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**COMPARISON OF BANKRUPTCY CONSIDERATIONS
FOR ISSUERS OF STUDENT LOAN DEBT**

Investors purchase debt instruments with the expectation they will be paid principal and interest in full and when it is due. The insolvency or bankruptcy of the issuer can interrupt or diminish the ability of the issuer of debt instruments to make principal and interest payments. Depending on the type of bankruptcy proceeding, a bankruptcy can result in, among other things, a temporary suspension of payments on the debt (known as a "stay"), exercise of setoff rights by other parties, substitution of collateral, avoidance of certain payments on the debt as preferential or fraudulent transfers and less than full payment on the debt if the collateral securing the debt is insufficient to pay the debt in full. Some issuers have a lower risk of becoming subject to a bankruptcy proceeding than others.

This memorandum is intended as a brief comparison of the ways in which three categories of issuers of student loan debt may be treated in a bankruptcy proceeding under the Bankruptcy Code: (a) corporations, partnerships, limited liability companies and Delaware statutory trusts structured as special-purpose entities to be bankruptcy-remote; (b) non-profit (501(c)(3)) entities; (c) political subdivisions, public agencies or instrumentalities of a State. Currently, there is no provision in the Bankruptcy Code permitting a State to file a bankruptcy proceeding. This memorandum is not intended to detail the technical requirements with respect to each entity.

The following chart generally illustrates the significant bankruptcy filing options for entity types described above that may be used to issue student loan debt. Following the chart is a summary of the bankruptcy filing options for these entities, subject to the limitations in the discussion below.

	Voluntary	**Involuntary**	**Chapter 7 Liquidation**	**Chapter 11 Reorganization**	**Chapter 9 Municipality**
Corporation, partnership, LLC or statutory trust	Y	Y	X	X	
Non-profit 501(c)(3)	Y	N	X	X	
Political subdivision, public agency or instrumentality of a State	Y (if filing is authorized)	N			X

1. Special Purpose Entities: Corporations, Partnerships, Limited Liability Companies and Delaware Statutory Trusts

- An issuer of debt that is a corporation, partnership, statutory trust or limited liability company is subject to a voluntary or involuntary bankruptcy filing under chapter 7 or 11 of the Bankruptcy Code.

- Certain conditions are imposed on the structure and operation of these entities and in the transaction documents for the debt offering that tend to make them special-purpose entities that are also “bankruptcy-remote,” which reduces the chance of a bankruptcy filing.

- The “bankruptcy-remote” requirements may not prevent a bankruptcy filing.

Certain legal entities, such as corporations, partnerships (including limited partnerships), business or statutory trusts or limited liability companies, may voluntarily subject themselves to a bankruptcy proceeding by filing a petition with the bankruptcy court, or be involuntarily subjected to a bankruptcy proceeding by their creditors. Such proceedings are commonly brought under chapter 11 of the Bankruptcy Code in order to restructure debt and reorganize the operations of the debtor. They also may be brought under chapter 7 of the Bankruptcy Code in order to liquidate the assets and operations of the debtor.

Although there are certain substantive and procedural requirements that must be met to commence a voluntary or involuntary bankruptcy proceeding, it is important to note that the issuer does not need to be insolvent. If the case is commenced in “good faith,” the bankruptcy court is likely to allow the proceeding to continue. A proceeding against an otherwise solvent entity may be permitted merely because it is in “financial distress” or its parents or affiliates are in “financial distress” and it is advantageous to the parents or affiliates to have the solvent subsidiaries become debtors in a bankruptcy case, for example, to maintain control of the subsidiaries or to obtain cash flow from the subsidiaries. “Financial distress” can result from circumstances that indicate a restructuring might eventually be necessary, such as debt maturing in a few years that the borrower may be unable to repay when due or other factors as discussed below with respect to the General Growth Properties case.

An issuer structured in a manner that reduces the likelihood of both voluntary and involuntary bankruptcy filings is sometimes referred to as a “special-purpose entity” (an “SPE”) or as being “bankruptcy-remote.” Generally, an issuer is bankruptcy-remote if its activities are limited and it is structured so as to (i) isolate its assets from other entities, (ii) restrict the circumstances under which it may file a voluntary bankruptcy and (iii) limit the likelihood the issuer would have any creditors (other than the debt holders) and to limit any such creditors’ ability to file involuntary bankruptcy proceedings against the issuer. Standard & Poor’s has published criteria that summarize the requirements that must be met in order to make an issuer bankruptcy-remote. Also, rating agencies often impose additional requirements that tend to reduce the likelihood of a voluntary or involuntary bankruptcy filing with respect to an SPE issuer. These requirements can include:

- Restricting the issuer's ability to incur liabilities other than the rated debt and unsecured trade payables;

- Limiting the issuer's activities to preserving the security for the rated debt and payment of the rated debt;

- Restricting the issuer's interaction with affiliates so that it will not be consolidated into a bankruptcy filing by an affiliate;

- Restricting the issuer's ability to liquidate, merge, consolidate or sell substantially all of its assets without the prior written consent of the debt holders (or their trustee) before the rated debt is repaid;

- Restricting the ability of a solvent issuer to file a bankruptcy petition (or take any other insolvency action) or take other actions that may make a bankruptcy filing more likely by requiring the issuer to obtain the consent of an independent person, such as an independent director or manager, to the filing of any bankruptcy petition or other actions (such requirements are intended to protect against a voluntary bankruptcy petition being filed by a solvent issuer or its shareholders, members, partners, directors, or managers);

- Restricting the transfer of ownership of the issuer to an entity that may increase the risk of the issuer being consolidated into a bankruptcy proceeding of an affiliate;

- Restricting the ability of the issuer or its owners to amend its organizational documents and the transaction documents with respect to its bankruptcy-remote status;

- Requiring the issuer to maintain its qualification to do business in all jurisdictions in which it conducts its business;

- Requiring potential creditors, other than the debt holders, to enter into nonpetition covenants under which the creditors agree not to file bankruptcy against the issuer;

- Requiring the rated debt to be secured by a first priority, perfected security interest in the assets of the issuer that secure the rated debt;

- Requiring the issuer to be a pass-through entity for tax purposes to avoid the issuer being subject to tax which would reduce the funds available to pay debt holders; and

- Requiring reasoned legal opinions subject to qualifications and limitations that the issuer owns the assets securing the rated debt and that it will not be consolidated into any bankruptcy of certain of its affiliates (the "true sale" and "nonconsolidation" opinions).

These requirements can be incorporated into a transaction in various ways. Generally, they are often included in the issuer's articles of incorporation, partnership agreement, operating agreement or trust agreement, depending upon how the issuer's formation. The requirement that an independent party determine whether a bankruptcy filing by the issuer is appropriate can be met by using an independent director, manager or member (or independent trustee for an issuer that is a statutory trust).

It is important to understand that, although these bankruptcy-remote requirements are helpful in reducing the likelihood an issuer will become a debtor in a bankruptcy proceeding or its assets will be consolidated into the bankruptcy proceeding of an affiliate, these requirements cannot prevent it. In numerous cases, issuers that were bankruptcy-remote have been debtors in bankruptcy proceedings. In some cases, the issuer has been insolvent and the independent director, manager or member properly authorized the bankruptcy filing. In other cases, the operating parent of the issuer replaced the independent director or manager with one that was more amenable to authorizing the issuer to file for bankruptcy. In still other cases, the bankruptcy-remote requirements were drafted in a manner that allowed issuers to avoid some of the more onerous limitations on the issuer's operations which were intended to protect debt holders, or the issuer's parent intentionally breached the issuer's operating covenants to make a consolidation of the issuer into the parent's bankruptcy more likely.

The General Growth Properties bankruptcy proceedings provide a recent example of the ability of otherwise bankruptcy-remote SPEs to file for bankruptcy. In those cases, the bankruptcy court allowed separate bankruptcy filings by the SPE subsidiaries of General Growth Properties even though some of the SPEs technically were not insolvent and independent managers were replaced immediately prior to the bankruptcy filing and then voted to authorize the filing by the SPEs. In an effort to prevent the replacement of an independent director or manager prior to a bankruptcy filing with one more amenable to a bankruptcy filing, some transactions now require the trustee for the debt holders to consent to any change in the independent director, manager or member. Also, following established case law, the court allowed the SPEs to file for bankruptcy even though they were not insolvent because they were in "financial distress" caused by one or more of the following: cross-default provisions in some loans triggered by the bankruptcy filing of affiliates; balloon payments maturing within several years which the borrowers were unlikely to be able to refinance before maturity; loans that had high loan-to-value ratios that might not be paid when due; or certain other factors which made default on loans to the SPEs likely.

An issuer formed as a Delaware statutory trust has an additional advantage in reducing the chance it will file for bankruptcy. A Delaware statutory trust is required to have a Delaware trustee. Typically, the Delaware trustee must authorize a bankruptcy filing by the Delaware statutory trust. Because the Delaware trustee is usually required under the transaction documents to be a Delaware trust company which has certain fiduciary obligations to the debt holders, there is little risk the Delaware trustee can be replaced with one more amenable to a bankruptcy filing. Often, before the Delaware trustee authorizes a bankruptcy filing, it is required to obtain a certification from an independent accountant that the Delaware statutory trust is insolvent. These features of a Delaware statutory trust can provide more protection to the debt holders against the bankruptcy filing by a Delaware statutory trust issuer than, for example, an issuer that is a Delaware limited liability company.

2. Nonprofit 501(c)(3) Issuers

- A 501(c)(3) issuer may voluntarily file for bankruptcy under chapter 7 or 11 of the Bankruptcy Code.

- A 501(c)(3) issuer is not subject to an involuntary bankruptcy filing under the Bankruptcy Code if it is not "a moneyed, business, or commercial corporation" under Section 303(a) of the Bankruptcy Code.

- The activities of a 501(c)(3) issuer are not limited to those of a bankruptcy-remote SPE. However, a 501(c)(3) issuer must limit its activities generally to educational, charitable or certain other similar purposes, which in some cases can include originating, purchasing and servicing loans in addition to issuing debt.

Some issuers of student loan debt are formed as nonprofit entities that also qualify for federal income tax exemption under 501(c)(3) of the Internal Revenue Code (a "501(c)(3) issuer"). To qualify under 501(c)(3) of the Internal Revenue Code, a nonprofit issuer must strictly limit its activities generally to educational, charitable or certain other similar purposes.

501(c)(3) issuers present a somewhat different risk that a bankruptcy will be filed than do SPEs. Unlike the SPEs discussed above, 501(c)(3) issuers and their transactions do not meet most of the bankruptcy-remote requirements discussed above. For example, the activities of such issuers usually are not limited to holding assets securing a single series of debt. They can engage in a variety of general business activities not related to the issuance of the secured debt itself. These are activities that an SPE generally is not permitted to conduct. With respect to student loan 501(c)(3) issuers (with perhaps the exception of entities that can issue tax-exempt debt under Section 150(d) of the Internal Revenue Code and are limited to acquiring FFELP loans under the Internal Revenue Code), certain student loan 501(c)(3) issuers engage in a broad range of activities, such as originating, purchasing and servicing assets or other unrelated activities that further the purpose for which the 501(c)(3) issuer was formed. Such issuers also may incur short-term or long-term debt other than the debt issued in term securitizations of specific pools of assets.

501(c)(3) issuers are permitted to file a voluntary bankruptcy petition. Unlike the SPEs discussed above, 501(c)(3) issuers are able to file a bankruptcy petition without obtaining the consent of an independent person, such as an independent director, trustee, manager or member. In addition, as discussed above with respect to the General Growth Properties case, a 501(c)(3) issuer does not need to be insolvent in order to file a bankruptcy petition. In analyzing debt offerings by 501(c)(3) issuers, however, rating agencies generally conclude the risk of a voluntary bankruptcy filing by these issuers is limited, in part, because the activities of the issuers are restricted to their 501(c)(3) charitable, educational or other nonprofit purposes.

The rating agencies have focused on another feature of the Bankruptcy Code that protects these issuers against becoming the subject of a bankruptcy proceeding. Under Section 303(a) of the Bankruptcy Code, an involuntary bankruptcy case may not be commenced against "a corporation that is not a moneyed, business, or commercial corporation." The term "corporation," as used in the Bankruptcy Code, generally includes limited liability companies and statutory trusts, but does not include partnerships.

Many 501(c)(3) issuers qualify for this exclusion under Section 303(a) from involuntary bankruptcy filings. The determination, however, of whether a 501(c)(3) issuer is "a corporation that is not a moneyed, business, or commercial corporation" is based on an analysis of complex facts involving the issuer's formation and operation and sometimes inconsistent case law. As a result, the risk that an involuntary bankruptcy case could be filed against a 501(c)(3) issuer usually is addressed in a reasoned legal opinion subject to qualifications and limitations which concludes that, due to the 501(c)(3) issuer's nonprofit status and related facts, the issuer is not a moneyed, business or commercial corporation under Section 303(a) and therefore is not subject to an involuntary bankruptcy filing.

In summary, a 501(c)(3) issuer generally is not formed as a bankruptcy-remote entity such as an SPE. It may voluntarily file for bankruptcy which would have the same consequences to debt holders discussed above in the introduction to this memorandum. If a 501(c)(3) issuer is determined not to be "a moneyed, business, or commercial corporation," an involuntary bankruptcy case may not be commenced against it by any of its creditors. The rating agency and the trustee under the indenture for debt offerings by these issuers generally rely on a reasoned legal opinion subject to qualifications and limitations which concludes the issuer is not subject to an involuntary bankruptcy filing. If, however, the 501(c)(3) issuer is treated as "a moneyed, business, or commercial corporation," it could be subject to an involuntary bankruptcy filing to the same extent as the entities discussed above.

In order to reduce the risk of a voluntary bankruptcy filing, in unique circumstances, some 501(c)(3) issuers (that are not qualified to issue tax-exempt debt under Section 150(d) of the Internal Revenue Code) have formed non-501(c)(3) for-profit bankruptcy-remote SPE subsidiaries to warehouse student loans and issue related debt. Although this may provide additional protection against voluntary bankruptcy filings, these for-profit subsidiaries are unlikely to be protected by Section 303(a) of the Bankruptcy Code against an involuntary filing. As a result, the voluntary and involuntary bankruptcy risks for non-501(c)(3) for-profit SPE subsidiaries would be as described above for bankruptcy-remote SPEs.

3. Political Subdivisions, Public Agencies or Instrumentalities of a State

- A political subdivision, public agency or instrumentality of a State (each of which is referred to in the Bankruptcy Code as a "municipality") that is permitted to file for bankruptcy is subject only to chapter 9 of the Bankruptcy Code, not chapter 7 or 11. Chapter 9 provides some protection for the assets, activities and creditors of the "municipality" not available to other types of debtors in bankruptcy.

- A "municipality" may voluntarily file for bankruptcy under the Bankruptcy Code only under chapter 9 and only if it meets certain conditions, including (but not limited to) specific authorization under State law or permission of an authorized governmental officer or organization and it is insolvent. Otherwise, it may not file for bankruptcy under the Bankruptcy Code.

- A “municipality” may not be the subject of an involuntary bankruptcy filing under the Bankruptcy Code.

Political subdivisions, public agencies and instrumentalities of a State receive special protections under the Bankruptcy Code. These entities are referred to in the Bankruptcy Code (and in this memorandum) as “municipalities.” Municipalities have a special status for bankruptcy purposes because they often perform essential or important governmental functions. In addition, the Bankruptcy Code provides special protections for municipalities to prevent substantial interference in the inherently local nature of the operations of “municipalities” by a federal bankruptcy court.

It is not always clear whether an issuer is a “municipality.” The determination is based on sometimes inconsistent case law and an analysis of complex facts involving, among other things, the issuer’s formation statutes, the degree of governmental control over its management and operation and whether it has traditional governmental powers, such as the power to tax. The question of whether an issuer is a “municipality” is usually addressed in a reasoned legal opinion and is subject to limitations and qualifications.

If an issuer is treated as a “municipality,” it is not subject to a bankruptcy proceeding under chapter 7 (liquidation) or chapter 11 (reorganization) of the Bankruptcy Code. Under certain limited circumstances, however, a “municipality” may file a voluntary bankruptcy petition under chapter 9, which is a special chapter of the Bankruptcy Code that contains only provisions governing the bankruptcy of a “municipality.” An involuntary bankruptcy case cannot be filed against a “municipality” under any chapter of the Bankruptcy Code, including chapter 9.

Section 109 of the Bankruptcy Code sets forth the requirements that must be met before a “municipality” may file a voluntary bankruptcy petition, which must be filed under chapter 9 of the Bankruptcy Code. In general, these requirements are substantially more difficult to meet than the requirements of the entities discussed above. In order to file a petition under chapter 9, a “municipality” must:

- Be specifically authorized, in its capacity as a municipality or by name, to be a debtor under chapter 9 by State law, or by a governmental officer or organization empowered by State law to authorize it to be a debtor under chapter 9;

- Be insolvent, which means that it generally is not paying its debts as they become due unless the debts are the subject of a bona fide dispute or it is unable to pay its debts as they become due;

- Intend to effect a plan to adjust its debts; and

- Either obtain an agreement of certain of its creditors, fail to obtain an agreement with the creditors if it has negotiated in good faith with them, be unable to negotiate with creditors because the negotiation is impracticable or reasonably believe that a creditor may attempt to obtain a transfer that is an avoidable preference.

With respect to the first requirement above, as of 2010, approximately 16 States have laws that "specifically authorize" "municipalities" to file bankruptcy under chapter 9; approximately eight States permit a filing if there is further action by the State or another authorized entity or official; and approximately three States "specifically authorize" only certain "municipalities" to file bankruptcy under chapter 9. The remaining 23 States either prohibit filing by "municipalities" or have no laws or no clear laws addressing the filing.

Even if a State permits, limits or conditions a bankruptcy filing under chapter 9 by a "municipality," a governmental officer or organization empowered by State law could authorize the filing, for example, based solely on the authority provided in an executive order issued by the State's governor. Because an authorized governmental officer or organization can permit a chapter 9 filing by a "municipality," the holders of the debt of a "municipality" may not be able to determine, based solely on a review of State statutes, whether the "municipality" could file for bankruptcy under chapter 9.

Chapter 9 of the Bankruptcy Code provides some protections for the "municipality" and its debt holders that are not available for other types of debtors in bankruptcy. For example, the automatic stay (which prevents, among other things, actions by creditors to collect their debts after the bankruptcy filing) is expanded under chapter 9 and the ability of the bankruptcy court to interfere with governmental functions is limited. These protections make it more likely that the assets of the "municipality" can be preserved for distribution to secured and unsecured creditors and that the "municipality" can continue to perform its functions, including the collection of revenue and the payment of its debt. In addition, the payment of a bond or note of a "municipality," even if made within 90 days of the chapter 9 filing, will not be avoidable as a preferential payment as may be the case in a chapter 7 or chapter 11 bankruptcy proceeding.

Chapter 9 bankruptcy filings by "municipalities" have been comparatively rare. This, in addition to the restrictions in the Bankruptcy Code on the ability of "municipalities" to voluntarily file for bankruptcy, has reduced in past years the concern of the rating agencies and investors regarding possible defaults on the debt of "municipalities." As a result, rating agencies and investors have not required debt offerings by "municipalities" to incorporate the provisions described above that might make them bankruptcy-remote. In most cases, bankruptcy-remote restrictions on the "municipalities" themselves may be impractical or impossible due to the lack of statutory authority. With respect to the formation of a subsidiary of a "municipality" that would be a bankruptcy-remote SPE through which debt could be offered, it would be rare for statutory authority to exist which would permit the formation of such an SPE. In some cases, State law or a State constitutional provision may affirmatively restrict the ability of "municipalities" to form bankruptcy-remote subsidiaries. Even if such subsidiaries were formed, the "municipality" could be required to retain substantial control of the subsidiary such that the subsidiary would itself be deemed a "municipality" which may be able to file a voluntary bankruptcy under chapter 9 of the Bankruptcy Code.

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