EMORY
LAW

Emory Bankruptcy Developments Journal

Volume 36
Issue 2 *The Seventeenth Annual Emory Bankruptcy Developments Journal Symposium*

Article 1

2020

Special Purpose Municipal Entities and Bankruptcy: The Case of Public Colleges

Matthew A. Bruckner

SPECIAL PURPOSE MUNICIPAL ENTITIES AND BANKRUPTCY: THE CASE OF PUBLIC COLLEGES

Matthew A. Bruckner[*]

ABSTRACT

This Article builds on the municipal bankruptcy literature by showing why the common analogy between corporate shareholders and city residents does not hold in the case of certain special purpose municipal entities. For example, some scholars argue that "local residents" are best situated to avoid municipal financial distress by preventing it ex ante through the political process or remedying it ex post by repaying creditors through increased taxes. But residents' ability to avoid financial distress is limited when a special purpose municipal entity spans political boundaries or tax jurisdictions because it is not clear who counts as a "local resident" in such cases. These boundary-spanning entities include certain hospitals and institutions of higher education. Instead of residents, this Article concludes that either creditors or the state are better situated to address the financial distress of boundary-spanning special purpose municipal entities, such as public institutions of higher education.

This Article also reviews every decision where eligibility for relief under chapter 9 of the Bankruptcy Code was contested and distills a set of definitions for "municipality" that can be used to determine whether an entity must seek relief under chapter 9 (or if chapter 11 is available). Then, this Article applies those definitions to public institutions of higher education and determines that they, unlike private institutions, are eligible for relief only under chapter 9 of the Bankruptcy Code. This is the same set of provisions under which Detroit, Michigan and Stockton, California sought relief. But because many states restrict access to chapter 9 entirely, access to the bankruptcy courts may be completely unavailable for public institutions of higher education in those states.

---

[*] Associate Professor of Law, Howard University School of Law. For their comments, ideas, and suggestions, I owe a debt to Kevin Baum, Chris Bradley, Kara Bruce, Vincent Buccola, Laura Napoli Coordes, Perry Dane, Steve Golden, Juliet Moringiello, Nancy Rapoport, and Amy Schmitz. I am also indebted for the comments received from attendees at the 2018 SEALS conference, the 2019 AALS Section on Nonprofits and Philanthropy Law meeting, and a faculty colloquium at Widener University Commonwealth Law School. I would like to extend a special thanks to Pamela Foohey for serving as my mentor at the SEALS New Scholars Workshop and commenting on this article. Research assistance was provided by Donte Z. Bronaugh, Victoria Capatosto, Elizabeth Gabaud, Paul Lisbon, Alexander Scott McGee, and Zoe Nwabunka. As always, this Article would not have been possible without the support and feedback of my wife, Morgan Hall. A grant from Howard University School of Law made this Article possible.

INTRODUCTION

Financial distress continues to plague institutions of higher education (IHEs), including public IHEs.[1] For example, in 2019 Alaska threatened to slash its higher education budget by $135 million, equivalent to a "41 percent reduction in state funding."[2] The severity of these cuts prompted an "unusual" letter from the University of Alaska's accrediting body, the Northwest Commission on Colleges and Universities, to the Alaska Legislature warning that the cuts could "potentially jeopardize the accreditation status of these institutions."[3] Also arguing against the cuts, University of Alaska president Jim Johnsen claimed that the size of these reductions would force the system to:

> abruptly halt[] numerous student career pathways midstream, eliminat[e] services or shut[] down community campuses or universities[,] . . . discontinu[e] . . . programs and services with little or no notice, and that in turn will have ripple effects, damaging UA's ability to generate revenue and causing even greater harm across the state.[4]

In response to these cuts, the University of Alaska system declared a "so-called financial exigency," which would allow employees, including tenured professors, to be quickly fired and programs, or even entire campuses, to be closed.[5] Financial exigency has been called the "the academic equivalent of bankruptcy reorganization . . . ."[6] But why not use the regular bankruptcy system? After all, debtors in a bankruptcy proceeding gain access to a set of tools for resolving that entity's financial distress.[7]

---

[1] Many land grant colleges and universities have become public IHEs in the way we think about these categories today. As such, the analysis contained herein applies to them as it does to other public IHEs. To the extent that a land grant college or university is now a private institution, the analysis contained herein does not apply to them. *See* Perry Dane et al., *Saving Rutgers-Camden*, 44 RUTGERS L.J. 337, 398 (2014) (arguing that "the concepts of 'public' and 'private' are deeply, and rightly, consequential, the meaning of those concepts, and not only their specific applications, turn out to be contingent, contested, and richly complex.").

[2] Colleen Flaherty, *Accreditation Risk from Alaska Cuts*, INSIDE HIGHER ED (July 10, 2019), https://www.insidehighered.com/news/2019/07/10/u-alaskas-accreditor-warns-funding-cuts-could-threaten-systems-status. Ultimately, the university's budget was cut by $70 million over three years, instead of an immediate, $135 million cut. *See* Doug Lederman, *Budget Compromise in Alaska*, INSIDE HIGHER ED (Aug. 14, 2019), https://www.insidehighered.com/news/2019/08/14/alaskas-governor-and-university-reach-compromise-nearly-halve-budget-cut.

[3] Flaherty, *supra* note 2; *see* Lederman, *supra* note 2.

[4] *Id.*

[5] Yereth Rosen, *University of Alaska Regents Postpone 'Financial-exigency' Decision*, REUTERS (July 15, 2019), https://www.reuters.com/article/us-alaska-politics-idUSKCN1UB05E.

[6] *Id.*

[7] *See infra* notes 38–49 and accompanying text (discussing the bankruptcy toolkit).

As discussed in several earlier articles, bankruptcy reorganization is functionally unavailable to nearly all IHEs because the Higher Education Act (HEA) makes entering bankruptcy "an effective death sentence" for most IHEs.[8] I've argued that this should be changed.[9] But even if the HEA were to be amended, bankruptcy reorganization would remain unavailable for many public IHEs because of state restrictions on bankruptcy access.

This Article highlights that public IHEs are, in many states, doubly barred from bankruptcy reorganization—one legal bar and one economic. By analyzing the existing case law on access to chapter 9 of the Bankruptcy Code, this Article concludes that public IHEs are likely to be classified as municipalities for bankruptcy purposes, meaning they are barred from using chapter 11. Instead of using chapter 11, they may use chapter 9, if they have access at all. Access to chapter 9 is severely restricted, with "[o]nly twelve states specifically authoriz[ing] chapter 9 filings. Fifteen state[s] offer some limited form of chapter 9 filings for municipalities. The remaining 23 states do not authorize chapter 9 filings for municipalities."[10] In other words, in approximately half the states, public IHEs have no access to bankruptcy reorganization in any form.[11]

Finally, this Article engages with the literatures on municipal financial distress and the governance of financially distressed entities to consider their application to public IHEs. Municipal bankruptcy law must balance the interests

---

8 Matthew Adam Bruckner, *Bankrupting Higher Education*, 91 AM. BANKR. L.J. 697, 698 (2017) [hereinafter, Bruckner, *Bankrupting*] (discussing the tools available to colleges in a bankruptcy reorganization, how colleges would benefit from the use of those tools, and arguing for lifting the bankruptcy ban for IHEs); *see* Matthew Adam Bruckner, *Higher Ed "Do Not Resuscitate" Orders*, 106 KY. L.J. 223, 228 (2018) [hereinafter, Bruckner, *DNRs*] ("Essentially, Congress has imposed an involuntary 'do not resuscitate' order on IHEs, condemning some socially valuable enterprises to an unnecessary death."). *But see Morris Brown: How an Atlanta HBCU Fell into Bankruptcy*, THE ATLANTA J.-CONSTITUTION (Jan. 31, 2018), https://www.ajc.com/news/local/morris-brown-college-timeline/I8aag6h6giHpHW84ExIAfM/ (discussing Morris Brown's emergence from chapter 11 as an operating entity, albeit without access to Title IV funds). And while bankruptcy reorganization is unavailable for most IHEs, IHEs can liquidate in bankruptcy. *See, e.g.*, Mark Reilly, *McNally Smith College Files for Bankruptcy*, MINNEAPOLIS / ST. PAUL BUS. J. (Feb. 9, 2018), https://www.bizjournals.com/twincities/news/2018/02/09/mcnally-smith-college-files-for-bankruptcy.html.

9 *See* Bruckner, *Bankrupting*, *supra* note 8, at 698–99; *see also* Bruckner, *DNRs*, *supra* note 8, at 229. Others have made similar claims as well. *See* Scott F. Norberg, *Bankruptcy and Higher Education Institutions*, 23 AM. BANKR. INST. L. REV. 385, 392 (2015); *see also* Michael B. Goldstein & Jay Indyke, *Bankruptcy Benefits*, TRUSTEESHIP MAGAZINE, (Sept./Oct. 2016), www.agb.org/trusteeship/2016/septemberoctober/bankruptcy-benefits.

10 D. Nicholas Panzarella, *Determining the Meaning of "Instrumentality" in the Bankruptcy Code*, 7 ST. JOHN'S BANKR. RESEARCH LIBR. No. 17, at *12 (2015) (citing Kenneth E. Noble & Kevin M. Baum, *Municipal Bankruptcies: An Overview and Recent History of Chapter 9 of the Bankruptcy Code*, 9 PRATT'S J. BANKR. L. 513 (2013)).

11 Legislatures could, of course, authorize a distressed public IHE to reorganize either through a one-off authorization or a more broadly-applicable statutory amendment.

of a state's residents, local (the municipality's) residents, and their creditors. This Article analyzes whether "residents," creditors, or state financial boards are best situated to prevent or remedy the financial distress of public IHEs. In doing so, this Article builds on the municipal bankruptcy literature by showing why the common analogy between corporate shareholders and city residents does not hold in the case of certain special purpose municipal entities.

For example, some scholars argue that "local residents" are best situated to avoid municipal financial distress by preventing it ex ante through the political process or remedying it ex post by repaying creditors through increased taxes or selling municipal assets. But residents' ability to prevent or remedy financial distress is limited when a special purpose municipal entity spans political boundaries and tax jurisdictions. These boundary-spanning entities include certain hospitals and institutions of higher education. In addition, it is not clear who counts as a "local resident" in such cases. This Article concludes that neither creditors[12] nor the state are necessarily better situated to prevent or remedy the financial distress of boundary-spanning special purpose municipal entities, such as public institutions of higher education. But local "residents" should clearly not bear that burden.

In conclusion, this Article argues that because public IHEs cannot currently reorganize in bankruptcy and because states have not created higher education financial control boards, many public IHEs suffer unnecessarily, harming students, residents, faculty, staff, and others. States need to reorganize their higher education systems and choose a path forward for their public IHEs.

---

[12] Forcing creditors to bear the brunt of a public IHE's financial distress would be best accomplished through bankruptcy reorganization, but this assumes that access to Title IV would remain available, which it currently does not for reasons addressed in earlier work. *See supra* note 9.

I. MANY PUBLIC IHES ARE FINANCIALLY DISTRESSED

Even before the losses IHEs are anticipating because of the novel coronavirus, SARS-CoV-2, many public IHEs were in financial trouble.[13] On an inflation-adjusted basis, funding for public IHEs is down substantially since the 2008 recession, with twenty states cutting per student support "by more than 20 percent," and nine states cutting more than 30 percent.[14] And the cuts continue. Alaska just cut approximately twenty percent of its planned allocation to the University of Alaska system (after threatening a forty percent reduction).[15] The threatened cuts were expected to result in "massive" layoffs, and a drop "in student enrollment because of program eliminations and reputational damage to the institutions."[16] But even the smaller reduction would result in restrictions, administrative consolidation, and restructuring.[17]

In Wisconsin, state funding dropped by "$362 million from fiscal 2012 to 2017," forcing "campuses to lay off employees, freeze vacant positions, consolidate administrative functions, cut back on academic advising and offer fewer course sections."[18] Similarly, the University of Puerto Rico expects to receive less than half the appropriation it has historically received from the Puerto Rican government.[19]

---

13 Michael Mitchell et al., *Unkept Promises: State Cuts to Higher Education Threaten Access and Equity*, CTR. ON BUDGET AND POLICY PRIORITIES (Oct. 4, 2018), https://www.cbpp.org/research/state-budget-and-tax/unkept-promises-state-cuts-to-higher-education-threaten-access-and ("Overall state funding for public two- and four-year colleges in the school year ending in 2018 was more than $7 billion below its 2008 level, after adjusting for inflation."); *cf.* Bruckner, *Bankrupting*, *supra* note 8, at 700–05 (discussing the financial headwinds faced by many IHEs); Bruckner, *DNRs*, *supra* note 8, at 231–38; Matthew Adam Bruckner, *Terminating Tenure: Rejecting Tenure Contracts in Bankruptcy*, 92 AM. BANKR. L.J. 255, 258–61 (2018) [hereinafter, Bruckner, *Terminating Tenure*].

14 Mitchell et al, *supra* note 13, at 3.

15 Nick Hazelrigg, *'Shocking' Cut May Force Layoffs for Alaska's Universities*, INSIDE HIGHER ED (July 1, 2019), https://www.insidehighered.com/news/2019/07/01/imminent-massive-cuts-could-force-faculty-staff-layoffs-university-alaska-system.

16 *Id.*

17 *See* Doug Lederman, *Budget Compromise in Alaska*, INSIDE HIGHER ED (Aug. 14, 2019), https://www.insidehighered.com/news/2019/08/14/alaskas-governor-and-university-reach-compromise-nearly-halve-budget-cut.

18 Karen Herzog & Jason Stein, *Walker Proposes Tuition Cut, UW Funding Boost*, MILWAUKEE J. SENTINEL (Feb. 7, 2017), https://www.jsonline.com/story/news/politics/2017/02/07/gov-scott-walker-announce-details-his-university-wisconsin-tuition-cut-tuesday/97586678/.

19 By 2022, its appropriation is expected to drop "under $400 million, 56 percent lower than the $879 million baseline figure at which the Puerto Rican government historically funded the university's operations." Elizabeth Redden, *Deep Cuts in Puerto Rico*, INSIDE HIGHER ED (July 11, 2019), https://www.insidehighered.com/news/2019/07/11/university-puerto-rico-faces-deep-cuts-appropriations#.XS4g74xpmk8.twitter (citing "estimates that the university has lost about 40 percent of its professors from attrition over the past decade" while tuition has nearly tripled on a per credit basis).

It is not clear that public IHEs will have to endure the "transformative re-alignment" that some commentators have long predicted for the entire higher education sector—though the current pandemic will surely have long-lasting effects.[20] But it is also undeniable that some IHEs that are currently struggling will merge or close.[21] Scores of IHEs close every year,[22] including more than two dozen public IHEs in the last few years.[23]

Most IHEs that close are small, for-profit trade schools, such as cosmetology schools.[24] But "a significant number" of small independent colleges have shuttered their doors, most of which suffered from a mix of questionable management, enrollment declines, and adverse economic headwinds.[25] Closer

[20] *See, e.g.*, Stuart M. Butler, *The Coming Higher-Ed Revolution*, NAT'L AFFAIRS (Winter 2012), http://www.nationalaffairs.com/publications/detail/the-coming-higher-ed-revolution (describing the higher education industry as being on the "verge of . . . a transformative re-alignment"); Doug Lederman, *The Culling of Higher Ed Begins*, INSIDE HIGHER ED (July 19, 2017), https://www.insidehighered.com/news/2017/07/19/number-colleges-and-universities-drops-sharply-amid-economic-turmoil [hereinafter, Lederman, *Culling*] (noting that "[i]t has become trendy to predict that higher education is on the verge of a major collapse . . . .").

[21] "Georgia, which has lapped all other states with a five-round consolidation tear that has combined 14 institutions into seven since 2011 and currently has leaders attempting to fold four more into two institutions." Rick Seltzer, *Are Mergers in Pennsylvania Higher Ed's Future?*, INSIDE HIGHER ED (Mar. 27, 2017), https://www.insidehighered.com/news/2017/03/27/mergers-havent-been-part-pennsylvania-public-higher-eds-past-might-future-be.

[22] Almost 100 (predominantly private) IHEs closed for good in 2015–16. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, *Education Should Address Oversight and Communication Gaps in Its Monitoring of the Financial Condition of Schools* (Aug. 2017), https://www.gao.gov/assets/690/686709.pdf; *see also* Richard Fossey, *763 Colleges and Schools Closed Last Year, and Most of Their Former Students Have Student Loan Debt*, CONDEMNED TO DEBT: THE $TUDENT LOAN CRISIS (Mar. 10, 2017), http://www.condemnedtodebt.org/2017/03/763-colleges-and-schools-closed-last.html (more than 13,000 federal-aid-receiving, post-secondary schools (or branch campuses) have closed since 1984); Goldstein & Indyke, *supra* note 9 (noting that 160 independent colleges have closed since 2000); Lederman, *Culling*, *supra* note 20; Kate Smith, *Here's What Happens to Endowments When Colleges Close*, BLOOMBERG (Mar. 6, 2017), https://www.bloomberg.com/news/articles/2017-03-06/orphan-endowments-of-dead-schools-bedevil-states-across-america (citing figures from the Education Department to conclude that hundreds of college campuses close each year, including 763 campuses in 2016).

[23] Lederman, *Culling*, *supra* note 20 ("The number of public colleges edged down to 1,985 in 2016–17, from 1,990 in 2015–16 and 2,009 in 2012–13.").

[24] Fossey, *supra* note 22 (describing most closed schools as "small propriety trade schools, barber schools, schools of cosmetology, etc, which had relatively small numbers of students.").

[25] *Id.*; *see also* Doug Lederman, *Another Small Private Closes Its Doors: Dowling College*, INSIDE HIGHER ED (June 1, 2016), https://www.insidehighered.com/quicktakes/2016/06/01/another-small-private-closes-its-doors-dowling-college. However, some closures have been large, publicly-traded educational enterprises. *See, e.g.*, Bruckner, *Bankrupting*, *supra* note 8, at 704 (discussing the collapse of Corinthian and Anthem colleges).

to home for many readers may be the news that, since 2017, six law schools have closed or announced they will close.[26] Other law schools have merged.[27]

But most relevant to this Article, public IHEs are also struggling.[28] In the last few years, twenty-five public IHEs closed.[29] And more might follow, including some public IHEs in Pennsylvania.[30] Pennsylvania has kept some of its IHEs afloat through a series of loans, but legislators' willingness to continue doing so and the universities' ability to credibly commit to repay those loans appears to be wearing out.[31] The Pennsylvania higher education system has weakened financially because of adverse demographic trends, falling

[26] These schools are Arizona Summit Law School, Charlotte School of Law, Indiana Tech Law School, Savannah Law School, Valparaiso University Law School, and Whittier Law School. *See Welcome to Arizona Summit Law School*, ARIZ. SUMMIT LAW SCH., https://azsummitlaw.edu/index.php (last accessed Apr. 2, 2019); Elizabeth Olson, *For-Profit Charlotte School of Law Closes*, N.Y. TIMES (Aug. 15, 2017), https://www.nytimes.com/2017/08/15/business/dealbook/for-profit-charlotte-school-of-law-closes.html?_r=0; Marilyn Odendahl, *Indiana Tech's Closing of Law School Leaves Unanswered Questions*, IND. LAWYER (May 31, 2017), https://www.theindianalawyer.com/articles/43828-indiana-techs-closing-of-law-school-leaves-unanswered-questions; Debra Cassens Weiss, *Savannah Law School Will Close, Students and Faculty Are Told*, AM. BAR ASS'N J. (Mar. 22, 2018), http://www.abajournal.com/news/article/savannah_law_school_will_close_students_and_faculty_are_told; Emma Whitford, *Another Law School Will Close*, INSIDE HIGHER ED (Oct. 31, 2018), https://www.insidehighered.com/news/2018/10/31/valparaiso-law-school-will-close-following-unsuccessful-attempt-transfer-middle; Sonali Kohli, et al., *Whittier Law School Is Closing, Due in Part to Low Student Achievement*, L.A. TIMES (Apr. 20, 2017), http://www.latimes.com/local/education/la-me-edu-whittier-law-school-closing-20170420-story.html. Western State College of Law at Argosy University was expected to close after its parent shut down, but appears to have struck a deal to remain open for now. *See* Matthew Adam Bruckner, *The Forgotten Stewards of Higher Education Quality*, 11 U.C. IRVINE L. REV. __ (forthcoming 2020) (unpublished manuscript on file with author) (discussing Argosy University's sudden closure).

[27] Hamline and William Mitchell merged their law schools, Cooley closed one of its campuses, and several law schools administratively merged. *See* Adam Wahlberg, *Why William Mitchell and Hamline Law Had to Merge*, MINN. POST (Feb. 18, 2015), https://www.minnpost.com/education/2015/02/why-william-mitchell-and-hamline-law-had-merge/ (discussing the Hamline-William Mitchell merger); Nathan Bomey, *Cooley Law School Closing Ann Arbor Campus*, DETROIT FREE PRESS (Oct. 9, 2014), http://www.freep.com/story/money/business/michigan/2014/10/09/cooley-law-school-closing-ann-arbor-campus/16960617/ (discussing Cooley "closing its Ann Arbor campus amid a nationwide downturn in law school enrollments"); *American Bar Association Approves Merger Creating Rutgers Law School*, RUTGERS NEWS (July 31, 2015), https://news.rutgers.edu/news-release/american-bar-association-approves-merger-creating-rutgers-law-school/20150727#.WhJDGktrzBI (noting the merger of Rutgers-Camden and Rutgers-Newark); Dawn Rhodes, *UIC Approves Merger with John Marshall Law School*, CHI. TRIB. (July 19, 2018), http://www.chicagotribune.com/news/ct-met-john-marshall-law-school-uic-20180719-story.html (focusing on the merger between John Marshall Law School and the University of Illinois at Chicago, creating Chicago's first public law school).

[28] Lederman, *Culling*, *supra* note 20 ("While for-profit colleges' woes may be driving the numbers, public and private nonprofit colleges have not been immune.").

[29] *Id.*

[30] *See* Marc Levy, *Some PA State Colleges in Danger of Closing*, THE MORNING CALL (Feb. 27, 2017, 12:08 PM), http://www.mcall.com/news/breaking/mc-pa-state-colleges-in-danger-20170225-story.html#.

[31] *See* Rick Seltzer, *Are Mergers in Pennsylvania Higher Ed's Future?*, INSIDE HIGHER ED (Mar. 27, 2017), https://www.insidehighered.com/news/2017/03/27/mergers-havent-been-part-pennsylvania-public-higher-eds-past-might-future-be.

enrollment, and decreased state funding.[32] As a result, some expect the state to recommend "that some of the schools shut their doors."[33]

Many other state higher education systems are facing issues similar to Pennsylvania's.[34] And some, such as Georgia, have responded by aggressively reducing the number of its public IHEs.[35] Among states with struggling public higher education systems, Georgia has shown itself to be particularly willing to consolidate its public IHEs, with multiple rounds of forced mergers occurring since 2011.[36]

II. THE BANKRUPTCY REORGANIZATION TOOLKIT

"Going bankrupt" is an expression with negative connotations for many people.[37] But bankruptcy lawyers know that bankruptcy reorganization allows struggling enterprises to access a set of tools for addressing financial distress that are generally not available outside of bankruptcy. As a result, bankruptcy lawyers often encourage their financially distressed clients to seek bankruptcy

---

32 *Id.* ("as enrollment dropped, state funding slowed and Rust Belt demographic trends increased downward pressure on the system's potential for a long-term recovery."); *see also* Kellie Woodhouse, *Mergers on the Rise?*, INSIDE HIGHER ED (July 7, 2015), https://www.insidehighered.com/news/2015/07/07/colleges-struggle-some-look-partnerships-and-mergers-relief ("Per-student funding at public colleges has seen near across-the-board decreases in the U.S."); Levy, *supra* note 30 ("Pennsylvania's university system is suffering from dropping in-state high school graduations, a result of fewer school-age youth, and similarly deep cuts in state aid over the past eight years. The system is also at a disadvantage with many campuses in relatively rural areas trying to compete with urban powerhouses such as Temple University or the University of Pittsburgh, or Penn State and its satellite campuses.").

33 Levy, *supra* note 30.

34 *See, e.g.*, Scott Waldman, *Consolidation Cuts 3 SUNY President Jobs*, TIMESUNION (Aug. 18, 2011), https://www.timesunion.com/local/article/Consolidation-cuts-3-SUNY-president-jobs-2079006.php (reporting on financial issues in the New York State public college system that resulted in administrative consolidation).

35 Ry Rivard, *Going Wild on Mergers*, INSIDE HIGHER ED (Jan. 7, 2015), https://www.insidehighered.com/news/2015/01/07/georgia-officials-hope-georgia-state-u-can-improve-local-two-year-college-taking-it ("With this change, he'll have reduced the number of colleges in the system to 29 from 35 when he took office in 2011. The system's Board of Regents also on Tuesday finalized the merger of Kennesaw State University and Southern Polytechnic State University."); Levy, *supra* note 30 ("In Georgia, the state university system is pursuing a five-year plan to merge eight public colleges into four following cuts in state aid."); Woodhouse, *supra* note 32 (discussing the merger of public IHE, Salem State).

36 "Georgia, which has lapped all other states with a five-round consolidation tear that has combined 14 institutions into seven since 2011 and currently has leaders attempting to fold four more into two institutions." Seltzer, *supra* note 31. In 2018, the University of Wisconsin received approval from its accreditor "to merge its 13 two-year campuses with seven of its four-year colleges . . . ." Kelly Meyerhofer, *UW System Merger Approved. Here's When the Official Transfer Takes Place*, WISCONSIN STATE J. (June 30, 2018), https://madison.com/wsj/news/local/education/university/uw-system-merger-approved-here-s-when-the-official-transfer/article_aa4d164b-4983-5306-ab53-b1e766bd465c.html.

37 *See, e.g.*, Michael D. Sousa, *Bankruptcy Stigma: A Socio-Legal Study*, 87 AM. BANKR. L.J. 435, 464 (2013) (reporting that "feelings of shame and embarrassment can persist for years after the bankruptcy filing.").

protection sooner rather than later. And the bankruptcy toolkit may be useful for some public IHEs.[38]

The bankruptcy toolkit includes: (i) deleveraging an entity's balance sheet through the discharge available at the confirmation of a bankruptcy case;[39] and (ii) the ability to renegotiate, assume, assign, or reject certain pre-bankruptcy contracts, including unexpired leases and collective bargaining agreements.[40] Bankruptcy courts also have a convening power that encourages creditors to renegotiate various obligations.[41]

The ability to renegotiate contractual obligations is critical for public IHEs that are "likely to need to restructure their operations and finances in response to changes in student demand."[42] For example, public IHEs have employment contracts with athletic coaches and vendors that they may want to terminate if they eliminate a particular sport program.[43] They may also want to reduce

---

[38] For most IHEs, the bankruptcy toolkit includes the automatic stay, which can give an entity that is trying to turn itself around "the breathing room needed to focus on restructuring their obligations instead of lurching from crisis to crisis." Bruckner, *DNRs*, *supra* note 8, at 245; *see also* 11 U.S.C. § 362 (2019). But while the ability to seize the debtor's property is "[t]he most basic remedy available to creditors in the private sphere," courts have long restricted creditor's ability to seize the property of a public debtor. *See* Randal C. Picker & Michael W. McConnell, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 429–30 (1993) (citing City of Chicago v. Hasley, 25 Ill. 485, 487 (1861) (holding "that a *fi. fa.* cannot issue against the city of Chicago.")); *see also* Juliet M. Moringiello, *Municipal Capital Structure and Chapter 9 Creditor Priorities*, BROOKINGS INST. (2016), https://www.brookings.edu/wp-content/uploads/2016/10/moringiello1.pdf ("Public debtors are unique in that their assets are not available to creditors, thus limiting creditor remedies against municipalities."); Farmerville v. Commercial Credit Co., 136 So. 82, 84 (1931) (holding that machinery incorporated into a public waterworks was unavailable to be levied upon, despite the town having voluntarily granted a lien on the machinery).

[39] *See* 11 U.S.C. §§ 901(a), 943(b), and 944(b) (2019); *cf.* 11 U.S.C. § 1129 (2019). Public IHEs may be better able to take advantage of this tool than many debtors because they are less likely to have secured debt. Public IHEs cannot issue blanket liens on all assets as many private companies claim to do. *See generally* Melissa B. Jacoby & Edward J. Janger, *Tracing Equity: Realizing and Allocating Value in Chapter 11*, 96 TEX. L. REV. 673 (2018) (contesting the claim that either Article 9 of the UCC or the Bankruptcy Code allows a company to issue a blanket lien covering a firm's going concern value).

[40] *See* 11 U.S.C. §§ 365, 1113, 1114 (2019); *see also In re* City of Vallejo, 403 B.R. 72, 78 (2009) ("[S]ection 1113 is not applicable in chapter 9 cases, and a chapter 9 debtor is not required to comply with it in order to reject an executory collective bargaining agreement."); *see generally* Bruckner, *Terminating Tenure*, *supra* note 13 (focusing on the treatment of tenure contracts by bankrupt IHEs).

[41] *See, e.g.*, Adam J. Levitin, *Bankrupt Politics and the Politics of Bankruptcy*, 97 CORNELL L. REV. 1399, 1447 (2012) ("As a convening tool, bankruptcy brings all claimants together into a single proceeding and settles (nearly) all claims.").

[42] Bruckner, *DNRs*, *supra* note 8, at 247.

[43] *See, e.g.*, Blair Kerkhoff, *As Missouri Higher Education Budget Is Slashed, Sports Programs Also Face Cuts*, KAN. CITY STAR (July 7, 2017), https://www.kansascity.com/sports/college/article160193359.html (discussing the cost savings from, among other things staff reductions, that accompanies eliminating various sport teams, such as field hockey at Missouri State, the dance team at Missouri Southern, and cheerleading at UMKC).

headcount in other areas as well, such as dismissing tenured faculty or unionized adjuncts, particularly in departments that no longer attract many students.[44] While some of these contracts are likely to have financial exigency clauses that allow termination outside of bankruptcy, not all do and many financial exigency clauses require that certain procedural steps be taken before they can be exercised.[45] Thus, this bankruptcy tool remains valuable for public IHEs.

Public IHEs may restructure their contractual obligations outside of bankruptcy. But they are liable to their counterparties for the full amounts due under those contracts if they breach their obligations outside of bankruptcy. By contrast, the Bankruptcy Code puts debtors in a very strong negotiating position vis-à-vis their contractual counterparties by allowing debtors to terminate their contracts and pay their counterparties as unsecured creditors, meaning that counterparties often receive a very small payout. The threat of reduced payouts can create a strong incentive for counterparties to restrike their bargain and to offer debtors more favorable terms. This power is even more pronounced in municipal bankruptcy cases, which removes certain limits on terminating collective bargaining agreements, which are present in other types of bankruptcy cases.[46]

Another important tool in the bankruptcy toolkit is the ability to discharge some forms of overindebtedness. Southern Vermont College blamed, in part, excessive debt as the reason for the school's financial difficulties and ultimate closure.[47] An IHE may grow overindebted for various reasons, including because it expanded too quickly[48] or because of "lax oversight and startling

---

[44] *See* Gregory M. Saltzman, *Dismissals, Layoffs, and Tenure Denials in Colleges and Universities*, *in* Harold S. Wechsler (ed.), *NEA 2008 ALMANAC OF HIGHER EDUCATION 1, 52* (2008), https://www.nea.org/assets/img/PubAlmanac/ALM_08_05.pdf ("Layoffs at a college or university may result from reduced state appropriations for public higher education, enrollment declines that lower the need for personnel, or a decision to close an academic program to free up funding for others."); *see generally* Bruckner, *Terminating Tenure*, *supra* note 13.

[45] *See* Bruckner, *Terminating Tenure*, *supra* note 13, at 284–85.

[46] *See* Picker & McConnell, *supra* note 38, at 467 ("Unlike private debtors, therefore, municipal debtors might be able to unilaterally abrogate collective bargaining agreements, subject only to liability for damages for breach of contract.").

[47] *See* Lola Duffort, *Southern Vermont College Says It Will Close This Summer*, VT. DIGGER (Mar. 4, 2019), https://vtdigger.org/2019/03/04/southern-vermont-college-says-will-close-summer/ (noting that Southern Vermont College's "heavy debt service was a factor in the school's financial difficulties" and ultimate closure).

[48] *See* Bruckner, *Bankrupting*, *supra* note 8, at 702 (discussing the rapid expansion of Corinthian Colleges and suggesting that this may have contributed to its demise); *see also* Alex Keefe, et al., *A Look at Jane Sanders' Role in the Closure of Burlington College*, VPR (May 18, 2016), http://digital.vpr.net/ post/look-jane-sanders-role-closure-burlington-college (discussing Burlington College's failed plan to repay debt related to a substantial expansion of its physical plant, which ultimately contributing to the college's closure).

mismanagement . . . ."[49] By improving operations, and focusing on the IHE's distinctive attributes, a formerly distressed IHE may be able to balance its budget and return to good financial health.

An example of a distressed IHE that could likely benefit from the bankrupcy toolkit is Cheyney University of Pennsylvania. Cheyney, a historically black college that is part of the Pennsylvania State System of Higher Education, has endured a raft of financial issues recently.[50] Cheyney's problems arise from a variety of sources, but mismanagement seems to be one of the most important. For example, Cheyney's enrollment declined precipitously from about 1,500 students in 2007 to fewer than 500 enrollees in 2018 in part because the university "failed to open or process the applications of as many as 3,000 prospective students between 2012 and 2015."[51] The university also failed to collect tuition from students that it did enroll, with as much as "$7 million in outstanding tuition bills" at one point.[52] Even more troubling, Cheyney may have violated state and federal law, including U.S. Department of Education regulations related to its handling of federal grant, loan, and work-study funds.[53] These failures have imperiled Cheyney's financial health, requiring repeated cash infusions from the Pennsylvania,[54] placed Cheyney's accreditation in serious risk,[55] and resulted in Cheyney being placed on Heightened Cash Management 2 status by the Education Department.[56]

---

[49] Nancy Phillips, et al., *Can Cheyney University Survive?*, PHILA. INQUIRER (Nov. 15, 2017) https://www.inquirer.com/education/inq/cheyney-university-pennsylvania-hbcu-admissions-graduation-rate-failure-investigation-20171115.html ("Those dismal statistics come after more than a decade of unstable and at times questionable leadership, leaving the school with soaring debt as well as shrinking enrollment. But in the last several years, Cheyney's top administrators, along with its trustees and the state system's board of governors, have deepened the crisis through lax oversight and startling mismanagement . . . .").

[50] *Id.*

[51] *See id.* (listing Cheyney's various issues, including enrollment issues); *see also* Ryanne Persinger, *Cheyney University's President: 'There Will Be a Cheyney in the Future,'* PHILA. TRIB. (Mar. 4, 2019), https://www.phillytrib.com/news/local_news/cheyney-university-s-president-there-will-be-a-cheyney-in/article_a41725c0-15f0-50f3-b972-30209f1cd38c.html ("Cheyney had the steepest fall in enrollment among the 14 state-run colleges, according to data from the PASSHE. The number of students had plummeted by nearly 38 percent, going from 755 students being enrolled in the spring of 2018 to only 469 enrollees that fall.").

[52] Phillips, et al., *supra* note 49.

[53] *Id.* (describing possible violations including that "Cheyney administrators raided scholarship funds and research grants meant for students and faculty as well as other restricted funds totaling $3.4 million. They spent the money on day-to-day expenses, in possible violation of state and federal law." And a Justice Department investigation found "serious lapses in Cheyney's handling of $29 million in federal grants, loans, and work-study funds.").

[54] Persinger, *supra* note 51 (noting that Cheyney owes approximately $43 million to the state).

[55] *Id.* ("'[T]he issue is accreditation. If you don't get accredited, you're no longer eligible for Title IV funds, nor are you eligible for Pell Grants, etc., and we would default on one of the conditions of staying accredited,' he said about federal grants, student loans[,] and other funding.").

[56] Dan Bauman, *These Colleges' Finances Are Now Being Watched More Closely by the Education Dept.*, CHRONICLE OF HIGHER ED. (Sept. 27, 2018), https://www.chronicle.com/article/These-Colleges-Finances-

Although Pennsylvania seemed willing to work with Cheyney to forgive a substantial portion of its debt,[57] bankruptcy reorganization would allow an IHE to discharge some or all of its debt regardless of whether its creditors are willing to negotiate. While debt reduction alone is often not sufficient to return an IHE to financial health and ensure its continued viability, it is an important part of the equation. And schools like Cheyney, a historically black university serving historically disadvantaged students, is exactly the type of school that ought to be given a chance to recover from managerial missteps. Moreover, IHEs that are forced to close instead of reorganizing disrupt students' academic careers, with some students likely dropping out instead of transferring to another college.

* * *

In previous articles, I've made the case for allowing IHEs access to bankruptcy reorganization and I won't rehash those arguments here.[58] But even assuming that the HEA amendments I've previously recommended are adopted, those would only lift the higher education "do not resuscitate" order for private colleges.[59] Unless further steps are taken, bankruptcy reorganization is likely to remain unavailable for many public IHEs.[60] In the next section, this Article analyzes the existing case law regarding which entities must use chapter 9. It concludes that, unlike private IHEs, public IHEs are likely required to file bankruptcy under chapter 9 of the Bankruptcy Code. Although the case law is very sparse, existing doctrine provides a roadmap for courts to use when analyzing the availability of bankruptcy relief for public IHEs.

Assuming that courts agree with my analysis, many public IHEs will be forced to wind down entirely outside of bankruptcy because many states restrict access to chapter 9, and chapter 11 will be unavailable to public IHEs.[61] This

---

Are/244661.

[57] *See* Susan Snyder, *Cheyney University to Partner with Thomas Jefferson, Starbucks in a Comeback Bid*, PHILA. INQUIRER (July 31, 2018), https://www.inquirer.com/philly/education/cheyney-university-starbucks-partnership-institute-thomas-jefferson-starbucks-20180731.html ("The state system last year agreed to forgive $30 million in loans to Cheyney if it balances its budget in each of the next four years, with a warning that it would be the last financial lifeline."); *see also* Susan Snyder, *State Throws Cheyney University $30 Million Lifeline*, PHILA. INQUIRER (Aug. 22, 2017), https://www.inquirer.com/philly/education/cheyney-university-loan-state-forgives-30-million-20170822.html ("Pennsylvania's state university system on Tuesday extended a lifeline to struggling Cheyney University, agreeing to forgive more than $30 million in loans if the school can achieve and maintain a balanced budget over the next four years.").

[58] *See supra* note 9. I note, however, that the case has only been strengthened because of the current pandemic.

[59] Bruckner, *DNRs*, *supra* note 8.

[60] *See infra* Section III.

[61] In addition to chapter 9's advantageous collective bargaining rules, public IHEs could prefer to reorganize under chapter 9 instead of chapter 11. For instance, chapter 9 debtors have the exclusive right to

stands in contrast to the options available to private IHEs, which may currently liquidate in chapter 7 and which would be allowed to reorganize under chapter 11, if the HEA were amended according to my previous suggestions.

III. PUBLIC IHES MAY NOT FILE CHAPTER 11

Under the United States Bankruptcy Code, relief is available to almost every type of enterprise and individual person.[62] However, the Bankruptcy Code is divided into several chapters and access to each chapter is generally limited to certain types of persons or entities. For example, railroads, banks, domestic insurance companies, and, most relevant to this Article, municipalities, are ineligible for relief under chapter 7.[63] And although chapter 11 is generally available to most debtors, municipalities may not use chapter 11.[64] Instead, chapter 9 is the only type of bankruptcy available to a "municipality," which includes cities, counties, townships, school districts, public improvement districts, and certain revenue-producing entities.[65] Although there is no authority directly on point, the term municipality likely includes public IHEs.

Under the Bankruptcy Code, "municipality" is defined as a "political subdivision or public agency or instrumentality of a State."[66] While these terms are not further defined by the Bankruptcy Code, their meaning has been addressed directly in a few cases. The case law is sparse because parties do not often litigate over whether a particular entity is a municipality.[67] Nevertheless, this Article will analyze the existing case law to consider whether public IHEs would be considered a municipality for chapter 9's purposes. This issue has

submit a plan of adjustment, whereas the debtor's exclusive right to propose a plan of organization in chapter 11 can be curtailed. *Compare* 11 U.S.C. § 941 (2019), *with* 11 U.S.C. § 1121 (2019).

[62] *See* 11 U.S.C. § 109 (2019); *cf.* David A. Skeel, Jr., *When Should Bankruptcy Be an Option (for People, Places or Things)?*, 55 WM. & MARY L. REV. 2217, 2225 (2014) (arguing that administrative resolution is sufficiently similar to federal bankruptcy protection that they should be treated as synonymous).

[63] 11 U.S.C. § 109(b)(1)–(2).

[64] 11 U.S.C. § 109(d).

[65] 11 U.S.C. § 109(c)(1); *see, e.g.*, *In re* City of Detroit, 524 B.R. 147 (Bankr. E.D. Mich. 2014); *In re* City of Stockton, 526 B.R. 35 (Bankr. E.D. Cal. 2015); *In re* Sullivan Cty. Reg'l Refuse Disposal Dist., 165 B.R. 60 (Bankr. C.D.N.H. 1994) (revenue-producing waste disposal districts); *In re* N.Y.C. Off-Track Betting Corp., 427 B.R. 256 (Bankr. S.D.N.Y. 2010) (revenue-producing horse-racing-betting parlors). *Compare In re* Cty. of Orange, 183 B.R. 594 (Bankr. C.D. Cal. 1995) (holding public school district is a municipality), *with In re* City of Central Falls, 468 B.R. 36 (Bankr. D.R.I. 2012) (holding public school district is not a municipality).

[66] 11 U.S.C. § 101(40) (2019).

[67] United States v. Hosp. Auth. of Charlton Cty. (*In re* Hosp. Auth. of Charlton Cty., No. 12-50305, 2012 Bankr. LEXIS 3042 (Bankr. S.D. Ga. July 3, 2012), at *13–14 ("In reaching its decision, the court noted that 'statutory or caselaw guidance on what constitutes an instrumentality, or even a municipality, is scarce.'") (citing *In re* Las Vegas Monorail, 429 B.R. 770, 775 (Bankr. D. Nev. 2010).

never been addressed by the courts.[68] If public IHEs are a municipality, and if they satisfy chapter 9's other eligibility requirements, they will be eligible for relief under chapter 9.[69] But they will not be eligible for relief under chapters 7 or 11.

There are important differences between the relief available under chapter 9 of the Bankruptcy Code relative to that available under chapters 7 and 11. For example, collective bargaining agreements are easier to abrogate under chapter 9.[70] And this difference is highly salient in light of the importance of personnel costs to IHE budgets. Another important difference is that relief is presumptively available to qualified entities under chapters 7 and 11, but not under chapter 9.[71] Because of constitutional issues related to state sovereignty, chapter 9 is only available to municipalities if "specifically authorized" under state law to reorganize in bankruptcy.[72] And many states do not offer a blanket authorization for municipalities to file chapter 9.[73] As a result, if public IHEs are limited to reorganizing under chapter 9, many will find that they lack access to bankruptcy altogether.

---

[68] Given the paucity of case law analyzing municipal chapter choice issues, it is worth emphasizing the need to be cautious about any conclusions drawn from the analysis in this section.

[69] 11 U.S.C. § 109(c) provides that "[a]n entity may be a debtor under chapter 9 of this title if and only if such entity— (1) is a municipality; (2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter; (3) is insolvent; (4) desires to effect a plan to adjust such debts; and (5) (A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter; (B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter; (C) is unable to negotiate with creditors because such negotiation is impracticable; or (D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title."

[70] 11 U.S.C. § 1113 (2019), which limits an entity's ability to terminate collective bargaining agreements, is not applicable in a chapter 9 proceeding.

[71] Panzarella, *supra* note 10, at *2 ("Chapter 11 debtors have relatively relaxed requirements as compared to chapter 9 debtors.").

[72] *See* 11 U.S.C. § 109(c)(2); *see also* Panzarella, *supra* note 10, at *2 (citing Kenneth E. Noble & Kevin M. Baum, *Municipal Bankruptcies: An Overview and Recent History of Chapter 9 of the Bankruptcy Code*, 9 PRATT'S J. BANKR. L. 513 (2013)).

[73] *See* Vincent S.J. Buccola, *Law and Legislation in Municipal Bankruptcy*, 38 CARDOZO L. REV. 1301, 1322–23 (discussing veto rights held by various gatekeepers to chapter 9) [hereinafter, Buccola, *Legislation*]; *see also* Laura Napoli Coordes, *Gatekeepers Gone Wrong: Reforming the Chapter 9 Eligibility Rules*, 94 WASH. U. L. REV. 1191, 1236–37 (2017).

A. *The Political Subdivision Case Law*

A few cases have closely examined whether an entity is a political subdivision for purposes of chapter 9 eligibility.[74] Usually, these cases involve an entity that sought protection under chapter 9 of the Bankruptcy Code and found its eligibility challenged on the grounds that it was not a political subdivision. Although there are other cases of political subdivisions accessing chapter 9 relief, those cases did not contest the question of whether the debtor was a political subdivision.[75]

In this section I attempt to distill the key factors relied on by courts for determining whether an entity is a political subdivision. There appear to be three: (i) the label assigned to an entity by its creator; (ii) the statutes or regulations governing the formation of such entities; and (iii) the powers possessed by the entity in question. Each will be explored in more detail.

Several of the relevant cases considering whether an entity was a political subdivision have focused their analysis primarily on the label ascribed to the bankrupt entity by statute.[76] For example, in *In re Sullivan County Regional Refuse Disposal District*, the court determined that two garbage disposal facilities were political subdivisions because the entities were "statutorily defined as a body politic and corporate."[77] Similarly, in *In re Boise County*, the bankruptcy court concluded that Boise County, Idaho was a political subdivision for chapter 9's purposes because Idaho state law describes counties as "a body

---

[74] The issue has been raised in other instances, but in those cases, the courts did not provide a reasoned analysis as to why the relevant entity was a political subdivision. *See, e.g.*, *In re* Sullivan Cty. Reg'l Refuse Disposal Dist., 165 B.R. 60 (Bankr. C.D.N.H. 1994); *In re* Boise Cty., 465 B.R. 156 (Bankr. C.D. Idaho 2011); *In re* Columbia Falls, Special Improv. Dist. No. 25, 143 B.R. 750 (Bankr. D. Mont. 1992); *In re* Cty. of Orange, 183 B.R. 594 (Bankr. C.D. Cal. 1995).

[75] *See, e.g.*, *In re* City of Detroit, 524 B.R. 147 (Bankr. E.D. Mich. 2014); *In re* City of Stockton, 526 B.R. 35 (Bankr. E.D. Cal. 2015).

[76] *See* United States v. Hosp. Auth. of Charlton Cty. (*In re* Hosp. Auth. of Charlton Cty.), No. 12-50305, 2012 Bankr. LEXIS 3042, at *9 (Bankr. S.D. Ga. July 3, 2012) ("The final factor considers the state's own classification or description of the entity. When an entity is created as a 'body corporate and politic,' courts generally find that the entity is a governmental unit.") (citing *In* re Westport Transit Dist., 165 B.R. 93, 95–96 (Bankr. D. Conn. 1994)); *see also In re* Sullivan Cty. Reg'l Refuse Disposal Dist., 165 B.R. 60, 73 (Bankr. C.D.N.H. 1994); *In re* Pleasant View Util. Dist. of Cheatham Cty., 24 B.R. 632, 637 (Bankr. M.D. Tenn. 1982); *In re* N.Y.C. Off-Track Betting Corp., 427 B.R. 256 (Bankr. S.D.N.Y. 2010) (citing McKinney's Racing, Pari-Mutuel Wagering and Breeding Law § 603(1), which describes OTB as a "body corporate and politic.").

[77] *In re* Sullivan Cty. Reg'l Refuse Disposal Dist., 165 B.R. 60, 73 (Bankr. C.D.N.H. 1994). However, the court found that the waste disposal districts were ineligible for chapter 9 because they had failed to engage in good faith, pre-filing efforts to restructure their debts. *See id.* at 82 ("[T]he debtors still deliberately refrained from accessing their primary asset to attempt to resolve their financial problems.").

politic and corporate."[78] This fact alone was sufficient for the court and no further discussion of the question occurred.[79]

By contrast, other cases have focused on whether the entity in question "possess[ed] the characteristics of a sovereign"[80] and whether they perform functions that are "essentially governmental in nature."[81] These cases find support for their approach in the IRS's definition of "political subdivision," which is "any division of any State or local government unit which is a municipal corporation or which has been delegated the right to exercise part of the sovereign power of the unit."[82] At a minimum, elements of sovereign power include: "the power to tax, the power of eminent domain or the police power."[83] In *In re County of Orange*, the court found that the bankrupt entity (an investment vehicle, not the county itself) had "neither sovereign power delegated to it by the State of California, nor . . . [did] it have by its existence some inherent sovereign power to act."[84] Instead, the bankrupt entity was merely "an investment vehicle formed by the County and administered by the Treasurer to receive, commingle, invest, hold, account for, and distribute funds of the participants who are authorized by state law to deposit their excess funds with the Treasurer."[85]

---

[78] *In re Boise Cty.*, 465 B.R. at 167 (Bankr. C.D. Idaho 2011) ("Under Idaho law, the County is a body politic of the state of Idaho. *See Idaho Code § 31-601*") (emphasis in original).

[79] Although other courts sometimes discuss additional factors, a legislature's decision to designate an entity as a body politic and corporate appears to be a salient fact in almost every case where a court has determined that an entity is a municipality. *See, e.g.*, *In re* Westport Transit Dist., 165 B.R. 93, 95–96 (Bankr. D. Conn. 1994). This is true even when the court's analysis suggests that other factors were considered.

[80] *In re* Cty. of Orange, 183 B.R. 594, 602 (Bankr. C.D. Cal. 1995); *see also In re Sullivan Cty. Reg'l Refuse Disposal Dist.*, 165 B.R. 60; *In re Hosp. Auth. of Charlton Cty.*, No. 12-50305, 2012 Bankr. LEXIS 3042, at *7.

[81] *In re* N.Y.C. City Off-Track Betting Corp., 427 B.R. 256, 261, 265 (Bankr. S.D.N.Y. 2010) (finding that New York City's Off-Track Betting Corporation, which operated "a pari-mutuel betting system" with the dual purposes of raising revenue and "fighting the role of organized crime in horse-race gambling," was a municipality).

[82] 26 C.F.R. § 1.103-1(b) (2011) (suggesting that political subdivisions may "include special assessment districts so created, such as road, water, sewer, gas, light, reclamation, drainage, irrigation, levee, *school*, harbor, port improvement, and similar districts and divisions of any such unit.") (emphasis added).

[83] *In re Cty. of Orange*, 183 B.R. at 602; *see also* Comm'r of Internal Revenue v. Shamberg's Estate, 144 F. 2d 998 (2d Cir. 1944), cert. denied, 323 U.S. 792 (1945) (Although Shamberg only required that part or a portion of those powers be present to conclude that an entity created under state law for a governmental purpose is a political subdivision, subsequent authorities indicate that possession of only an insubstantial amount of any or all sovereign powers is not sufficient); Mark Norell et al., *Comments on the Definition of Political Subdivision for Tax-Exempt Bonds and Other Tax-Advantaged Bonds*, AM. BAR ASS'N SECTION OF TAXATION (2015), https://www.americanbar.org/content/dam/aba/publishing/tax_lawyer/vol69/692/tax-comments-definiton-of-political-subdivision-p313.pdf.

[84] *In re Cty. of Orange*, 183 B.R. at 602.

[85] *Id.*

Similarly, the *Seven Counties* court noted that the debtor was allowed to "seek a special ad valorem tax" if the board believed it lacked sufficient funding.[86] However, the court concluded that Seven Counties lacked the traditional government power to tax because the entity could only request an assessment and could not levy the tax directly.[87] This finding supported the court's conclusion that the debtor was not a political subdivision.

But, the power to tax is not a mandatory feature for all political subdivisions. For example, the court in *Charlton County* considered a broader array of "[a]ttributes that tend to establish that an entity is governmental in nature includ[ing]: that it is a creature of specific legislative enactment, that it has sovereign immunity, that it may exercise the right of eminent domain, that it is tax-exempt, that it has the power to tax, and that it receives tax revenues."[88] There, the court concluded that the debtor was a governmental unit,[89] in part, because it was "a creature of specific legislative enactment," could "exercise the right of eminent domain to acquire property," was "exempt from paying taxes in the same way cities and counties are exempt from taxes for the operation of similar facilities," was "authorized to receive tax revenues from the County's general fund or from an ad valorem tax," and was "also authorized to issue tax-exempt revenue anticipation certificates which are declared to be issued for an essential public and governmental purpose."[90] The debtor lacked sovereign immunity and the power to levy taxes directly, but the court found that entity may be a governmental unit if it enjoys "numerous governmental powers."[91]

B. *Application to Public IHEs*

This section applies the three factors just identified from the case law to public IHEs. It concludes that in many states, courts are likely to determine that public IHEs are political subdivisions. As such, they are eligible only for bankruptcy relief under chapter 9, if at all.

---

86 *In re* Seven Ctys. Srvcs., 550 B.R. 741, 758 (W.D. Ky. 2016).

87 *Id.*

88 United States v. Hosp. Auth. of Charlton Cty. (*In re* Hosp. Auth. of Charlton Cty.), No. 12-50305, 2012 Bankr. LEXIS 3042, at *1 (Bankr. S.D. Ga. July 3, 2012); *see also In re* Lombard Public Facilities Corp., 579 B.R. 493 (Bankr. N.D. Ill. 2017) (suggesting that the phrase "governmental unit" denotes an entity "actually carrying out some governmental function" and finding that "a commercial enterprise which competes with others in the hotel and convention center industry" is not such a function).

89 While "[t]he definition of 'governmental unit' is broader than the definition of 'municipality,'" the same factors are relevant to both inquiries. *In re Hosp. Auth. of Charlton Cty.*, No. 12-50305, 2012 Bankr. LEXIS 3042, at *14.

90 *Id.* at *16.

91 *Id.* at *7 (specifically noting that sovereign immunity "is only one of many traditional government attributes that an entity may possess").

The determinative factor in *In re Sullivan County Regional Refuse Disposal District* and *In re Boise County* was the states' own description of the entities as "a body politic."[92] At least twenty-one states define one or more of their state universities as a "body politic and corporate."[93] Thus, under the *Sullivan*/*Boise* test, public IHEs in these states would be considered municipalities. Additionally, some states describe their public IHE systems as an "arm of the state," which seems sufficiently analogous that a court is likely to determine that those entities are also political subdivisions.[94]

By contrast, *Orange County* and similar cases focused on whether the debtor entity had sovereign powers, including "the power to tax, the power of eminent domain or the police power."[95] Exactly how much or how many sovereign powers a debtor must exercise to be a political subdivision is unclear. For example, the court in *Orange County*'s language is phrased in the disjunctive, suggesting that the ability to exercise even a single sovereign power may be sufficient for an entity to be considered a political subdivision.[96] However, the *Charlton County* court suggested that an entity needed "numerous" sovereign powers to be considered a governmental unit.[97]

Public IHEs are often created by specific legislative enactment, enjoy sovereign immunity as an "arm of the state,"[98] are sometimes authorized to

---

[92] *In re* Sullivan Cty. Reg'l Refuse Disposal Dist., 165 B.R. 60, 73 (Bankr. C.D.N.H. 1994); *In re* Boise Cty., 465 B.R. 156, 167 (Bankr. C.D. Idaho 2011) (citing McKinney's Racing, Pari-Mutuel Wagering and Breeding Law § 603(1), which describes OTB as a "body corporate and politic"); *cf. In re* N.Y.C. Off-Track Betting Corp., 427 B.R. 256 (Bankr. S.D.N.Y. 2010).

[93] This information was gathered by going through each individual state's laws about the public college to determine how each state classified its own state school. The list includes Alabama, Arkansas, Colorado, Connecticut, Idaho, Illinois, Indiana, Louisiana, Maine, Maryland, Michigan, Mississippi, New Hampshire New Jersey, North Carolina Ohio, Rhode Island, South Carolina, Tennessee, and Utah.

[94] *See, e.g.*, KAN. STAT. ANN. § 76-3304 (West 2018); MO. ANN. STAT. § 173.360 (West 2018); Sussex Commons Assocs. LLC v. Rutgers, 210 N.J. 531, 543–44 (2012) (noting that an institution may be an arm of the state for some purposes, but not others).

[95] *In re* Cty. of Orange, 183 B.R. 594, 602 (Bankr. C.D. Cal. 1995); *see also In re Sullivan Cty. Reg'l Refuse Disposal Dist.*, 165 B.R. 60; *In re* Las Vegas Monorail Co., 429 B.R. 770, 795 (Bankr. D. Nev. 2010) ("No one seriously contends that LVMC is a political subdivision or agency of the State of Nevada. It has no power to tax, no power of eminent domain, and no sovereign immunity.").

[96] *In re Cty. of Orange*, 183 B.R. at 602 (stating that "[t]he common thread that ties these entities together is their ability to exercise various sovereign powers such as the power to tax, the power of eminent domain or the police power."). Similarly, the court stated that the debtor in *Orange County* was not "similar in *any* other respect to the political subdivisions described." *Id.* (emphasis added); *see also In re* Las Vegas Monorail Co., 429 B.R. 770, 797 (Bankr. D. Nev. 2010) (finding that the debtor was not a municipality because it exercised "no traditional public powers: it cannot tax; it cannot condemn by eminent domain; and it has no sovereign immunity.").

[97] United States v. Hosp. Auth. of Charlton Cty. (*In re* Hosp. Auth. of Charlton Cty.), No. 12-50305, 2012 Bankr. LEXIS 3042, at *7 (Bankr. S.D. Ga. July 3, 2012).

[98] *See* Glenn M. Wong & Karen R. Skinner, *Sovereign Immunity Saves a University's Employees,*

exercise the power of eminent domain, can often issue tax-exempt bonds, and are themselves tax-exempt.[99] In addition and unlike the investment pool in *Orange County*, most public IHEs may exercise eminent domain.[100] However, while public IHEs have numerous attributes of a sovereign (at least under *Charlton County*'s broader conception of this term), they do not clearly possess the power to tax or police powers.[101] Thus, public IHEs appear to sit somewhere in between the debtor in *Orange County* that lacked any sovereign powers and an entity exercising every sovereign power.

But no court has required an entity exercise every sovereign power. As a result, whether a court follows the *Orange County* or *Charlton County* test, it is likely that a public IHE would be considered a political subdivision.

C. The Instrumentality of the State Case Law

A public IHE might also qualify as a municipality if it is an "instrumentality of the state." Once again, there are only a small handful of cases that have grappled directly with the question of whether an entity is an instrumentality.[102] This section also reviews case law that addressed the broader question of whether an entity is a governmental unit because these cases may be helpful in understanding the narrower question of whether an entity is an instrumentality.

The central inquiry in many of the instrumentality cases is "whether the authority or agency is subject to control by public authority, state or municipal."[103] But the precise degree of requisite control is not particularly clear

---

ATHLETIC BUS. (Feb. 2000), https://www.athleticbusiness.com/sovereign-immunity-saves-a-university-s-employees.html (discussing cases involving claims of sovereign immunity for public colleges and their officials). *But see* Jon Campisi, *Attorneys: Sovereign Immunity Won't Shield Penn State from Sex Abuse Claims*, LEGAL NEWSLINE (Nov. 16, 2011), http://legalnewsline.com/stories/510525862-attorneys-sovereign-immunity-won-t-shield-penn-state-from-sex-abuse-claims.

[99] Minutes of the Board of Regents of Higher Education for the State of Montana (May 29, 2003), https://mus.edu/board/meetings/Archives/ITEM119-112-R0503BondResol.pdf (on Montana's tax-exempt bond issuances).

[100] *See, e.g.*, NEB. REV. STAT. ANN. § 85-133 (LexisNexis 2020); CAL EDUC. CODE § 94500 (LexisNexis 2020); Kevin Kiley, *Change is Eminent*, INSIDE HIGHER ED. (Sept. 19, 2012), https://www.insidehighered.com/news/2012/09/19/ball-state-use-eminent-domain-spotlights-rare-potent-tool-state-universities.

[101] *But see In re Las Vegas Monorail Co*., 429 B.R. at 799 ("Again, consistent with the origins of municipal bankruptcy, the key is the power to tax").

[102] *See In re Hosp. Auth. of Charlton Cty.*, LEXIS 3042; *see also In re* Barnwell Cty. Hosp., 471 B.R. 849 (Bankr. D.S.C. 2011); *In re Las Vegas Monorail Co.*, 429 B.R. 770; *In re* Cty. of Orange, 183 B.R. 594 (Bankr. C.D. Cal. 1995); Ky. Emps. Ret. Sys. v. Seven Ctys. Servs. (*In re* Seven Ctys. Servs.), 550 B.R. 741 (Bankr. W.D. Ky. 2014).

[103] *See, e.g.*, *In re Barnwell Cty. Hosp.*, 471 B.R. at 859 (citing *In re* Connector 2000 Ass'n, 447 B.R. 752 (Bankr. D.S.C. 2011)); *ex parte* York Cty. Nat. Gas Ass'n, 238 F. Supp. 964 (D.S.C. 1965), *modified by* 352 F.2d 78 (4th Cir. 1965), *cert. denied*, 383 U.S. 970 (1966); *cf. In re Las Vegas Monorail Co.*, 429 B.R. 770; *In*

from the cases. For example, in *In re Barnwell County Hospital*,[104] the debtor was an entity created by the South Carolina Legislature to provide hospital facilities to residents of Barnwell County. A party-in-interest objected to confirmation of the hospital's bankruptcy plan, arguing that the hospital was ineligible for relief under chapter 9 of the Bankruptcy Code. The court disagreed, determining that the hospital was a municipality within the meaning of § 109(c) because it was an instrumentality of the state.[105]

The court's analysis centered on the degree of control exercised by the County Council over the hospital. The court determined that the hospital was under a sufficient degree of control because: (i) "[t]he Debtor [hospital] is operated by a Board of Directors, which is comprised of members who are appointed by the County Council or are employees of the Debtor [hospital];" (ii) "[t]he County Council created the Board and conveyed its powers and duties by ordinance;" and (iii) "[t]he Board reports to the County Council, and the Hospital's budget is subject to County Council approval."[106] The result of this governing structure, the court concluded, was that the County Council ultimately controlled the hospital because the citizens of Barnwell County elected its members.[107]

---

re Westport Transit Dist., 165 B.R. 93, 96 (Bankr. D. Conn. 1994); *In re Hosp. Auth. of Charlton Cty.*, LEXIS 3042. To aid their inquiry, courts often turn to the dictionary definition of "instrumentality," but usually report that the definition is too ambiguous to be useful. *See, e.g.*, *In re Seven Ctys. Servs.*, 550 B.R. at 756 (citing the instrumentality definition from BLACK'S LAW DICTIONARY 919 (10th ed. 2014), as "(1) 'A thing used to achieve an end or purpose'; and (2) 'A means or agency through which a function of another entity is accomplished, such as a branch of a governing body[,]'" but pointing out that "the word's plain meaning is unhelpful for determining what qualifies as an 'instrumentality of the state' under the Bankruptcy Code."). There was some suggestion in *In re Seven Ctys. Servs.*, 550 B.R. at 760 that it was relevant that the debtor was a private charitable organization, not created by the Commonwealth of Kentucky. But a close reading of that case finds that the court does not appear to assign any significant weight to this fact. *Id.* In any event, public IHEs are not private enterprises.

[104] *In re Barnwell Cty. Hosp.*, 471 B.R. 849.

[105] *Id.*

[106] *Id.* at 860. *But see In re Las Vegas Monorail Co.*, 429 B.R. at 797 (finding the debtor was not an instrumentality, despite the need for the governor to approve the debtor's fare structure and budget, and to appoint its directors, because the debtor "operates its day-to-day business in significant isolation from the State.").

[107] *In re Barnwell Cty. Hosp.*, 471 B.R. at 860. By contrast, the *County of Orange* court determined that an entity that was an instrumentality of a county was not a municipality because it was not an instrumentality of the state. *In re Cty. of Orange*, 183 B.R. at 603. This appears to be different from the conclusion reached by *Barnwell County*. However, one difference may be that in *County of Orange*, there was "no enactment of the California legislature creates or establishes the [debtor] as a political subdivision, public agency or instrumentality of the State of California." *In re Cty. of Orange*, 183 B.R. at 600. By contrast, the debtor in *Barnwell County* was created through an act of the South Carolina legislature. *In re Barnwell Cty. Hosp.*, 471 B.R. at 853.

Similarly, in *Las Vegas Monorail*, the Governor had the authority to approve the prices the debtor charged and its overall budget, and to appoint its directors.[108] Yet the court found that the debtor was *not* an instrumentality because it operated "its day-to-day business in significant isolation from the State" and "[i]ts creditors are not, and do not expect to be, creditors of the State."[109] The court noted that "[w]hile the elements of control are many . . . these controls go to the service LVMC provides and not to protection of Nevada's finances."[110] Similarly, the *Seven Counties* court found that an entity is not an instrumentality merely because it owes its existence, in part, to state action, or because an entity has an ongoing relationship with the state through regulation and because it contracts with the state for the vast majority of its revenue.[111]

In addition to considering how a state government might exercise control over an entity, courts have also considered the purpose of such control.[112] For example, in *Seven Counties*, the court noted that "[i]f the government's control is meant to protect the government's finances or the public fisc, then the entity is an instrumentality of the government. On the other hand, if the government's control 'is more akin to oversight or regulation, then the entity is not an instrumentality.'"[113] In *Seven Counties*, the court concluded that an entity was not an instrumentality merely because the state government could "impact Seven Counties' 'structure, funding, budget and operations,'" because Seven Counties relied on state money, or because the state could "name a caretaker for CMHCs or even revoke recognition of the CMHCs."[114] While these factors undoubtedly constitute some degree of control over the debtor, the court concluded "that Kentucky's power over Seven Counties is limited to largely typical oversight

[108] *In re Las Vegas Monorail Co.*, 429 B.R. at 797.

[109] *Id.*

[110] *Id.*

[111] *In re* Seven Ctys. Servs. 550 B.R. 741, 756 (W.D. Ky. 2016). By contrast, in *In re* N.Y.C. Off-Track Betting Corp., 427 B.R. 256, 266 (Bankr. S.D.N.Y. 2010), the court highlighted that the debtor was "a creation of the state, made for the purpose of operating a 'revenue producing enterprise.'"

[112] *In re Las Vegas Monorail Co.*, 429 B.R. at 789 (noting that "the type of control is critical. If the control retained or exercised is necessary or designed to allow the State to manage its finances or its fisc—the traditional concerns of Chapter 9—then the entity is an instrumentality. If the control, however, is more akin to oversight or regulation, then the entity is not an instrumentality.") (citing *In re* Ellicott Sch. Bldg. Auth., 150 B.R. 261, 263 (Bankr. D. Colo. 1992), and *In re* Greene Cty. Hosp., 59 B.R. 388, 389 (Bankr. S.D. Miss. 1986)).

[113] *In re Seven Ctys. Servs.*, 550 B.R. at 758 (internal citation omitted); *see also In re Las Vegas Monorail Co.*, 429 B.R. at 797 ("Another way to frame this question is to ask whether LVMC operates in place of the State or whether its operations are simply subject to regulation to ensure that LVMC's decisions further the public good.").

[114] *In re Seven Ctys. Servs.*, 550 B.R. at 758.

and regulation."[115] To justify a conclusion that an entity was an instrumentality of the state, the court suggested that it might expect that (i) the state might retain some control over the appointment of some or all of the entity's board of directors, or its officers, executives, or employees,[116] (ii) the entity's employees might qualify as public employees,[117] (iii) the state would be able to take away the entity's corporate status, or otherwise force the entity to close, or (iv) that the state "can 'seize or exercise dominion' over Seven Counties' property."[118]

By contrast, other courts have focused less on the indicia of control and more on whether state control was directed toward the debtor's day-to-day operations.[119] For example, in *Las Vegas Monorail*, the court concluded that the debtor was not a municipality despite numerous indicia of control because "[t]he day-to-day operations are still within the purview of LVMC's officers and employees, without any direct control from a State official."[120] Similarly, in *In re Lombard Public Facilities Corp.*, the court required that, for an entity to be considered a municipality, there be "an active relationship with federal, state or municipal governments and that [the entity] carry out governmental functions."[121]

---

115 *Id.*

116 This alone does not appear to be sufficient, however. *See In re Las Vegas Monorail Co.*, 429 B.R. at 797 (finding that the debtor was not an instrumentality, despite the Nevada Governor having the power to appoint the debtor's directors, among other indicia of control); *see also In re* Lombard Pub. Facilities Corp., 579 B.R. 493, 500 (Bankr. N.D. Ill. 2017) (finding that the debtor was not an instrumentality because while the "Village appoints the Debtor's directors . . . it does not control its operations or management.").

117 Although the debtor's employees participated in the state's retirement system, they were not paid according to the state salary schedules, nor were they subject to "any other state personnel regulations." *In re Seven Ctys. Servs.*, 511 B.R. at 466 (Bankr. W.D. Ky. 2014), *affm'd in part, rev'd in part by In re* Seven Ctys. Servs., 550 B.R. 741 (W.D. Ky. 2016). The court concluded this was insufficient to find that Seven Counties' employees were state employees. *In re Seven Ctys. Servs.*, 511 B.R. at 466. Employees may also be state employees for some purposes, but not others. *See* Sussex Commons Assocs. LLC v. Rutgers, 210 N.J. 531, 545–46 (2012) (discussing whether Rutgers University "teaching faculty are State employees [for] all purposes" and concluding that they are not) (citing *In re* Exec. Comm'n on Ethical Standards, 561 A.2d 542, 548 (1989).

118 *In re Seven Ctys. Servs.*, 550 B.R. at 758–59.

119 *See In re Las Vegas Monorail Co.*, 429 B.R. at 797; *see also In re Lombard Pub. Facilities Corp.*, 579 B.R. at 500.

120 *In re Las Vegas Monorail Co.*, 429 B.R. at 797.

121 *In re Lombard Pub. Facilities Corp.*, 579 B.R. at 500; Travis A. McRoberts & Karol K. Denniston, *Chapter 11 or Chapter 9: Investors Beware*, NAT'L L. REV. (July 31, 2018), https://www.natlawreview.com/article/chapter-11-or-chapter-9-investors-beware (reporting that the court found it important to note that the corporation had day-to-day operational control over the enterprise and that the corporation's management did not report directly to the Village).

D. *Application to Public IHEs*

Turning now to the application of the rules that we have extracted from the instrumentality-of-the-state cases, we see that the degree of control over the public IHE is often the paramount question in determining whether the IHE is a municipality. More particularly, the following questions all rise to the fore: (1) whether the public IHE has been created by an act of the State legislature, (2) whether an agent of the state, such as the governor, appoints the public IHE's board of trustees, approves its budget, or oversees day-to-day managerial questions, such as the tuition it may charge, the number of students it can enroll, or the courses it may offer, and (3) whether the public IHE relies on direct state appropriations. Given these criteria, some public IHEs will almost certainly qualify as municipalities.

Public IHEs are generally creatures of the State in which they reside, being both created and controlled by State legislatures.[122] Public IHEs are generally created through a legislative act.[123] For example, an Idaho teacher's college—Albion State Normal School—"was created by an act of the Idaho legislature in 1893."[124] And, most public IHEs have some or all of their Board of Trustees appointed by the state governor.[125] New Jersey's public IHEs, for instance, are subject to oversight by a Board of Governors, most of which are appointed by the Governor and confirmed by the New Jersey State Senate.[126] In addition, New Jersey has specifically designated Rutgers "as an instrumentality of the State for providing public higher education."[127]

---

[122] IHEs are delegated their powers through state laws and the charters that establish the institution.

[123] However, some IHEs are called for in a state's constitution. *See, e.g.*, Paul Batesel, *State Normal and Industrial School*, LOST COLLEGES, http://www.lostcolleges.com/state-normal-and-industrial-school (last visited May 18, 2020) ("North Dakota Normal and Industrial School was constitutionally established as State Industrial School in 1889, with 40,000 acres of land to pay for its maintenance.").

[124] Paul Batesel, *Albion State Normal School*, LOST COLLEGES, http://www.lostcolleges.com/albion-normal-college (last visited May 18, 2020).

[125] *See* Bruckner, *Bankrupting*, *supra* note 8, at 718 (discussing the ways that Ohio exercises control over Cleveland State University by appointing the IHE's board of trustees).

[126] Rutgers, *Bylaws of the Board of Trustees* (Mar. 26, 2019), https://governingboards.rutgers.edu/sites/default/files/00038416.PDF.

[127] Dane, *supra* note 1, at 382 ("In 1945, the Legislature enacted chapter 49, Laws of New Jersey 1945, declaring that the school be 'designated as the State University of New Jersey to be utilized as an instrumentality of the State for providing public higher education and thereby to increase the efficiency of the public school system of the State.'") (citing Act of June 5, 1945, ch. 49, § 1, 1945 N.J. Laws 115, 127); *see also* Sussex Commons Assocs. LLC v. Rutgers, 210 N.J. 531, 542 (2012) (describing Rutgers as "a hybrid institution—at one and the same time private and public, with the State being granted a major voice in management, and the designation 'State University'; and the institution being granted private autonomy and control of physical properties and assets.").

Public IHEs typically receive a direct appropriation from the State in which they reside, and, therefore, the State exercises some degree of direct budgetary control over them.[128] At Rutgers, which describes itself as "the state of New Jersey's preeminent comprehensive public institution of higher education,"[129] the school's budget is subject to approval by the state legislature.[130] Some states take an even more active role in directing their IHEs and commandeering their day-to-day operations. For example, South Carolina lawmakers have weighed in on the curriculum at two public colleges, threatening to cut off funding because "incoming first-year students were asked to read books that discuss homosexuality."[131]

There is no question that the state often has significant control over public IHEs.[132] However, to qualify as a municipality, an entity must not just be subject to government control; it must also serve a public purpose. Public IHEs should easily qualify because educating the populace is a traditional function of government.[133] While private institutions may also serve this function, public IHEs surely serve a public purpose. As such, public IHEs are intended to be instrumentalities of the state.

Other factors also suggest that public IHEs are municipalities. For example, employees of public IHEs are usually considered public sector employees. They are subject to oversight by the state legislature and are subject to certain disclosures not relevant to private sector employees. For example, the salaries of most public IHE employees are generally publicly available. Other rules concerning state employees, including the right to participate in state retirement schemes, also generally apply to public IHE employees.[134]

---

128 Bruckner, *Bankrupting*, *supra* note 8, at 718 (discussing the ways that Ohio exercises control over Cleveland State University through the grant of state funds).

129 *Summer Session New Brunswick*, RUTGERS (2020), https://summersession.rutgers.edu/precollege-academies/about-rutgers.

130 Jonathan Lai, *N.J. Colleges Ask: Why Does Christie Want to Cut Student Success Program?*, THE INQUIRER (Mar. 13, 2017), http://www.philly.com/philly/education/Gov-Chris-Christie-NJ-budget-proposal-cuts-EOF-college-aid-program.html.

131 Adrienne Lu, *Brandishing Budget Power, State Lawmakers Pressure Public Universities*, PEW (Apr. 24, 2014), https://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2014/04/24/brandishing-budget-power-state-lawmakers-pressure-public-universities (discussing numerous other examples of state control of day-to-day operations).

132 Dane, *supra* note 1, at 391–99 (discussing the "pervasive fluidity of those nagging categories of 'public' and 'private'" and discussing examples that show that "[t]he line between 'public' and 'private' arises in many contexts and is contested in most of them.").

133 *In re* Las Vegas Monorail Co., 429 B.R. 770, 797 (Bankr. D. Nev. 2010) (noting that "education, for example, may be a traditional governmental function.").

134 Karen Eilers Lahey, et al., *Retirement Plans for College Faculty at Public Institutions*, 17 FIN. SERVS. REV. 323, 324 (2008) ("College professors who teach at public institutions of higher education have historically

Although the precise degree of governmental control over IHEs varies from institution to institution and from state to state, public IHEs are, as a general rule, instrumental in furthering essential government functions, and the state governments have at least some say in the management of those entities. Given the limited and somewhat muddled case law, courts may not conclude that every public IHE is an instrumentality. But it seems more likely than not that a court would conclude that a public IHE is an instrumentality of the state and therefore a municipality for purposes of the Bankruptcy Code.

E. The Public Agency Case Law

Finally, a public IHE might also be a municipality (and thus required to file under chapter 9) if it is a "public agency."[135] While not defined by the Bankruptcy Code, the term "public agency" was defined by the Code's precursor, the Bankruptcy Act, and that definition remains relevant. Section 81(6) of the Bankruptcy Act defined public agencies as "incorporated authorities, commissions, or similar public agencies organized for the purpose of constructing, maintaining and operating revenue producing enterprises . . . ."[136] Only three cases appear to squarely address whether a debtor is a public agency, and none provide much analysis. In *In re New York City Off-Track Betting Corp*., the court merely asserted that "NYC OTB is a creation of the state, made for the purpose of operating a "'revenue producing enterprise.'"[137] Similarly, in *In re County of Orange*, the court asserted that "the [debtor] is not a public agency as that term is used in § 81(6) because the [debtor] was not organized for the purpose of maintaining or operating a revenue producing enterprise."[138] Even without in-depth analysis of these issues, we can see that both legislative intent and revenue generation are important to consider.

Finally, the court in *In re Westport Transit District* concluded that the debtor was a public agency but failed to discuss revenue at all in its analysis.[139] Instead, the court focused on the following factors: was the entity created pursuant to a state statute, was a body politic and corporate, the state's control over the entity (e.g., its board was appointed by the government, the state could establish the

been enrolled in defined benefit (DB) plans that are provided by their institution and may be sponsored by state governments.").

[135] 11 U.S.C. § 101(40) (2019).

[136] *In re* Cty. of Orange, 183 B.R. 594, 602 (Bankr. C.D. Cal. 1995) (internal citations omitted); *see* Act of Aug. 16, 1937, ch. 657, 30 Stat. 544.

[137] *In re* N.Y.C. Off-Track Betting Corp., 427 B.R. 256, 265 (Bankr. S.D.N.Y. 2010).

[138] *In re Cty. of Orange*, 183 B.R. at 602.

[139] *In re* Westport Transit District, 165 B.R. 93, 96 (Bankr. D. Conn. 1994).

entity's prices and direct the entity's revenue to third parties), and the entity's possession of sovereign power (e.g., it had the power of eminent domain).[140] Somewhat unhelpfully, these are the same factors that other courts have used when discussing whether an entity is an instrumentality or a political subdivision. As such, they do not add to our ability to assess whether a public IHE is a municipality.

F. Application to Public IHEs

Despite the paucity of analysis on the public agency issue, we can extract some guidance on whether a court is likely to find that a public IHE is a public agency. Legislative statements or intent and an entity's design are likely probative of whether the legislature intended to create a "revenue producing enterprise."[141] Applying this limited guidance to public IHEs, we can conclude that many public IHEs are likely to be public agencies.

Public IHEs are revenue-producing enterprises. Even though public IHEs tend to offer education at a substantial discount to private colleges, all public IHEs charge at least some tuition. For three examples, in 2016 the Ohio State University, Rutgers, State University of New Jersey, and Florida State University systems had revenues of at least $5.1 billion, $3.5 billion and $1.1 billion, respectively.[142] Analogizing from *New York City Off-Track Betting Corp.*, this alone would appear to be sufficient.

* * *

It seems that there are several good arguments that public IHEs are municipalities for chapter 9 purposes. Many, if not most, public IHEs are likely instrumentalities because they are subject to significant control by the State. Others are likely political subdivisions because they are characterized as a "body politic and corporate" and exercise a significant degree of sovereign power. Finally, others are likely public agencies because they are revenue-producing enterprises. It is also important to note that Collier's—the preeminent bankruptcy treatise—takes the view that Congress did not want to unduly restrict

---

140 *Id.* at 95–96.

141 *In re N.Y.C. Off-Track Betting Corp.*, 427 B.R. at 265; *see In re* Westport Transit, 165 B.R. 93 (Bankr. D. Conn. 1994); *In re Cty. of Orange*, 183 B.R. 594.

142 *2017 Annual Financial Report*, THE OHIO STATE UNIV. 20 (2017), https://busfin.osu.edu/sites/default/files/ohiostate_financialreport2017.pdf; *Financial Report 2015–2016*, RUTGERS THE STATE UNIV. OF N.J. 20–21 (2016), https://uco.rutgers.edu/files/rutgers-fiscal-year-2016-financial-report0pdf; *Annual Report 2015–2016*, FLA. STATE UNIV. 10–11 (2016), https://controller.vpfa.fsu.edu/sites/default/files/media/doc/Financial_Rep/Annual_Reports/2015_2016%20Annual%20Report.pdf.

eligibility for chapter 9 relief and thus courts may be inclined to give effect to Congress' intent to have chapter 9 be broadly applicable.[143] Municipal bankruptcy scholars, such as Professor Laura Napoli Coordes, also agree that chapter 9 should not be unduly restrictive.[144] As such, it seems that—under existing doctrine and policy—public IHEs are likely eligible to file bankruptcy in chapter 9, if they are eligible at all. That being settled—to the extent possible—as a descriptive matter, this Article next turns to the normative question of who is best situated to avoid the financial distress of public IHEs.

IV. WHO CAN AVOID THE FINANCIAL DISTRESS OF PUBLIC IHES?

When a public IHE becomes financially distressed, there are three primary options for who should bear the burden of the entity's debt: the residual claimant (who are, in the case of cities, often thought to be the city's residents), the creditors, or the state.[145] Thus, the goal of this section is to consider which party is best situated to prevent public IHEs from becoming financially distressed or, if financial distress is unavoidable, which party is best situated to resolve the public IHE's financial issues. This analysis will assist in determining whether distressed public IHEs should be allowed to reorganize in bankruptcy (shifting the burden to creditors) or not (forcing "residents" or the state to repay the entity's debts). In the context of financially distressed cities, municipal bankruptcy scholars have reached different conclusions about which entity is best positioned to avoid municipal financial distress or bear the costs of

[143] 6 Collier on Bankruptcy ¶ 900.02[1] (16th ed. 2009) ("the eligibility requirements for relief under chapter 9 should be construed broadly"). Of course, states remain the ultimate decision-makers about municipal eligibility for chapter 9.

[144] Coordes, *Gatekeepers Gone Wrong: Reforming the Chapter 9 Eligibility Rules*, *supra* note 73, at 1231–32.

[145] Scholars have tended to focus on three possible parties who might be the superior risk bearer: local residents, creditors, and the state. *See* Kevin Kordana, *Tax Increases in Municipal Bankruptcies*, 83 VA. L. REV. 1035, 1096–1105 (1997) ("[b]ondholders are, on average, better risk-bearers than municipal residents"); *see also* Omer Kimhi, *Reviving Cities: Legal Remedies to Municipal Financial Crises*, 88 B.U. L. REV. 633, 656–72 (2008) (considering whether "the residents, the creditors, or the state—is the most effective risk bearer of a municipal financial crisis."); Picker & McConnell, *supra* note 38, at 437; Vincent S.J. Buccola, *The Logic and Limits of Municipal Bankruptcy Law*, 86 U. CHI. L. REV. 817, 840 (2019) ("the owners of locally situated real estate are, after a fashion, the residual beneficiaries of municipal policy and action, and in that sense resemble corporate stockholders . . . .") [hereinafter, Buccola, *Limits*]; Clayton P. Gillette & David A. Skeel, Jr., *Governance Reform and the Judicial Role in Municipal Bankruptcy*, 125 YALE L.J. 1150, 1154 (2016) ("Ideally, the outside catalyst would be the state, which retains substantial authority over its political subdivisions. But political entrenchment may also constrain the state from inducing or imposing structural reforms that are needed for fiscal stability.").

resolving those financial issues.[146] This section will apply their lessons to the case of public IHEs.

Unfortunately, there is not a clear analogy between cities and public colleges in terms of who is the most efficient risk bearer. Nevertheless, this Article will consider the same three parties—"residents," creditors, and the state. It concludes that the superior risk bearer is not local residents (and, in this context, it is not even clear who counts as a local resident or how "local residents" could be forced to bear the cost of resolving a public IHE's financial issues). But this Article does not firmly conclude whether creditors or the state is the optimal risk bearer. Instead, the decision will ultimately be a political one and different states may reasonably draw different conclusions on the appropriate answer. This conclusion has important implications for the normative question of whether many public IHE's likely ineligibility for any type of bankruptcy relief is problematic.[147]

A. Residents as Risk Bearers

Various scholars, most notably Professors Picker and McConnell, have suggested that city residents may be ideally situated to avoid municipal financial distress.[148] In the corporate context, shareholders are thought to be the superior risk bearer because they both control the entity's decision-making (by electing the board of directors) and are the residual claimant.[149] City residents are thought to be similar because they exert control over municipal decision-making by electing municipal officials and because (property-owning) residents can benefit if municipal investment increases the value of their property.[150] As such, some

---

146 *See* Kordana, *supra* note 145, at 1039 (arguing that creditors are best situated to bear the risk of municipal default); *see also* Picker & McConnell, *supra* note 38, at 437 (focusing on residents); Kimhi, *supra* note 145, at 636 (claiming that "state financial boards, which place the burden of the crisis on the state—is the most efficient remedy for local crises."); Gillette & Skeel, *supra* note 145, at 1154 (focusing on the state as the ideal party).

147 *See* Kordana, *supra* note 145, at 1043–46.

148 Picker & McConnell, *supra* note 38, at 437.

149 Kordana, *supra* note 145, at 1046. *But see* Robert K. Rasmussen, *Taking Control Rights Seriously*, 166 U. PENN. L. REV. 1749, 1756 (2018) (arguing that "it would be a mistake to analogize [the election of the board of directors] to political contests" because board of director elections are normally not open contests). For distressed companies, many scholars assert that it is neither the board nor the shareholders that exert the most control over the entity, but the company's creditors. *See, e.g.*, David A. Skeel, *Creditors' Ball: The 'New' New Corporate Governance in Chapter 11*, 152 U. PENN. L. REV. 917, 918 (2003).

150 *See* Buccola, *Limits*, *supra* note 145, at 847 ("In the municipal case, residents and (especially) landowners bear the primary residual interest in activities overseen by the mayor or council they elect, because the value of local real estate depends on, among other things, the relationship between taxes and the municipal infrastructure they procure.").

argue that requiring residents to backstop the debts of distressed municipal entities is appropriate.[151]

To allow losses to be foisted upon a different party would allow municipalities to act in a financially irresponsible manner, exacerbating problems of moral hazard, or so goes the argument.[152] In other words, if elected officials are allowed to run up debts that city residents will never repay, cities may be prevented "from making efficient investments in particular parts of town" because lenders will refuse to lend in the first instance.[153] By contrast, if city residents bear the risk of municipal default, city residents will elect more risk averse politicians, better monitor municipal spending, and be assured of the ability to borrow at reasonable rates in the future.[154]

Even in the context of cities, this line of reasoning is suspect. There are at least four reasons to doubt that residents are best situated to control inappropriate risk-taking and overspending by most municipalities.[155] And the case is even weaker when we turn to public IHEs. First, residents are poorly equipped to monitor free-spending local politicians and prevent them from making poor financial decisions.[156] For example, Professor Kimhi contends that New York City officials knew they needed to make different financial decisions in the years leading up to the city's financial crisis in the 1970s, but argues that officials were prevented from taking the necessary steps because of the city's fragmented political environment, including concentrated interest groups, disorganized decision-making processes, and poor financial planning.[157]

---

151 Picker & McConnell, *supra* note 38, at 437; *see also* Kordana, *supra* note 145, at 1092.

152 *See* Picker & McConnell, *supra* note 38, at 475–76 ("Allowing a city to keep all of its assets while being discharged of its debts is the principal source of the moral hazard problem in municipal bankruptcy."); *see also* Kordana, *supra* note 145, at 1067 ("The strongest argument for requiring a municipality to raise taxes in order to pay off general obligation bonds in full is that, otherwise, too many municipalities will seek Chapter 9 protection, exploiting bondholders by paying them off in cents on the dollar under the terms of their reorganization plans.").

153 *See* Picker & McConnell, *supra* note 38, at 426, 490–91.

154 *See id*. at 476; *see also* Buccola, *Limits*, *supra* note 145, at 840.

155 Kordana suggests that residents are to municipalities what shareholders are to corporations, but this comparison doesn't hold when public IHEs are the municipal entity at issue. Kordana, *supra* note 145, at 1056 ("Municipal residents have the functional relationship, vis-à-vis the municipality, of both the shareholders and the customers of a corporation."); *see also* Buccola, *Limits*, *supra* note 145, at 847.

156 Kordana, *supra* note 145, at 1093 ("Monitoring by residents is likely to be weak in any event . . . ."); *see also* Kimhi, *supra* note 145, at 663 ("the causes of local financial crises are often out of the local officials' realm of control, [as such] the state's involvement is warranted."); *cf.* Reid K. Weisbord, *Charitable Insolvency and Corporate Governance in Bankruptcy Reorganization*, 10 BERKELEY BUS. L.J. 305, 316 (2014) ("the current legal regime inadequately holds charitable insiders accountable for breaching fiduciary duties.").

157 *See* Kimhi, *supra* note 145, at 663 ("Clearly the officials understood the gravity of the city's financial position, but the political environment did not allow them to take the steps needed for rehabilitation. The city was fragmented, its decision-making process was disorganized and lacked adequate financial planning, and

Second, "municipal opportunism" is constrained by municipalities' need to borrow in the future, and thus their need to be perceived as an entity that repays its debts.[158] Third, Professor Kordana asserts that bondholders are, on average, wealthier than the residents of distressed municipalities and therefore less risk averse. He argues that bondholders' lower risk aversion makes them more suitable risk bearers because "risk is more efficiently borne by those who are less risk averse than by those who are more risk averse."[159]

Finally, lenders are already aware that losses can be shifted from parties who control an entity to those who have a contractual relationship with it, whether the debtor is in bankruptcy or otherwise.[160] For example, a bankrupt entity can impose losses on its contractual counterparties by breaching executory contracts, such as employment contracts and collective bargaining agreements, and then paying creditors a fraction of what they would have been entitled to under the contract.[161] Thus, the risk of loss is likely already priced into municipal borrowing.

Although public IHEs are unlikely to use bankruptcy to shift losses its contractual counterparties, the other critiques of residents as superior risk bearers have bite in the context of public IHEs. And, if these critiques are not enough, the case for residents to backstop a municipality's financial distress is even more difficult to support in the context of public IHEs. In the context of a public IHE-as-debtor, it is not even clear who is a "resident" in the sense that other municipal bankruptcy scholars have used the term.[162] If a college refurbishes faculty and staff offices and then defaults on its construction loan, should faculty and staff have their salaries cut to repay creditors?[163] Should all state residents have to pay higher taxes because of a failed investment in a public

interest groups blocked any possibility of a significant change.").

[158] Kordana, *supra* note 145, at 1038–39, 1071–73 (arguing that sovereign borrowing is a prime example of "a real world situation that the moral hazard-driven analysis would predict to be characterized by an unwillingness to lend, and by debtor exploitation of creditors if money were lent, instead features willing lending and a seeming absence of significant problems of exploitation.").

[159] *Id.* at 1096–99.

[160] *Id.* at 1058 ("Thus private law parallels, in which limited liability shifts losses in bankruptcy from control parties onto parties with contractual relationships with the bankrupt entity, suggest that a mandatory tax increase imposed on municipal residents in favor of bond-holders and other investors is neither an inevitable nor obviously correct default rule.").

[161] *See, e.g.*, 11 U.S.C. § 365 (2019).

[162] Residents are only weakly similar to shareholders. While both have exit rights, those may be considerably easier and less expensive to exercise in the context of stock ownership (selling shares) than home ownership (moving). *See* Weisbord, *supra* note 156, at 321–22 (describing the methods corporate shareholders use "to monitor and regulate" corporate officers and directors).

[163] In the case of tenured professors, it may be a breach of contract to decrease their pay. *See generally* Bruckner, *Terminating Tenure*, *supra* note 13.

IHE? Or maybe just nearby property owners who may see their property values increase.[164] After all, these groups may benefit from the IHE's (over)spending. Yet none of these parties are likely to have substantial control over the college's decision-making[165] and may not have consumed the goods or services that led to financial trouble in the first instance.[166] Thus, in the context of public IHE-as-debtor, "the relation between risk-creation and risk-bearing [is] tenuous."[167]

B. Creditors as Risk Bearers

For every dollar improvidently borrowed, there was a dollar improvidently lent. In other words, creditors control a municipality's access to money. In theory, creditors can use this leverage to force local politicians to take the steps necessary to either prevent financial distress or address problems once they arise.[168] Professor Kordana notes that the "backdrop of state municipal finance law against which municipal borrowing occurs" may allow lenders to perfectly coordinate cutting a municipal [city] debtor off from additional borrowing.[169] If they fail to do so, Kordana argues that creditors should bear the cost of their improvident lending.

---

164 *Cf.* Buccola, *Limits*, *supra* note 145.

165 A possible exception is faculty at a school that takes its commitment to shared governance seriously.

166 *See* Buccola, *Limits*, *supra* note 145, at 820 (arguing that the "beneficiaries of successful municipal government are not investors in that government (as shareholders are investors in a commercial firm), but are rather the owners of land under its authority.").

167 *Cf.* Kordana, *supra* note 145, at 1101–02 (noting that the ability for "residents" to move "in and out of a municipality, makes the relation between risk-creation and risk-bearing even more tenuous.").

168 Kimhi, *supra* note 145, at 661 ("The creditors, after all, control the locality's most important resource —money—and this control may enable them to pressure the local officials into taking the steps creditors think necessary. Localities often need the funds that creditors supply, so officials are often coerced into following the creditors' demands. The creditors can set the conditions for extending loans to the locality, and this gives them leverage to force the locality to undergo a recovery process. Moreover, since municipalities wish to pay the lowest interest rates they possibly can on their loans, the credit markets—even when the creditors are dispersed and unorganized—may push local officials to improve the local financial condition."); Kordana, *supra* note 145, at 1099 (arguing that bondholders are wealthier and therefore less risk averse, making them more efficient risk bearers because "risk is more efficiently borne by those who are less risk averse than by those who are more risk averse."); Rasmussen, *supra* note 149, at 1752 (noting that creditors as creditors are not entitled to control an entities' decision-making, but noting that chapter 11 can change "creditors (or at least some of them) into" decision-makers); Weisbord, *supra* note 156, at 328 (describing "the senior lender" as having "substantial control over the debtor because it can withhold consent until the debtor agrees to replace blameworthy incumbents.").

169 Kordana, *supra* note 145, at 1070; *see also* Adam C. Parker, *Positive Liberty in Public Finance: State Oversight of Local-Government Debt and the North Carolina Model*, 37 CAMPBELL L. REV. 107, 114 (2015) (some states "impose constitutional or statutory limitations on the type and amount of debt that local governments may incur, although local governments sometimes design creative ways to circumvent those limits."). The restrictions Professor Kordana is concerned about may have more force (and therefore allow better coordination) in the context of cities-as-borrowers than in the case of IHE-as-borrower.

In the context of distressed business enterprises, many scholars have argued that pervasive creditor control is the norm.[170] For example, Professor Rasmussen notes that "[i]t is now commonplace for creditors to be the driving force behind reorganization efforts" in chapter 11 cases.[171] But there are several reasons to believe that this argument holds less weight in the context of distressed municipalities than in the corporate context, particularly when we focus on public IHEs.

First, although public IHEs regularly borrow money, they do so far less frequently than for-profit companies.[172] In addition, public IHEs often raise money by issuing tax-exempt, municipal bonds and thus their creditors are more likely to be somewhat dispersed cohorts of bondholders rather than banks or similar lenders.[173] The nature of the creditor is important. As Professors Douglas Baird and Bob Rasmussen have noted, "[b]ondholders typically can do little until a corporation defaults on a loan payment. Even then, their remedies are limited. Not so with bank debt or debt issued by nonfinancial institutions."[174]

---

170 *See* Anthony J. Casey, *The Creditors' Bargain and Option-Preservation Priority in Chapter 11*, 78 U. CHI. L. REV. 759, 760, n.2 ("While it may seem strange to those unfamiliar with the current practice in bankruptcy, creditor control is a pervasive fact in corporate reorganization"); *see also* Skeel, *supra* note 149, at 919 ("To an increasing extent, lenders are using these loan contracts to influence corporate governance in bankruptcy. The fate of an asset or division of the company, even the terms of a transfer of control, has been spelled out as terms in a debtor's DIP financing agreement."); Adam J. Levitin, *Bankruptcy's Lorelei: The Dangerous Allure of Financial Institution Bankruptcy*, 97 N.C. L. REV. 243, 290 (2019) (arguing that "calling the shots" in a bankruptcy case is what DIP lenders do); *cf.* Laura N. Coordes, *Beyond the Bankruptcy Code: A New Statutory Bankruptcy Regime for Tribal Debtors*, 35 EMORY BANKR. DEV. J. 363, 405 (2019) (cautioning that undue influence not be accorded to lenders while arguing for new tribal bankruptcy legislation).

171 Rasmussen, *supra* note 149, at 1755.

172 *See* Weisbord, *supra* note 156, at 329–33 (2014) (noting that "[e]mpirical scholarship, while scarce, suggests that charities prefer to draw from internal capital sources rather than seek external debt financing from outside sources."); Charlie Eaton, et al., *Borrowing Against the Future: The Hidden Costs of Financing U.S. Higher Education*, DEBT AND SOCIETY (May 22, 2014) at *10, http:// debtandsociety.org/wp-content/uploads/ 2014/05/Borrowing_Against_the_Future_052214.pdf (reporting that borrowing is on the rise, with a near tripling of public IHE debt over ten years leading up to 2014).

173 Eaton, *supra* note 172, at 7–8 (2014) (describing the primary capital source of all non-profit IHEs as municipal bonds, but also noting that "[i]nvestment banking houses like JP Morgan and Barclays today have helped some higher education institutions to issue general revenue bonds that collateralize all college revenue in exchange for lower interest rates.").

174 Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PENN. L. REV. 1209, 1211, 1216 (2006) ("In the standard model, debt is diversely held among public bondholders who rely on an indenture trustee to guard their interests. The indenture trustee, however, can do no more than insist on rigid compliance with the bond covenants. She cannot exert any active role in the affairs of the corporation, as she lacks the power to alter the essential terms of the loan without the unanimous consent of the bondholders."); *see also* Weisbord, *supra* note 156, at 327 (describing creditor control as stemming from the lender's right to accelerate the repayment of preexisting debt and by offering to supply additional secured debt).

Additionally, the mechanisms by which creditors exert control include demanding seats on the board of directors of the borrowing entity, or the appointment of a chief restructuring officer.[175] But these control mechanisms require the debtor's consent, which, in the context of public IHEs, would likely require the consent of the state governor and, possibly, the legislature. It seems unlikely that the governor would appoint a creditor's agents to a public IHE's board of trustees in exchange for an emergency loan.[176] Public IHEs are likely able to turn to alternative funding sources (i.e. the state treasury) if the lender's terms are too onerous. By contrast, financially distressed companies' most likely source of new funds are its existing lenders.[177]

Second, even coordinated creditor activity is unlikely to cause a public IHE to increase revenue substantially for at least two reasons.[178] The problems that confront public IHEs—"(i) growing competition for students, [and] (ii) declining state revenues devoted to higher education"—are largely outside of the control of school administrators.[179] For example, community colleges generally have open admission policies and thus have an extremely limited ability to increase enrollment.[180] As Professor Kimhi notes,

> [I]f the processes which cause the local financial decline are beyond the local officials' realm of control, then creditors' pressures directed at the local officials will also be ineffective. The creditors can signal to local officials that the locality's financial condition has declined, but the officials themselves are often helpless in the face of the problems the locality confronts.[181]

---

175 Once a bankruptcy case has been commenced, creditors can also displace management through the appointment of a trustee. While this does not increase creditor control, it does eliminate the debtor's control.

176 By contrast, "[f]ew companies that encounter financial distress have sufficient unencumbered assets to fund a Chapter 11 proceeding" without additional borrowing. Rasmussen, *supra* note 149, at 1767.

177 *Id.* at 1767 ("The most likely source of new funds or the ability to use cash on hand that is part of the lenders' collateral package therefore lies with the existing lenders.").

178 *Id.* at 1758 (pointing out that lenders may have substantial leverage, but have few legal rights to direct a debtor to act in a particular way).

179 Bruckner, *DNRs*, *supra* note 8, at 234 (internal citations omitted). *See also* Bruckner, *Bankrupting*, *supra* note 8, at 701 ("The higher education sector faces significant headwinds, including: (i) growing competition for a diminishing pool of students; (ii) technological change, such as the rise of online education; and (iii) stagnant family incomes." (internal citations omitted)); Kimhi, *supra* note 145, at 662 (claiming that local "officials themselves may be unable to address the underlying causes of the financial deterioration.").

180 Bruckner, *DNRs*, *supra* note 8, at 235 ("For instance, an IHE may not be able to raise additional tuition revenue if it already has an open enrollment policy or if it already significantly discounts its tuition to lure new students." (internal citations omitted)); *see also* Bruckner, *Bankrupting*, *supra* note 8, at 703 (describing a college's lack of selectivity as a risk factor for financial distress). Of course, some state schools are highly selective, but those are not the norm.

181 Kimhi, *supra* note 145, at 662 ("They cannot do much about a national recession, they are unable to stop suburbanization, and they certainly cannot compel the state to send more funds their way or force it to

In addition, Professor Kimhi argues that administrators "often lack the legal authority or the political power to take the required action."[182] As in cities, decision-making at public IHEs is also fractured. At public IHEs, authority is split across state legislatures (who control appropriations), the governor (who often appoints the entire Board of Trustees),[183] the Board of Trustees (who approves the entity's strategic plan and selects the IHE's top administrators, among other things), the IHE's administration (who manages overall budgeting), individual deans (who control day-to-day spending), and faculty (who may have a say in various decisions through shared governance mechanisms).[184]

Nevertheless, for every dollar borrowed, there is a dollar lent. Even if creditors are unable to prevent financial crises ex ante or resolve it ex post, it is not clear why they should be absolved from having made non-performing loans in the first instance. Why should creditors not bear the cost of their lending decisions?[185] At a minimum, creditors are probably better risk monitors than "residents" and thus are relatively more deserving to take unavoidable losses.[186] Allowing public IHEs to reorganize in bankruptcy could help force creditors to bear the risk of their improvident lending. Thus, it is an option that legislatures, especially Congress, should consider.

C. State Financial Boards as Risk Bearers

There are at least two reasons why intervention by the state government, through some sort of state financial board or emergency manager, might be the best way to avoid municipal financial distress.[187] First, the state can change a

decrease the amount of unfunded mandates.").

182 *Id.* at 661–62 ("The reason is that while the creditors' pressures are directed at local officials, the officials themselves may be unable to address the underlying causes of the financial deterioration. The creditors can try to force the local officials to take measures to rehabilitate the locality, but the local officials often lack the legal authority or the political power to take the required action.").

183 *See* Bruckner, *Bankrupting*, *supra* note 8, at 718 (noting that the Governor of Ohio appoints all nine voting members of the Board of Trustees for Cleveland State University, a public IHE in Ohio).

184 Kimhi, *supra* note 145, at 661 ("[T]he creditors cannot implement the required economic reforms at the local level, and they also do not have the requisite legal powers to force the locality to take remedial action. Therefore, since the creditors are in a worse position than the state to avoid a local crisis or to minimize its consequences, it is less efficient to place the burden of the crisis on their shoulders.").

185 Kordana, *supra* note 145, at 1058 ("[T]his Article suggests it also may place losses on those who have lent money to the municipality on contractual terms.").

186 *Id.* at 1091 ("By monitoring who will be doing what with the borrowed money in a municipality, investors may be able not only to protect themselves by charging for opportunistic conduct ahead of time, but also, at least by charging higher rates, signal the rest of the municipality's residents as to what is occurring. We should be confident that investors can monitor municipal borrowers.").

187 *See* Kimhi, *supra* note 145, at 661 (describing the state as "the superior bearer of local insolvency because it can address the causes of a local crisis, or deal with its consequences, better than the creditors can.");

municipality's political environment because municipalities are creatures of the state in which they reside.[188] For example, if a municipality's decision-making process is too disorganized or fragmented to make the necessary changes, the state can literally remake the municipality's structure by eliminating roles and consolidating positions.[189] States may also use their financial resources as a carrot for municipal restructuring.[190] Second, states have "broader legal authority than municipal officials" and may, therefore, be able to address certain issues that are beyond the reach of the municipal debtor's authority.[191]

In the context of distressed cities-as-municipalities, Kimhi argues that reforming a municipality's tax system and reducing its labor costs are the two primary tasks of a municipal restructuring. There are clear parallels to distressed public IHEs, which also often need to right-size their faculties, better align faculty expertise with student demand, and ensure that they offer a competitively-priced degree.[192]

And states do have some direct control over a public IHE's financial matters. States sometimes force their public IHEs to merge.[193] Some states also control tuition levels.[194] And state legislative approval may be needed before a public

---

see also Gillette & Skeel, *supra* note 145, at 1155 ("Where the state intervenes to redress structural difficulties that cause fiscal distress, there may be little need for bankruptcy court intervention.").

188 *See* Gillette & Skeel, *supra* note 145, at 1154 ("Ideally, the outside catalyst would be the state, which retains substantial authority over its political subdivisions. But political entrenchment may also constrain the state from inducing or imposing structural reforms that are needed for fiscal stability.").

189 *See id.* at 1184 ("The most common governance problem—our principal focus in the discussion that follows—is a fragmented local decision-making structure."); Kimhi, *supra* note 145, at 664 ("[T]he state has the ability to change the political environment in the municipality, and thus the state can decrease the political pressures that contribute to overspending.").

190 Buccola, *Legislation*, *supra* note 73, at 1328 ("Governors often have discretion to allocate funds for investments they deem useful for the general public. The governor could make clear to a municipal government that such funds will not be forthcoming if the city tries to force through a plan of adjustment he dislikes or, in the alternative, that a proposed infrastructure project looks promising if the city confirms a plan more amenable to his preferences. As a functional matter, bargaining leverage can look very similar to a formal veto power.").

191 Kimhi, *supra* note 145, at 664 ("[T]he state has broader legal authority than municipal officials, and so it can better address the external socioeconomic processes"); *see also* Gillette & Skeel, *supra* note 145, at 1222 ("acknowledging that states have political and institutional advantages over courts" in terms of their capacity "to restructure dysfunctional local governments").

192 *See, e.g.*, Bruckner, *Terminating Tenure*, *supra* note 13.

193 *See* notes 35–36, *infra*.

194 *See, e.g.*, Robert Kelchen, *Tuition Control Policies: A Challenging Approach to College Affordability*, MHEC POLICY BRIEF (Aug. 2017), https://www.mhec.org/sites/default/files/resources/mhec_affordability_series3_20170824.pdf (reporting on various ways to control tuition, including the express tuition caps or curbs reported by "[t]wenty-seven of 44 state higher education agencies that responded to a recent survey"). Although pricing is important, it seems that the variability in public IHE revenue streams are much more likely to come from the number of students that attend than the price of attendance (though they are related). State officials seem less likely to be able to encourage students to attend than the college administration, as it is the latter's

IHE can grant tenure to faculty, and they could decline to do so, which could affect labor costs.

Finally, states could decline to allow a distressed IHE to take on new debt through the issuance of municipal bonds.[195] But in this regard, states are no more powerful than creditors who could refuse to underwrite that debt issuance or to buy the debt if it were offered anyway.[196]

But consider other problems that public IHEs face, such as changing demographics.[197] Many IHEs are receiving fewer applications these days. To the extent that this is a national trend, a state's ability to alter decision-making at public IHEs and its greater legal authority are irrelevant. Public IHEs also face declining state support.[198] Obviously, states are sometimes well situated to reverse that decline and increase appropriations for public IHEs. But if the problem is stagnating or declining state budgets, IHEs cannot get money from a stone. There may be greater legal authority but no difference in result.

Finally, Professor Kimhi is correct that states have the ability to reshape a public IHE's organizational structure to consolidate authority and avoid special interests exerting undue control.[199] But while states may have the legal authority to adjust a public IHE's governance structure, it is not clear that the state can or will exercise that authority.[200] After all, if a public IHE has become financially distressed despite state oversight, then state control has *already* failed ex ante.[201] Anecdotes about the wholesale replacement of free-spending Boards of Trustees

---

full-time job.

[195] *See* Parker, *supra* note 169, at 114 ("Some states also review certain types of debt instruments and require state approval before issuing the debt"); Kordana, *supra* note 145, at 1050 ("GO [general obligation] bonds often require taxpayer approval before they can be issued . . . .").

[196] At least where coordinated creditor control is easy. *See* text accompanying *supra* note 169.

[197] *See* Jacqueline Palochko, *Kutztown University President: Higher Ed Institutions Must Adjust to Demographics*, MORNING CALL (Mar. 8, 2019, 8:30 PM), https://www.mcall.com/news/education/mc-nws-kutztown-legislative-breakfast-20190307-story.html (describing how some colleges respond to demographic shifts). For a description of other problems faced by IHEs, *see also* Bruckner, *Bankrupting*, *supra* note 8, at 701; Bruckner, *DNRs*, *supra* note 8, at 232–33; Bruckner, *Terminating Tenure*, *supra* note 13, at 257.

[198] Michael Mitchell et al., *supra* note 13.

[199] Buccola, *Legislation*, *supra* note 73, at 1326 ("A municipality's veto power is, however, defeasible at the will of its state legislature, which can divest the municipality's elected officials of their holdout threat, typically through the agency of an emergency manager or control board."); *see also* Gillette & Skeel, *supra* note 145, at 1152 (suggesting that "local fiscal crises usually are caused by a governance structure that tolerates financial decisions in which the benefits and costs of public expenditures are misaligned.").

[200] *See* Gillette & Skeel, *supra* note 145, at 1222 (highlighting at least two situations where states will be unable to reform municipal financial decision-making); Weisbord, *supra* note 156, at 316 (noting that sufficient oversight over the officers and directors of charities is often "inadequate[]").

[201] Gillette & Skeel, *supra* note 145, at 1223 (describing as "very common" that states fail to rein in flawed municipal financing decision-making even "in the face of fiscal distress").

are hard to come by.[202] As Professor Buccola argues, existing legal structures are "sticky" because change often requires a majority vote of "each legislative chamber, plus acquiescence by the governor."[203] Thus, it can be difficult for state governments to reform problematic governance structures in their public IHEs.

The challenging political environment in state capitals can help explain why so many state legislatures delegate the difficult decision-making of municipal reform to emergency managers and state financial boards.[204] However it is not particularly clear why state financial boards would be less subject to special interest politicking than appointed members of a college's board of trustees.[205] After all, both are appointed by the governor or state legislature.

* * *

In conclusion, it appears that there are reasons to doubt that creditors or state financial boards are particularly well-situated to prevent public IHEs from becoming financially distressed or to bear the cost of responding to that financial distress. As a result, I believe it is appropriate for each state to reach its own conclusion about whether lenders should bear the cost of their non-performing loans or whether the state should repay creditors.[206] In large part, I believe this decision will depend on several factors, including whether state officials believe that lenders knowingly assumed the risk of non-repayment, whether lenders are able to distinguish between public IHEs that remain good credit risks and those that are not (or if bond market contagion is a serious risk), and the state's own financial health.

V. HOW TO OPTIMIZE PUBLIC IHES' FINANCIAL DISCIPLINE?

This section will address the normative issue of whether public IHEs should be required to file bankruptcy under chapter 9. Alternatives include leaving creditors with state law collection remedies, or using a state financial board

[202] It would be an interesting empirical project to examine how often trustees are replaced in the months leading up to and soon after an IHE's financial crisis. *Cf.* Weisbord, *supra* note 156, at 309 (discussing how the bankruptcy court might "hasten[] the resignation or removal of blameworthy officers and directors").

[203] Buccola, *Legislation*, *supra* note 73, at 1323 ("Rules are sticky when only a majority in each legislative chamber, plus acquiescence by the governor, can change them. Depending on the rules peculiar to a given state's legislative process, a small minority may be able to defeat even legislation with strong support.").

[204] *See* Weisbord, *supra* note 156, at 316 (discussing the need to remove incumbent managers of charities in some cases "to protect the public interest from continued neglect, mismanagement, and misuse of charitable assets").

[205] *Cf.* Kimhi, *supra* note 145.

[206] In many cases, the state may also be a major creditor.

designed to help a distressed public IHE resolve its financial problems.[207] Each option offers a different procedure for resolving a public IHE's financial distress "and each places the burden of the crisis on a different entity."[208]

If state officials believe that it is appropriate to force creditors to bear the cost of their non-performing loans, theoretically, they have two choices. In theory, they could allow the public IHE to discharge their obligations to creditors in bankruptcy. Alternatively, they could deny the public IHE access to bankruptcy and leave creditors with their "exceedingly weak remedies under state law."[209] At the moment, however, the former solution is largely illusory.[210] Under current law, bankruptcy is effectively a death sentence for IHEs because they lose access to Title IV student loan and grant programs (i.e. Stafford Loans, Grad Plus, Pell, etc.) if they enter bankruptcy.[211]

Unfortunately, without a bankruptcy option, creditors are likely to hound public IHEs in an attempt to collect on their debts. One example is the City of Harrisburg, PA. In 2003, Harrisburg borrowed "$125 million to rebuild and expand the city's enormous trash incinerator."[212] For various reasons, the project was not economically successful, and the city's incinerator-related obligations swelled to almost $300 million,[213] with incinerator-related payments due that sometimes exceeded the city's annual budget.[214] But after Pennsylvania blocked the city from filing bankruptcy and made clear that it would not bail the city out

207 *See, e.g.*, Kimhi, *supra* note 145, at 654 (suggested that there are three options for resolving the financial distress of cities: "creditors' remedies, chapter 9 of the Bankruptcy Code, and state financial boards."); Kordana, *supra* note 145, at 1046 (1997) (focusing only on whether creditors or city residents should bear the risk of municipal insolvency, either in chapter 9 or through state law remedies).

208 Kimhi, *supra* note 145, at 636.

209 Buccola, *Limits*, *supra* note 145 ("Creditors have exceedingly weak remedies under state law. They cannot foreclose on municipal property in any meaningful sense, and consequently bankruptcy's utility, if it has any, must lie in its capacity to do something other than coordinate collection efforts.").

210 Where the state fails to prevent municipal financial distress ex ante and cannot resolve it ex post, municipal bankruptcy should be an option. *See* Gillette & Skeel, *supra* note 145, at 1155 (Where the state fails to intervene to redress structural difficulties that cause fiscal distress "because of its own political constraints, rather than as a consequence of a deliberate decision . . . we find fewer reasons to preclude bankruptcy courts from filling the gap.").

211 *See* Bruckner, *DNRs*, *supra* note 8, at 228 ("Essentially, Congress has imposed an involuntary 'do not resuscitate' order on IHEs, condemning some socially valuable enterprises to an unnecessary death."); *see also* Bruckner, *Bankrupting*, *supra* note 8, at 698 (calling bankruptcy "an effective death sentence" for most IHEs); Bruckner, *Terminating Tenure*, *supra* note 13, at 262; Norberg, *supra* note 9.

212 Michael Cooper, *An Incinerator Becomes Harrisburg's Money Pit*, N.Y. TIMES (May 20, 2010), http://www.nytimes.com/2010/05/21/us/21harrisburg.html?_r=0.

213 *Id.* ("The incinerator, which the city had hoped to turn into a moneymaker, is instead $288 million in debt.").

214 *Id.* ("[T]he $68 million in incinerator-related payments due this year [2010]—more than it spends in its annual budget.").

using state funds, creditors continued to seek repayment. City residents were forced to find alternative ways to repay their creditors by, for example, monetizing certain city assets.[215]

In addition, by denying IHEs access to bankruptcy, IHEs will not be able to receive the fresh start they could otherwise accomplish by discharging their un-repayable debts, and rejecting executory contracts, including some collectively-bargained agreements.[216] To be clear, though, even if IHEs had access to bankruptcy, they might not be able to regain their economic footing. Bankruptcy cannot, for example, force students to attend a college if the "product" it offers is no longer a desirable one.[217] And many higher education leaders may think that bankruptcy is a non-starter because they fear students would not attend a bankrupt institution.

By contrast, if state officials believe that creditors should not bear the risk of improvident lending to public IHEs, they should invest greater resources in ensuring that public IHEs make better financial decisions. They might look to borrow from structures devised in North Carolina or Ohio to aid municipal borrowing. For example, North Carolina has something called the Local Government Commission (LGC).[218] The LGC is "legally responsible for the approval of nearly all local-government debt" in North Carolina.[219] Before it will approve a debt issuance, the LGC first meets with the local government that seeks to issue the debt to discuss the purpose and amount of the debt and the likelihood that the local government will be able to fulfill its obligations to bondholders.[220] The LGC can also intervene to either direct local officials to act

215 Buccola, *Legislation*, *supra* note 73, at 1324 ("The legislature had vetoed Harrisburg's use of bankruptcy. Harrisburg eventually entered state receivership, the net economic effect being—in the eyes of some, at least—to spare creditors at the expense of residents."); *see also* Cooper, *supra* note 212 (discussing the possible sale or lease of city property—garages—that could repay some of the incinerator-related debt after the state "made it clear that it [was] unlikely to bail out its capital . . . .").

216 *See* Buccola, *Limits*, *supra* note 145 ("The economic function of bankruptcy, in general, is to cure allocative distortions that follow from high levels of debt . . . . By cleaning up a debtor's balance sheet, it encourages people to make investment decisions in accord with the underlying value of available resources."); Bruckner, *Terminating Tenure*, *supra* note 13 (discussing possible limitations on terminating tenured faculty at public IHEs).

217 *See* Bruckner, *DNRs*, *supra* note 8, at 247–48 (discussing Sweet Briar College's "difficulty of recruiting applicants to a rural women's liberal arts college" and noting that bankruptcy could not help) (citing Scott Jaschik, *Sweet Briar Survives*, INSIDE HIGHER ED (June 22, 2015), https://www.insidehighered.com/news/2015/06/22/deal-will-save-sweet-briar-college); *cf.* Buccola, *Limits*, *supra* note 147.

218 *See* Omer Kimhi, *A Tale of Four Cities—Models of State Intervention in Distressed Localities Fiscal Affairs*, 80 U. CIN. L. REV. 881, 887 (2012); Parker, *supra* note 169, at 115 (providing an extensive discussion of North Carolina's Local Government Commission).

219 Parker, *supra* note 169, at 145.

220 *Id.* at 146–47 (listing the information the LGC considers and the factors upon which the LGC decides

or to displace existing officials and act in their stead.[221] As one author wrote, "[l]aying out the ground rules for all local governments and imposing fiscal responsibility for their actions—as opposed to the vague notion that the state will bail the locality out if distress is great enough—creates an environment where political leaders take a higher level of responsibility for their financial decision-making."[222]

Similarly, Ohio has designed an "'early warning system[]' to monitor and alert the state to financially troubled local governments," which can prompt the state government to intervene "before a crisis like those in Orange County, Harrisburg, or Detroit can emerge."[223] The Ohio State Auditor's Office encourages local governments to maintain certain financial performance ratios and collects data on whether local governments maintain these ratios.[224] Something similar to either the North Carolina or Ohio models could be developed and applied to public IHEs to help ensure that they make better financial decisions.[225]

CONCLUSION

Like all IHEs, public IHEs labor under the current prohibition on bankrupt IHEs disbursing Title IV student aid. But even if the HEA were amended to remove this prohibition,[226] public IHEs in more than a score of states would very likely remain cut off from bankruptcy entirely. This conclusion emerges from a first-of-its-kind parsing of the existing case law on the eligibility of various entities for either chapter 9 or 11 of the Bankruptcy Code.

Access to bankruptcy reorganization could make a difference for some public IHEs. It cannot fix all the problems that ail IHEs, but it could help them reduce expenses by, for example, allowing them to renegotiate collective

---

whether to approve the debt).

[221] By contrast, without the LGC, normally the state governor must act to remove blameworthy officers and directors. But governors do not appear to do so. *See id.* at 152 ("The LGC may also remove individuals from office. Additionally, if the local unit is not cooperative, the LGC may impound the entity's financial records and assume control of its financial affairs.").

[222] *Id.* at 153.

[223] *Id.* at 113–14.

[224] *Id.* at 113–14, n.22 (citing PUB. FIN. MGMT., STATE PROGRAMS FOR MUN. FIN. RECOVERY: AN OVERVIEW 1 (2011), https://www.pfm.com/uploadedFiles/Content/Knowledge_Center/Whitepapers,_Articles,_Commentary/Whitepapers/State%20Programs%20for%20Municipal%20Financial%20 Recovery.pdf).

[225] *But see* Gillette & Skeel, *supra* note 145, at 1235–36 (suggesting that states may not act due to legislative inertia).

[226] Or § 525 were amended to effectively overrule In re Betty Owen Schools, Inc., 195 B.R. 23 (Bankr. S.D.N.Y. 1996).

bargaining agreements, terminating unnecessary executory contracts or unexpired leases, and right-sizing faculty and staff levels. Bankruptcy can achieve these goals while placing the burden of improvident lending to public IHEs on creditors, which state officials may legitimately prefer.

This Article furthers our understanding of the limits of federal bankruptcy law. Bankruptcy reorganization offers a set of tools for addressing financial distress but is not available to certain entities. Some of these restrictions are explicitly set forth in the Bankruptcy Code. But others, such as the restriction on bankruptcy reorganization's use for IHEs, have been less well-known. Hopefully this Article, along with the others I have written on related topics, helps to reveal the holes in the fabric of our bankruptcy system.

This Article also builds on the municipal bankruptcy literature by applying that literature in a new setting: public IHEs. This Article concludes that there is no one group that plays the role of residual claimant of public IHEs, or that controls decision-making at public IHEs. This finding highlights that the municipal bankruptcy literature's animating analogy—that shareholders of corporations can be analogized to residents of cities—lacks bite in the context of certain special purpose municipal entities such as public IHEs. Thus, the risk of improvident higher education borrowing must instead be placed on either the state or on creditors. The decision of how to resolve the financial distress of public IHEs is likely to come down to a political calculation about whether public IHEs should be authorized to reorganize in bankruptcy (harming creditors) or if the state should repay the debts of defaulting public IHEs.