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Can a For-profit Institution of Higher Education Take Advantage of Chapter 11?

Article By:

Restructuring & Bankruptcy

The **for-profit education space** is under pressure with many institutions needing some level of **restructuring**. Unfortunately, provisions of the **Higher Education Act** largely eliminate **Chapter 11** as a viable alternative for restructuring higher education institutions. The inability of for-profit institutions of higher education to file for Chapter 11 and maintain operations results from the dependence of most of those institutions on funding under Title IV of the Higher Education Act which is not available to an institution if the institution or an affiliate of the institution has filed for bankruptcy (20 U.S.C. 1002(a)(4)(A)). The result is that a for-profit institution that has filed (or had an affiliate file) for Chapter 11 is permanently ineligible for Title IV funding and therefore has limited reorganization alternatives.

Relatively few cases have addressed the impact of Title IV program eligibility upon an institution commencing a bankruptcy proceeding but those cases are uniformly consistent in holding that institutions that have filed for Chapter 11 are permanently ineligible for Title IV programs despite Section 525 of the Bankruptcy Code. In *In re Betty Owen Schools, Inc*., 195 B.R. 23 (Bankr. S.D.N.Y. 1996), Betty Owen provided adult or vocational education and received loans from the Department of Education under the Higher Education Act. Betty Owen filed a petition under Chapter 11 of the Bankruptcy Code and the Department revoked Betty Owen's right to participate in financial aid programs under Title IV because the schools were no longer eligible institutions. Betty Owen challenged that initial revocation and reached a settlement with the Department for certain limited funding. Thereafter, Betty Owen moved to sell substantially all of its assets pursuant to a 363 sale which was approved by the Bankruptcy Court. After the closing of the sale, the buyer filed an application for re-certification for Title IV funding under regulations that allow for a waiver of the normal two-year waiting period for certification if there is a change of ownership of an eligible institution. The Department denied the application because the buyer had purchased an institution that was not eligible for Title IV funds at the time of the sale. When Betty Owen and the buyer sought to overturn that decision, the Bankruptcy Court determined that the Department had acted consistent with the legislative intent and statutory interpretation of the Higher Education Act and therefore was not in violation of section 525(a) of the Bankruptcy Code. A similar result was reached in *New York Institute of Dietetics, Inc. v. Riley*, 966 F.Supp. 1300 (S.D.N.Y. 1997).

Another case that addressed these issues is In re the Women's Technical Institute, Inc., 200 B.R. 77 (Bankr. D. Mass. 1996). In that case, the Women's Technical Institute, Inc. filed a petition for relief

under Chapter 11 and the Department terminated WTI's eligibility to participate in the federal programs. The Department subsequently denied WTI's request for reimbursement and issued a notification of liability to WTI all without obtaining relief from the automatic stay. WTI then filed an adversary proceeding. WTI challenged the ability of the Department to take those actions. While the Court found a stay violation had occurred, it granted the United States relief from the automatic stay to effect a setoff. While the Court did protect the application of the automatic stay, it otherwise upheld the statutory scheme of the Higher Education Act.

This article was written with contributions from Beth Hodgman.

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