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SWAPPING PAST THE LAW SCHOOL GRAVEYARD: IN RESPONSE TO
PROFESSORS LEFF AND HUGHES

MICHAEL C. MACCHIAROLA* AND ARUN ABRAHAM**

“The poor man retains the prejudices of his forefathers without their faith, and their ignorance without their virtues; he has adopted the doctrine of self-interest as the rule of his actions, without understanding the science which put it to use; and his selfishness is no less blind than was formerly his devotedness to others.”

- Alexis de Tocqueville, *Democracy in America*

IN *Student Loan Derivatives: Improving on Income-Based Approaches to Financing Law School* (the Article), Professors Benjamin M. Leff and Heather Hughes suggest “a new and innovative approach to financing law school”¹ in an attempt “to tie students’ financing obligations to post-graduate income rather than interest rates.”² The authors posit that the proper model for financing higher education must transition from today’s debt-based version to one incorporating the post-graduate income of its subjects. To that end, the authors propose a so-called Income-Based Repayment Swap (IBR Swap), which employs derivatives to “enable income-based payment for education that does not (1) rely on taxpayer subsidies or (2) implicate the practical and legal impediments associated with human capital contracts.”³

The Article represents a significant and welcomed development, serving as an important addition to the increasing dialogue of academics and commentators concerning the exploding costs of legal education.⁴ The skeptic might question whether the academy’s newfound focus on the subject matter is motivated as much by scholarly investigation as by self-preservation.⁵ Such judgment,

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1. Benjamin M. Leff & Heather Hughes, *Student Loan Derivatives: Improving on Income-Based Approaches to Financing Law School*, 61 VILL. L. REV. 99, 100 (2016).

2. *Id.* at 99.

3. *Id.* at 100.

4. See, e.g., Paul Campos, *The Crisis of the American Law School*, 46 U. MICH. J.L. REFORM 177 (2012) (bemoaning relentless growth in law school costs and unsustainability of current model); Jonathan D. Glater, *Student Debt and Higher Education Risk*, 103 CALIF. L. REV. 1561 (2015) (describing dramatic increase in student borrowing and negative effects that have followed); John A. Seibert, *The Cost and Financing of Legal Education*, 52 J. LEGAL EDUC. 516 (2002) (suggesting reforms to limit law school costs); Maulik Shah, Note, *The Legal Education Bubble: How Law Schools Should Respond to Changes in the Legal Market*, 23 GEO. J. LEGAL ETHICS 843 (2010) (suggesting reforms).

5. For an interesting discussion of the cartel protection tendencies of the behavior of school officials, see Lloyd Cohen, *Comments on the Legal Education Cartel*, 17 J. CONTEMP. LEGAL ISSUES 25 (2008); see also George B. Shepherd & William G. Shepherd, *Scholarly Restraints? ABA Accreditation and Legal Education*, 19 CARDOZO L. REV. 2091 (1998).

however, is best left for another time and place.

As authors who have studied this subject and proposed the original derivative-based model for financing legal education some years ago,⁶ we are pleased to pen this short response (the Response) to Professors Leff and Hughes. We hope to focus attention, advance debate, and improve the collective wisdom of the academy, lawmakers, and students alike. As many others, we continue to lament that “for too many [students], debt-financed higher education represents a stifling encumbrance instead of the great investment that society’s collective commonsense has long advanced.”⁷ In fact, absent meaningful change, which must include an express acknowledgment that the laws of economics apply, the entire system of legal education and the integrity of the legal profession in the United States remain at risk.⁸

This brief Response proceeds in four parts. Part I examines the state of today’s legal education market, paying special attention to the significant deterioration in the half decade since we last investigated it. A full appreciation for the depth of the problem is essential before any solution can be evaluated properly. Part II outlines the Article’s basic proposal. Here, our goal is an impartial and succinct summary of the contribution of Professors Leff and Hughes.⁹ This Part of the Response lays the proper predicate for the points of critique to follow. It also offers a very simple summary of the derivatives-related solution that we first proposed several years ago and fashions a brief comparison of our scheme to the Article’s IBR Swap plan. Part III of the Response is our critique of the Article. Finally, the Response finishes with some brief conclusions and renews our call to arms for those interested in improving the market for legal education and protecting the students who continue to suffer a system that grows more non-economic with each passing academic season.

PART I

The past several years have seen a stream of law school graduates, lower starting salaries, increased competition for the few positions available, and a large cohort of graduates buried in student loan debt with too little income to repay it.¹⁰

6. See Michael C. Macchiarola & Arun Abraham, *Options for Student Borrowers: A Derivatives-Based Proposal to Protect Students and Control Debt-Fueled Inflation in the Higher Education Market*, 20 CORNELL J.L. & PUB. POL’Y 67 (2010).

7. *Id.* at 70; cf. Hedlund v. Educ. Res. Inst., Inc., 468 B.R. 901, 907 (D. Or. 2012) (“Attending law school was a guaranteed way to ensure financial stability.”), *rev’d*, 718 F.3d 848 (9th Cir. 2013).

8. See Daniela Kraiem, *The Cost of Opportunity: Student Debt and Social Mobility*, 48 SUFFOLK U. L. REV. 689, 691 (2015) (“Unmanageable individual debt threatens widespread social mobility and contributes to growing inequality. Rising debt is undermining the economic recovery. Most disturbingly, the institution of higher education is itself threatened because public support for higher education has diminished.”).

9. Admittedly, such an effort might not result in the same emphasis that Professors Leff and Hughes might choose themselves. And, apologies are made for any inartful or inexact presentation.

10. See Christopher Gorman, Note, *Undoing Hardship: Applying the Principles of Dodd-Frank to the Law Student Debt Crisis*, 47 U.C. DAVIS L. REV. 1887, 1899 (2014) (“Despite historic debt levels, law graduates currently face the worst employment environment in

Against such prospects, the ivory tower happy-talk that continues to promote the non-economic value of a law degree can no longer be excused as a charming justification by an out-of-touch academic class.¹¹ Instead, such sermons must be seen as contrary to economic reality and a luxury higher education can no longer abide. At this point, such efforts might be better understood as part of a deliberate attempt to entice the next starry-eyed group to enroll in large enough numbers to preserve a cushy status quo for those invested in the continuation of the school as enterprise.¹² Regardless, as one scholar has suggested, “the question of whether and to what extent law school actually transforms law students into smarter and better people” must be separated from the “question of how much money is necessary to spend to achieve these impressive-sounding results.”¹³

The primary organization that tracks employment results for recent law school graduates began its most recent report with the sobering observation that “[n]ew law school graduates from the Class of 2015 secured fewer private practice jobs than any class since 1996.”¹⁴ The study also reported that the earning power of the class, as measured by the median starting salary for recent law school graduates, “is still well below what it was in 2009.”¹⁵ Also notable, the study described a precipitous 35% year-over-year drop in law-school funded jobs, “following the ABA decision to reclassify how these jobs are recorded and counted.”¹⁶ The study concluded with the following summary from the group’s

decades.” (citing *Law School Grads Face Worst Job Market Yet—Less Than Half Find Jobs in Private Practice*, NALP (June 7, 2012), <http://www.nalp.org/2011selectedfindingsrelease>); Robert Farrington, *Law School and Student Loan Debt: Be Careful*, FORBES (Dec. 18, 2014, 8:46 AM), <http://www.forbes.com/sites/robertfarrington/2014/12/18/law-school-and-student-loan-debt-be-careful/#2b665a874f06>. Interestingly enough, while student outcomes have suffered, ABA data suggest that the number of law school faculty relative to J.D. students almost doubled between 1980 and 2013. See *Statistics*, AM. BAR ASS’N, http://www.americanbar.org/groups/legal_education/resources/statistics.html [<https://perma.cc/6528-ht6l>] (reporting change from 27-to-1 to 13.6-to-1 during time period).

11. See, e.g., Brian Z. Tamanaha, *Is Law School Worth the Cost?*, 63 J. LEGAL EDUC. 173, 179 (2014) (citing Paul Berman, *Thinking About Law School Tuition*, DEAN OF THE GEO. WASH. UNIV. L. SCH. (Aug. 8, 2011), <https://gwlawdean.wordpress.com/2011/08/30/thinking-about-law-school-tuition> [<https://perma.cc/yc3f-wrd7>] (arguing cost-benefit analysis is “only a crude measure that ignores the intrinsic value of education in personal, intellectual, spiritual, and emotional growth”).

12. One of our favorite quotations is attributed to the great Derek Bok: “Universities share one characteristic with compulsive gamblers and exiled royalty: there is never enough money to satisfy their desires.” See DEREK BOK, *UNIVERSITIES IN THE MARKETPLACE: THE COMMERCIALIZATION OF HIGHER EDUCATION* 9 (2003).

13. Paul Campos, *Has the Increased Cost of Law School Improved Legal Education?*, WAKE FOREST L. REV. (Oct. 19, 2015), <http://wakeforestlawreview.com/2015/10/has-the-increased-cost-of-law-school-improved-legal-education> [<https://perma.cc/6yuc-87ep>].

14. See *Salaries for New Graduates Rise While Employment Rate Remains Unchanged, Number of Private Practice Jobs Tumbles*, NALP (Aug. 17, 2016), http://www.nalp.org/2015_selectedfindings_pr [<https://perma.cc/bav6-mhrl>] [hereinafter *Salaries for New Graduates*, NALP].

15. *Id.* For additional challenges with the reliability of mean or median as an appropriate forecasting measure within the bimodal distribution characteristics of the legal marketplace, see Macchiarola & Abraham, *supra* note 6, at 107–10.

16. *Salaries for New Graduates*, NALP, *supra* note 14; see also Kellie Woodhouse, *ABA Tightens Rules on Employment Reporting*, INSIDE HIGHER ED (Aug. 4, 2015), <https://www.insidehighered.com/quicktakes/2015/08/04/aba-tightens-rules-employment>

executive director:

[I]n this flat jobs market there is no evidence that the entry-level legal job market will continue to improve, or at least there can be little confidence that it will return to what it was before the recession.¹⁷

The picture on the financing side is no less bleak. Almost 90% of law school students borrow to help finance their legal education.¹⁸ “Over the last three decades, the price of a legal education has increased approximately three times faster than the average household income.”¹⁹ According to the American Bar Association (ABA), the average law school graduate borrows a staggering \$88,000 to attend a public law school and a whopping \$127,000 to attend a private school.²⁰ As alarming as the high debt load is the pace of its growth. Similar levels measured in 2005 were \$66,000 and \$102,000, equating to 33.3% and 24.5% growth in borrowings for the decade, respectively.²¹

The high cost of law school and the stagnant jobs market for new lawyers have compromised the demand for a law school education.²² According to a recent report of the ABA, between the academic years beginning 2009 and 2014, respectively, private law school entrants sank by 30%.²³ During the same period, 18% fewer students entered public law schools.²⁴ Fewer students means fewer tuition dollars to finance a school’s operations.²⁵ The combination of stifling debt and an uninspiring jobs market has jeopardized the survival of many law schools and “the long-term supply of competent and willing lawyers.”²⁶ More insidiously, the current structure continues to encourage “an unprecedented, debt-fueled wealth transfer from students of modest means to the increasingly affluent

reporting [<https://perma.cc/af3c-sdcx>] (describing changes implemented by ABA following criticism that schools with large fellowship programs were skewing employment data and overstating real job opportunities for graduates).

17. *Salaries for New Graduates*, NALP, *supra* note 14.

18. See Memorandum from Dennis W. Archer, Chair, ABA Task Force on Fin. Legal Educ., to Interested Parties 8 (June 17, 2015), http://www.americanbar.org/content/dam/aba/administrative/legal_education_and_admissions_to_the_bar/reports/2015_june_report_of_the_aba_task_force_on_the_financing_of_legal_education.authcheckdam.pdf [<https://perma.cc/r451-qap7>] (reporting ABA Task Force on Financing Legal Education’s findings regarding enrollment, financing, and student debt).

19. Deborah L. Rhode, *Legal Education: Rethinking the Problem, Reimagining the Reforms*, 40 PEPP. L. REV. 437, 440 (2013).

20. See Archer, *supra* note 18, at 8.

21. *Id.*

22. See, e.g., Rhode, *supra* note 19, at 443 (“As debt burdens are rising and employment prospects are declining, fewer individuals are taking the LSAT and applying to law schools.” (citing David Segal, *For 2nd Year, a Sharp Drop in Law School Entrance Tests*, N.Y. TIMES (Mar. 19, 2012), <http://www.nytimes.com/2012/03/20/business/for-lsat-sharp-drop-in-popularity-for-second-year.html> [<https://perma.cc/dx56-kskp>]; Brian Tamahana, *The Law School Crunch Is Here—Finances and Quality to Suffer*, BALKINIZATION BLOG (Apr. 9, 2012, 10:11 AM), <https://balkin.blogspot.com/2012/04/law-school-crunch-is-here-finances-and.html> [<https://perma.cc/ah9l-keaj>])).

23. See Archer, *supra* note 18, at 6.

24. See *id.*

25. See *id.* Of course, this issue is particularly tricky in an academic setting where many of the most expensive personnel enjoy academic tenure.

26. See Macchiarola & Abraham, *supra* note 6, at 73.

higher education industry.”²⁷ Thus far, school mergers and closures, or minor tweaks to the traditional financing model simply have not proven meaningful against this bleak financing, enrollment, and jobs picture.²⁸ And, cleverly-designed, law-school-funded, post-graduate programs paying students a stipend to work for organizations who otherwise would not have had an available job have improved jobs data at the margins, but represent more a scheme to massage data than an earnest plan to address systemic and persistent value disappointments.²⁹

Moved by these disheartening economic realities for the law school enterprise and the dearth in “creativity in thinking about the optimal mechanism for funding a legal education,” Professors Leff and Hughes offered their Article and its IBR Swap structure.³⁰ Because such honest, creative, and solution-focused thinking is a welcomed development and should be considered purposefully by the academy, the following sections of this Response represent our consideration of their proposal.

PART II

As Professors Leff and Hughes describe them, IBR Swaps will coordinate with existing, traditional student loans to introduce an income-based regime. The structure will also allow investors to avoid substantial upfront payments in favor of a monthly fixed payment to a student that is then passed on to service a pre-existing student loan. Under the plan, a student will borrow money to fund a legal education from the federal government, much in the same manner as is common today, and required repayment would begin some short time after graduation. In addition to the federal loan, however, the student would enter into a swap

27. Michael C. Macchiarola, “*Too Big to Fail*” Goes to College, MINDING THE CAMPUS (June 21, 2010), http://www.mindingthecampus.org/2010/06/too_big_to_fail_goes_to_colleg [<https://perma.cc/a2ua-q8sz>]; Mary Pilon, *Student-Loan Debt Surpasses Credit Cards*, WALL ST. J. REAL TIME ECON. BLOG (Aug. 9, 2010, 1:13 PM), <http://blogs.wsj.com/economics/2010/08/09/student-loan-debt-surpasses-credit-cards> [<https://perma.cc/rzj7-xu55>].

28. See, e.g., Jordan Weissmann, *The Great Law School Bust is About to Claim its First Victim*, SLATE (Feb. 18, 2015), http://www.slate.com/blogs/moneybox/2015/02/18/hamline_william_mitchell_merger_the_la_w_school_bust_claims_its_first_victim.html [<https://perma.cc/29pk-8w35>] (discussing merger of William Mitchell College of Law and Hamline University School of Law in Minnesota); Dorothy A. Brown, *Which Top Law School Will Close? Follow the Money*, FORBES (Mar. 17, 2016), <http://www.forbes.com/sites/schoolboard/2016/03/17/which-top-law-school-will-close-follow-the-money/#25c21ffd3457> (predicting that “[i]n two to four years, a university administration will shut down a top law school and we may never see it coming”); Staci Zaretsky, *Law Schools in Trouble: Several Schools May Soon ‘Wither Away’ into Closure*, ABOVE THE LAW (Mar. 31, 2016) (describing headwinds for law schools, particularly in “Rust Belt” region of country).

29. See, e.g., Sara Randazzo, *New Rules Limit Impact of Law School-Funded Jobs*, WALL ST. J.L. BLOG (Jul. 31, 2015, 9:21 PM), <http://blogs.wsj.com/law/2015/07/31/new-rules-limit-impact-of-law-school-funded-jobs> [<https://perma.cc/u9pj-qg6x>] (describing changes by ABA’s accrediting arm designed to limit amount of credit schools get for paying to find graduates jobs).

30. See Leff & Hughes, *supra* note 1, at 99.

transaction with a sophisticated financial institution whereby “the institutional counterparty agrees to pay the student the exact amount needed to pay back their [sic] loans for exactly the same term.”³¹ In exchange for this backstop, the student would make reciprocal payments to the institutional swap counterparty, based on a percentage of her post-graduate income.³² The authors cite as the structure’s primary advantages (i) the lack of an upfront payment, which decreases the risk of nonpayment dramatically, and (ii) the fact that the IBR Swap will likely not be treated as debt, and, therefore “could become a reality without new legislation or other law reform.”³³

When we penned *Options for Student Borrowers*, more than half a decade ago, we too were committed to calling attention to the strains on the non-economic model of law school financing. We were hopeful too that the academy and political leaders might abandon the traditional model of debt financing in favor of a newer, more dynamic structure that might “reshape the entire American legal education model for the benefit of students.”³⁴ Of course, the indefatigability of the status quo is rarely overstated.

As the authors describe, the appeal of income share arrangements stems from the idea that “they do a better job than debt of aligning the costs of an education to the financial benefit to the student.”³⁵ A debt arrangement defines costs before the student’s earnings prospects have come into focus and is frustrated easily by the unknown of a large variation in the earnings outcomes of its student-borrowers.³⁶ In contrast, the IBR Swap, and similar income share arrangements, overcome the variable earnings problem by “retrospectively tailoring the cost of education . . . based on the amount the graduate actually earns.”³⁷ Such a scheme allows graduates earning above the mean income level to subsidize those earning below, a significant benefit in the law school context, where the variation in earnings outcomes is extreme.³⁸

Similar to the IBR Swap proposal, our model employed basic financial derivatives as a risk-shifting mechanism. Under our proposed structure, law school graduates would be able to transfer a portion of their debt payment obligations *back to their law school* in the event that their post-graduation earnings proved less robust than the students and the law schools had envisioned upon the student’s law school matriculation. Our derivatives-based model was structured with options instead of swaps. And, the terms of each put option would be standardized, yet tailored via negotiation between the school and its student prior to enrollment. The option structure would trigger a funding backstop from the school in the event that the student’s post-graduate earnings potential failed

31. *Id.* at 106.

32. *See generally id.* at 100.

33. *See id.* at 101.

34. *See* Macchiarola & Abraham, *supra* note 6, at 119.

35. Leff & Hughes, *supra* note 1, at 111–12 (citing ROBERT J. SHILLER, *THE NEW FINANCIAL ORDER: RISK IN THE 21ST CENTURY* 139 (2003)).

36. *Id.*

37. *Id.* at 112.

38. *See id.*

to materialize as the parties had originally anticipated.³⁹

The experienced derivatives trader will recognize a resemblance between our proposed put option and the authors' proposed swaps. As a general matter, the two models differ in two regards. First, the put option scheme anticipates a nominal upfront premium payment by the student put holder.⁴⁰ Second, and most importantly, our model replaces the financial institution as counterparty with the law school.

PART III

The authors concede at least two potential shortcomings to their proposal. First, they observe that such an income-sharing arrangement might result in "students from more privileged backgrounds" being extended greater credit "simply because investors believe that the more privileged student is a better investment."⁴¹ Second, the authors worry that "income-shar[ing]-arrangements [generally] potentially obscure the non-financial value of higher education to the individual and the collective value of higher education to society."⁴²

With regard to the first potential shortcoming the authors cite, students of finance might recognize such behavior by another name—underwriting standards. Most basically, lenders establish guidelines to ensure the safety and security of the loans they issue. Such efforts are meant to standardize the process for the amount of debt that may be issued to a borrower, the terms of loans, and the appropriate rate of interest to be charged.⁴³ More importantly, these efforts protect the viability and sustainability of a lending business.⁴⁴ It is one thing to promote government programs which provide access to education to the less fortunate or the underprivileged. It is quite another to mandate a program of access for underprivileged students through private funding sources. In the first case, society—presumably following robust legislative debate and consideration—decides to expend its resources in pursuit of a goal based on equality of access to education. Such a public choice would be both noble for its

39. Unlike a swap, an option provides its holder the right but not the obligation to exercise. Accordingly, the option holder is not required to go through with the transaction. For example, if the option's "strike price" is not favorable, the holder can let the option expire without exercising it.

40. We believe that this payment would be nominal and would be imbedded in tuition costs. It is significant, however, that the benefit provided to a prospective student has a cost.

41. Leff & Hughes, *supra* note 1, at 101.

42. *Id.* (citing Kraiem, *supra* note 8).

43. See, e.g., *2015 Survey of Credit Underwriting Practices*, OFFICE OF THE COMPTROLLER OF THE CURRENCY 2 (Dec. 2015), <https://www.occ.gov/publications/publications-by-type/survey-credit-underwriting-practices-report/pub-survey-cred-under-2015.pdf> [<https://perma.cc/2tvv-4ttt>] (describing underwriting standards as "the terms and conditions under which banks approve, extend, or renew credit, such as financial reporting, collateral requirements, repayment terms, pricing, and covenants").

44. See generally FED. RESERVE BANK OF MINNEAPOLIS, *Underwriting Standards - Lessons from the Past*, BANKING IN THE NINTH (June 18, 2014), <https://www.minneapolisfed.org/publications/banking-in-the-ninth/underwriting-standards-lessons-from-the-past> [<https://perma.cc/4qfu-pejj>] (commenting that "[c]onsistently sound underwriting is essential to maintaining safety and soundness of financial institutions").

objective and proper as a function of democratic process. In stark contrast, an attempt to mandate a similar system through the marketplace's private participants frustrates their efforts at maintaining underwriting standards and represents an ignoble government intrusion into the affairs of private economic actors.

The worry should also be tempered by three additional realities. First, higher education, unlike most other goods and services, is an "associative" good, with consumer choice prescribed by "not just the quality and price of the firm's products, but also . . . the personal characteristics of the firm's other customers."⁴⁵ With a law school's appeal dictated, in part, by the quality of the other students in the pool, plenty of incentive remains for the finest schools to gather diverse, well-qualified groups for each successive cohort.⁴⁶ Second, as we suggested several years ago, the uniform requirements of law schools should be revisited because they leave "substantially diminished room for price differentiation, effectively forcing all consumers to purchase the luxury model."⁴⁷ If concerns for inclusion lead to a cheaper, more inclusive model of legal education, such a result would be a welcomed development indeed.⁴⁸ Finally, efforts at improving access to legal education must be weighed carefully against the observable reality that students "who did poorly on the Law School Admission Test didn't just pay more than everyone else [for law school], they also got less for their money."⁴⁹ And, this high-cost, low-value phenomenon means that there is no virtue in herding additional students into the law school factory if outcomes are likely to disappoint.⁵⁰

The second worry of the authors strikes us more as happy talk of the type that can no longer be indulged. We too anticipated that an outcome-based model

45. Henry Hansmann, *Proprieta' e Concorrenza nell'Istruzione Universitaria* [Ownership and Competition in Higher Education], 1 MERCATO CONCORRENZA REGOLE [MKT. COMPETITION REG.] 475, 487 (1999) (It.), https://www.law.yale.edu/system/files/documents/pdf/Faculty/Hansmann_The_State_and_the_Market_in_Higher_Education.pdf [<https://perma.cc/az2b-t56m>] [hereinafter Hansmann, *Ownership and Competition*].

46. See generally Macchiarola & Abraham, *supra* note 6, at 126–27.

47. *Id.* at 79.

48. See generally Frank J. Macchiarola & Michael C. Macchiarola, *Does U.S. News Make Law Schools More Expensive?*, MINDING THE CAMPUS (Jan. 11, 2010), http://www.mindingthecampus.org/2010/01/does_us_news_make_law_schools [<https://perma.cc/4xxc-umh5>] (noting that "the virtual monopoly on bar admission accorded to the 200 ABA-approved law schools excludes prospective attorneys who cannot afford the cost of a legal education in the way in which it is currently delivered").

49. See Natalie Kitroeff, *Some People Are Paying Way Too Much for Law School*, BLOOMBERG (Jan. 21, 2015, 6:00 AM), <http://www.bloomberg.com/news/articles/2015-01-21-are-you-paying-too-much-for-law-school-> [<https://perma.cc/7ehs-uc8j>]. This reality results from law school efforts to attract highest performing students by dispensing aid tactically. Also, law schools are accepting weaker students to overcome a shrinking pool of applicants. Often, the results of these trends take years to develop in the data because, for example, bar passage rates can be measured only after a student finances three years of a law school education.

50. See Macchiarola & Abraham, *supra* note 6, at 126 (commenting that "if the victims of exclusion avoid a clique comprised of law school graduates who are struggling like the dickens to repay their stifling debt levels, an argument rooted in 'inclusion' seems rather curious").

would offend the higher-minded ideals of the academy and might face criticism for failing to appreciate fully the immeasurable benefits of a law school education.⁵¹ Today, we proclaim unabashedly that such an allowance results in a continual embrace of non-economic choices. Higher education is a labor and resource-intensive activity, more expensive than most individuals can afford to pay out of pocket.⁵² And, to the student footing the bill and likely to struggle for years under the burden of its attendant debt, arguments of collective societal benefit ring particularly hollow.

In addition to the two shortcomings that the authors highlight, their private IBR Swap proposal has additional identifiable weaknesses that are worth noting. Here, we highlight briefly particular vulnerabilities of the IBR Swap model.

The primary shortcoming relative to the government-mandated put option right that we sketched out in *Options for Student Borrowers* is a failure of the proposed IBR Swap to properly align and internalize the costs of tuition-setting decisions by law schools. In offering *Options for Student Borrowers*, we envisioned a government mandate that would directly impose tuition and cost discipline on the law schools themselves. Our model, based in enterprise liability theory, would have levied on these schools the portion of the long-term costs of high tuitions misaligned with the financial outcomes of students following graduation. Too often, in the world of higher education financing, the risks of poor outcomes are borne by the student or the lender (read: federal government). It has long struck us as curious that the third participant in the higher education transaction, the law school, enjoys the lion's share of the enterprise's benefit yet bears very minimal risk of non-performance.⁵³ The IBR Swap model fails to address this reality. It simply externalizes the full cost of the student loan derivative on students and third-party financial institutions. Unfortunately, such a scheme fails to align directly the incentives of students with their law schools. Absent such a check, it is unlikely that the same law schools that have displayed a tendency to raise tuitions in a manner disconnected from the economic realities their students encounter in the job market following graduation will alter their behavior.

A system incorporating an enforcement mechanism against the law schools would be consistent with enterprise liability theory's dual aims of reducing an accident's costs and compensating its victims.⁵⁴ Typically, such goals are achieved by allocating costs to the enterprise whose activities gave rise to the

51. *See id.* at 129–31.

52. *See* Kraiem, *supra* note 8, at 690–91.

53. Former Secretary of Education William J. Bennett long ago lamented that “increases in financial aid in recent years have enabled colleges and universities blithely to raise their tuitions, confident that [f]ederal loan subsidies would help cushion the increase.” William J. Bennett, Op-Ed, *Our Greedy Colleges*, N.Y. TIMES, Feb. 18, 1987, at A31, <http://www.nytimes.com/1987/02/18/opinion/our-greedy-colleges.html> [https://perma.cc/wzj9-rkjl]; *see also* Glater, *supra* note 4, at 1583 (“The consequences to the institution of a poor education outcome are slight; the default rate among student borrowers must rise to quite a high level and persist for a few years before the institution suffers any consequences under Education Department regulations.”).

54. *See* Guido Calabresi, *The Decision for Accidents: An Approach to Nonfault Allocation of Costs*, 78 HARV. L. REV. 713, 719 (1965).

accident.⁵⁵ Moreover, such a system would not be dissimilar from the “skin in the game” provisions of the Dodd-Frank Act, enforced upon mortgage securitizers following the financial crisis.⁵⁶ As mortgage securitizers are now required to retain some of the risk of the loans they originate, they bear at least some burden of the costs in the enterprise they enjoy, and are never entirely divorced from the risks of the loans they pass on.⁵⁷ Notably, the Dodd-Frank Act also requires lenders to undertake reasonable efforts to determine a borrower’s ability to repay.⁵⁸ A similar requirement applied to the law school financing market would likely protect a significant number of potential law students from non-economic choices that take years to untangle. Unfortunately, the plan offered by Professors Leff and Hughes fails to address these important points.

The free-market approach encouraged by the IBR Swap proposal also appears to underestimate some of the likely shortcomings of leaving these student loan derivatives to the capital markets to solve without concomitant government oversight. First, absent a government mandate, the spontaneous creation of a robust market for these highly bespoke IBR Swap instruments, for which there is no current market, seems improbable. The creation of an organic market of this type is made even less likely by the federal government’s most recent hostility to derivatives, in general,⁵⁹ and to private lenders in the education space.⁶⁰

If a market were to form spontaneously, its overall liquidity and the integrity of the price signals at the individual school and loan level might prove unreliable, absent a federal or state mandate and its attendant regulation. Broad and deep liquidity are not assured. Their absence might compromise any ability to uncover satisfactorily the information benefits to be conveyed to students and potential students through the IBR Swap pricing described by the professors. Left unregulated, it is possible that any financial institutions willing to extend IBR Swaps would be highly selective in choosing the institutions and individual students for the extension of credit. Such a result would leave large swaths of both institutions and students without access to such IBR Swaps. On the flip side, some of the strongest students, in the absence of a government mandate, may opt out of electing to enter into a voluntary IBR Swap, thus creating a lemons problem for potential IBR Swap counterparties and discouraging their

55. *See id.*

56. For a favorite summary of the financial crisis and its underlying causes, see generally Michael C. Macchiarola, *Beware of Risk Everywhere: An Important Lesson from the Current Credit Crisis*, 5 HASTINGS BUS. L.J. 267 (2009).

57. *See generally* Dodd-Frank Act, 15 U.S.C. § 78o-11 (2012).

58. *See id.* § 1639c.

59. *See, e.g.*, Ben White, *Warren to Roll out New Derivatives Bill*, POLITICO (June 29, 2016, 8:00 AM), <http://www.politico.com/tipsheets/morning-money/2016/06/warren-to-roll-out-new-derivatives-bill-215073> [<https://perma.cc/ks43-9kt9>] (describing introduction of new bill designed to further tax and regulate derivatives transactions).

60. When the Health Care and Education Reconciliation Act of 2010 eliminated the Federal Family Education Loan Program (FFELP), the role of banks in federal student lending was discontinued for new loans. On July 1, 2010, the Direct Loan Program replaced FFELP, and it has been the only source of new federal student loans since then. *See generally* OFFICE OF THE COMPTROLLER OF THE CURRENCY, *Comptroller’s Handbook: Safety and Soundness, Student Lending* 4 (May 2016), <https://www.occ.gov/publications/publications-by-type/comptrollers-handbook/pub-ch-sl.pdf> [<https://perma.cc/k3fp-xaxm>].

participation in the market as envisioned.⁶¹

In an unregulated, free-market IBR system, the question of fair swap pricing is particularly acute. Market pricing in traditional over-the-counter swap markets depends on sophisticated counterparties on two sides of a transaction. In the IBR swap context, however, only one side of the trade would be a sophisticated, repeat player.⁶² The financial institution's trade would be contra a student who would likely be a one-time player in the market, and who would lack the financial sophistication to participate properly in the pricing decisions and negotiation related to the IBR Swap.⁶³ Such a model would be notable for its informational asymmetries. Moreover, such a model would face significant societal and governmental resistance, as there does not seem to be an appetite for a structure that encourages students to face off against financial institutions in the negotiation of derivatives-based contracts.⁶⁴ This problem would be exacerbated by a thin, illiquid market in IBR Swaps, as the lack of competitive bids for these highly bespoke and opaque financial products would tend not to improve the cost to students. Government regulation through a mandate and controls to ensure fair pricing to unsophisticated student players in this hypothetical market would thus both provide a significant benefit and encourage the level of participation required to form a deep and robust market.

CONCLUSION

Today's model for financing legal education is long overdue for a significant rethink.⁶⁵ And, the limited efforts at repair offered to date represent far less than the best of our collective effort. A strategy which combines hope with a patchwork of half-measures might represent the natural reaction of decision makers dependent upon the status quo. Yet, such an approach remains incapable

61. In a used car market comprised of cheaters and honest dealers, there is no way to distinguish good cars from "lemons" absent a method to eliminate the informational asymmetry beyond buyer and seller. For a general introduction to the economic theory regarding asymmetric information, see George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970).

62. For a further discussion of the mismatch, see Macchiarola & Abraham, *supra* note 6, at 110–13.

63. More importantly, a law student is unlikely to "represent an adequate restraint on the pricing power of a more seasoned lender and law school." *See id.* at 113. Notably, both our structure and the IBR Swap structure would likely require some relief from the requirement of an "eligible contract participant" embedded in the Commodity Exchange Act. *See* 7 U.S.C. § 1a(18) (2012).

64. *See, e.g.*, Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 6 (2008) (suggesting that "sellers of credit products have learned to exploit the lack of information and cognitive limitations of consumers in ways that put consumers' economic security at risk, turning them into far more dangerous products than they need to be").

65. *See* Abraham & Macchiarola, *supra* note 6, at 133 ("The higher education model that has educated generations of America's best, delivered incomparable achievement, solidified unsurpassed scientific and technological advancement, and improved the social standing of its students, requires a fundamental reexamination."); Jessica L. Gregory, Note, *The Student Debt Crisis: A Synthesized Solution for the Next Potential Bubble*, 18 N.C. BANKING INST. 481, 482–83 (2014) (highlighting "desperate need for a change in attitude towards loans to risky student debtors").

of providing the significant boost required to surmount the rising tide of disappointments fueled by a model that has grown unresponsive to the needs of the students it was intended to serve.

Professors Leff and Hughes have done a real service by offering their IBR Swap model for comment, critique, and improvement. The proposal goes well beyond the usual half measures and calls for a significant re-examination of today's inflexible model. Their most important contribution is in the unequivocal pronouncement that a meaningful shift is required from a debt-based financing model to one more closely tied to the outcomes of students.⁶⁶ Their proposal appreciates the benefits of "agreements under which investors provide capital to students in exchange for a share of students' future incomes."⁶⁷ It seeks also to improve upon the shortcomings of many of the previously suggested models aimed in that direction.⁶⁸

We remain steadfast in our belief that it is just as important that the law schools themselves bear at least some of the risk of student non-performance. We take no comfort from the fact that measures designed to ensure law schools remain exposed to student disappointments would likely cost many schools their existence. As importantly, however, such measures would serve both as a check on each school's value proposition and as a reliable signal of the particulars of that value/non-value to those entering the law school market. And, this mechanism would encourage the long term viability of those particular schools that deliver value to their students.

In the end, our hope is that decision makers understand that time is of the essence. We fear that the actors in the law school market who remain invested in the status quo are also those in control of the levers of decision making. In the end, our fear is this: absent a meaningful groundswell in favor of significant change—and, with alacrity—minor tweaks at the margin will amount to little more than swapping past the law school graveyard.⁶⁹

66. See generally Mitchell E. Daniels Jr., *Could Income-Share Agreements Help Solve the Student Debt Crisis?*, WASH. POST (Aug. 15, 2015), https://www.washingtonpost.com/opinions/a-different-solution-to-student-debt/2015/08/20/d2e140b8-37bb-11e5-9d0f-7865a67390ee_story.html?utm_term=.f4624b873168 [<https://perma.cc/2bfj-jrz7>] (offering that income sharing arrangements "offer a constructive addition to today's government loan programs and perhaps the only option for students and families who have low credit ratings and extra financial need").

67. Leff & Hughes, *supra* note 1, at 99.

68. See *id.*

69. Of course, this expression is a derivation of the popular idiom "whistling past the graveyard." That phrase describes an individual who is "genuinely confident and cheerful while in pursuit of a course of action at the same time blithely oblivious to the real risks involved." See DISAPPEARING IDIOMS, "Whistling Past the Graveyard", <http://disappearingidioms.com/whistling-past-the-graveyard> [<https://perma.cc/f7qq-d64n>] (describing history and usage of expression).