JONES DAY

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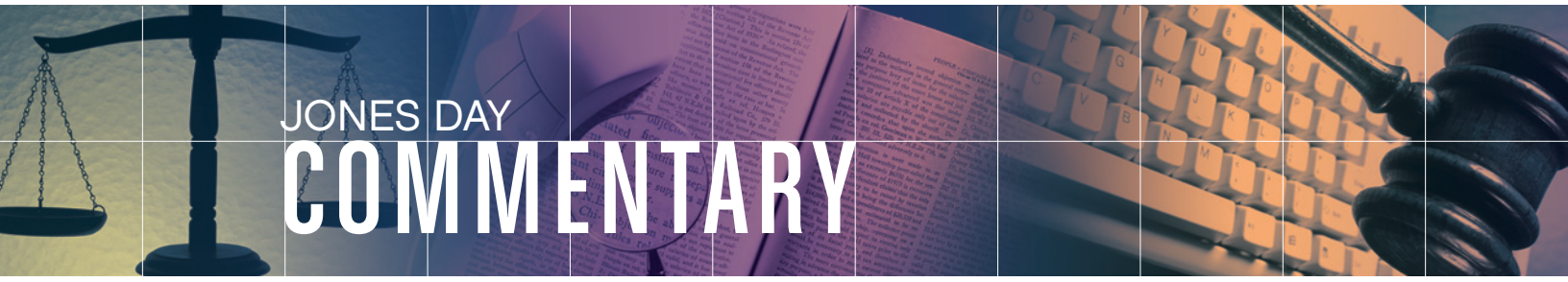

NEW HEA REGULATIONS SIGNAL MAJOR CHANGES IN THE REGULATORY LANDSCAPE FOR ADMISSION AND FINANCIAL AID OFFICERS

The past year brought substantial change to the regulation of for-profit institutions of higher education. In late 2010, the Department of Education ("DOE") issued new regulations intended to ensure the "integrity" of programs administered under Title IV of the Higher Education Act of 1965, as amended ("HEA").[1] These regulatory changes came after significant investigation by the Senate Health, Education, Labor and Pensions Committee and an influential, though heavily criticized, study of for-profit colleges by the United States Government Accountability Office.[2] Among the most controversial subjects addressed by the new regulations are 1) incentive compensation for admission and financial aid officers, and 2) misrepresentation of information to students, prospective students, and others. In fact, these aspects of the new regulations are the subject of a pending lawsuit against the DOE brought by the Association of Private Sector Colleges and Universities ("APSCU"). What follows is a brief overview of the new regulations regarding incentive compensation and misrepresentation, which become effective in July 2011, as well as the APSCU suit.

THE NEW "INCENTIVE COMPENSATION" REGULATIONS

The new incentive compensation regulations expand the preexisting limitations on incentive compensation

1 20 U.S.C. § 1070 et seq.

2 *See U.S. Gov't Accountability Office*, GAO-10-948T, "For-Profit Colleges: Undercover Testing Finds Colleges Encouraged Fraud and Engaged in Deceptive and Questionable Marketing Practice" (2010). The study itself states that it was based on an investigation of a "nonrepresentative selection of 15 for-profit colleges," *id.* at 2, and the Government Accountability Office ("GAO") uncharacteristically decided to revise the report in November 2010. A wide range of industry participants and expert commentators have criticized the report, and the Coalition for Educational Success has filed a professional malpractice lawsuit against the GAO, characterizing the study as "negligently written, biased and distorted." *See* Complaint, *Coal. for Educ. Success v. United States*, No. 1:11-cv-00287 (D.D.C. Feb. 2, 2011).

for admission and financial aid officers by eliminating 12 DOE "safe harbor" provisions that had clarified activities that would and would not be deemed permissible.[3]

The institutions subject to the HEA's compensation regulations include public institutions, private nonprofit institutions, and private for-profit institutions. Under the HEA, these institutions are generally prohibited from "provid[ing] 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…."[4]

One of the safe harbor provisions that was abandoned, however, permitted "fixed compensation" (*e.g.*, "a fixed annual salary or a fixed hourly wage") "as long as that compensation [was] not adjusted up or down more than twice during any twelve month period, and any adjustment [was] not based *solely* on the number of students recruited, admitted, enrolled, or awarded financial aid."[5] According to the DOE guidance issued in 2002, the term "solely" was to be given a "dictionary definition."[6] This guidance indicated that an institution could determine the compensation of its recruiters and admissions personnel based in part on enrollment and/or financial aid success. As long as the institution also took into account other considerations in its compensation determinations, it had a good-faith basis for claiming that it fell within this safe harbor and that it therefore could not be deemed to have violated the HEA's general prohibition against incentive compensation.

Against this backdrop, the dramatic change effected by the new incentive compensation regulations is patently clear. Far from authorizing multifactored compensation determinations that rely in part—but not "solely"—on enrollment or financial aid success, the new regulations establish an absolute prohibition against any use of such information, however partial.[7] In this regard, the regulations continue to expressly permit "merit-based adjustments to employee compensation" and "profit-sharing payments," but add that merit-based adjustments cannot be "based *in any part*, directly or indirectly, upon success in securing enrollments or the award of financial aid" and that profit-sharing payments cannot be "provided to any person who is engaged in student recruitment or admission activity or in making decisions regarding the award of title IV, HEA program funds."[8] These regulations apply to "any higher level employee with responsibility for recruitment or admission of students, or making decisions about [awarding financial aid]," and also to any compensation "based upon retention, completion, graduation, or [job] placement."[9]

THE NEW "MISREPRESENTATION" REGULATIONS

The new misrepresentation regulations likewise enlarge the scope of sanctionable conduct. For more than 25 years, the DOE has prohibited "substantial misrepresentations" "by an institution" related to the educational programs, financial charges, and employability of graduates of regulated institutions.[10]

Under the preexisting DOE regulations, the term "substantial misrepresentation" was defined as "[a]ny misrepresentation on which the person to whom it was made could reasonably be expected to rely, or has reasonably relied, to that person's detriment," while the term "misrepresentation" was separately defined in part as "[a]ny false, erroneous or

3 *See* 75 Fed. Reg. 66,832, 66,950-51 (Oct. 29, 2010) (to be codified at 34 C.F.R. § 668.14(b)(22)).

4 20 U.S.C. § 1094(a)(2). This general prohibition does not apply to "the recruitment of foreign students residing in foreign countries who are not eligible to receive Federal student assistance." *Id.*

5 34 C.F.R. § 668.14(b)(22)(ii)(A) (emphasis added).

6 *See* 67 Fed. Reg. 67055 (Nov. 1, 2002). *The American Heritage Dictionary* defines "solely" as "alone; singly" and "entirely; exclusively." *American Heritage Dictionary of the English Language* 1654 (4th ed. 2000).

7 *See* 75 Fed. Reg. 66,832, 66,950-51 (Oct. 29, 2010) (to be codified at 34 C.F.R. § 668.14(b)(22)).

8 *Id.*

9 *Id.*

10 *See* 34 C.F.R. § 668.71-75.

misleading statement an eligible institution makes to a student enrolled at the institution, to any prospective student, to the family of an enrolled or prospective student, or to the Secretary."[11] Given these definitions, in order to be deemed a violation for which the DOE could take enforcement action, a misrepresentation had to be (1) false, erroneous, or misleading, (2) made by an institution, (3) "substantial," and (4) directed at someone within a specified category of persons (*e.g.*, prospective student).

The new regulations leave the definition of "substantial misrepresentation" intact but redefine "misrepresentation" (and therein newly define "misleading statement" and "statement") in part as follows:

> *Misrepresentation:* Any false, erroneous or misleading statement an eligible institution, one of its representatives, or any ineligible institution, organization, or person with whom the eligible institution has an agreement to provide educational programs, or to provide marketing, advertising, recruiting or admissions services makes directly or indirectly to a student, prospective student or any member of the public, or to an accrediting agency, to a State agency, or to the Secretary. A misleading statement includes any statement that has the likelihood or tendency to deceive or confuse. A statement is any communication made in writing, visually, orally, or through other means.[12]

As such, the new regulations expand the reach of the "misrepresentation" provision by expressly prohibiting not just institutions from engaging in the proscribed conduct, but also their agents and parties with whom the institutions have an agreement, thus making the institutions liable for actions of such third parties. The regulations work a further expansion insofar as they prohibit "indirect[]" in addition to "direct[]" misrepresentations, and add to the list of persons and entities to whom a substantial misrepresentation can subject an institution to sanctions under the HEA. In particular, whereas some direct relationship between an institution and specific individuals (*e.g.*, prospective students and their families) was previously a prerequisite to liability for misrepresentation under the HEA, under the new regulations, institutions can be sanctioned for misrepresentations made to "any member of the public" (*i.e.*, where no such direct relationship exists).

Finally, it bears emphasis that "misleading statement" (one type of "misrepresentation" under the new definition) is defined to "include[] any statement that has the likelihood or tendency to deceive or confuse." An allegation that a party *deceived* another is, of course, typically the essence of a traditional misrepresentation or fraud charge; such a charge ordinarily involves a claim that the party conveyed false or otherwise deceptive information with the requisite mental state (*e.g.*, knowledge or intent) to warrant sanctioning the conduct. The same cannot necessarily be said for an allegation that a party *confused* another. This is so because confusion does not imply a culpable mental state to the same degree, if at all, as does deception, and, indeed, confusion does not even, by definition, connote falsity or erroneousness.[13] The fact that a person was confused by a statement may be attributable to factors having nothing whatsoever to do with any intent—proper or improper—by the party that made the statement, nor does that fact automatically mean that the confused person was mistaken or that the statement was actually wrong.

In short, a literal construction of these new definitions could result in the regulation and sanctioning of statements that were: not false, but merely "confusing" (or if false, only inadvertently so); not made by an institution or its agents but by third parties; and not made to anyone in any form of privity with the institution but to a "member of the public." The cumulative effect of the changes to the misrepresentation regulations, in other words, is potentially much greater than the tinkering to any one aspect thereof might suggest and implicates fairness concerns. As such, it will be interesting

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11 *Id.* § 668.71(b).

12 75 Fed. Reg. 66,959 (Oct. 29, 2010) (to be codified at 34 C.F.R. § 668.71(c)) (emphasis added).

13 *The American Heritage Dictionary* defines "confuse" as "[t]o cause to be unable to think with clarity or act with intelligence or understanding; throw off" and "[t]o make something unclear or incomprehensible," while it defines "deceive" as "[t]o cause to believe what is not true; mislead" and "[t]o give a false impression." *American Heritage Dictionary of the English Language* 387, 470 (4th ed. 2000).

to see how courts treat the new language and whether, in so doing, they exhibit an appropriate sensitivity to these concerns through reasonably narrow constructions.

ONGOING LITIGATION REGARDING INCENTIVE COMPENSATION AND MISREPRESENTATION REGULATIONS

In January 2011, APSCU filed a lawsuit challenging certain of the DOE's new regulations, including the incentive compensation and misrepresentation regulations, on vagueness, overbreadth, and other grounds.[14] APSCU argues that the incentive compensation regulations violate the HEA and the Administrative Procedures Act ("APA")[15] by:

- "[U]nlawfully restrict[ing] forms of compensation that Congress did not subject to government control in the HEA, including merit-based salaries, graduation-based payments, senior management compensation, and revenue-sharing plans"; and

- "[Being] the product of an unreasoned decisionmaking process that, among other things, ignored pertinent legislative and regulatory history surrounding the underlying statutory provision."[16]

Furthermore, according to APSCU, the misrepresentation regulations violate the HEA, APA, and the rights to free speech and due process under the United States Constitution by:

- "[O]mitting materiality and intent requirements that are essential to ensuring that the regulations do not reach statements not covered by the statutory prohibition, which specifically only punishes 'substantial misrepresentation[s]'";

- "[D]epriving schools of their rights to prior notice and opportunity for a hearing before losing their ability to participate in Title IV programs";

- "[I]mpermissibly restricting and chilling legitimate and truthful speech"; and

- "[Being] the product of an unreasoned decisionmaking process that, among other things, rejected out-of-hand valid concerns raised by commenters."[17]

As of the date of this publication, APSCU and the DOE have argued for and against these theories in various motions that could terminate the case, but the court has not yet ruled. While it is currently unclear whether APSCU's lawsuit will affect the new higher education regulatory landscape, industry participants should carefully monitor the case and related regulatory activity. For example, in what appears to be, in part, a response to the lawsuit, the DOE reported on January 25, 2011 that it would clarify some of its regulations through "Dear Colleague" letters (*i.e.*, official correspondence providing additional information about legislation and other subject matters).

THE DOE'S "DEAR COLLEAGUE" LETTER

The DOE issued a Dear Colleague letter on March 17, 2011 addressing the incentive compensation and misrepresentation regulations.[18] The DOE explained that the letter "provides additional guidance ... to assist institutions with understanding the changes to the regulations in these areas, and does not make any changes to the regulations."[19]

With regard to incentive compensation, the March 17 Dear Colleague letter:

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14 *See* Complaint, *Career Coll. Ass'n d/b/a Ass'n of Private Sector Colls. & Univs. v. Duncan*, No. 1:11-cv-00138-RMC (D.D.C. Jan. 21, 2011).

15 5 U.S.C. §§ 553, 701-706.

16 *See* Compl. ¶¶ 13-14.

17 *See id.* ¶¶ 13, 15.

18 *See* Dep't of Educ., Dear Colleague Letter, Implementation of Program Integrity Regulations (Mar. 17, 2011), *available at* http://www.ifap.ed.gov/dpcletters/attachments/GEN1105.pdf.

19 *Id.* at 1.

- Clarifies that the only types of activities subject to the incentive compensation ban are securing enrollment (recruitment) and securing financial aid;

- Provides examples of different types of payments that are and are not characterized as incentive compensation;

- Clarifies that the incentive compensation ban does apply to all employees regardless of their titles or positions, but adds that "[s]enior managers and executive level employees who are *only* involved in the development of policy and do not engage in individual student contact or [] other covered activities … will not generally be subject to the incentive compensation ban";

- Provides "standard evaluative factors" other than seniority that an institution may take into account in determining compensation of employees;

- Clarifies that compensation of recruiters based on recruited students' academic performance violates the incentive compensation ban, although the compensation of employees engaged in activites unrelated to recruitment may be based on successful student performance; and

- Clarifies the scope of the final rule on profit-sharing arrangements.[20]

The March 17 Dear Colleague letter provides less guidance regarding the misrepresentation regulations but clarifies that they:

- Do not reduce the procedural protection given by the HEA—the regulations will provide "the same notice and opportunity for a hearing that has always existed for institutions that face an action the HEA addresses in section 487(c)(3)," and will offer provisionally certified institutions the opportunity provided in 34 C.F.R. § 668.13(d) to contest that action;

- Do not create a private right of action; and

- Do not extend beyond substantial misrepresentations made about the nature of an eligible institution's educational programs, its financial charges, or the employability of its graduates.[21]

While this guidance helps to illustrate the DOE's stance on the new regulations, it remains to be seen what effect, if any, this and any subsequent Dear Colleague letters will have on judicial and administrative bodies' interpretations of the regulations. In any event, the DOE will have broad discretionary power in its implementation and enforcement of the regulations.[22]

CONCLUSION

The regulations discussed above impose heightened restrictions on educational institutions with respect to compensation and marketing practices, although the particular contours of these restrictions remain, for the moment, opaque. It is not clear which, if any, of the current challenges to the regulations—that they exceed the scope of the HEA, that their approval violated the APA, or that they are unconstitutional—will succeed. Moreover, the DOE has signaled that it intends to increase its enforcement activities in this area. As such, institutions should carefully monitor the APSCU case, additional official guidance and other pronouncements from the DOE, and other relevant developments. In light of such developments, institutions may want to review their existing policies, processes, and practices to judge if they are adequate to satisfy the requirements of the new regulatory regime and, if not, what changes to compensations policies, employment policies, and third-party agreements and what other measures (*e.g.*, due diligence or compliance training) they should undertake to achieve compliance. Jones Day will likewise continue to monitor the regulatory environment and issue updates accordingly.

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20 *See id.* at 8-14.

21 *See id.* at 14-15.

22 *See Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

LAWYER CONTACTS

For more information regarding matters related to any of the above issues, please contact your principal Jones Day representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com. Jones Day prepares summaries of significant litigation and policy events as a service to clients and interested readers in order to provide timely insight on these matters. Please use our Publications Sign-Up Form, available at www.jonesday.com/newsknowledge/PublicationSignup.aspx, to add your name to our distribution list.

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