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# PROGRAM INTEGRITY AND THE IMPLICATIONS OF THE CORPORATE IDENTITY IN HIGHER EDUCATION

## INTRODUCTION

In July 2011, the Department of Education promulgated new regulations as an effort to improve the performance of for-profit universities that receive Title IV federal student aid.<sup>1</sup> These regulations responded to data illustrating students at for-profit universities borrowed and defaulted on student loans at disproportionate rates, faced a lack of employment opportunity, and were being induced into enrollment by misrepresentations of employment prospects and income earnings potential.<sup>2</sup> Poor student outcomes in an industry heavily reliant on Title IV student aid brought considerable debate on how to improve the industry's performance.<sup>3</sup> The regulations (entitled Program Integrity) intended to create new measurement standards to evaluate Title IV receiving for-profit institutions.<sup>4</sup> These standards created a post-graduation focus on programs' potential to lead to "gainful employment in a recognized occupation" to evaluate institutional performance.<sup>5</sup> The Department of Education (DOE or the Department) believed its final regulations "reflect the Department's policy determination that students are not adequately protected by [the DOE's] current regulatory framework."<sup>6</sup> However, soon before they were to take effect, the United States District Court for the District of Columbia vacated the regulations because the Department "failed to provide a reasoned explanation" for the approach taken.<sup>7</sup>

At the heart of Program Integrity was the concern that students at for-profit universities graduate with "unaffordable debts and poor employment prospects"<sup>8</sup> with corresponding problems of "wide-spread evidence of waste, fraud and abuse."<sup>9</sup> The Department noted that "for-profit programs are most likely to leave their students with unaffordable debts and poor employment prospects."<sup>10</sup> Although outstanding student loan debt as a

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1. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. 34,386 (June 13, 2011) (to be codified at 34 C.F.R. pt. 668).

2. *Id.*

3. *See infra* Part III.A.

4. *See* Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. at 34,386.

5. *Id.*

6. *Id.*

7. *Assoc. of Private Colls. and Univs. v. Duncan*, 870 F. Supp. 2d 133, 158 (D.D.C. 2012).

8. Press Release, Dep't of Educ., Obama Administration Announces New Steps to Protect Students from Ineffective Career College Programs: Gives Programs Every Chance to Improve While Holding Them Accountable (June 2, 2011), *available at* <http://www.ed.gov/news/press-releases/gainful-employment-regulations>.

9. *Id.*

10. *Id.*

whole is nearing \$1 trillion in the United States,<sup>11</sup> this note focuses on for-profit institutions due to the industry's rapidly growing enrollments and thus its growing importance in higher education, the industry's reliance on Title IV student aid, the potential vulnerability of students in for-profit education, and the disproportionate percentage of student loan defaults by for-profit university students.<sup>12</sup>

While Program Integrity sought accountability for the industry's representations and performance, the Department's rules would have been insufficient to reduce student need to borrow great amounts for tuition, and were unlikely to ebb the burgeoning wave of student loan default. The fatal shortcoming of Program Integrity was its reliance on an antiquated assumption that for-profit institutions operate as traditional collegiate bodies, while ignoring the interworking of the industry's corporate identity to its collegiate operations. As a result, Program Integrity's impact would ultimately have been limited as it failed to recognize the underlying motives of for-profit education as a corporate enterprise. Thus, improving performance at these institutions and the opportunities for their students must take an approach that appropriately considers the industry's corporate identity.

The social costs of an increased rate of student loan defaults not only leaves individuals with unmanageable debt obligations, but also shifts the burden of default onto taxpayers,<sup>13</sup> while public for-profit universities yield massive returns through these loans that are guaranteed by the federal government.<sup>14</sup> The extreme proliferation of for-profit universities coupled with their reliance on federal student aid mimics an operation reminiscent of those that exacerbated the subprime mortgage crisis.<sup>15</sup> Although Program Integrity was vacated, this note evaluates its regulations to demonstrate how the Department's approach, or any similar approach contemplated by the Department in the wake of Program Integrity's abrogation, would not combat rising student debt and the risks rising debts pose to taxpayer dollars. As will be discussed, the current for-profit education industry is an entirely different animal than when it became Title IV eligible. If these

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11. FED. RESERVE BANK OF NY, QUARTERLY REPORT ON HOUSEHOLD DEBT AND CREDIT 1 (Feb. 2013), available at [http://www.newyorkfed.org/research/national\\_economy/householdcredit/DistrictReport\\_Q42012.pdf](http://www.newyorkfed.org/research/national_economy/householdcredit/DistrictReport_Q42012.pdf).

12. See *infra* Parts II–III.

13. See Cheryl L. Auster, *Promising a Better Future but Delivering Debt: Understanding the Financial and Social Impact of For-Profit College and the Effect of the New Program Integrity Rules*, 13 SCHOLAR 631, 668 (2011).

14. See *infra* Part I.A. See also Nicholas R. Johnson, *Phoenix Rising: Default Rates at Proprietary Institutions of Higher Education and What Can Be Done to Reduce Them*, 40 J.L. & EDUC. 225, 230–33 (2011).

15. See *Subprime Goes to College: Hearing Before the S. Comm. on Health, Educ., Labor and Pensions*, 111th Cong. 3 (2010) [hereinafter Eisman] (testimony of Steven Eisman, Portfolio Manager, FrontPoint Financial Services Fund).

universities wish to utilize the corporate identity, then obligations and liabilities of such enterprises should not be shielded with values attributed to traditional higher education. Part I of this note will describe the historical emergence of for-profit universities in the United States. Part II will describe the current context and practices of for-profit institutions. Part III will then describe the current legislative and regulatory context of the for-profit education industry and elucidate the impetus behind increases in borrowing and default by students at for-profit universities. Part IV will evaluate the approach contemplated by the Department with Program Integrity and the potential impact it could have had on the rise of student default, reduction of student loan debt, and improvement of institutional performance.<sup>16</sup> Finally, Part V will distinguish between the for-profit enterprises of today and the enterprises contemplated when the industry was granted Title IV eligibility, while also offering an alternative regulatory focus for consideration: the for-profit education sector of higher education would be at its most efficient if increased profits were tied to improved institutional performance. While for-profit education offers attractive benefits through specific and market-responsive education, the current regulatory framework fails to consider its inherent profit motive, which in turn encourages these institutions to offer a substandard product. Failing to tie profit to performance allows the industry to post enormous profits from large amounts of leveraged student debt guaranteed by taxpayer dollars, without providing any reason to improve educational value.

## **I. BACKGROUND AND PRACTICES OF FOR-PROFIT UNIVERSITIES IN THE UNITED STATES**

### **A. EMERGENCE IN THE UNITED STATES**

In 2009, about 1,200 degree-granting for-profit universities operated in the United States.<sup>17</sup> The genesis of for-profit education in the United States dates to the colonial period, when access to higher education was limited.<sup>18</sup> Pedagogical endeavors in colonial America focused on teaching technical skills, mathematics, reading, and writing.<sup>19</sup> Opportunistic educators responded to student and employer demand for greater technical training by creating occupational programs in navigation, surveying, and

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16. Before Program Integrity was set to take effect, the United States District Court for the District of Columbia vacated two of the operative regulations, nullifying the entire rulemaking. *See Assoc. of Private Colls. and Univs. v. Duncan*, 870 F.Supp.2d 133, 158 (2012).

17. NAT'L CTR. FOR EDUC. STATISTICS, U.S. DEPT' OF EDUC., DIGEST OF EDUCATION STATISTICS 2010, 404 at tbl. 275 (2010) [hereinafter DIGEST OF EDUCATION STATISTICS 2010].

18. RICHARD S. RUCH, HIGHER ED, INC.: THE RISE OF THE FOR-PROFIT UNIVERSITY 52 (2001).

19. *Id.*

bookkeeping.<sup>20</sup> Entrepreneurs increased the efficiency of technical training by merging apprenticeships into schools with a curriculum that allowed a master to teach several students at once.<sup>21</sup> Proprietary schools at this time did not offer degrees, but instead taught skills in areas that led to professional employment.<sup>22</sup> The industrial revolution and its development of new technologies should have encouraged for-profit education, but demand by populist movements for a public system of vocational education led to the demise of the for-profit education industry.<sup>23</sup>

### B. HIGHER EDUCATION ACT AND EXPANDED OPPORTUNITY

For-profit education reemerged in the United States with the Higher Education Assistance Act (HEA) of 1965.<sup>24</sup> As part of his sweeping “Great Society” domestic agenda, President Lyndon Johnson introduced the HEA to broaden access to postsecondary education.<sup>25</sup> At this time, higher education costs dissuaded students from lower socioeconomic backgrounds from pursuing higher education.<sup>26</sup> The HEA authorized “Title IV” federal assistance to eligible students and institutions.<sup>27</sup> The HEA would become the most important program for student aid in the history of the United States.<sup>28</sup> Amendments to the HEA in 1972 expanded Title IV eligibility to allow students to borrow student loans for the purposes of attending a for-profit college or university.<sup>29</sup> This expansion of eligibility “sought to broaden higher-education access” to prospective students without the financial means or desire to attend a four-year program.<sup>30</sup> The availability of Title IV caused the metamorphosis of the smaller vocational programs

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20. *Id.*

21. *Id.* at 53.

22. See EARNINGS FROM LEARNING: THE RISE OF FOR-PROFIT UNIVERSITIES (David W. Breneman, Brian Pusser & Sarah E. Turner eds., 2006); David W. Breneman, Brian Pusser & Sarah E. Turner, *The Contemporary Provision of For-Profit Higher Education: Mapping the Competitive Market*, in EARNINGS FROM LEARNING: THE RISE OF FOR-PROFIT UNIVERSITIES, *id.* at 3, 5 (David W. Breneman, Brian Pusser & Sarah E. Turner eds., 2006).

23. Breneman, Pusser & Turner, *supra* note 22, at 3, 5.

24. Higher Education Act of 1965, Pub. L. No. 89-329, 79 Stat. 1219 (codified as amended at 20 U.S.C. §§ 1001–1099c-2 (2006)).

25. David W. Breneman & David A. Wolcott, *A Crowded Lobby: Nonprofit and For-Profit Universities and the Emerging Politics of Higher Education*, in EARNINGS FROM LEARNING: THE RISE OF FOR-PROFIT UNIVERSITIES, *supra* note 22, at 170.

26. Jonathan D. Glater, *The Other Big Test: Why Congress Should Allow College Students to Borrow More Through Federal Aid Programs*, 14 N.Y.U. J. LEGIS. & PUB. POL’Y 11, 20 (2011).

27. 20 U.S.C. §§ 1070–1099 (2006). At the time, Pell Grants were known as “Basic Educational Opportunity Grants.”

28. Breneman & Wolcott, *supra* note 25, at 170.

29. See Education Amendments of 1972, Pub. L. No. 92-318, 86 Stat. 235 (codified as amended at 20 U.S.C. § 1001 (2000)); see also Breneman, Pusser & Turner, *supra* note 22, at 6; Johnson, *supra* note 14, at 229.

30. Aaron N. Taylor, “Your Results May Vary”: *Protecting Students and Taxpayers Through Tighter Regulation of Proprietary School Representations*, 62 ADMIN. L. REV. 729, 753 (2010).

that defined for-profit education into a different animal—the sophisticated corporate enterprise.<sup>31</sup> Unsavory and opportunistic entrepreneurs exploited the availability of federal assistance by opening “sham schools” and “diploma mills,” with Title IV funds funneled as profit into owners’ pockets with little to no regulatory oversight.<sup>32</sup> This lack of oversight permitted such “sham schools” to use deceptive and fraudulent marketing practices to increase enrollments, thereby increasing profits.<sup>33</sup> Eventually, increased enforcement led to over 800 schools between 1992 and 1997 losing federal assistance eligibility because of such marketing practices.<sup>34</sup> For these schools, losing federal aid eligibility operated as an executioner throwing the lever to the gallows. As will be seen, for-profit institutions today also exist by way of their Title IV eligibility, where a loss of Title IV eligibility would be an institutional death sentence.<sup>35</sup>

## II. CONTEMPORARY PRACTICE OF FOR-PROFIT UNIVERSITIES

For-profit universities are perceived to focus on post-graduate “employability,” yet demonstrate little concern for “educational value.”<sup>36</sup> The industry’s perspective is that this sentiment understates the totality of the educational value offered by for-profit learning.<sup>37</sup> Nevertheless, the industry embraces an employability-focused approach as pragmatic and responsive, as it reflects public expectation that higher education should result in employability.<sup>38</sup>

### A. STUDENT POPULATION

For-profit education prides itself on opening access to higher education for groups typically underrepresented and unaccustomed to traditional higher education institutions.<sup>39</sup> Such students look for a “no frills” approach to education to provide them with specific training in minimal time.<sup>40</sup> Such

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31. Sarah E. Turner, *For-Profit Colleges in the Context of the Market for Higher Education*, in EARNINGS FROM LEARNING: THE RISE OF FOR-PROFIT UNIVERSITIES, *supra* note 22, at 51.

32. Taylor, *supra* note 30, at 753.

33. *Id.*

34. Patrick F. Linehan, *Dreams Protected: A New Approach to Policing Proprietary Schools’ Misrepresentations*, 89 GEO. L.J. 753, 760 (2001).

35. *See infra* Part III.A.

36. *See* Ruch, *supra* note 18, at 7.

37. *See, e.g., id.*

38. *Id.*

39. STAFF OF S. HEALTH, EDUCATION LABOR AND PENSIONS COMM., 111TH CONG., THE RETURN ON THE FEDERAL INVESTMENT IN FOR-PROFIT EDUCATION: DEBT WITHOUT A DIPLOMA 3 (2010) [hereinafter DEBT WITHOUT A DIPLOMA] (Report of Sen. Harkin).

40. *See, e.g.,* Breneman, Pusser & Turner, *supra* note 22, at 78.

“non-traditional” students comprise a majority of the for-profit education student population.<sup>41</sup>

#### Demographics<sup>42</sup>

	Public	Private Non-Profit	Private For-Profit
Female <sup>43</sup>	55.1%	56.1%	69.2%
Minority Students <sup>44</sup>	37.1%	33.4%	53.3%
Average Age <sup>45</sup>	26	24	28
Income <20k <sup>46</sup>	24.2%	17.8%	44.5%

These figures demonstrate that more “non-traditional” students compose the student populations at for-profit universities. The populations at for-profit schools are more likely to be female, older, from lower means, and more racially and ethnically diverse than their public and private non-profit counterparts.

#### B. PROGRAMS AND EDUCATION

The for-profit education industry strives to provide a high quality education for skills that markets demand, while cutting the “fat” off of expenses in traditional higher education curricula.<sup>47</sup> The industry prides itself on having the ability to swiftly change to provide new skills that meet the needs when employment demands shift to new and different industries.<sup>48</sup> The industry believes this market response separates it from a traditional higher education structure that ignores such new opportunities.<sup>49</sup>

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41. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-600, STRONGER DEP'T OF EDUC. OVERSIGHT NEEDED TO HELP ENSURE ONLY ELIGIBLE STUDENTS RECEIVE FEDERAL STUDENT AID I (2009) [hereinafter OVERSIGHT]. Non-traditional student characteristics include women, minorities, students over 25, and financially independent students. *Id.*

42. See generally U.S. DEP'T OF EDUC., NAT'L CTR. FOR EDUC. STATISTICS, PROFILE OF UNDERGRADUATE STUDENTS: 2007-2008 (2010), [hereinafter 2007-2008 Education Statistics], available at <http://nces.ed.gov/pubs2010/2010205.pdf> (Both Public and For-Profit figures aggregate two-year and four-year program statistics).

43. *Id.* at 56 tbl.3.1.

44. *Id.* at 60 tbl.3.2 (aggregating all minority students).

45. *Id.* at 64 tbl.3.3.

46. *Id.* at 72 tbl.3.5-A. (aggregating both dependent and independent income figures).

47. See Ruch, *supra* note 18, at 17–19.

48. See Breneman, Pusser & Turner, *supra* note 22, at 5.

49. See Ruch, *supra* note 18, at 69 (“Trusting the market . . . appears to be a radical and foreign notion for most non-profit colleges and universities. Although they acknowledge the

The control that industry exercises over programs allows institutions to offer certifications in skills by experienced practitioners in both traditional and emerging fields.<sup>50</sup> Since its early colonial days and the “mom-and-pop” school pre-HEA era, the for-profit education industry has evolved to be dominated by large multi-state institutions that offer diplomas in two-year and four-year programs,<sup>51</sup> with some institutions even offering degrees at the graduate and doctoral level.<sup>52</sup>

### C. INDUSTRY MOTIVE

For-profit education is “unabashedly” driven to realize profit.<sup>53</sup> There are currently thirteen publicly held for-profit universities that dominate the industry, with many others closely held.<sup>54</sup> Inherent in this profit motive is the incentive to reduce costs by eliminating inefficient and ineffective programs to increase margins.<sup>55</sup> For-profit institutions minimize costs by utilizing new technologies and organizational practices to deliver higher education programs.<sup>56</sup> Expansion into online course offerings facilitates flexible scheduling and convenience, while creating potential for unlimited class sizes free from the physical classroom needs of traditional college campuses.<sup>57</sup> This convenience offers greater access to higher education for potential students underserved by traditional public and private nonprofit institutions.<sup>58</sup> For-profit universities keep costs low and return greater margins by precluding expenditures associated with traditional institutions of higher education—e.g., student housing, auditoriums, stadiums, and sports teams<sup>59</sup>—and also by eliminating the need to provide faculty with

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reality of the market and are willing to respond to it, they generally do not regard it as trustworthy.”).

50. For a general list of typical programs, see Turner, *supra* note 31, at 58.

51. See Johnson, *supra* note 14, at 230; OVERSIGHT, *supra* note 41, at 1.

52. OVERSIGHT, *supra* note 41, at 1.

53. Ruch, *supra* note 18, at 95–97.

54. Robin Wilson, *For-Profit Colleges Change Higher Education’s Landscape*, CHRON. HIGHER EDUC. (Feb. 7, 2010), <http://chronicle.com/article/For-Profit-Colleges-Change/64012/>; see also DIGEST OF EDUC. STATISTICS 2010, *supra* note 17, at 404 tbl.275.

55. Turner, *supra* note 31, at 58.

56. Breneman, Pusser & Turner, *supra* note 22, at 6.

57. Catherine Elton, *Degrees of Difficulty: The Truth About Online Universities*, CONSUMERS DIG. (Mar. 2009), <http://www.consumersdigest.com/family/degrees-of-difficulty>. Until 2006, accredited institutions were required to offer 50 percent of their courses on a physical campus to receive Title IV aid. Sam Dillon, *Online Colleges Receive a Boost from Congress*, N.Y. TIMES, Mar. 1, 2006, [http://www.nytimes.com/2006/03/01/national/01educ.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2006/03/01/national/01educ.html?pagewanted=all&_r=0). The Higher Education Reconciliation Act of 2006 eliminated this “50 percent Rule” for courses attended via telecommunication, like online courses. Pub. L. 109-171 Title VII § 8002 (2006) (codified as 20 U.S.C. §§ 102(a)(3), 484(1)(1)(A) (2006)).

58. Taylor, *supra* note 31, at 782. See also *supra* Part I-B; Glater, *supra* note 26.

59. In a bit of irony, the University of Phoenix paid \$154.5 million for the naming rights to the stadium of the NFL’s Arizona Cardinals for twenty years, although the University of Phoenix



compensation for “nonteaching activities” while optimizing class sizes to be the most efficient.<sup>60</sup>

### 1. Increased Enrollment and Revenues

Higher education as a whole offers prospective students various and diverse courses of learning and programs, but ultimately no matter the structure or label of the institution there is only one consumer—the student. With this in mind, for-profit universities must continually increase enrollment to realize increased profit.<sup>61</sup> In the competitive market for students, for-profit institutions have managed to achieve dramatic enrollment increases by recruiting students through attractive benefits like flexible course schedules, including courses taken online, with the availability of federal student aid to cover tuition.<sup>62</sup> These efforts have shown success: in an eight-year period, industry-wide enrollment increased by 474 percent through the addition of 1.7 million individuals to the student populations.<sup>63</sup> The Apollo Group, the owner of the University of Phoenix, in one year itself increased enrollment between Fiscal Year (FY) 2009 and 2010 by 27,800 students, an increase of 6.3 percent.<sup>64</sup> This enrollment increase corresponded to increased revenue from roughly \$4 billion in FY 2009,<sup>65</sup> to \$4.925 billion in FY 2010<sup>66</sup>—an increase of 23.1 percent.<sup>67</sup> In October 2009, another of the largest for-profit education providers, Education Management Corporation (EDMC), posted a 22.7 percent increase in enrollment by adding 25,200 students to a total population of

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itself has no football team. *U. of Phoenix Buys Naming Rights to Cardinal Stadium*, ESPN NFL (Sept. 26, 2006, 4:18 PM), <http://sports.espn.go.com/nfl/news/story?id=2603052>.

60. Ruch, *supra* note 18, at 87–88.

61. *Id.* at 95–97.

62. Johnson, *supra* note 14, at 229–30.

63. *Compare* LAURA G. KNAPP ET AL., U.S. DEP’T OF EDUC., NAT’L CTR. FOR EDUC. STATISTICS, ENROLLMENT IN POSTSECONDARY INSTITUTIONS, FALL 2001 AND FINANCIAL STATISTICS FISCAL YEAR 2001, at 5 (2003) [hereinafter 2001 EDUCATION STATISTICS] (472,021 students enrolled in Title IV eligible private, for-profit institutions), *with* LAURA G. KNAPP ET AL., U.S. DEP’T OF EDUC., NAT’L CTR. FOR EDUCATION STATISTICS, ENROLLMENT IN POSTSECONDARY INSTITUTIONS, FALL 2009; GRADUATION RATES, 2003 & 2006 COHORTS; AND FINANCIAL STATISTICS, FISCAL YEAR 2009, at 7 (2011) [hereinafter 2009 DEP’T OF EDUC. REPORT] (2,239,026 students enrolled in private, for-profit institutions).

64. *Compare* Apollo Grp., Inc., Annual Report (Form 10-K) 6 (Oct. 27, 2009) [hereinafter 2009 Apollo Annual Report] (443,000 students enrolled at the end of FY 2009), *with* Apollo Grp., Inc., Annual Report (Form 10-K) 6 (Oct. 21, 2010) [hereinafter 2010 Apollo Annual Report] (470,800 students enrolled at the end of FY 2010).

65. 2009 Apollo Annual Report, *supra* note 64, at 6.

66. 2010 Apollo Annual Report, *supra* note 64, at 5.

67. An inference can be made from this data is that since revenue increases outpaced enrollment increases, either tuition costs increased from 2009 and 2010, an increased percentage of students left the university after paying tuition but before the student population was reported in the 10-K, the university became more cost efficient, or a combination thereof.

136,000.<sup>68</sup> This dramatic increase in enrollment also resulted in a corresponding revenue increase from \$2.011 billion<sup>69</sup> to \$2.508 billion,<sup>70</sup> a 24.7 percent increase. As a whole, the for-profit education industry generated \$23.4 billion in revenues in FY 2009.<sup>71</sup> One Senate committee report showed that the FY 2009 profits of sixteen institutions totaled \$2.7 billion, with margins ranging from 16.1 percent to 37.1 percent.<sup>72</sup>

## 2. Returns on Investment

Large returns produced from increased enrollments and profit margins coupled with prioritizing cost efficiency made the for-profit education industry a “Wall Street darling.”<sup>73</sup> From 1995 to 2011, the stock price of the Apollo Group appreciated by 4,900 percent.<sup>74</sup> In boasting its business model, one author put these eye-popping numbers into perspective: “[I]f one had purchased \$10,000 worth of Apollo [Group] stock when first issued in 1994, by December 2004 it would have been worth roughly \$1,034,743.”<sup>75</sup> That same year, Apollo and ITT Technical Institute (another large for-profit institution) outperformed the heavyweights of the energy and technology industries.<sup>76</sup> Not only do investors reap benefits, but for-profit universities are also cash cows for parent companies. Kaplan University, a subsidiary of The Washington Post, saw growth of 9 percent in one quarter to \$743.3 million in revenue,<sup>77</sup> with annual net revenue for that year of \$1.789 billion.<sup>78</sup> The revenue of its Kaplan subsidiary represented 38 percent of revenue for its parent Washington Post Co. that

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68. *Compare* Educ. Mgmt. LLC, Annual Report (Form 10-K) 79 (Aug. 27, 2009) [hereinafter 2009 EDMC Annual Report] (110,800 students), *with* Educ. Mgmt. LLC, Annual Report (Form 10-K) 88 (Sept. 1, 2010) [hereinafter 2010 EDMC Annual Report] (136,000 students).

69. 2009 EDMC Annual Report, *supra* note 68, at 5.

70. 2010 EDMC Annual Report, *supra* note 68, at 5.

71. *See* 2009 Dep’t of Educ. Report, *supra* note 63, at 13 tbl.5.

72. DEBT WITHOUT A DIPLOMA, *supra* note 39, at 34.

73. Andreas Ortmann, *Capital Romance: Why Wall Street Fell in Love with Higher Education*, in EARNINGS FROM LEARNING: THE RISE OF FOR-PROFIT UNIVERSITIES, *supra* note 22, at 145, 149–51, 157.

74. On January 6, 1995, Apollo was priced at \$.99, while later priced at \$38.91 on October 4, 2011. *See Google Finance*, GOOGLE, <http://www.google.com/finance?cid=657521> (last visited Feb. 13, 2013).

75. David W. Breneman, *The University of Phoenix: Icon of For-Profit Higher Education*, in EARNINGS FROM LEARNING: THE RISE OF FOR-PROFIT UNIVERSITIES, *supra* note 22, at 71, 73.

76. “In 2006, Apollo Group and ITT boasted returns on investment capital of 69% and 40%, respective, beating out companies such as Exxon Mobil and Microsoft.” Taylor, *supra* note 30, at 757.

77. Tamar Lewin, *Scrutiny Takes Toll on For-Profit College Company*, N.Y. TIMES, Nov. 10, 2010, at A1.

78. Wash. Post Co., Annual Report (Form 10-K) 1 (Jan. 2, 2011). This revenue figure does not take into account revenue derived through Kaplan University’s other divisions, such as its test preparation division. *Id.*

year.<sup>79</sup> These large returns and revenues turned the for-profit industry into an attractive option for investors.<sup>80</sup>

#### D. MARKETING EXPENSES AND METHODS TO INCREASE ENROLLMENT

To encourage increased enrollments, for-profit institutions spend large amounts on marketing, an expense that amounts to a substantial portion of annual revenues.<sup>81</sup> For example, EDMC spent \$300 million on marketing in FY 2011, accounting for 22.4 percent of its revenue.<sup>82</sup> In the same year, in order to “differentiate the University of Phoenix, and expand [Apollo’s] business,” the Apollo Group spent roughly \$665 million (or 13.9 percent of its revenue) on marketing.<sup>83</sup> Because increased enrollments are necessary to achieve growth,<sup>84</sup> some commentators are concerned that institutions use forceful and deceptive methods to increase enrollment in programs that offer little to no meaningful employment prospects.<sup>85</sup> Claims of attractive employment opportunities and increased earnings potential in particular fields are predominant in these marketing endeavors, but these representations have been found to be illusory or even fraudulent.<sup>86</sup> In one report, the Government Accountability Office (GAO) found that thirteen of fifteen for-profit schools used deceptive tactics and misleading statements in their recruitment practices.<sup>87</sup> The GAO report found that schools misrepresented graduation rates, coached individuals on admissions tests, exaggerated earnings potential, and claimed programs could lead to jobs that often required training more advanced than the degree the schools’ programs offered.<sup>88</sup> Of particular concern is that the qualifications of the

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79. *Id.*

80. Johnson, *supra* note 14, at 230. *See also* Ortmann, *supra* note 73, at 149 (“[O]ne of the features that make the education industry interesting is its very predictable revenues and earnings . . . . That government funding is, and will be, a steady source of significant revenue was considered an important argument.”).

81. *See* Lewin, *supra* note 77 (“On average, for-profit universities spend about 30 percent of their revenue on advertising and marketing.”).

82. Educ. Mgmt. LLC., Annual Report (Form 10-K) 68, 96 (Aug. 30, 2011).

83. Press Release, Apollo Grp., Apollo Group, Inc. Reports Fiscal 2011 Fourth Quarter and Year End Results (Oct. 19, 2011), *available at* <http://phx.corporate-ir.net/phoenix.zhtml?c=79624&p=irol-newsArticle&ID=1618736&highlight=>.

84. Auster, *supra* note 13, at 640.

85. Johnson, *supra* note 14, at 227.

86. One former instructor at Kaplan College described recruiters for a criminal justice program that enticed potential students with future placements in federal law enforcement agencies, but were ultimately offered minimum wage security guard jobs that did not require the training Kaplan offered. Lewin, *supra* note 77.

87. U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-10-948T 9-10, FOR-PROFIT COLLEGES: UNDERCOVER TESTING FINDS COLLEGES ENCOURAGED FRAUD AND ENGAGED IN DECEPTIVE AND QUESTIONABLE MARKETING PRACTICES 9–10 (2010).

88. *Id.*

students recruited by these representations make it more likely that they would be unable to independently evaluate the opportunities offered by higher education, and thus are more susceptible to relying on such claims of better employment opportunity and increased income.<sup>89</sup> Although marketing expenses are sizeable, the data demonstrates that such expenses are easily recouped and surpassed through increased revenue growth caused by increased student enrollments.<sup>90</sup>

In addition to suspicious marketing tactics, claims emerged that institutions circumvent the law by compensating recruiters based on enrollments. Enrollment-based compensation is strictly forbidden for institutions receiving Title IV funding.<sup>91</sup> A proscription on recruitment-based compensation aims to prevent institutions from incentivizing employees to enroll unqualified or poorly qualified students in programs that provide little benefit or leave students unable to repay the incurred debt.<sup>92</sup> Lawsuits brought against for-profit institutions demonstrate that using recruitment-based compensation in contravention of Title IV's proscription may be more worthwhile than not.<sup>93</sup> Former recruiters and employees of for-profit universities have brought suits under the False Claims Act,<sup>94</sup> alleging their salary was correlated to the number of students they enrolled.<sup>95</sup> Though Title IV eligibility requires compliance with the

89. Taylor, *supra* note 30, at 761; *see also* Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. 34,386, 34,388 (June 13, 2011) (to be codified at 34 C.F.R. pt. 668).

90. *See supra* Part I.C.

91. “The institution will not provide any commission, bonus, or other incentive payment based directly or indirectly on success in securing enrollments or financial aid to any persons or entities engaged in any student recruiting or admission activities or in making decisions regarding the award of student financial assistance . . .” 20 U.S.C. § 1094(a)(20) (2006).

92. *See United States ex rel. Main v. Oakland City Univ.*, 426 F.3d 914, 916 (7th Cir. 2005).

93. *See infra* note 96; Eisman, *supra* note 15, at 4 (“[A]s long as the government continues to flood the for profit education industry with loan dollars [and] the risk for these loans is borne solely by the students and the government, the industry has every incentive to grow *at all costs* [and] *compensate employees based on enrollment* . . .” (emphasis added)).

94. *See* 31 U.S.C. § 3729 (2006).

95. For example, in 2009, the Apollo Group agreed to pay \$78.5 million (including attorney’s fees) to settle a claim of recruitment-based compensation. Press Release, Apollo Grp., Apollo Group, Inc. Resolves University of Phoenix False Claims Act Case (Dec. 14, 2009), *available at* [http://phx.corporate-ir.net/phoenix.zhtml?c=79624&p=irol-newsArticle\\_print&ID=1365655](http://phx.corporate-ir.net/phoenix.zhtml?c=79624&p=irol-newsArticle_print&ID=1365655) &highlight=. This settlement followed the Ninth Circuit’s reversal of a motion to dismiss, holding that plaintiffs alleged sufficient facts to state a claim under the False Claims Act. *U.S. ex rel. Hendow v. Univ. of Phoenix*, 461 F.3d 1166, 1177–78 (9th Cir. 2006). Recently, the Department of Justice, as well as Attorneys General from eleven states and the District of Columbia, intervened in a *qui tam* action under the False Claims Act against EDMC for allegations of recruitment-based compensation. *See Complaint, United States v. Educ. Mgmt. Corp.*, 871 F. Supp. 2d 433 (W.D. Pa. 2012) (No. 07-461), 2011 WL 3435895. Also, in 2007, California settled its complaint against Corinthian Schools for \$6.5 million for allegations of recruitment-based compensation. *California v. Corinthian Sch. Inc.*, No. BC374999, 2007 WL 2983118 (Cal. Super. Ct. July 31, 2007).

recruitment compensation ban,<sup>96</sup> cutting off Title IV eligibility has a perverse consequence on students, as it effectively cuts off all access to higher education. As it stands, civil damages currently operate as the preferred stick for noncompliance with the proscription on recruitment-based compensation.<sup>97</sup> However, simple economics dictates that if programs use prohibited recruitment-based compensation programs that remain profitable after subtracting the costs from quick settlements in civil actions, then it is to the benefit of the for-profit education institutions to use whatever means necessary to recruit students so long as their doors remain open.

### III. TRENDS IN TITLE IV BORROWING

#### A. INSTITUTIONAL RELIANCE ON TITLE IV

“If we lose our Title IV eligibility, we would experience a dramatic decline in revenue and we would be unable to continue our business as it currently is conducted.”<sup>98</sup>

For-profit universities derive nearly all their revenues from student tuition payments and fees.<sup>99</sup> In 2001, public universities derived 19.5 percent and 17.8 percent of their revenues from tuition and fees for their two-year and four-year programs, respectively,<sup>100</sup> while private non-profit universities derived 53.1 percent and 38 percent from their two-year and four-year programs, respectively.<sup>101</sup> By comparison, 87.2 percent of the revenues for-profit universities generated for two-year programs were derived from tuition and fees, with 87.5 percent of the revenues from four-year programs coming from tuition and fees.<sup>102</sup> Even with the large increase of enrollment during this period,<sup>103</sup> these figures remained constant through 2009.<sup>104</sup>

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96. 20 U.S.C. § 1094(a)(20) (2006).

97. See Tamar Lewin, *Questions Follow Leader of For-Profit Colleges*, N.Y. TIMES, May 26, 2011, [http://www.nytimes.com/2011/05/27/education/27edmc.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2011/05/27/education/27edmc.html?pagewanted=all&_r=0). To date, no institution’s eligibility has been revoked for noncompliance with 20 U.S.C.

§ 1094(a)(20).

98. Apollo Grp., Inc., Annual Report (Form 10-K) 32 (Oct. 20, 2011).

99. See 2009 Dep’t of Educ. Report, *supra* note 63, at 13 tbl.5.

100. 2001 Education Statistics, *supra* note 63, at 10 tbl.4.

101. *Id.*

102. *Id.*

103. Compare *id.* at 5 (472,021 students enrolled in Title IV eligible public for-profit institutions), with 2009 Dep’t of Educ. Report, *supra* note 63, at 7 (demonstrating an enrollment increase of 474 percent); see also *supra*, Part II-C-1.

104. Public universities earned 16.3 percent and 19.6 percent, private non-profit derived 64.7 percent and 77.8 percent, and for-profit universities deriving 81.8 percent and 87.7 percent of revenues from its two-year and four-year offerings, respectively. See 2009 Dep’t of Educ. Report, *supra* note 63, at 12–13 tbl.5.

Public and private nonprofit schools derive much of their revenue from state and federal allocations, while tuition is the source for nearly all revenue at for-profit universities.<sup>105</sup> Although these monies come from the same sources (governments), allocations to public and private nonprofit universities are received directly from the federal and state governments,<sup>106</sup> whereas student loans are received from the student borrower<sup>107</sup>—the university in this transaction is neither a creditor, nor is it on the hook to the debtor (apart from its pedagogical obligation). The distinction between loans and allocations is found in the expectations of the funds' recipients. Allocations are fixed and predictable, while risk of lost taxpayer dollars is more uncertain in student loans since debts are expected to be repaid. Since loans are subject to the action, or inaction, of individual borrowers, the rate or repayment or nonpayment of loans may shift from changing trends in the default rate; increased rates of defaults as more students receive federal aid puts more taxpayer money at risk. Moreover, a default on student loans leaves an individual with a credit burden that generally cannot be discharged in bankruptcy,<sup>108</sup> whereas there is no risk of default in direct federal and state dollars being allocated to public and nonprofit private universities.

#### **B. STUDENT RELIANCE ON FEDERAL AID**

Heavy dependence on tuition coincides with disproportionate amounts of Title IV borrowing by students who attend for-profit universities. Though less expensive on average than private nonprofit universities, tuition costs at for-profit institutions are markedly higher than tuition at public universities.<sup>109</sup> As for-profit universities tend to be focused towards non-traditional students who often have minimal education qualifications,<sup>110</sup> a greater percentage of students must take out Title IV funding and in greater amounts.<sup>111</sup> The 2009 average tuition for a for-profit institution was \$26,976, compared to \$16,271 and \$31,401 for public and private nonprofit universities, respectively.<sup>112</sup> In 2001, 83.4 percent of students attending for-profit universities borrowed student loans, with an average of \$5,518 borrowed.<sup>113</sup> By comparison, students at public non-profit universities

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105. *See id.*

106. Ruch, *supra* note 18, at 97.

107. 20 U.S.C. § 1070a(a)(1) (2006).

108. 11 U.S.C. § 523(a)(8) (2006).

109. 2009 Dep't of Educ. Report, *supra* note 63, at 24 tbl.14 (2011); *see also* DEBT WITHOUT A DIPLOMA, *supra* note 39, at 7 (suggesting a causal connection between higher tuition costs at for-profit universities and a "high rate" of borrowing).

110. Linehan, *supra* note 34, at 756.

111. 2009 Dep't of Educ. Report, *supra* note 63, at 22 tbl.12.

112. *Id.* at 24 tbl.14.

113. 2001 Education Statistics, *supra* note 63, at 8 tbl.E (2003).

borrowed an average of \$3,050 with only 46.9 percent borrowing.<sup>114</sup> In 2009, 81.3 percent of students at for-profit university in a four-year program received federal student loans, borrowing an average of \$9,660.<sup>115</sup> By comparison, 46.8 percent of students at public universities in a four-year program borrowed an average of \$5,972.<sup>116</sup> These figures stem from the higher costs of tuition at for-profit institutions for students who generally come from lower socioeconomic backgrounds.<sup>117</sup>

In addition to borrowing at higher *rates* compared to students at traditional universities, for-profit university students receive a disproportionate *share* of all federal student assistance.<sup>118</sup> Students at for-profit institutions often must take out loans to cover these institutions' higher tuition rates.<sup>119</sup> The lower socioeconomic status of students at for-profit universities exacerbates this need to borrow.<sup>120</sup> Though students at for-profit universities only accounted for 10.6 percent of all students in postsecondary education during 2009,<sup>121</sup> these students receive approximately 24 percent of Pell Grants, 25 percent of subsidized Stafford loans, 28 percent of unsubsidized Stafford loans, and 12 percent of PLUS loans of the pools of available funds.<sup>122</sup> Combined, these forms of assistance amount to \$26.5 billion—more than a quarter of all distributed federal aid.<sup>123</sup> The student populations at for-profit universities amount only to a sliver of the higher education population,<sup>124</sup> yet these students receive a significant and disproportionate amount of all available federal student aid.<sup>125</sup>

### C. THE DEFAULT PROBLEM: INSTITUTIONAL FAILURE AND GRADING THE BUSINESS OF EDUCATION

The logical conclusion to student borrowing trends is that students attending for-profit universities exit school with more debt than do students at public and private non-profit universities. The impetus behind the

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114. *Id.*

115. 2009 Dep't of Educ. Report, *supra* note 63, at 22 tbl.12.

116. *Id.*

117. *See supra* Part I.A.

118. Johnson, *supra* note 14, at 231.

119. *See* 2009 Dep't of Educ. Report, *supra* note 63, at 29 tbl.14.

120. *See* Glater, *supra* note 26, at 20; *see also* 2007-2008 Education Statistics, *supra* note 42, at 70.

121. 2009 Dep't of Educ. Report, *supra* note 63, at 13 tbl.1.

122. COLLEGEBOARD ADVOCACY & POLICY CTR., TRENDS IN STUDENT AID 2010 at 16 (2010), available at [http://trends.collegeboard.org/sites/default/files/SA\\_2010.pdf](http://trends.collegeboard.org/sites/default/files/SA_2010.pdf).

123. Richard A. Posner, *The Controversy Over For-Profit Colleges*, BECKER-POSNER BLOG (Aug. 6, 2011, 2:26 PM), <http://www.becker-posner-blog.com/2010/06/the-controversy-over-forprofit-collegesposner.html>.

124. 2009 Dep't of Educ. Report, *supra* note 63, at 13 tbl.1.

125. COLLEGEBOARD ADVOCACY & POLICY CTR., *supra* note 122, at 16.

Department's attempt to impose stricter regulations on institutions receiving Title IV funding is not necessarily that these students must take on more debt, it is that the debt incurred is so encumbering, while these students have minimal chances of repaying their debts due to poor employment prospects or opportunities for increased income.<sup>126</sup> The Department sought to hold institutions accountable to both their costs and their claims that induced enrollment.<sup>127</sup> The inability to repay loans often occurs because the massive debt taken on to attend a for-profit university is not realized from earnings potential as students often graduate with minimal employment opportunities in already oversaturated occupations.<sup>128</sup> As the federal government guarantees Title IV funding,<sup>129</sup> when students cannot repay loan debt, the federal government pays a lending agency the remaining balance.<sup>130</sup> This system results in taxpayers simultaneously paying someone's debt and another's dividend because an institution's high tuition costs for a program leading to inadequate opportunities to repay the loans leads to a default.

This high tuition, low opportunity system created concern that unpaid student loans may become the next market bubble.<sup>131</sup> Unfortunately for these students, they often do not have the means to later repay their loans and must default.<sup>132</sup> When federal student loans are in default, the schools have already received their tuition payments, while the remaining balance of the loan is footed by taxpayer dollars.<sup>133</sup> In addition to disproportionate rates of borrowing,<sup>134</sup> students attending for-profit institutions account for only 12 percent of the higher education population, yet they account for 46 percent of student loan defaults.<sup>135</sup> One bankruptcy judge, after hearing a case of a student recruited by misrepresentations of future employment value, defined the situation as "the farmer (U.S. government) putting the fox ([a trade school]) in charge of the hen house (students) and not only blaming the students if they get eaten, but also charging them for the cost of the meal."<sup>136</sup> Moreover, when a student loan is in default, the borrowing student is precluded from receiving other federal student assistance while

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126. See Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. 34,386, 34,387 (June 13, 2011) (to be codified at 34 C.F.R. pt. 668).

127. *Id.* at 34,386.

128. See *id.* at 34,387.

129. See generally 20 U.S.C. § 1080(a) (2006); see also Johnson, *supra* note 14, at 227–28.

130. 20 U.S.C. § 1080(a).

131. Cristian Deritis, *Student Lending's Failing Grade*, MOODY'S ANALYTICS - REGIONAL FINANCIAL REVIEW, July 2011 at 55.

132. See Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. at 34,387

133. See 20 U.S.C. § 1080(a).

134. See COLLEGEBOARD ADVOCACY & POLICY CTR., *supra* note 122, at 16; see also *supra*, Part III.B.

135. See Press Release, Dep't of Educ., *supra* note 8.

136. *In re Troy G. Speer v. Educ. Credit Mgmt. Corp.*, 272 B.R. 186, 192 (W.D.Tex. 2001).



the loan is in default,<sup>137</sup> potentially foreclosing the opportunity of higher education for the student.<sup>138</sup> The high rate of default among for-profit university students after taking out large amounts in aid that is then given to institutions who post enormous revenues through taxpayer money prompted the DOE to promulgate tighter regulations focused on holding the industry accountable for its claims of “gainful employment.”<sup>139</sup>

#### D. CURRENT REGULATION AND UNIVERSITY MANIPULATION

Currently, a for-profit university’s Title IV eligibility is contingent upon it meeting a “cohort default rate.”<sup>140</sup> A cohort default rate is the calculation based on the rate of default of students on their federal loans over the two-year period after loans begin repayment.<sup>141</sup> An institution loses its Title IV eligibility when its cohort default rate exceeds 25 percent for three consecutive years, or exceeds 40 percent in the most recent fiscal year.<sup>142</sup> The GAO found that the average cohort default rate for for-profit institutions in 2004 was 8.6 percent, compared to 4.7 percent and 3 percent of public and private nonprofit institutions, respectively.<sup>143</sup> However, the DOE believed that the cohort default rate is inadequate to assess institutional performance and must be supplemented.<sup>144</sup>

##### 1. Cohort Manipulation

Though the for-profit industry average cohort default rate is below the statutory threshold, institutions use dilatory tactics to manipulate their default rate to fall under the statutory threshold. Payment of loans by a school on behalf of a borrower is forbidden under Title IV, and such conduct would result as an event of default on that student’s loan for the purpose of calculating an institution’s cohort default rate.<sup>145</sup> A 2008 investigation of Technical Career Institute (TCI), a for-profit institution with approximately 3,000 students, revealed that the college paid over \$440,000 to federal lenders on behalf of students who withdrew during their first semester, in order to prevent an increase in its cohort default rate.<sup>146</sup> A

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137. 20 U.S.C. § 1091(a)(3) (2006); *see also* Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. at 34,387.

138. DEBT WITHOUT A DIPLOMA, *supra* note 39, at 8.

139. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. at 34,386.

140. 20 U.S.C. § 1085(m) (2012).

141. OVERSIGHT, *supra* note 41, at 3. *See also* 20 U.S.C. § 1085(m).

142. 34 C.F.R. § 668.187(a) (2011).

143. OVERSIGHT, *supra* note 41, at 3.

144. *See* Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. at 34,386.

145. “A loan on which a payment is made by the school . . . in order to avoid default by the borrower, is considered as in default for purposes of this subsection.” 20 U.S.C. § 1085(m)(2)(B).

146. U.S. DEP’T OF EDUC., OFFICE OF THE INSPECTOR GENERAL, TECHNICAL CAREER INSTITUTES, INC.’S ADMINISTRATION OF THE FEDERAL PELL GRANT AND FEDERAL FAMILY

benevolent act at first glance by TCI for students who chose not to continue their education, this action was in no respect a refund. TCI's actions stopped a rise in the school's cohort default rate, and TCI later attempted to collect the amounts from its students through repayment plans.<sup>147</sup> When the students did not pay, TCI would send the accounts to collection agencies.<sup>148</sup> A similar complaint was brought against the University of Phoenix.<sup>149</sup> Such lawsuits strengthen the case for allegations that some institutions carry out ethically questionable and illegal conduct in order to satisfy statutory thresholds.<sup>150</sup>

## 2. The 90/10 Rule

In addition to the cohort default rate, for-profit universities are subject to the "90/10" rule.<sup>151</sup> Amendments to the HEA in 1998 mandated that for-profit institutions must derive no more than 90 percent of its revenue from non-Title IV aid in two consecutive years to remain Title IV eligible.<sup>152</sup> As noted, for-profit universities receive nearly 90 percent of their revenue from tuition.<sup>153</sup> Some commentators suggest that for-profit universities skew their revenue sources to keep the relevant figures below the statutory limit, as losing a source that contributes nearly 90 percent of revenue would likely shut down many of these institutions.<sup>154</sup> Some of the larger for-profit institutions expressed concern that they may be in violation of the 90/10

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EDUCATION LOAN PROGRAMS, ED-OIG/A02H0007 at 2 (2008) (final audit report), *available at* <http://ed.gov/about/offices/list/oig/auditreports/fy2008/a02h0007.pdf>.

147. Doug Lederman, *Unusual (and Improper) Way to Lower Default Rates*, INSIDE HIGHER ED. (May 21, 2008), *available at* <http://www.insidehighered.com/news/2008/05/21/default>.

148. *Id.*

149. *See* Russ v. Apollo Grp., Inc., No. 209CV00904, 2009 WL 2920333, at \*1 (C.D.Cal. Aug. 11, 2009).

150. *See* Eisman, *supra* note 15, at 4.

151. *See* Higher Education Amendments of 1998, 20 U.S.C. § 1094(a)(24) (2012).

152. The 90/10 rule takes into consideration only Title IV assistance. The rule does not account for other revenue received from alternate sources of federal aid such as the GI bill, Workforce Investment Act, Vocational Rehabilitation et al. *See* DEBT WITHOUT A DIPLOMA, *supra* note 39, at 11. For one example of "other federal aid," for-profit universities received a projected \$521.2 million in 2010 from a federal program that provides veterans with tuition for higher education; an increase of 683 percent from 2006. STAFF OF S. HEALTH, EDUCATION LABOR AND PENSIONS COMM. BENEFITTING WHOM? FOR-PROFIT EDUCATION COMPANIES AND THE GROWTH OF MILITARY EDUCATIONAL BENEFITS 9 (2010) (Report of Sen. Harkin), *available at* <http://harkin.senate.gov/documents/pdf/4d0bbba63cba1.pdf>.

153. *See* 2009 Dep't of Educ. Report, *supra* note 63, at 12 tbl.5. *See also* 2001 Education Statistics, *supra* note 63.

154. *See* Goldie Blumenstyk, *Colleges Scramble to Avoid Violating Federal-Aid Limit; For-Profits' Tactics to Comply with 90/10 Rule Raise Questions*, CHRON. OF HIGHER EDUC. Apr. 2, 2011; Eisman, *supra* note 15, at 3 ("Isn't it amazing that Apollo's percentage of revenue from Title IV is 89% and not over 90%. How lucky can they be?").

rule,<sup>155</sup> while others blame the “restrictiveness” of the 90/10 rule as necessitating tuition increases in order to maintain compliance.<sup>156</sup>

#### IV. PROGRAM INTEGRITY

Through Program Integrity, the Department wanted to compel for-profit institutions to substantiate their claims of providing gainful post-graduate employment.<sup>157</sup> The Department believes that Title IV assistance to students at for-profit universities provides the potential for a worthwhile education for nontraditional students.<sup>158</sup> However, the Department was concerned that the amount of debt that most students incur to pay for the higher tuition costs at for-profit universities provides no return through gainful employment.<sup>159</sup> To allay this concern, the Department wanted to shift the focus from institutional-level performance via the cohort default rate, to post-graduation performance of the student aggregation.<sup>160</sup> The DOE states:

The Department’s experience with the [cohort default rate] is that . . . it does not identify the harm to students that can come from enrolling in a specific program that leaves them with high education debts and limited job opportunities. An institution’s average default rate does not measure the effect of any individual program, and that information alone does not provide a student with a measure of whether he or she will be able to achieve a career goal and pay off loan debt.<sup>161</sup>

Under Program Integrity, if an institution achieves “a repayment rate of at least 35 percent or its annual loan payment under the debt-to-earnings ratios is 12 percent or less of annual earnings or 30 percent or less of discretionary income,” that institution would be offering programs that lead to gainful employment.<sup>162</sup> Only after an institution failed to meet these three debt measures for three out of four fiscal years would that institution have

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155. John Laueran, *For-Profit Colleges Facing Loss of Taxpayer Funds Fighting Aid Limit*, BLOOMBERG (Jan. 12, 2011), available at <http://www.bloomberg.com/news/2011-01-12/for-profit-colleges-facing-taxpayer-funds-loss-fight-aid-limit.html>.

156. Wash. Post Co., Annual Report (Form 10-K) 6 (Jan. 2, 2011) (“But the 90/10 rule has a perverse consequence: each time the federal government raises the maximum amount granted under Pell Grants or the maximum federal loan amount, we end up compelled to raise tuitions to comply with 90/10.”).

157. See Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. 34,386, 34,386 (June 13, 2011) (to be codified at 34 C.F.R. pt. 668).

158. *Id.* (“By pioneering creative course schedules and online programs and serving nontraditional students, many of these institutions have developed impressive, beneficial practices that both public and non-profit institutions might emulate.”).

159. “[F]or-profit institutions typically charge higher tuitions for their programs than do their public and non-profit [private] counterparts . . . . As a result, students on average assume more debt to enroll in a program.” *Id.*

160. *Id.*

161. *Id.*

162. *Id.* at 34,388.

lost its Title IV eligibility.<sup>163</sup> Should the institution have failed to meet one of the measures, new students could not qualify for Title IV funds, since the program would not have been one leading to gainful employment.<sup>164</sup> The Department permitted institutions three years to come into compliance with Program Integrity by delaying calculations based on these metrics until FY 2014.<sup>165</sup> No institution would have lost Title IV eligibility through the Program Integrity metrics until FY 2015.<sup>166</sup> While these metrics defined institutional performance through student outcomes, Program Integrity would have had little impact on student debt burdens.

#### A. REPAYMENT RATE

Program Integrity sought to measure a program's performance by its collective student repayment rate.<sup>167</sup> The DOE believed this metric was needed as the cohort default rate measures the effective use of taxpayer dollars, but does not address the burdens on borrowers.<sup>168</sup> Secretary of Education Arne Duncan stated, "[W]e're asking companies that get up to 90 percent of their profits from taxpayer dollars to be at least 35 percent effective."<sup>169</sup> Counterintuitive in this metric though was that an institution would still be leading to gainful employment even if 65 percent of its students were *not* repaying their loans. When examining the consequences of unaffordable debt, the DOE stated how "46 percent of student loans . . . borrowed by students at two-year for-profit institutions are expected to go into default over the life of the loans."<sup>170</sup> Under the cohort default rate, this 46 percent of default expectancy would not result in Title IV ineligibility or restriction, as the rate only calculates defaults of loans within the first two years of repayment.<sup>171</sup> The Program Integrity repayment rate wanted to address this gap between the statutory calculation and the post-graduation period with a substantial number of defaults by calculating the rate of loan repayment after two years after a loan enters repayment.<sup>172</sup> One improvement through this change would be that a loan is not considered in default for the purposes of calculating a cohort default rate if the default had existed for 270 days if the loan were to be repaid on a monthly schedule.<sup>173</sup>

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163. *Id.*

164. Program Integrity: Gainful Employment, 75 Fed. Reg. 43,616, 43,623 (July 26, 2010).

165. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. at 34,389.

166. *Id.* at 34,390.

167. *See id.* at 34,389.

168. *Id.* at 34,386.

169. Tamar Lewin *Education Department Increases its Regulation of For-Profit Colleges*, N.Y. TIMES, June 2, 2011, <http://www.nytimes.com/2011/06/02/education/02gainful.html>.

170. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. at 34,387.

171. *See* 20 U.S.C. § 1085(m) (2012).

172. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. 34,389.

173. 20 U.S.C. § 1085(l).

Effectively, a default could occur within the first two years of repayment, but not be calculated in the cohort default rate until the following year or never included at all. The new metric would have eliminated this potential delay by focusing on repayment in the third and fourth years of a loan's repayment period.<sup>174</sup> The new calculation of the repayment rate would have provided the DOE more accurate data for loans in default during the typical course of repayment that would not be encompassed in the current cohort default rate.<sup>175</sup>

Program Integrity tightened regulatory enforcement through expanding the frequency of repayment failure. The cohort default rate does not result in Title IV ineligibility unless an institution's default rate exceeds 25 percent for three consecutive years.<sup>176</sup> Had Program Integrity become effective, a school would also have been subject to Title IV ineligibility if its repayment rate fell below 35 percent for "three out of four [fiscal years]."<sup>177</sup> Under that rule, a school could not cleanse itself from potential ineligibility for another three years by simply improving its repayment rate for one year after two years of inadequacy. Furthermore, it would have decreased the incentive through potential manipulation of an institutions cohort default rate.<sup>178</sup> As actors of business acumen in "maximizing efficiency,"<sup>179</sup> for-profit institutions would be encouraged to create or improve programs that provide consistent results, or eliminate inefficient or failing programs.

The repayment rate metric the DOE wanted to adopt would have defined borrowers to be in repayment when they are successfully repaying their loans.<sup>180</sup> Such a definition of "repayment" is tautologous, but a borrower would be in repayment when it reduced the balance of its principal by at least one dollar.<sup>181</sup> A borrower making payments only on accrued interest thus would not have been considered in repayment of a loan, and if a borrower failed to pay off at least a dollar of the balance, the loan would be in default for calculation of the repayment rate metric.<sup>182</sup> One exception exists for borrowers under income-sensitive repayment plans.<sup>183</sup>

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174. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. at 34,389.

175. *Id.*

176. 34 C.F.R. § 668.187(a)(2) (2009).

177. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. at 34,389.

178. *See supra* Part III-C(2).

179. Ruch, *supra* note 18, at 88.

180. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. at 34,389.

181. *Id.* at 34,400.

182. *Id.* at 34,389.

183. "Income sensitive repayment plans" are a system of repayment in which a borrower determines his or her monthly payment on a student loan by fixing repayment to a percentage of gross monthly income. *Income Sensitive Repayment*, FINAID, <http://www.finaid.org/loans/isr.phtml> (last visited May 19, 2013). Monthly payments following the termination of these plans

These borrowers, so long as they meet their obligations under the repayment plans, would be considered in repayment even if their repayments only cover accrued interest, so long as “the program at issue does not have unusually large numbers of students in those categories.”<sup>184</sup>

### B. INCOME-BASED METRICS

Program Integrity also required two income-based metrics to ensure that a borrower repaying the loan and repayment were feasible and still within living standards. For-profit institutions would have been required to demonstrate that the aggregation of borrowing students maintain an annual debt-to-earnings ratio below 12 percent of yearly earnings and less than 30 percent of discretionary income.<sup>185</sup> Measuring student debt with annual earnings would allow DOE to determine whether a program’s cost relates to the possibility for future earnings. Furthermore, in providing for no more than 30 percent of earned discretionary income<sup>186</sup> going toward debt payments, a borrower would not have to enter a vicious cycle of working only for the purpose of paying off debt that was incurred to only later work it off.

As noted above, an institution would have been deemed ineligible for Title IV aid if it failed to meet all three metrics in Program Integrity for three out of four fiscal years.<sup>187</sup> However, if an institution failed to meet either the repayment rate or one of the debt-to-earnings ratios for one fiscal year, the institution would have been warned by the DOE and would then have to provide enrolled and prospective students notice of its failure to comply with the regulation and explain the possible consequences—the potential loss of Title IV eligibility.<sup>188</sup> Furthermore, the institution would have had to explain the debt measures and describe any actions planned to improve performance under the debt measures.<sup>189</sup> This notice would have required an institution to be directly accountable to its students and prospective students for its failure to meet its own representations regarding gainful employment.

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will inevitably be larger than the payments made during the term of the income sensitive repayment plan. *See* 20 U.S.C.A. § 1098e(b) (2010).

184. The DOE did not define “unusually large numbers.” *See* Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. at 34,389.

185. *Id.* at 34,388.

186. Discretionary income for this purpose is defined as “the difference between the mean or median annual earnings and 150 percent of the most current Poverty Guideline for a single person in the continental U.S.” 34 C.F.R. § 668.7(a)(vi).

187. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. at 34,388.

188. 34 C.F.R. §668.7(j)(1).

189. *Id.*

### C. LOBBYING: FILING DOWN THE TEETH OF REGULATORY BITE

In addition to expending large amount of revenue on marketing,<sup>190</sup> the for-profit higher education industry maintains a strong lobbying base in Washington, D.C. Extensive lobbying efforts by the for-profit education industry diluted the earliest proposals of the Program Integrity regulations. The earliest provisions of Program Integrity would have permitted governmental action should an institution's borrowing students fail to reach a repayment rate of 45 percent, a 40 percent of discretionary income, and an 8 percent debt-to-earnings ratio.<sup>191</sup> This lobbying effort claimed institutions would not be able to meet the new regulations, in effect claiming that less than half of their students would not be able to repay their debt.<sup>192</sup> To combat the perceived "restrictiveness" of the early draft of Program Integrity, the for-profit education industry more than doubled its lobbying expenses in 2010 to nearly \$4 million.<sup>193</sup> The potential for Program Integrity to reduce student loan debt is exhibited by the lobbying efforts against Program Integrity by the for-profit education that ultimately "watered down" the final product.<sup>194</sup> Ultimately, it was an industry lobbying group challenging the rulemaking that sounded Program Integrity's death knell.

### D. PROGRAM INTEGRITY: A TOOTHLESS SMILE

The impact of Program Integrity on student loan debt would have been negligible. The DOE enacted Program Integrity with a market-based perspective—that students would make informed decisions to enroll in an institution by measuring a program's value relative to its costs and the potential for gainful employment—and, ultimately, institutions would have been encouraged to improve performance therewith.<sup>195</sup> Through Program Integrity, disclosures to students would have given them information to know if a program offers gainful employment, and the worst performing programs could be easily identified from its students' failure to repay loans.<sup>196</sup> Though the Department wanted to ensure that programs are at least 35 percent effective, under the final regulation only 4 percent of four-year

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190. See *supra* Part I-A.

191. See Program Integrity: Gainful Employment, 75 Fed. Reg. 43,616, 43,638 (July 26, 2010).

192. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. at 34,394.

193. John Lauerman & Jonathan D. Salant, *For-Profit Colleges Double Spending, Hire Ex-Congressmen to Beat Aid Rules*, BLOOMBERG, Dec. 23, 2010, <http://www.bloomberg.com/news/2010-12-23/for-profit-colleges-double-spending-hire-ex-congressmen-to-beat-aid-rules.html>.

194. Indeed, for-profit lobbying measures in the past succeeded in limiting restrictions on Title IV aid. In 1992, the 90/10 rule was then the 85/15 rule. However, industry pressure raised the maximum amount of revenue through Title IV aid to 90 percent. See DEBT WITHOUT A DIPLOMA, *supra* note 39, at 3.

195. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. at 34,387.

196. *Id.*

for profit institutions would have failed to meet the repayment requirement, and 6.2 percent would have fallen below the threshold for two-year institutions.<sup>197</sup> Moreover, only 3 percent of institutions would have failed a metric once, and only 1 percent of schools would have lost eligibility, corresponding to only 7 percent of the student population in a program that failed one metric, and only 1 percent of students would have been affected by a program's lost eligibility.<sup>198</sup> If these numbers were correct, then 97 percent of institutions were providing programs that lead to gainful employment. Effectively, the DOE said through its Program Integrity rulemaking that it had concerns about programs leaving students with no future employment prospects, but also saying such concerns only extend to, at most, 3 percent of the regulated institutions—that its then current regulatory approach was inadequate for a problem affecting a mere 3 percent of the industry. Rather, the calculated results of Program Integrity demonstrate how ineffectual the regulations would have been. These insignificant figures contradict the DOE's acknowledgement of the high default rate of for-profit university students. Program Integrity would have revealed the industry's worst performers, but severing Title IV eligibility would have only removed the most culpable cheaters from a rigged game—the worst offenders are removed, but the play remains unfair. Without fear of lost federal aid, schools would have had no incentive to reduce tuition, limit selectivity, or reduce marketing practices that tempt people into ineffective programs.<sup>199</sup> With these factors remaining, students would need to continue borrowing high amounts for programs that at best needed to only be 35 percent effective.

## V. “HORSE OF A DIFFERENT COLOR”

### A. THE FAULTY ASSUMPTION BEHIND PROGRAM INTEGRITY

In measuring institutional performance by post-graduate gainful employment rates, the DOE views education from a for-profit university as more of a marketable commodity than intellectual pursuit in itself; if such programs exist solely for employability purposes then they should be regulated as such. Program Integrity's focus on the value of education offered was guided mainly by post-graduation employment performance. Obvious, yet nascent, in Program Integrity is an assumption that the for-profit education industry is similar to the industry that existed when HEA opened Title IV access to the for-profit sector. While many amendments to the HEA changed the rules for eligibility for Title IV access, Program

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197. *Id.* at 34,396 tbl.A.

198. *Id.* at 34,459.

199. See Eisman, *supra* note 15, at 3.



Integrity glossed over the troubling aspect of this sector of the education industry—the conflict between providing valuable education and the incentive for large profits and pressure to meet shareholder demand.

*“The purpose of any organization under the law is earnings—profit.”*<sup>200</sup>

A fundamental principle underlying the corporate identity is that the primary purpose of corporate existence is the maximization of shareholder profit.<sup>201</sup> This plain definition holds that the corporation must act on behalf of shareholder interest when making business decisions.<sup>202</sup> When the HEA first opened Title IV eligibility to for-profit institutions, the industry consisted primarily of independent “mom-and-pop” schools offering training in vocational fields such as cosmetology and truck driving.<sup>203</sup> Today, for-profit universities are large, highly sophisticated multi-state institutions that offer even advanced doctoral-level degrees.<sup>204</sup> The hand of government aid is feeding the mouth of a different beast than the puppy it let indoors in 1972, but the Department’s regulatory approach fails to address this institutional evolution. Though institutions in 1972 were still driven by profit, current for-profit universities owe obligations to stockholders and parent companies. The focus of Program Integrity on for-profit universities as institutions of education neglected the primary purpose of the for-profit education industry—profit.

A fair understanding of profit motive would be that providing a valuable commodity serves the benefit of profit. However, given the high percentage of revenues earned by federal aid, the for-profit education industry is able to provide an ineffective product for more than half of its consumers and remain highly profitable.<sup>205</sup> With the constant supply of Title IV dollars, the industry is under no incentive to improve institutional performance beyond federal requirements. The for-profit education industry is successful in luring people through the door, but Program Integrity sought to regulate educational value through an implied out-the-door warranty policy. Program Integrity only provided a floor for which the industry must perform, an outcome-determinative approach that measures the outcomes of a system rather than the rules under which that system operates. Effective regulation of the for-profit education industry will best

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200. *Dodge v. Ford*, 170 N.W. 668, 681 (Mich. 1919).

201. 5 WILLIAM MEADE FLETCHER ET AL., *FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 2096.30 (perm. ed., rev. vol. 2003).

202. “[A] corporation . . . should have as its objective the conduct of business activities with a view enhancing corporate profit and shareholder gain.” 1 A.L.I. *PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS* § 2.01(a) (1994).

203. Turner, *supra* note 31, at 51; *see also* Johnson, *supra* note 14, at 230.

204. Johnson, *supra* note 14, at 230. OVERSIGHT, *supra* note 41, at 1.

205. *See* DEBT WITHOUT A DIPLOMA, *supra* note 39, at 8.

serve the interests of the students' education and their ability to repay subsequent debt obligations by aligning the industry's profit interests with student success. The DOE recognizes the dependence on revenues to enrollment,<sup>206</sup> yet its regulatory approach failed to correct the methods by which students are enrolled. Instead, the Department attempted to focus on after-the-fact data wherein students would have still suffered debilitating debt.

## **B. CONSIDER THE PROFIT**

### **1. The Benefit to For-Profit Universities of Students Holding the Risk**

Given the operation of for-profit universities, students borrow what are, in effect, junk bonds. The potential for a return on the debt instrument is very speculative, with the high risk of default being allocated entirely on the holder—the student. Universities receive payment from the students through tuition and fees via a debt instrument, but apart from a lenient legislative structure, universities have no obligations on that debt and payment is guaranteed. The product of education is unique where the potential for risk is entirely absolved, federal loans are guaranteed by the federal government, and the debts are generally non-dischargeable in bankruptcy.<sup>207</sup> Once an enrolled student pays tuition, the for-profit university achieves its profit goal. Retaining students would enable further profit growth; however, even with a withdrawal rate over 50 percent, the industry is highly profitable.<sup>208</sup> With increasing enrollments, it is to the university's benefit to *reduce* educational value by cutting costs, so long as students keep filing through the doors and filling their financial aid forms. So long as enrollments increase, universities have no incentive to improve institutional performance. Rather, further investment into educational value would be to the detriment of profit margins.

### **2. Requiring a Marketing-to-Institutional Expenses Ratio**

In focusing on the industry's profit motive, one alternative remedy would be to require Title IV recipients to maintain a ratio on revenue expenditures based on the institution's marketing and institutional expenses. The current problem underpinning the industry is that the profit motive is driven solely on recruitment for enrollment and that the education itself is ignored. By imposing a metric that determines the amount a university may

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206. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. 34,386, 34,387 (June 13, 2011) (to be codified at 34 C.F.R. pt. 668).

207. See 11 U.S.C. § 523(a)(8) (2012).

208. DEBT WITHOUT A DIPLOMA, *supra* note 39, at 5.

spend on marketing, schools will improve the educational value rendered, increasing the likelihood that a student's investment will be returned. This would not necessarily require schools to cut marketing expenses or force it to spend more money. If a school wishes to promote itself more, it would then be required to allocate more funds into new faculty, new technologies or infrastructure, or student resources to correspond with increased marketing expenses. Moreover, marketing expenses could be displaced into education expenses, without the school needing to increase or cut expenses.

### **3. Easing the Restrictions on Dischargeability of Student Loans in Bankruptcy**

One remedy to ease student debt burdens would be to ease the restrictive "undue hardship" exception in the bankruptcy code. Generally, student loans are non-dischargeable unless a debtor shows he or she cannot maintain a minimal standard of living if forced to repay loans and that the debtor has made a good faith effort to repay the loan and additional circumstances exist indicating the state of affairs is likely to persist for the repayment period of the loan.<sup>209</sup> This is a difficult showing.<sup>210</sup> Allowing students who graduated from a for-profit university and demonstrated a good faith effort to obtain employment in the specified occupation of the program would be aligned with the policy underlying the required showing under undue hardship exception,<sup>211</sup> while absolving the student from a burdensome debt that resulted in no return.

## **CONCLUSION**

The for-profit education industry quickly grew into a titan in higher education. The industry's focus on employability and career oriented programs offer an alternative to traditional forms of higher education for students seeking specific skills and training, while also allowing an inroad for non-traditional students to access higher education. However, the profit motive of the industry led to substandard student performance following graduation. The current legislative and regulatory approach to for-profit higher education does not adequately prevent abuse by the industry in

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209. *Brunner v. New York State Higher Educ. Serv. Corp.*, 831 F.2d 395 (2d Cir. 1987).

210. *See generally* *United Student Aid Funds, Inc. v. Espinosa*, 130 S. Ct. 1367 (2010) (discussing the requisite showing, procedural and jurisdictional requirements and adversarial proceeding necessary to demonstrate an "undue hardship" exception).

211. Congress made student loans non-dischargeable to avoid potential abuse of the bankruptcy system. *See* Jennifer L. Frattini, *The Dischargeability of Student Loans: An Undue Burden?* 17 *BANKR. DEV. J.* 537, 546 (2001). Congress was concerned that newly minted college graduates would attempt to free ride their college education by discharging their student loan debts in bankruptcy just before entering a lucrative career. *Id.*

recruiting students, nor does it incentivize the industry to promote students' post-graduation success. Program Integrity attempted to hold the industry accountable to its claims that it leads to gainful employment. However, if the Department continues to take a similar regulatory approach, it will fail to address the looming problem of collective student loan debt and default. Without regulation that encourages institutional performance to coincide with the industry's profit motive, regulations like Program Integrity will not halt student debt burdens. Such regulations only sever the worst performers, while leaving the broken system intact. Rather, current regulatory enforcement encourages for-profit universities to maintain questionable business practices, as circumventing the law may be necessary to avoid the Title IV ineligibility death sentence. The investment of taxpayer dollars and the mortgaging of students' financial future is too great a risk to leave in the hands of an industry that has competing and perhaps conflicting interests between its shareholders and students.

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