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November 6, 2018

RECENT DEVELOPMENTS RELATED TO REGULATION AND LITIGATION INVOLVING THE EDUCATION SECTOR

To Our Clients and Friends:

This is the latest update of significant developments related to regulatory, administrative, and legal actions involving schools. This quarter saw the Ninth Circuit issue its long-awaited decision in *United States ex rel. Rose v. Stephens Institute*, a number of other interesting developments related to the False Claims Act ("FCA"), a flurry of activity from the Department of Education and other federal agencies, and more.

A. Strict Rules in Name Only?

On August 24, 2018, the United States Court of Appeals for the Ninth Circuit issued its opinion in *United States ex rel. Rose v. Stephens Institute*, No. 17-1511, 901 F.3d 1124 (9th Cir. 2018). As discussed in the February alert, the three judges on the panel appeared to be struggling at oral argument with what the Supreme Court held in *Universal Health Services v. United States ex rel. Escobar*, 136 S. Ct. 1989 (2016); how the Ninth Circuit had previously interpreted the FCA and *Escobar*; and how that might apply to the situation of a for-profit school. That struggle carried over to the opinion.

All three judges agreed that a relator in the Ninth Circuit could only establish liability under the so-called implied certification theory—whereby FCA liability can exist for claims for payment that falsely, implicitly represent compliance with a law—if "'first, the claim does not merely request payment, but also makes specific representations about the goods or services provided; and second, the defendant's failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths.'" *Rose*, 901 F.3d at 1129–30 (quoting *Escobar*, 136 S. Ct. at 2001). The court explained, however, that it did not believe these "two conditions" were actually required by *Escobar* and instead followed that rule only because the Ninth Circuit's "post-*Escobar* cases … appear to require Escobar's two conditions." *Id.* The three judges even went so far as to indirectly call for en banc (11-judge) review. *Id.*

The three judges also agreed, however, that the relator had met both of those requirements. The Ninth Circuit reasoned that the Federal Stafford Loan Certification form contained the required representation about goods or services provided: "Defendant specifically represented that the student applying for federal financial aid is an 'eligible borrower' and is 'accepted for enrollment in an eligible program.'" *Id.* at 1130. And the Ninth Circuit believed "those representations could be considered 'misleading half-truths'" because "Defendant failed to disclose its [alleged] noncompliance with the incentive compensation ban." *Id.*

This aspect of the decision is troubling. Compliance with the incentive compensation provision is nowhere in the Federal Stafford Loan Certification form, but the panel found that the representations in the form that the student was an "eligible borrower" and would be attending an "eligible program" were sufficient to impliedly certify compliance with the incentive compensation provision, as such is a condition of participation in the Title IV program.

The Ninth Circuit also reached a troubling conclusion on the second issue in the case: whether the alleged violations of the incentive compensation provision were material—and therefore actionable—under the FCA. Relying on a pre-*Escobar* decision on the pleadings in *United States ex rel. Hendow v. University of Phoenix*, 461 F.3d 1166 (9th Cir. 2006), the Ninth Circuit held that, even on the more demanding summary judgment standard and even after *Escobar*, the relator in *Rose* had met the materiality standard because of: (1) the "triple-conditioning of Title IV funds on compliance with the incentive compensation ban" in the statute, regulations, and program participation agreement; (2) "evidence … that [ED] did care about violations of the incentive compensation ban," including evidence it issued fines or corrective actions for such alleged violations; and (3) the "magnitude" of the alleged violation in the case was purportedly "substantial" because the "large monetary awards" for enrollments were in the tens of thousands of dollars. *Id.* at 1132–34.

Judge Smith dissented on this aspect of the decision, explaining that "caring is not enough to make it material under the *Escobar* standard." *Id.* at 1137. What is needed, and was missing according to Judge Smith, was evidence "about what the Government would actually do in this case (or even in a similar case)"—*i.e.*, would the alleged improper payments to employees have affected the Government's "payment decision" of financial aid. *Id.* at 1137 & n.3.

What was perhaps most shocking about the majority's opinion, claiming to enforce the "rigorous" materiality standard from *Escobar*, is that the panel did not even mention—let alone discuss—the Department of Education's 2002 memorandum from the then Deputy Secretary of Education (William D. Hansen), in which Mr. Hansen explained that the incentive compensation provision generally should *not* provide the basis for a loss of institutional or student eligibility and should instead be handled by a fine. That memorandum is strong evidence that the Department did *not* condition eligibility—including student or institution eligibility—or payment decisions on the incentive compensation provision. But it was ignored by the Ninth Circuit.

Stephens Institute is seeking en banc review.

B. Other False Claims Act Developments

While the case law on the FCA may not have been particularly positive for schools in the last quarter, the Department of Justice ("DOJ") continued to show a more considered approach to FCA enforcement. Specifically, on June 14, 2018, acting Associate Attorney General Jesse Panuccio gave a speech about the DOJ's ongoing efforts to promote a fair application of the FCA. As discussed in our February report, the DOJ issued two memoranda in January that: (i) outlined factors for when the Government should intervene and *voluntarily dismiss* qui tam FCA lawsuits; and (ii) clarified that the "Department may not use its enforcement authority to effectively convert agency guidance documents

into binding rules." In his speech, Mr. Panuccio discussed those two initiatives and also (1) formalizing cooperation credits, (2) rewarding "companies that invest in strong compliance measures," and (3) promoting coordination within the agency and with other regulatory bodies to prevent "piling on."

On the FCA front, a few other developments:

- The U.S. District Court for the Western District of Pennsylvania ordered the Government to produce to a law clinic at Harvard Law School documents the Government obtained from a 2007 FCA case filed against Education Management Corp.

- The qui tam lawsuit filed against EduTrek and a number of schools in the United States District Court for the District of Utah was voluntarily dismissed.

- The U.S. District Court for the District of Utah ordered supplemental briefing in *U.S. ex rel. Brooks v. Stevens-Henagar College* about whether a relator and the United States are entitled to separately pursue different claims in the same FCA case.

C. Activity by the Department of Education

As readers of this alert likely know, the Department of Education (ED) has had a busy quarter:

Borrower Defense: On July 31, ED released a notice of proposed rulemaking on the Borrower Defense to Repayment (BDR) regulations. The proposed regulations are intended to supplant the BDR rule promulgated by the Obama Administration in November 2016. Some of the proposed changes include (1) establishing a federal standard for review of BDR claims; (2) limiting the basis of a claim to misrepresentation by a school; (3) requiring that such misrepresentation be (i) false, misleading, or deceptive, and (ii) made with knowledge of its false, misleading, or deceptive nature or with a reckless disregard for the truth, (iii) clearly related to the making of the loan or provision of educational services; and (iv) requiring the borrower to establish reasonable reliance on the misrepresentation and resulting financial harm.

After the notice of rulemaking was published, ED received a large number of comments and has announced that the earliest implementation date would be July 2020.

In the meantime, at least for the time being, the old 2016 BDR regulations will remain in effect. That is because 19 states and the District of Columbia previously sued Secretary DeVos for wrongly delaying implementation of the 2016 BDR regulations. On September 12, the judge ruled that ED's postponement measures of the 2016 BDR regulations were procedurally improper. Instead of ordering ED to immediately implement the 2016 BDR rule, the judge issued a temporary suspension to permit ED to remedy deficiencies with the procedures it had followed. However, ED did not do so before the deadline of October 16, and the 2016 version of the BDR rule is now in effect. Secretary DeVos has indicated she will implement the 2016 rule, even as she works to rescind it.

ED also suffered setbacks in another lawsuit involving the BDR rules. As reported in our last alert, former Corinthian College students filed a class action lawsuit for declaratory and injunctive relief

against Secretary DeVos and ED in December 2017, alleging that after Corinthian closed, ED promised the students complete loan forgiveness but then, in December 2017, announced a plan to award only partial relief using a formula based on students' earnings. On May 25, a magistrate judge issued a preliminary injunction, blocking enforcement of ED's partial loan relief program. In June, the magistrate clarified that ED did not presently need to provide the full debt relief the students claimed but that ED must stop collecting loan payments from *all* former Corinthian students who applied for debt relief—not just the four named plaintiffs in the case. And on October 15, the judge certified a nationwide class of approximately 110,000 students.

Gainful Employment: On August 14, ED filed a notice of proposed rulemaking that proposed rescinding the Gainful Employment regulations. Instead of these regulations, ED plans to update the College Scorecard, or a similar web-based tool, to provide program-level outcomes for all higher education programs at all institutions that participate in programs authorized by Title IV. The public comment period closed on September 13.

State Authorization: On July 3, ED further delayed the effective date of four provisions of the State Authorization rules that had been published in December 2016 and were scheduled to go into effect on July 1, 2018. The new effective date is now July 1, 2020. The State Authorization rules would have required institutions that offer distance education to students in states where the institution is not physically located to either meet those states' requirements for offering postsecondary education or to participate in a state authorization reciprocity agreement and then document that there is a state process for review and action on student complaints. In response to this delay, the National Student Legal Defense Network filed a lawsuit on August 23 in the U.S. District Court for the Northern District of California, arguing that the methods ED used to delay implementation of the rules violated both the Higher Education Act and the Administrative Procedure Act. The case has been assigned to a magistrate judge.

Accreditation: On July 31, ED announced a new round of rulemaking related to accreditation and proposed negotiation of the following topics: requirements for accrediting agencies in their oversight of member institutions; requirements for accrediting agencies to honor institutional mission; criteria used by the Secretary to recognize accrediting agencies, emphasizing criteria that focus on educational quality; developing a single definition for purposes of measuring and reporting job placement rates; and simplifying ED's process for recognition and review of accrediting agencies. Negotiations are expected to begin in January 2019.

Speaking of accreditors, in late September, after having tentatively restored its accrediting status in April, ED sent a letter to the Accrediting Council for Independent Colleges and Schools (ACICS), stating that the accreditor was in compliance with all but two of the necessary standards for recognition and that it has 12 months to meet the final two criteria.

To round out the news about ED, on June 21, the White House unveiled a plan to merge the Education and Labor departments into a single Cabinet agency: the Department of Education and the Workforce. The change would require congressional approval. The merger reflects the Administration's desire to streamline government and focus on career technical education and skill-building.

D. Activity by Other Federal Agencies

ED is not the only federal body that has kept busy.

The SEC settled its case against two executives of ITT Educational Services, Inc., days before trial was to begin. The two executives were alleged to have hidden ITT's financial condition from investors. The settlements include penalties of $200,000 and $100,000 and temporary suspensions from serving on boards of publicly-traded companies. In the meantime, the bankruptcy trustee representing ITT's debtors filed suit against one of the executives and eight former board directors, alleging that they breached their fiduciary duties by not taking steps that might have kept the company out of bankruptcy. In September, the bankruptcy trustee also filed suit against ED and lenders who backed ITT's private loan program, alleging that ED failed to adequately protect students.

On the CFPB front, CFPB has accused ED of blocking Navient from producing student borrower documents to CFPB in its lawsuit against Navient. On August 10, the court held that Navient must produce the documents if they are in Navient's possession, regardless of whether they are "owned" by ED.

The FTC reached settlements of over $60 million with eight separate parties accused of scamming consumers out of millions of dollars by promising to reduce or eliminate their loan debt. The settlements are part of a coordinated federal-state law enforcement initiative targeting deceptive student loan debt relief scams announced by the FTC in October 2017, called Operation Game of Loans.

Finally, in July, the FBI concluded an investigation into an alleged "bait-and-switch" scheme that purportedly affected more than 2,500 student veterans. A company called Ed4Mil allegedly recruited service members and veterans for what they thought were classes taught by a private liberal arts school, but were actually unaccredited correspondence classes. Ed4Mil allegedly charged the government the university tuition rates and pocketed the difference. Ed4Mil's founder pleaded guilty to conspiracy to commit wire fraud and was sentenced to five years in prison. He was also ordered to pay $24 million in restitution. Two co-conspirators pleaded guilty to conspiracy to commit wire fraud and were sentenced to probation.

E. State Attorney General Activity

As we've reported, state attorneys general also remain busy in their policing of the education sector.

1. California Attorney General Gets Mixed Results.

California, one of the busiest state AG offices, has seen mixed results in recent months. In one win, Attorney General Javier Becerra settled with Balboa Student Loan Trust for $67 million in debt relief for former students of Corinthian College. The settlement calls for Balboa to immediately halt debt collection, forgive 100 percent of the balances on over 30,000 private student loans, and to refund past payments.

The Attorney General next announced a suit against student loan servicer, Navient, alleging Navient violated California's unfair competition and false advertising laws by failing to sufficiently disclose how borrowers could be considered for income-driven repayment plans, thus steering borrowers to more expensive plans. Navient has stated that the allegations are baseless and that it will "vigorously defend" the suit.

In August, a magistrate judge in the U.S. District Court for Northern District of California dismissed California's complaint against ED and Secretary DeVos alleging ED had improperly halted debt relief claims of former Corinthian Colleges students. The court held that California lacked standing to challenge the Trump administration's actions. California has filed an amended complaint that seeks to remedy the deficiencies identified by the court.

California also suffered another defeat in August when a court issued a temporary restraining order, halting the practice by the California State Approving Agency for Veterans Education (CSAAVE)—which certifies colleges to award federal education aid to veterans—of suspending the eligibility of colleges from other states based on its interpretation of a rule to require "extension" campuses to be operationally dependent on a campus in California. The college plaintiffs alleged that CSAAVE's interpretation has no basis in governing law and that its implementation of this interpretation violated the California Administrative Procedures Act. The Agency stated its decisions were based on the inadequacy of the colleges' locations in California, but the colleges' lawsuit alleged that the Agency's own documentation demonstrated that the colleges were compliant with all rules.

2. Massachusetts Attorney General Sues New England Institute of Art for Fraud.

In July, Massachusetts Attorney General Maura Healy sued the New England Institute of Art (NEIA) and Education Management Corporation (EDMC) for fraud. Massachusetts's lawsuit alleges NEIA and EDMC targeted and aggressively recruited students by misrepresenting job placement rates, NEIA's job search assistance resources, and the availability of financial aid. NEIA closed in 2017, and EDMC filed for bankruptcy in June. Nevertheless, it appears Massachusetts is pursuing its claims.

3. New York City Department of Consumer Affairs Alleges Berkeley College Violated Consumer and Local Debt Protection Laws.

In New York, it appears other agencies are participating in enforcement as well. After a two-year investigation of Berkeley College, the New York City Department of Consumer Affairs has sued the for-profit institution, alleging that it employed "predatory marketing tactics," made misrepresentations about financial aid and employment prospects, and attempted to collect debts not actually owed. The investigation reportedly included undercover investigators who communicated with recruiters and students and the review of over 50,000 pages of documents produced by the college.

4. Investigations and Press Reports Demonstrate Vulnerability of Schools Beyond the For-Profit Sector.

In July, Pennsylvania Attorney General Josh Shapiro announced his office would investigate claims that Temple University knowingly provided false data to U.S. News & World Reports to boost the rankings

of its online MBA program. And in August, the Commission on Institutions of Higher Education at the New England Association of Schools and Colleges voted to place on probation two independent nonprofit schools—College of St. Joseph and Newbury College. The accreditor reports that the two schools, both facing declining enrollment, failed to meet a standard on institutional financial resources.

Further, at least one news outlet recently reported on alleged disgruntled customers of Woz U, the coding boot camp started by Apple co-founder Steve Wozniak. In the report, Woz U's President acknowledged errors in the program and stated that a quality control system has been adopted.

F. Corporate Transactions and For-Profit to Nonprofit Status Changes

There were several notable developments in the area of sales and mergers.

Strayer Education, Inc. finalized its merger with Capella Education Company in August. The new combined entity, called Strategic Education, Inc. (SEI) will continue to operate Strayer University and Capella University as separately accredited institutions.

ED has given primary approval to Adtalem Global Education's proposed transfer of DeVry University to Cogswell Capital LLC. The transfer will still need approval from the Higher Learning Commission. (Unrelated to the transfer but also notable is a recent class action lawsuit against DeVry, filed by former students who say DeVry falsely advertised employment and graduation rates to induce them to enroll.)

Adtalem also finalized a deal to transfer ownership of Carrington College to San Joaquin Valley College, Inc. The deal will need regulatory and creditor approval and is expected to be finalized in mid-2019.

Bridgepoint Education announced in July that its accreditor has given initial approval for a merger of two of Bridgepoint's subsidiary institutions, Ashford University and University of the Rockies. Ashford University will be the surviving entity of the merger, which will now seek approval from state regulators and ED.

This quarter also saw more examples of a trend we've reported previously: for-profit institutions seeking to become nonprofit entities. In July, National University System, a nonprofit network of universities, announced it will acquire for-profit Northcentral University to expand its online graduate and doctoral program offerings. Grand Canyon University, which had tried for several years to convert back to a nonprofit, sold off assets necessary to complete the status change. This trend has gained so much steam that the National Advisory Committee on Institutional Quality and Integrity (NACIQI) recently held an event on it, hosting 22 panelists to weigh in on the topic of for-profit to nonprofit conversions in higher education. Most of the panelists cited regulatory and public scrutiny as the major factor driving these conversions.

Not all of these deals have been successful. The proposed acquisition of 31 Art Institute schools by nonprofit Dream Center Education Holdings faces a new hurdle. The Higher Learning Commission temporarily suspended accreditation of four Art Institute schools. Senator Dick Durbin (D-Ill.) has

called for an investigation of Dream Center, in part because Dream Center's websites allegedly continued to list the schools as accredited.

G. Other News

The American Bar Association (ABA) has revoked the accreditation of Arizona Summit Law School. The revocation follows a year-long probation period for allegedly failing to meet academic and admissions standards. Arizona Summit plans to appeal the decision.

During the probationary period, InfiLaw Corp., which owns Arizona Summit, fought back by suing the ABA, alleging it discriminated against for-profit law schools. In August, the ABA had a setback in that lawsuit when the U.S. Judicial Panel on Multidistrict Litigation rejected the ABA's argument that that three separate lawsuits brought by InfiLaw schools should be consolidated. The Panel reasoned that the number of suits was small and discovery would be minimal given that the suit would likely turn on questions of law. The three cases will now proceed independently.

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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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