

SPECIAL BULLETIN

March 13, 2009

ENROLLMENT AGREEMENTS.

One of the many unfortunate impacts of the economic downturn is an increase in families being unable to fully pay tuition. This Special Bulletin is intended to address some of the questions LCW has been receiving from independent and private schools related to the topic of enrollment agreements. This bulletin is the second special bulletin designed to assist independent and private schools with issues related to these challenging economic times. The first bulletin, related to layoffs, may be found at http://lcwlegal.com/newspublications/PDFs/SB_2009_3_3_Layoffs_Private_Sch.pdf

I. General Principles of Enrollment Agreements

An enrollment agreement is a contract and thus, is mainly governed by contract principles. An enrollment agreement typically involves the promise of a parent to pay tuition in exchange for the school's promise to provide educational services to the parent's child. The failure to pay tuition may be viewed as a breach of contract. In addition, a family may bring a breach of contract claim against a school if the school violates the terms of this or other contracts between the school and the family. If a family is successful, the family may be excused from payment of all or part of the tuition owed.

California provides for a cause of action for breach of contract. There are four elements that must be established in order to raise this cause of action: the non-breaching party must demonstrate (1) the existence of a contract; (2) the non-breaching party's performance of its promise or an excuse for non-performance; (3) the breaching party's breach of its promise; and (4) damage to the non-breaching party.

II. The Language of Enrollment Agreements

One of the most important aspects of an enrollment agreement is the specific language it contains with regard to payment of tuition. This section of the agreement sets forth the contractual requirements related to tuition owed for enrolled students and also contains language addressing the events of student withdrawal, dismissal, separation or expulsion. In the case of a dispute over unpaid tuition, the language of the agreement will more often than not govern the terms of recovery, if any. For this reason, it is important to carefully prepare well-crafted enrollment agreements.

Many private school enrollment agreements include language whereby parents are permitted to withdraw by a certain date, usually well before the start of the school year. The parent's failure to cancel by the agreed-upon date results in an obligation to pay the full tuition, regardless of whether the student ultimately attends. Some schools also include language whereby parents are permitted to recover a certain amount of tuition if the student does not attend the full academic year. For example, if a student withdraws within a certain time frame from the beginning of the school year, these enrollment agreements permit the parent to recover a predetermined amount of tuition. Alternatively, some independent and private school enrollment contracts are binding when executed. These contracts have no window period and require full payment of tuition whether or not the student ultimately attends the school. Regardless of

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which arrangement is chosen, all schools must ensure that their enrollment agreements contain legal, specific and unambiguous language governing the payment of tuition.

The case of *The Barrie School v. Patch* (Md. 2007) 401 Md. 497, 933 A.2d 382 illustrates the significance of having well-crafted agreements. In this case, The Barrie School entered into an enrollment agreement with Andrew and Pamela Patch, who paid an initial deposit to enroll their daughter, Christiana, at the School. The agreement allowed the Patches to cancel the agreement unilaterally by May 31. If they did not cancel by this date, the agreement provided that they would be liable for the entire year's charges of tuition, including any expenses incurred by the School for collection. The Patches delivered a cancellation notice to the School on July 14, well past the May 31 deadline. The Patches demanded a refund of their initial deposit and refused to pay the remaining tuition balance. The School brought suit for breach of contract.

The Maryland Supreme Court ultimately ruled in favor of the School. It found that the tuition provision could be interpreted as a valid liquidated damages clause, which is an agreement to pay a specific sum in the event of a breach. The Court found that this was enforceable so long as it was not punitive in nature and the precise amount of damages resulting from the breach was uncertain. The Court stated that it would be difficult to determine certain damages resulting from the loss of one student, as the School's expenses (e.g. wages, maintenance and utilities) did not easily correspond to one student's tuition. The purpose of a liquidated damages provision is, in part, to avoid the time and expense of calculating damages which are difficult to determine. The Court also determined that although mitigating damages is typically required in a breach of contract action so as to prevent the non-breaching party from receiving a windfall, the School was not required to do so in this case. Therefore, the issue of whether or not Christiana's spot was filled did not impact the outcome of this case.

This case was decided in Maryland and thus is not binding in California. However, California law regarding contracts and liquidated damages clauses is very similar. This case provides a great example of the importance of well-crafted language and its significance in determining how tuition disputes are resolved.

III. Methods for Recovering Tuition That is in Arrears

It is common and appropriate for schools to work very hard with families to reach mutual agreement on a plan for payment of past-due tuition. In most cases agreement is reached or, as we see in some difficult discipline or medical separation cases, the balance of the tuition may be waived in exchange for a settlement agreement containing a release and promise not to sue the school. In those rare cases where formal legal action is required there are several options for recovering tuition that is past-due.

A. Collection Agencies

One option is to use a collection agency to recover overdue tuition. Collection agencies may "work off" a debt on behalf of a school, and then withhold a percentage of the amount as commission once payment is received. Alternatively, collection agencies may purchase a debt from the school and then retain whatever funds are later received as payment. Typically, schools do not sell debts unless they are several years in arrears.

Due to the annoying tactics and stigma associated with collection agencies, schools should evaluate whether the use of a collection agency may irreparably harm an existing relationship with a school community member. Unless the relationship has already been severed, using a collection agency may damage the relationship of trust between a school and parent. For relationships that have already been severed, however, or debts that are several years in arrears, using a collection agency may be a cost-effective option.

B. Court Action

Generally, for breach of written contracts, a school has up to four years from the breach to pursue recovery in court. It should be noted, however, that many enrollment agreements contain provisions that allow prevail-

ing schools to recover reasonable attorneys' fees and other costs in the event of litigation. Under the threat of litigation, such provisions may provide strong incentive for families to either seek an informal means of resolving tuition disputes, or enter into a plan for payment of the amount past-due without proceeding to court.

i. Small Claims Court

Another option is to seek recovery of overdue tuition in small claims court. Small claims court is the judicial system's "self-help" center. Parties are not permitted to bring a lawyer to court, but may consult and prepare with a lawyer prior to the court proceeding. Due to the prohibition against legal representation, the fairly short legal proceedings involved, the lack of discovery and other pleadings, and the relatively small filing fees, small claims court is an extremely cost-effective option.

There are limitations in the amounts of money that may be sought in small claims court. For a corporation or other business entity, the maximum amount that may be sought is \$5,000.00. Entities may file as many claims per year as needed only if the amount requested is less than or equal to \$2,500.00. Entities may only file two claims per year seeking more than \$2,500.00 (but less than or equal to \$5,000.00 each.) The filing fees range between \$30.00 to \$100.00 per claim depending on the amount of money sought and the number of claims filed by the entity per year.

If a smaller balance of tuition is due, and attempts to work with the family have failed schools might consider using the services of small claims court. For more information, please visit <http://www.courtinfo.ca.gov/selfhelp/smallclaims/>.

ii. Limited Civil Action in Superior Court

Another option is to file a limited civil action in a local Superior Court. A limited civil action is a case at law in which the demand or the value of the property in controversy amounts to \$25,000.00 or less. (Code Civ. Pro § 86(a)(1).) A limited civil action resembles an unlimited civil action - the parties are permitted to file certain pleadings, limited discovery is allowed, and parties have the right to appeal any judgment or final order. However, parties may use this avenue of recovery without the assistance of an attorney (a.k.a. in *propria persona*). Be advised that a school's opposing party may wish to retain legal counsel, which could add to the expense of recovery. Despite this, many consider a limited civil action as an attractive option due to the fact that its process is much more streamlined and slightly simplified, while still providing the parties the right to appeal any judgment or final order. Although the filing fees are slightly higher than in small claims court, filing a limited civil action can be a reasonable method of recovering unpaid tuition.

iii. Unlimited Civil Action in Superior Court

Alternatively, another option is to file an unlimited civil action in a local Superior Court. Unlimited civil actions are cases at law in which the amount in controversy exceeds \$25,000.00. An unlimited civil action is a full blown lawsuit. Although parties may act in *propria persona*, typically parties retain legal counsel, numerous pleadings are filed and full discovery is conducted. An unlimited civil action can be expensive, and schools should carefully evaluate whether the amount of outstanding tuition is worth the potential costs of engaging in this type of litigation.

If a school obtains a judgment against the family, regardless of whether from an unlimited or limited civil action, the school may then pursue the option of recording liens on the family's property or attaching the wages of the parents to recover the unpaid tuition.

C. Other Creative Solutions

Due to the increasing inability of some families to pay full tuition, many schools and families are attempting to devise other creative solutions for the payment of past-due tuition.

i. Stipulated Judgments

For example, rather than go through the potentially expensive course of filing a lawsuit and obtaining a judgment, a school could file suit against a family, and then enter into a stipulated judgment with the family. A stipulated judgment is one that is agreed upon by both parties and thus precludes the need to incur the costs and expenses of litigation. The terms of such an agreement vary depending on individual circumstances. However, they can be arranged so that they are favorable for both parties. For example, a school and family could agree that the stipulated judgment is for the sole purpose of recording a lien against certain property to secure payment of outstanding tuition. As part of this agreement, the family would promise to pay the outstanding tuition within a certain time frame. If the family is unable to pay within the agreed-upon time frame, the school's outstanding tuition is secured through the lien. This agreement benefits both the family and the school, as the family has the benefit of additional time to repay the outstanding tuition, and the school has the benefit of the lien to secure payment. As such, depending on the individual circumstances, this process may be favorable as it is less adversarial than undergoing a court hearing or trial.

ii. Promissory Notes

Another option is for the parties to enter into a promissory note. A promissory note is essentially a contract, in which the family promises to pay any past-due tuition upon certain terms. Although this solution is not as secure as recording a lien, a promissory note is more secure than an enrollment agreement, which is subject to defenses that may provide for non-payment of the amount due for certain reasons (such as failure to reasonably accommodate or other breach of contract by the school.) This option is also attractive to schools because it is a more informal option that tends to be less adversarial.

iii. Assignments of Interest

Parents with a sudden lack of resources who do not want to disrupt their child's education at a school are also offering creative solutions to pay past-due tuition. For example, we have seen cases where parents may offer to assign an interest in the sale of property as the means of settling the amount past-due. While such an arrangement may work, depending on the individual circumstances, this agreement would need to be carefully worded so that the school does not inadvertently relinquish certain rights. These types of creative solutions should not be dismissed out of hand, but they are fraught with technical and legal issues and schools should proceed cautiously and consult with their attorneys before entering into such agreements.

iv. Tuition Insurance

One preemptive means of protecting both schools and families is through the use of tuition insurance. Tuition insurance is commonly offered by schools through a third-party administrator. It allows a family to recover some or all of the money paid to the school in the event of certain circumstances, such as if the child becomes ill and must withdraw, or if a parent loses his or her job. Schools have the freedom to determine the specific terms of insurance that best suit their needs. For example, a school could implement a policy that requires families to obtain insurance, unless the family is able to pay the full year's tuition up-front. Alternatively, a school could implement a policy whereby obtaining insurance is entirely voluntary. Regardless of the specific requirements, tuition insurance offers peace of mind to both schools and families at relatively affordable costs.

IV. Other Considerations

Regardless of which options are used to recover unpaid tuition, one important consideration is the negotiating position of the school. If the student is still enrolled at the school, families generally have more incentive to enter into agreements that would allow the student to complete his or her education at the same school. The school is in a stronger position to negotiate terms that are more satisfactory for the school in this situation. One caveat for schools is to be aware of the timeline and the impact of the passage of time on the

negotiating strength of the school. Some families will take an excessively long time to reach an acceptable agreement or may, for example, become behind on payments for a note while the child is rapidly progressing towards graduation. If the student is no longer enrolled at the school, there is less incentive for a family to seek resolution on the school's terms or pay tuition that is in arrears. As such, it is advisable for a school to seek resolution of tuition issues with families while their children are still enrolled at the school.

In addition, another important consideration is whether a school should allow a student to remain enrolled after the school has notice that the family cannot pay tuition. Ultimately, the decision of whether to make such an exception is based on individual circumstances. However, schools should consider the big picture and be careful to avoid creating a pattern of exceptions that could appear discriminatory or improper. For example, if a school has a pattern of exceptions that seems to reflect that the school is only making exceptions for student athletes, this could create legal risks. Likewise if exceptions seem to be made more for girls than boys, parents may believe that the school is unfair in how it considers exceptions. Although these decisions are made privately with individual families, schools should anticipate the "parking lot" analysis that inevitably occurs around some of these issues. Thus, as schools work with families to make these case-by-case decisions they should consider appearances and how criteria and legitimate considerations might be articulated in the case of a challenge. Factors such as 1) a student in good standing; 2) a family that worked with the school prior to being significantly in arrears; 3) a family that worked collaboratively with the school to provide re-payment options; 4) no disciplinary history; and 5) a student who is near graduation, may be more objective and more defensible.

This Special Bulletin is intended to provide independent and private schools with introductory information related to the enforcement of enrollment agreements. For specific and individualized questions or issues, schools should consult with legal counsel.

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*If you have questions about this issue, please contact our
Los Angeles, Fresno or San Francisco offices.*