines in those line items hit hard. Starting several years ago, as the result of increasing federal regulation, adverse publicity over high dropout rates and graduates' poor employment success, and the economic downturn and slow recovery, Kaplan, Corinthian, Phoenix, and Capella saw enrollment declines of 30 percent, 23 percent, 34 percent, and 36 percent, respectively.[5]

On the NFP side, things are not particularly rosy, either. The University of Wisconsin's battles with Governor Scott Walker have been front-page news. Walker came down hard on unions, refused to grant tuition increases, cut state spending, and advocated selling certain of the university's hard assets. Early in the spring of 2015, Sweet Briar College's board voted to shut down the 114-year-old women's school due to "insurmountable financial difficulties." (The shutdown has been stayed by the Virginia Supreme Court.[6])

Part of the reason for these hardships is that since 1975, four-year college tuitions have increased a whopping 1,000 percent versus an increase in the Consumer Price Index of 240 percent. The better-endowed schools have been able to address the problem in part by scholarships and grants funded by the endowments, but the "everyone else" schools have resorted to discounting tuition, which of course simply means less revenue, and student loan debt is now estimated to be over $1 trillion.[7] The so-called "law of more" has seen NFPs attempting to build their way out of the problem, but that has only led to increases in their long-term debt of some 12 percent *per year*.[8] Thus, enrollments are down, revenue is down, and long-term debt is up at almost all but the elite schools.

FPs are hardly free from debt. As of its petition date, for example, Corinthian owed $105.6 million in secured debt and estimated its unsecured debt of various types at $100 million.[9] In addition, because of well-publicized (and apparently well-founded) complaints of costly, low-prestige degrees that led to big student loan debt but no jobs, and high percentages of "sales" of enrollments generated by recruiters who were paid incentives for volume, which led to the enrollment of many students who were not "college ready" (subprime *déjà vu?*), the federal government adopted "gainful employment" regulations pursuant to the Higher Education Act of 1965[10] and brought enforcement actions pursuant to the regulations.

The FPs challenged the regulations on a number of grounds, including that they were discriminatory because they did not apply to NFPs. In late June, however, the District Court for the D.C. Circuit upheld them in an opinion broadly criticizing the schools, their policies, and their association that brought the action, quoting the Circuit Court's earlier opinion on a similar challenge that "'[t]hese [statutory] requirements are intended to ensure that participating schools actually prepare their students for employment, such that those students can repay their loans.'"[11]

In addition to its financial and federal problems, Corinthian and many of its officers and employees faced numerous enforcement and remedial actions from state agencies and attorneys general, particularly in California. Because of all these problems, there was really no enterprise to preserve. Accordingly, Corinthian proposed and on August 26, 2015, barely more than three months after the case was filed, the Delaware bankruptcy court approved a liquidating plan of reorganization. The key features of the plan were "carveouts" for federal and state authorities to continue their enforcement actions against the key players and the creation of a two-trust structure, which is to hold claims of students, governmental agencies, and the Department of Education and is funded by a $4.3 million reserve. Claimants will be eligible to participate in a tiered recovery regime.

Key to the plan's approval was the court's approval two weeks earlier of permission for the official committee representing student claimants to file a "collective claim" of $2.5 billion for Chapter 11 plan voting purposes, a procedure to which the Department of Education had objected. The final version of the combined disclosure statement and plan appears as Docket No. 909, the order confirming it is Docket No. 913, and the order approving the collective claim for voting is Docket No. 750.

Possible Solutions

Is bankruptcy an option? Yes and no. As the Corinthian filing makes clear, Chapter 11 is an option for FPs and it helps calm the waters, stay litigation and certain enforcement actions, and provide for the orderly sale and redeployment of assets, including pools of student loans,[12] although it also may well put an immediate and irreversible end to any FP or NFP institution's ability to participate in federal student aid programs.[13]

A fundamental question, however, given the state of FPs generally, is whether there is a genuine market for them. In other words, can colleges be effectively run as profitmaking ventures? According to a department head of a large Midwestern university, the answer is a resounding "No." Nor, the department head said, should NFPs emulate that model: "The assumption is that universities should view themselves and their operations just like private-sector businesses do. The history of intellectual advance in the U.S., powered by public and private universities, is not consistent with this assumption. The ongoing decline in the intellectual atmosphere of many universities is."

One solution being adopted by some FPs to deal with regulators' concerns and to reduce failed enrollments is a program which gives prospective students a free look at course work and gives the school a chance to evaluate whether the student is ready for college-level work.[14] Whether that stanches the flow remains to be seen.

For NFPs the answer is very different, in large part because of the stigma of bankruptcy and, for many smaller institutions, the challenge of proposing a feasible plan of reorganization, in addition to the potentially immediate loss of federal funding noted earlier. Pursuant to Section 1129(a)(11) of the Bankruptcy Code, a Chapter 11 plan may be confirmed only if "[c]onfirmation of the plan is not likely to be followed

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by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan."

In *In re Save Our Springs (S.O.S.) Alliance Inc.*,[15] which appears to be the only authority on the subject, the Fifth Circuit affirmed the district court in denying confirmation of a plan which had no institutional financing plan, just alumni support: "Voluntary pledges alone are too speculative to provide evidence of [plan] feasibility."[16]

What are the alternatives? A number of commentators—mainly from outside of academia, it should be noted—and of course Walker and other politicians have suggested a number of solutions short of bankruptcy, some obvious and others not so obvious:

- Reduce support staff and administrative costs.[17]

- Eliminate redundancies in IT, procurement, and administrators over common functions, not department by department. And consider outsourcing certain of them for which an academic institution is not necessarily a good source.[18]

- Focus on strengths and eliminate "outlier" curricula and programs for which there is little student demand.[19]

- On the political front, adopt state programs such as Virginia's Restructured Higher Education Financial and Administrative Operations Act of 2005, which "provided public colleges and universities (University of Virginia, Virginia Tech and the College of William and Mary) with more operational and administrative autonomy in exchange for a renewed commitment to their public missions," at least according to the commonwealth.[20]

- Sell or enter into sale and leaseback arrangements for appropriate core and noncore assets, such as food service buildings, utility plants, and housing facilities.

- Limit tenure and encourage faculty reduction through attrition.

- Have management done by managers, not academics.[21]

Not surprisingly, while acknowledging that *something* needs to be done and certainly that redundancies need to be eliminated, academia bristles at some of these proposals. In addition to the earlier observations, on the subject of "monetization" of assets and cutting outlier courses and programs, the Midwestern academic also believes:

It is a slippery slope argument, but one I think is accurate: sell your buildings to the highest bidder, generate money, eventually [you will] see money-generating potential in selling your intellectual soul to the highest bidder. You develop intellectual talent within the virtual walls of university protection, not by making the walls completely permeable to what's on the other side. Business ventures have to have this kind of permeability. Not so much intellectual capital.

The same may well hold true for online coursework. University of Phoenix touts its fully online degree programs, but from its dropout numbers and falling enrollment noted earlier, it does not seem that necessarily is a winning solution.

Conclusion

It is clear that Corinthian is but the first of any number of potential for-profit Chapter 11 filings. The appetite of purchasers and financiers to buy assets or extend additional or replacement credit facilities is not clear, certainly, until some level of equilibrium begins to materialize in the for-profit market. For the elite NFPs, with their reputation for attracting well-to-do students who can pay the freight, state support and endowment funds will most likely help them weather the storm, especially those which have already or are in the process of addressing financial realities. For the "everyone else" NFPs, the future looks somewhat bleak:

"Without a reliable source of funding to fund ongoing operating expenses or fund a Chapter 11 plan, nonprofits may be forced to close their doors and liquidate their operations under state law or in Chapter 7."[22]

[1] *In re Corinthian Colleges, Inc.*, Case No. 15-10952(KJC), D. Del. Bankr., May 4, 2015.

[2] C. Barrow, "The New Economy and Restructuring Higher Education," 12

Thought & Action, the NEA Higher Education Journal, 37 (Spring 1996); 16 *Thought & Action, The NEA Higher Education Journal*, 65, at 78. (Fall 2000) 65-82.

3 Docket No. 10, ¶ 8; the "Corinthian Dec."

4 *See* Corinthian Dec. ¶14.

5 P. Fain, "Enrollments tumble at for-profit colleges," Inside Higher Ed (insidehighered.com), Nov. 11, 2011.

6 nytimes.com/2015/06/10/us/sweet-briar-colleges-closing-temporarily-blocked-by-virginia-supreme-court.html?_r=0. An expansive list of schools in trouble as of 2013 appears in R. Rivard, "Private colleges remain under the weather," *Inside Higher Ed*, (insidehighered.com), December 9, 2013.

7 T. Stallkamp, "Higher Education Economics 101: Can Colleges, Universities Ace the Test?", *TMA Journal of Corporate Renewal*, Vol. 28, No. 5 at 13 (June 2015).

8 J. Denneen & T. Dretler, "The Financially Sustainable University," bain.com/publications/articles/financially-sustainable-university.aspx (2012).

9 *See* Corinthian Dec. ¶¶ 12-13.

10 20 U.S.C. §§ 1001 *et seq.*, 34 C.F.R. § 668.101 *et seq.*

11 *Association Of Private Sector Colleges & Universities v. Duncan*, __F. Supp. 3d ___ , ___, Slip Opinion at 1 (Civil Action No. 14-1870, June 23, 2015 D.D.C).

12 *See, e.g.*, P. Fain, "Guaranty agency buys most of crumbling for-profit Corinthian Colleges in U.S.," Inside Higher Ed, (insidehighered.com), November 21, 2014 (prepetition transaction).

13 *See* Corinthian Dec. ¶16.

14 *See, e.g.*, P. Fain, "Enrollments tumble at for-profit colleges," Inside Higher Ed, supra.

15 632 F.3d 168 (5th Cir.2011).

16 *Id.* at 172. It should be noted that other not-for-profits looking much more like businesses have successfully liquidated or reorganized, such as Allegheny Health Systems in the late 1990s and more recently the Philadelphia Orchestra Association, whose largest donor's prepetition grant of $50 million, significantly, remained intact as of the petition date.

17 Stallkamp at 14.

18 *Id.*

19 *Id.*

20 schev.edu/restructuring/restructuring.asp

21 "Higher education administrators are poor strategic planners. They embrace the rhetoric of 21st century business enterprise, while promoting an outdated model of corporate bureaucracy now abandoned by successful corporations." Barrow at 78.

22 C. Oellermann & M. Douglas, "The Trouble With Ch. 11 For Nonprofits," Law360, April 20, 2011.

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