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RECENT DEVELOPMENTS RELATED TO REGULATION AND LITIGATION INVOLVING THE EDUCATION SECTOR

To Our Clients and Friends:

This is the latest update of significant developments relating to regulatory, administrative, and legal actions involving schools, especially private-sector schools. Since our last update, we saw oral argument in the Ninth Circuit Court of Appeals in a False Claims Act (FCA) case against Stephens Institute, two helpful Court of Appeals decisions, and two memos from the Department of Justice (DOJ) that will affect enforcement actions against schools. We also continued to see an uptick in activity from the state Attorneys General and the trend of school consolidations and reorganizations. Without further ado.

A. The False Claims Act

1. Oral Argument in *United States ex rel. Rose v. Stephens Institute*

On December 3, 2017, the Ninth Circuit heard oral argument in the FCA case of *United States ex rel. Rose v. Stephens Institute*, which presents two issues of importance to schools: (1) whether the so-called "implied certification" theory of FCA liability is viable outside of there being "specific [mis]representations about the goods and services" in claims for payment (of which there are very few, if any, in financial aid requests); and (2) whether the Department of Education's (ED) long history of *not* cutting off federal funds despite knowing about violations of the incentive compensation provision means a violation of that provision cannot be considered material—and therefore actionable—under the FCA. *See* Br. of Appellant at 2-3, *U.S. ex rel. Rose v. Stephens Inst.*, No. 17-15111 (9th Cir. May 30, 2017).

The three-judge panel of Judges Susan P. Graber, N. Randy Smith, and U.S. District Judge Jennifer G. Zipps struggled over these issues, with the litigants sparring over exactly what the Supreme Court held in *Universal Health Services v. United States ex rel. Escobar*, 136 S. Ct. 1989 (2016) and how the Ninth Circuit had previously interpreted the FCA and *Escobar*.

Arguing as an amicus curiae, the United States argued that *Escobar* did *not* adopt a test that required proof of "specific representations about the goods or services" to assert an implied certification claim. But as counsel for Stephens Institute explained, the Ninth Circuit has previously indicated that this *is* a requirement in both *United States ex rel. Campie v. Gilead Sciences, Inc.*, 862 F.3d 890 (9th Cir. 2017) and *United States ex rel. Kelly v. Serco, Inc.*, 846 F.3d 325 (9th Cir. 2017). This led Judge Smith at one point to ask whether the Ninth Circuit should take the case higher up and hear it *en banc* (i.e., with 11 judges).

Escobar's materiality standard also was hotly debated. The panel seemed particularly concerned about how to reconcile *Escobar* with the Ninth Circuit's decision in *United States ex rel. Hendow v. University of Phoenix*, 461 F.3d 1166 (9th Cir. 2006). *Hendow* held on a motion to dismiss that the incentive compensation provision was material, at least for purposes of the pleading stage, based on the language of the statute, the regulation, and a school's program participation agreement. *Id.* at 1175–76. But *Escobar* indicated that what "label the Government attaches to a requirement"—which is effectively what the court relied upon in *Hendow*—does not matter. *Escobar*, 136 S. Ct. at 1996. And as counsel for the school argued, an alleged violation of the incentive compensation provision should not be considered "material" following *Escobar*, particularly considering ED effectively conceded the provision was not a condition of funding in the so-called Hansen Memorandum. The Government and the relator, meanwhile, while both arguing for a lax materiality standard, took different views. The United States argued that the case (and perhaps all cases involving incentive compensation allegations) presented a factual dispute about materiality that could not be resolved short of trial. The relator's counsel, in contrast, argued that *Hendow* was binding law and determined materiality in the plaintiff's favor at every stage in legal proceedings.

The entire oral argument is available to view on YouTube at https://www.youtube.com/watch?v=hANGuY9tyQ8. We will keep an eye on this case, as it may result in a published opinion or even an unusual call for *en banc* review (the first time such would have occurred in a case involving a school to our knowledge).

2. Other Important FCA Developments

There were a number of other important FCA developments. *First*, the Seventh Circuit issued an important decision on causation and damages in *United States v. Luce*, 873 F.3d 999 (7th Cir. 2017). The court held that a relator or the Government can only recover for damages "proximately caused"—*i.e.*, that were the foreseeable consequence—of the allegedly false statement or fraudulent conduct. *Id.* at 1001. This is in contrast to the "but for" analysis the Government and relators often argue for—contending that, for instance, all funds received under a program participation agreement constitute damages on the premise that no funds would have been received had the Government been aware of the alleged violation. Now, at least in the Seventh, Third, Fifth, Tenth, and D.C. Circuits, the relator or the Government must show more; they must show some closer connection between the alleged damages and the alleged misconduct—that the damages were "proximately caused" by the misconduct. In situations in which the Government or the relator is pursuing a claim of misconduct far removed from funding for schools and the reasons students default on government loans, this will provide a tough standard for relators and the Government to meet.

Second, in *United States ex rel. Bennett v. Biotronik, Inc.*, the Ninth Circuit held that if the Government intervenes in an FCA case, the government-action bar, 31 U.S.C. § 3730(e)(3), bars any later suit on the same topics of the earlier FCA case, even if the Government did not intervene on these particular claims and instead dismissed them. 876 F.3d 1011 (9th Cir. 2017). This too has direct implications for schools. Imagine, for example, that a relator sues a school for allegedly violating the incentive compensation provision and the 90/10 rule. The Government then intervenes only as to the incentive compensation claims, settles with the school, and in the process dismisses the claim related to

90/10. Under *Bennett*, the government-action bar precludes not only future claims against the school for violations of the incentive compensation provision, but also allegations related to a 90/10 violation. This is an important reminder to schools when faced with FCA litigation to review prior litigation and settlements—and review *all* aspects of the prior litigation and settlements—with a learned eye; there are likely some good potential dismissal arguments lurking within.

Third, two memoranda from the Department of Justice were made public in January. On January 24, we learned of a memo that outlines factors for when the Government should take affirmative steps of intervening in and voluntarily dismissing *qui tam* FCA lawsuits. The Government outlined a series of factors it should consider, including curbing meritless suits and preventing interference with agency policies and programs. We have long argued that the DOJ should take a more active role in voluntarily intervening in and dismissing meritless cases that waste schools' and the courts' time. This memorandum should provide DOJ attorneys with the guidance and incentive to do so more often.

On January 25, just a day later, the DOJ released a second memo. This memo "prohibits the Department from using" agency guidance documents "to coerce regulated parties into taking any action or refraining from taking any action beyond what is required by the terms of the applicable statute or lawful regulation." In short, the memo explained that the "Department may not use its enforcement authority to effectively convert agency guidance documents into binding rules," which are found in statute and regulations. This too could have a significant impact on FCA cases against schools, which are often brought based upon sub-regulatory guidance or interpretations. The DOJ has now put its foot down, saying this is something that should not occur. Combined with the January 24 memo, this may provide another avenue for arguing that the DOJ should intervene in and voluntarily dismiss certain meritless FCA actions.

Finally, in a decade-old FCA case, a federal jury in Virginia unanimously ruled in favor of a student loan provider, the Pennsylvania Higher Education Assistance Agency. The case, *United States ex rel. Oberg v. Pennsylvania Higher Education Assistance Agency*, No. 1:07-cv-00960 (E.D. Va. Sept. 21, 2007), centered on whether the loan provider was appropriately taking advantage of the special allowance interest payments. This case, like so many others, illustrates that, although the road can be a long, tough one, defendants who are willing to persevere in FCA litigation often come out victorious in the end.

B. State Attorney General Activity

In keeping with the trend we've reported on, state Attorneys General continue to "pick up the slack" for what they perceive as lax enforcement of the for-profit sector by the Trump Administration.

1. State Attorneys General Continue to Challenge Suspension of Obama-Era Regulations

As we reported in our August 2017 update, the Attorneys General of 18 states and the District of Columbia sued Education Secretary Betsy DeVos in July over ED's suspension of the Obama-era borrower defense rules. Eighteen Attorneys General have now sued DeVos over ED's delay of the gainful employment rules. The suit, filed in October in the United States District Court for the District

of Columbia, alleges ED's delay in enforcing the gainful employment rule violated the Administrative Procedure Act by failing to engage in notice and comment rule making, failing to provide a justification for the action, and "acting arbitrarily and capriciously and in excess of statutory jurisdiction." *Maryland v. United States Dep't of Educ.*, No. 1:17-cv-02139, Dkt. No. 1 (D.D.C. Oct. 17, 2017). A spokesperson for ED called the suit a "frivolous" "stunt" designed to "score quick political points."

In December, California Attorney General Xavier Becerra filed a separate lawsuit in the Northern District of California, alleging that ED's delay in approving claims filed by former students of now-defunct Corinthian Colleges also violated the Administrative Procedures Act. The suit alleges that because ED already notified the students that they were entitled to discharge of their loans under the borrower defense regulations, the current delay while ED reconsiders regulations violates the Act's bar on applying rules retroactively. *People v. United States Dep't of Educ.*, No. 17-7106, Dkt. No. 1 (N.D. Cal. Dec. 14, 2017).

2. Other State Attorney General Lawsuits

There were also developments outside of the Obama-era regulations. *First*, California sued Ashford University and its parent company, Bridgepoint Education, alleging that the school made misrepresentations about financial aid, credit transfer policies, and employment statistics to induce students to enroll. *People v. Ashford Univ., LLC*, No. RG17883963, Dkt. No. 1 (Cal. Super. Ct. Nov. 29, 2017). Ashford and Bridgepoint have denied the allegations and stated they will vigorously defend against the suit.

Second, the United States has filed a statement of interest in a case brought by Massachusetts Attorney General Maura Healey against Pennsylvania Higher Education Assistance Agency (PHEAA). Healey's case alleges that PHEAA violated state and federal law by engaging in deceptive student loan-servicing practices on loans owned or subsidized by the Federal Government. In an interesting turn, the United States has argued the suit should be dismissed as preempted by federal law. That motion is awaiting decision.

C. Other News

1. Schools in the Courts

Outside of the FCA and state-Government realms, there were other interesting developments.

First, the Ninth Circuit held in *Benjamin v. B&H Education, Inc.*, 877 F.3d 1139 (9th Cir. 2017), that cosmetology students are not employees of their schools. The plaintiffs in the case were cosmetology students, who alleged they should have been paid wages for the time they spent practicing their skills by interacting with paying customers at their school. In affirming summary judgment in favor of B&H Education, the Ninth Circuit adopted the "primary beneficiary test" and held that the students were not employees because they—and not the school—were the primary beneficiaries of the educational program and the school had not "subordinated the educational function of its clinics to its own profit-making purposes." *Id.* at 1143. The students had not expected to be paid when they enrolled, had

received training and academic credits, had no expectation of employment with the school after graduation, and "did not routinely displace the work of paid employees." *Id.* at 1147.

Second, the former students who filed a lawsuit against ITT Educational Services, Inc. in the Southern District of Indiana last year received court approval for a settlement that will allow them to participate in bankruptcy proceedings and pursue $1.5 billion in claims. The settlement will also cancel $600 million in debts for students who attended ITT between 2006 and 2016.

Third, the Government appears close to wrapping up its pursuit of FastTrain College owner, Alejandro Amor. As you may recall, in 2016, Amor was sentenced to eight years in federal prison for his role in falsifying records and enrolling ineligible students to obtain Title IV funding. Now the Government has seized Amor's Florida home and boat to help satisfy the $1.9 million restitution Amor owes. FastTrain must also pay more than $20 million in damages and penalties, pursuant to a February 2017 district court judgment.

Finally, Florida Technical College reached a $600,000 settlement with the DOJ last month to settle a case alleging that employees at the school's Cutler Bay campus submitted financial aid paperwork that falsely stated that 27 students had high school diplomas or GEDs.

2. Consolidations, Sales, and Reorganization

This quarter, several institutions continued the trend of consolidations and reorganizations. Minneapolis-based Capella University and Virginia-based Strayer University will merge. The schools will continue to operate as separate institutions but will have a common parent company called Strategic Education, Inc. The parent company of DeVry University plans to transfer DeVry, along with Keller Graduate School of Management, to Cogswell Education, LLC, which owns Cogswell College, a small for-profit school with about 600 students. For-profit law school chain InfiLaw reportedly is looking to sell its two remaining law schools, Arizona Summit Law School and Florida Costal School of Law. Education Corporation of America, which owns and operates Virginia College and Brightwood College, announced that it will buy Vatterott Educational Centers. Finally, Grand Canyon University will make a second attempt to change its status from for-profit to nonprofit. The school previously applied in 2014, but its accreditor rejected the plan. It will be interesting to see how ED, under the new Administration, approaches these requests.

3. Increased Activity Beyond the For-Profit Sector

The past scrutiny of the for-profit education sector continues to turn more and more to the traditional educational sector. In December, for instance, the Better Government Association, a private, nonpartisan watchdog group, released a report claiming that City Colleges of Chicago's Kennedy-King College misreported graduation numbers in order to improve its chances of winning national recognition for improving performance.

The California Department of Education is facing allegations it inflated graduation rates. According to the results of a federal audit announced in January by ED, California inflated the state's 2014 high school graduation rate by 2 percentage points.

And finally, the DOJ has announced an investigation into whether the ethics code of the National Association for College Admission Counseling (NACAC) violates federal antitrust law. The ethics code, called the Statement of Principles of Good Practice, encourages ethical admissions practices, such as not tying faster acceptance of admission offers to better housing assignments. The DOJ has sent information requests to NACAC and to a number of professionals who helped draft the ethics code.

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As always, we will continue to monitor all of these developments, and you can look forward to updates in our next report.

Gibson, Dunn & Crutcher lawyers are available to assist in addressing any questions you may have regarding the issues discussed above. Please contact the Gibson Dunn lawyer with whom you usually work, or any of the following:

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