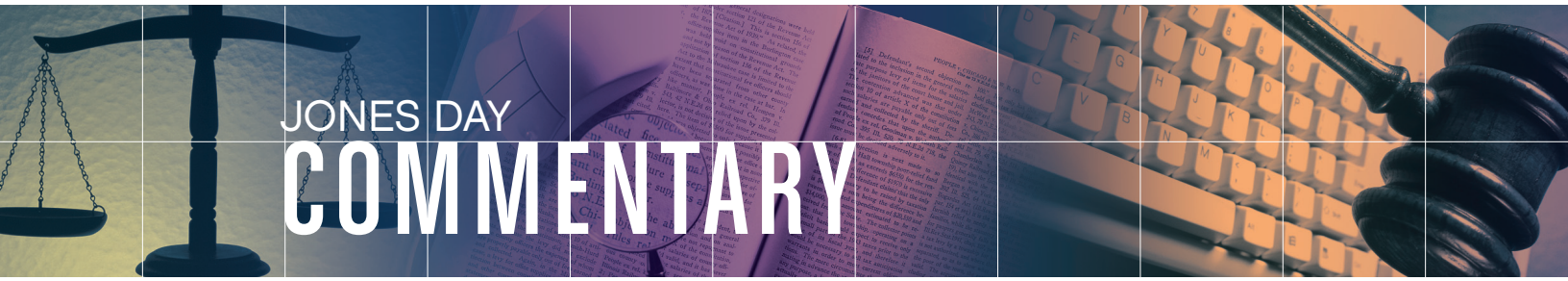
JONES DAY

MARCH 2012



DEPARTMENT OF EDUCATION EXPANDS REGULATORY AUTHORITY IN THE UNCERTAIN AND CONTROVERSIAL AREA OF GAINFUL EMPLOYMENT

In terms of legal and regulatory developments with significant consequences for higher education institutions, 2012 is picking up where 2011 left off. In fact, in a speech at the University of Michigan on January 27, 2012, President Obama made clear that higher education regulation will be a key component of his agenda in this election year, and he put institutions "on notice" that, under his plan, they will be held "accountable" to provide better value and performance for their students.[1]

The President's remarks are in keeping with regulations recently issued by the Department of Education ("DOE"), including regulations that define the term "gainful employment" as that term appears in the Higher Education Act ("HEA").[2] These regulations create "debt measures" and authorize sanctions against educational programs that do not "lead[] to gainful employment in a recognized occupation."[3] The regulations, which were issued in June 2011 and are set to go into effect on July 1, 2012, apply to "[v]irtually all educational programs" at for-profit colleges and "virtually all non-degree educational programs" at public and nonprofit colleges.[4] Notably, the regulations do not apply to any educational programs that lead to a degree at public or nonprofit colleges.[5]

Although it remains to be seen how courts and other administrative bodies will interpret the gainful employment regulations, the impact of the regulations on the higher education industry has the potential to be great. Indeed, the regulations already have proven to be highly controversial; they not only have stirred much debate but also have led to further inquiry into the underlying rulemaking process and to a second lawsuit against the DOE by the Association of Private Sector Colleges and Universities ("APSCU").[6]

This *Commentary* provides both an overview of the gainful employment regulations and an introduction to the developing controversy that surrounds them.

BREAKDOWN OF GAINFUL EMPLOYMENT REGULATIONS

The New Requirements. The new gainful employment regulations state that an educational program "leads to gainful employment in a recognized occupation" if the program satisfies at least one of the following: (1) the program has an annual loan repayment rate of 35 percent or more; (2) the program's debt-to-earnings ratio is 12 percent or less, or its debt-to-discretionary income ratio is 30 percent or less; or (3) the data necessary to compute (1) and (2) are not available to the Secretary.[7] The regulations thus create two separate "debt measures":

- Loan repayment rate (the percentage of federal loans that have been repaid or are being repaid by a program's former students who have entered repayment);[8] and

- Debt-to-earnings ratios (the relationship between the estimated annual loan payment owed by students who graduated from a program and either the average annual earnings or the discretionary income of those graduates).[9]

As long as gainful employment programs fulfill one of these measures, they are in compliance with the regulations. On the other hand, if a program fails to satisfy either of the measures, the program is subject to three steps of sanctions:

- After the first failure: The institution involved must provide a "debt warning" to enrolled and prospective students that discloses the amount by which the program missed the minimum standards, as well as the program's plans for improvement, and also must establish a three-day waiting period before students can enroll.[10]

- After a second failure within three years: The institution must expand upon the above-described debt warning, informing enrolled and prospective students that they "should expect to have difficulty repaying [their] student loans" and that the program may lose eligibility for Title IV funds, and also must provide those students with information regarding transfer and other educational options.[11]

- After a third failure within four years: The program loses eligibility for Title IV funds and cannot reestablish eligibility for at least three years, although it can choose to operate without Title IV funds.[12]

Despite the existence of contrary opinions, the DOE maintains that the gainful employment regulations are "designed to (1) provide better information to students, (2) identify the worst performing programs, and (3) create appropriate flexibility and provide institutions the opportunity to improve their programs before losing title IV, HEA program eligibility."[13]

Key Points Regarding the Debt Measures. The regulations discuss at length the manner in which the debt measures will be calculated,[14] including these key aspects:

- As a general matter, the DOE will perform the calculations, using "data that institutions have reported to the Department under 34 C.F.R. § 668.6, information included in [the National Student Loan Data System] about Title IV loans, and median [or mean] incomes obtained from the Social Security Administration [('SSA')]."[15]

- It is expected that the sources of the data generally will be former students in their third and fourth years of repayment, although the regulations employ different time frames for students in medical and dental programs and students in programs with small numbers of students.[16]

- Institutions will not have access to the earnings data provided by the SSA, and therefore challenging the accuracy of the data could be difficult.[17] As a result, institutions' input may be limited to (1) verifying or challenging the lists of individuals submitted to the SSA; and (2) attempting to correct the draft results of the debt measures that the DOE plans to issue.[18]

Regarding the loan repayment rate in particular:

- The rate pertains to students who *attended* a program, regardless of whether they graduated.[19]

- Former students are deemed to be repaying their loans as long as their outstanding loan balances (including any unpaid accrued interest that has not been capitalized) decline by at least $1.00 over the course of the year.[20]

As to the debt-to-earnings ratios:

- The DOE obtains from the SSA (or another federal agency) both the mean and median annual earnings of the students who graduated from the program during the relevant years and calculates the debt-to-earnings ratios using the higher of the mean or median annual earnings.[21]

- A program's median debt includes private student loans but does not include debt incurred for living expenses or debt incurred by students for attendance in programs at other institutions (unless the institutions are under common ownership or control).[22]

- The DOE estimates annual loan payments based on a 10-year repayment plan for certificate and associate's degree programs, a 15-year repayment plan for bachelor's and master's degree programs, and a 20-year repayment plan for doctoral and first-professional degree programs.[23]

LITIGATION AND CONTROVERSY SPURRED BY GAINFUL EMPLOYMENT REGULATIONS

For the second time in a year, APSCU has sued the DOE based on its promulgated HEA regulations.[24] In the lawsuit filed on July 20, 2011, APSCU alleges that the gainful employment regulations violate the HEA, the Administrative Procedures Act ("APA"),[25] and the First and Fifth Amendments to the United States Constitution.[26] For example, APSCU asserts that the DOE's interpretation of the statutory phrase "gainful employment" is "fatally flawed" and that the regulations "deprive APSCU's members of a meaningful opportunity to contest adverse determinations by the Department."[27] With regard to the alleged arbitrary and capricious nature of the regulations, APSCU contends that:

- "[B]oth of the gainful employment tests have the effect of penalizing schools for students' decisions to take on debt the Department now views as excessive and students' career and life choices, all of which are out of schools' control";[28] and

- "[T]he Department failed to consider … [that] the economic background of students receiving loans generally correlates with repayment rates … [and that] the regulations essentially punish private sector schools, which traditionally serve a disproportionate number of low-income and other non-traditional students, and would force schools to limit the enrollment of these students—potentially leaving this underserved group without the ability to obtain higher education."[29]

APSCU expresses concerns of regulatory overreach and harm to minority and nontraditional students throughout its complaint. Similar concerns have been articulated by individuals and organizations both in and outside of the higher education industry and by Republicans and Democrats alike.[30] In its complaint, APSCU draws the court's attention to allegations of bias and misconduct related to the regulations and the underlying rulemaking process that already "have led to a number of investigations, including an ongoing inquiry by the Department's Inspector General, referrals to the [Securities and Exchange Commission] and U.S. Attorney for the Southern District of New York, requests for congressional investigations, and substantial revisions to a [Government Accountability Office] report relied upon by the Department to justify the challenged regulations."[31]

Heightening the concerns of APSCU and others critical of the regulations is the analytical mistake that APSCU discovered as a direct result of the litigation and that the DOE formally corrected in the Federal Register on January 23, 2012.[32] In so doing, the DOE acknowledged that "[i]n the preamble of the final regulations, [it] used the wrong data to calculate the percent of total variance in institutions' repayment rates that may be explained by race/ethnicity … [and that it] mistakenly used the data for a subset of minority students per institution."[33] According to APSCU, the DOE made a "fundamental mistake" in its rulemaking by omitting African-American students in its analysis of the relationship between race and repayment rates, thus understating the impact of race on repayment.[34] While the DOE views its mistake as having no bearing on the final regulations, APSCU asserts that the mistake is yet another reason to vacate the regulations.[35] As of the date of this *Commentary*, the controversy does not appear to be nearing conclusion.[36]

CONCLUSION

It is clear that the courtroom and public debates over the gainful employment regulations are far from settled and that additional significant developments will be forthcoming. In the meantime, participants in the industry would be well served by keeping up to date in this regard and preparing for these complex regulations and the changes in the regulatory environment that they portend. Jones Day will likewise continue to monitor relevant developments and issue further updates as appropriate.

LAWYER CONTACTS

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ENDNOTES

1 *See* Libby A. Nelson, "Obama Higher Education Plan Signals Policy Shift," *Inside Higher Ed* (Jan. 30, 2012), http://www.insidehighered.com/news/2012/01/30/obama-higher-education-plan-signals-policy-shift. President Obama proposes linking federal aid to colleges' net price increases and also to whether the colleges provide a "quality education and training that prepares graduates to obtain employment and repay their loans." *Id.* Federal aid would be directed to colleges that "set[] a 'responsible tuition policy,' 2) provid[e] 'good value' to students, and enroll[] and graduat[e] relatively large numbers of low-income students." *Id.*

2 20 U.S.C. § 1070 *et seq.*

3 *See* 76 Fed. Reg. 34,448-53 (June 13, 2011) (to be codified at 34 C.F.R. § 668.7).

4 Dep't of Educ., Gainful Employment Electronic Announcement #11—"Determining Whether an Educational Program is a Gainful Employment Program" (June 24, 2011), *available at* http://www.ifap.ed.gov/eannouncements/062411WhatisGainfulEmploymentGEAnnounceNumber11.html; *see also* 76 Fed. Reg. 34,386 (June 13, 2011).

5 *See id.*

6 *See* Complaint, *Ass'n of Private Sector Colls. & Univs. v. Duncan*, No. 1:11-cv-01314 (D.D.C. July 20, 2011). APSCU filed a previous lawsuit against the DOE challenging regulations pertaining to incentive compensation, misrepresentation, and state authorization. *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). In July 2011, the district court ruled in favor of APSCU with regard to parts of the state authorization regulations, but against APSCU with regard to the remaining regulations. *See* 796 F. Supp. 2d 108 (D.D.C. 2011). APSCU has appealed the district court's decision, and the appeal is currently pending before the United States Court of Appeals for the District of Columbia Circuit. *See* Brief for Appellant/Cross-Appellee, *Ass'n of Private Sector Colls. & Univs. v. Duncan*, No. 11-5174 (D.C. Cir. October 26, 2011). Oral Argument in the appeal took place on February 21, 2012.

7 76 Fed. Reg. 34,448 (June 13, 2011) (to be codified at 34 C.F.R. § 668.7(a)(1)). Because the regulations apply to programs rather than institutions, institutions that offer the same program at different campuses will receive only one evaluation of the program's debt measures. *See id.* at 34,448, 34,450 (to be codified at 34 C.F.R. § 668.7(a)(2)(i), (c)(4)(iii)).

8 *See id.* at 34,449-50 (to be codified at 34 C.F.R. § 668.7(b)).

9 *See id.* at 34,450 (to be codified at 34 C.F.R. § 668.7(c)).

10 *See id.* at 34,452-53 (to be codified at 34 C.F.R. § 668.7(j)(1), (j)(3)(ii)).

11 *See id.* (to be codified at 34 C.F.R. § 668.7(j)(2)).

12 *See id.* (to be codified at 34 C.F.R. § 668.7(i), (l)(2)(ii)). Institutions that voluntarily discontinue failing programs before a third failure in four years are subject to similar "wait-out periods" before they may reestablish the programs' eligibility. *See id.* at 34,451, 34,453 (to be codified at 34 C.F.R. § 668.7(j)(5), (l)(2)(i)).

13 *Id.* at 34,387.

14 *See generally id.* at 34,448-52 (to be codified at 34 C.F.R. § 668.7(a)-(g)).

15 Dep't of Educ., "Information for Financial Aid Professionals (IFAP): Gainful Employment—FAQ DM-Q1" (Aug. 12, 2011), *available at* http://www.ifap.ed.gov/GainfulEmploymentInfo/2011GEFAQ.html#dm-q1. The calculation of the debt measures vary in some ways during fiscal years 2012 through 2014. For instance, until fiscal year 2015, institutions with failing programs may submit analyses based upon Bureau of Labor Statistics data on typical earnings for particular jobs. *See* 76 Fed. Reg. 34,452 (June 13, 2011) (to be codified at 34 C.F.R. § 668.7(g)(4)).

16 *See* 76 Fed. Reg. 34,449-51 (June 13, 2011) (to be codified at 34 C.F.R. § 668.7(a)(2)(iv)-(v), (c)(2)(i), (d)).

17 *See id*. at 34,451 (to be codified at 34 C.F.R. § 668.7(e)(1)(B)(iv)) ("An institution may not challenge the accuracy of the mean or median annual earnings the Secretary obtained from SSA to calculate the draft debt-to-earnings ratios for the program."). Institutions with failing programs also have the option to submit alternative earnings data based upon surveys or state longitudinal data systems in an effort to satisfy the debt-to-earnings ratios. *See id*. at 34,451-52 (to be codified at 34 C.F.R. § 668.7(g)).

18 *See id*. at 34,451 (to be codified at 34 C.F.R. § 668.7(e)).

19 *See id*. at 34,449 (to be codified at 34 C.F.R. § 668.7(b)(1)(i)).

20 *See id*. (to be codified at 34 C.F.R. § 668.7(b)(3)(A)(1)); *see also* Dep't of Educ., "Additional Background on the Gainful Employment Regulations" (June 1, 2011), *available at* www2.ed.gov/policy/highered/reg/hearulemaking/2009/ge-regs-supplemental.doc.

21 *See id*. at 34,450 (to be codified at 34 C.F.R. § 668.7(c)(3)).

22 *See id*. (to be codified at 34 C.F.R. § 668.7(c)(4)).

23 *See id*. (to be codified at 34 C.F.R. § 668.7(c)(2)(ii)).

24 *See* Complaint, *Ass'n of Private Sector Colls. & Univs. v. Duncan*, No. 1:11-cv-01314 (D.D.C. July 20, 2011); 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).

25 5 U.S.C. §§ 553, 701-706.

26 Complaint, *Ass'n of Private Sector Colls. & Univs. v. Duncan*, No. 1:11-cv-01314 (D.D.C. July 20, 2011).

27 *See id*. ¶¶ 87, 114.

28 *See id*. ¶ 105.

29 *See id*. ¶ 108.

30 Republican and Democratic House Representatives, including John Kline (R-MN), Virginia Foxx (R-NC), Carolyn McCarthy (D-NY), and Donald M. Payne (D-NJ), have expressed strong opposition to the regulations. *See*, *e.g.*, Education & The Workforce Committee, "Committee Republicans Denounce Poorly-Conceived Gainful Employment Regulation" (June 3, 2011), http://republicans.edlabor.house.gov/News/DocumentSingle.aspx?DocumentID=244720; CAPPS Online, "House Democrats Blast Department of Education on Gainful Employment Regulation" (June 2, 2011), http://www.cappsonline.org/2675/house-democrats-blast-department-of-education-on-gainful-employment-regulation. Organizations such as the U.S. Chamber of Commerce, National Black Chamber of Commerce, and Hispanic Leadership Fund also have spoken out in opposition of the regulations. *See*, *e.g.*, U.S. Chamber of Commerce, "U.S. Chamber Statement on Gainful Employment Regulation: Another Example of Undue Regulatory Burdens that will Limit American Prosperity and Reduce Our Competitiveness" (June 2, 2011), http://www.uschamber.com/press/releases/2011/june/us-chamber-statement-gainful-employment-regulation; PR Newswire, "National Black Chamber of Commerce Urges Congress to Reverse Job Killing 'Gainful Employment' Rule: NBCC President, Harry Alford, Calls for Investigation into Corrupt & Flawed Education Department Rulemaking Process" (July 8, 2011), http://www.prnewswire.com/news-releases/national-black-chamber-of-commerce-urges-congress-to-reverse-job-killing-gainful-employment-rule-125220939.html; Hispanic Leadership Fund, "Gainful Employment Rule Will Reduce Educational Opportunities for Students" (June 2, 2011), http://hispanicleadershipfund.org/blog/gainful-employment-rule-will-reduce-educational-opportunities-students; Elesha Barnette, "'Gainful Employment' Rule Threatens Black, Hispanic Matriculation," Politic365 (Jan. 31, 2012), http://politic365.com/2012/01/31/gainful-employment-rule-threatens-black-hispanic-matriculation/.

31 *See* Compl. ¶¶ 35, 46-56 (citing numerous outside sources and discussing the revised GAO report and aftermath, the involvement of Wall Street short sellers in the rulemaking process and subsequent investigations into the process, and other information obtained through the Freedom of Information Act).

32 *See* Memorandum of Law in Opposition to Defendants' Cross-Motion for Summary Judgment and Reply Memorandum of Law in Support of Plaintiff's Motion for Summary Judgment, *Ass'n of Private Sector Colls. & Univs. v. Duncan*, No. 1:11-cv-01314 (D.D.C. Jan. 12, 2012); 77 Fed. Reg. 3,121 (Jan. 23, 2012) (to be codified at 34 C.F.R. § 668); Business Wire, "Coalition Criticizes U.S. Department of Education over Misreported Data" (Jan. 24, 2012), http://www.marketwatch.com/story/coalition-criticizes-us-department-of-education-over-misreported-data-2012-01-24; Paul Fain, "Race Matters," *Inside Higher Ed* (Jan. 25, 2012), http://www.insidehighered.com/news/2012/01/25/education-department-admits-flawed-data-gainful-employment-analysis.

33 77 Fed. Reg. 3,121 (Jan. 23, 2012) (to be codified at 34 C.F.R. § 668).

34 Memorandum of Law in Opposition to Defendants' Cross-Motion for Summary Judgment and Reply Memorandum of Law in Support of Plaintiff's Motion for Summary Judgment, *Ass'n of Private Sector Colls. & Univs. v. Duncan*, No. 1:11-cv-01314 (D.D.C. Jan. 12, 2012).

35 77 Fed. Reg. 3,121 (Jan. 23, 2012) (to be codified at 34 C.F.R. § 668); Memorandum of Law in Opposition to Defendants' Cross-Motion for Summary Judgment and Reply Memorandum of Law in Support of Plaintiff's Motion for Summary Judgment, *Ass'n of Private Sector Colls. & Univs. v. Duncan*, No. 1:11-cv-01314 (D.D.C. Jan. 12, 2012).

36 The parties completed briefing in the APSCU Gainful Employment litigation on February 2, 2012.