COMMITTEE ON EDUCATION AND LABOR

U.S. HOUSE OF REPRESENTATIVES
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August 25, 2022

The Honorable Miguel Cardona
Secretary
U.S. Department of Education
400 Maryland Avenue, SW
Washington, D.C. 20202

Re: Docket ID ED–2022–OPE–0062

Dear Secretary Cardona:

I write to share my views on the Department of Education's (Department) Notice of Proposed Rulemaking (NPRM) to hold institutions of higher education (IHEs) accountable.[1] I am encouraged by the Department's proposed rule, which would make significant changes to regulations to close the 90/10 loophole, to better scrutinize changes in institutional ownership and for-profit to non-profit conversions, and to expand access to Pell Grants to incarcerated individuals.

90/10

I am encouraged by the Department's proposals to close the 90/10 loophole. The 90/10 rule is an important safeguard to protect students and taxpayers from predatory for-profit institutions by requiring them to derive not less than 10 percent of their revenue from non-Title IV sources. However, by allowing other federal sources, such as G.I. Bill benefits (which help veterans pay for post-secondary programs) to be counted, the law created a loophole. Thankfully, the *American Rescue Plan Act of 2021* included a requirement for the Department to broaden the 90 percent cap to include *all* federal education funds, including G.I. Bill

[1] *See* "Institutional Eligibility, Student Assistance General Provisions, and Federal Pell Gram Program," Proposed Rule, Docket ID ED–2022–OPE–0062, Fed. Reg. Vol. 87, No. 144, July 28, 2022, available at https://www.govinfo.gov/content/pkg/FR-2022-07-28/pdf/2022-15890.pdf (hereinafter "Eligibility NPRM").

benefits.[2] In response, the Department's new proposed rule makes several substantive changes to modify how for-profit institutions calculate and report revenue from federal sources. Specifically, the proposed rule would require that all federal aid, not just Title IV aid, count as federal revenue in the 90/10 calculation, restrict the circumstances when an institution can count income-share agreements (ISAs) as nonfederal aid, and prohibit the delay of drawing down Title IV funds past the end of the fiscal year. Additionally, the rule would require institutions that fail the 90/10 rule to notify students of their failure. These changes are critical for protecting students from aggressive and predatory tactics. I commend the Department and nonfederal negotiators for reaching consensus on this important provision.

Appendix C of this proposed rule details the new 90/10 calculation formula for institutions and provides thorough guidance to their auditors who make the determination on whether the institutions are compliant with the rule. As these new 90/10 changes are implemented, I encourage the Department to be vigilant in monitoring the cash flows of for-profit institutions, through the calculations derived from the modified Appendix C, to better understand how this new rule changes institutional financial behavior and to ensure the regulation is strongly enforced to protect students and taxpayers.

Conversions

I am encouraged by the Department's proposals to improve the process of reviewing institutions' changes in ownership and control and scrutinizing conversions of for-profit institutions to nonprofit institutions. The draft rule includes language to 1) create clearer definitions of campus locations and types, 2) increase transparency for the Department and for students when institutions change ownership, 3) provide the Department flexibility to add conditions to temporary provisional program participation agreements (TPPPAs), and 4) further scrutinize insider transactions.

While the Department's proposal represents very important steps in the right direction, I am concerned that the current proposal does not do enough to increase oversight of changes in ownership, control, and conversions.

The Department should narrow the proposed market price and market value exception to nonprofit conversions.

In changes in ownership, institutions use market price valuations of an institution's assets in order to define sale price. In changes of ownership where there is also a conversion of the institution from for-profit to nonprofit, market price valuations are sometimes used to manipulate sale price. A 2020 Government Accountability Office (GAO) report found shortcomings in the Department's monitoring of converted institutions, which gives rise to risks of insiders taking

[2] *See* American Rescue Plan, Pub. L. No. 117-2, §2013 (2021).

advantage of non-profit institutions at student and taxpayer expense.[3] In the report, GAO highlighted case studies of insider conversions in which the nonprofit entity always took out loans with the insiders to finance purchases of the for-profit college.[4] In nearly all cases, these loans primarily paid for *intangible* assets like goodwill, brand names, accreditation, or established student relationships as opposed to tangible assets like buildings, equipment, or other physical capital.[5] By comparison, GAO found that among randomly selected conversions that did not involve insiders, the nonprofits primarily purchased *tangible* assets and assumed no debt whatsoever to finance the transaction.[6] Further, in several conversions, the for-profit college retained some essential assets after the sale, effectively forcing the nonprofit college to enter a long-term contract for services with the legacy for-profit entity.[7] In these cases, the legacy for-profit could essentially exert control over the operations of the nonprofit in perpetuity while extracting most of the revenue at the nonprofit institution.

While I recognize that the Department has recently strengthened its reviews of conversions based on a new process developed in 2016 under the Obama Administration,[8] there is still more work to be done to improve the conversion review process, as revealed in the Committee's 2021 hearing entitled "For-Profit College Conversions: Examining Ways to Improve Accountability and Prevent Fraud".[9] At this hearing, witness testimony demonstrated that conversions sometimes use fraudulent representation or misleading advertising to recruit students while they are undergoing Department review, which often results in concrete harms to students and taxpayers, such as potential borrower's defense claims.[10] Additionally, in my June 2021 letter to the Department, I recommended that the Department 1) halt all decisions on conversion applications while the Department considers GAO's findings and recommendations and 2) establish formal interagency channels to share every conversion decision with the IRS and brief the IRS on its findings whenever the Department denies a conversion of an institution the IRS has approved for tax-exempt status.[11]

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[3] *See* U.S. Gov't Accountability Off., GAO-21-89, *Higher Education: IRS and Education Could Better Address Risks Associated with Some For-Profit College Conversions,* 39 (Dec. 31, 2020), available at https://www.gao.gov/assets/gao-21-89.pdf (hereinafter "GAO Conversions Report").
[4] *See id.* at 22.
[5] *See id.* at 29.
[6] *See id.* at 29.
[7] *See id.* at 34-35.
[8] *See id.* at 41-42; *see e.g.,* Letter from Dep't of Educ. to Eric Juhlin, Chief Executive Officer of Center for Excellence in Higher Education, Re: Decision on Change of Ownership, August 11, 2016, available at https://www2.ed.gov/documents/press-releases/08112016-cio-decision.pdf; *see also* "No Dice for Nonprofit Conversion," Andrew Kreighbaum, Inside Higher Ed, August 12, 2016, available at https://www.insidehighered.com/news/2016/08/12/department-education-denies-profit-colleges-application-nonprofit-status.
[9] *See* "For-Profit College Conversions: Examining Ways to Improve Accountability and Prevent Fraud," Hearing Before the H. Comm. On Educ. and Labor, 117th Cong. (2021), available at https://edlabor.house.gov/hearings/for-profit-college-conversions-examining-ways-to-improve-accountability-and-prevent-fraud.
[10] *See id*. at questioning by Rep. Jones of Ms. Yan Cao.
[11] *See* Letter from Rep. Robert "Bobby" Scott to Dep't of Ed., House Comm. on Ed. and Labor, June 03, 2021, available at https://edlabor.house.gov/imo/media/doc/For%20Profit%20Conversions%20Request.pdf (hereinafter "Scott Letter").

I am particularly concerned that the current proposal in §600.2's definition of nonprofit institution, subparagraphs (2)(ii)(B) and (2)(iii)(B), would still permit too much flexibility for legacy for-profit entities to continue profiting from the new nonprofit institution.[12] I applaud the prohibition in paragraph (2)(i), which outright prohibits an entity from being considered a nonprofit institution for the purposes of Title IV eligibility if the entity is an obligor on a debt owed to a former owner of the institution. However, I am concerned about the exemption in subparagraphs (2)(ii)(B) and (2)(iii)(B) which would permit revenue-sharing agreements if they are considered fair market. This would result in a large loophole to the definition of a nonprofit institution. As the Department itself recognizes[13] and the GAO has found, these transactions are extremely difficult to valuate, especially when insiders are involved. I urge the Department to remove these market price exemptions from the definition of nonprofit.

As an alternative, I encourage the Department to narrow the proposed language to only permit the Department to consider the fair market value of any continuing agreements with the institution's previous owner only when it comes to *tangible* assets. Tangible assets are things like land, buildings, equipment, furniture, transport, and computers. Intangible assets are things like an institution's goodwill, reputation, and brand recognition. In some conversions, there have been transactions structured such that the previous owner valued the tangible assets at a nominal price but placed the majority of the value of the institution in the intangible assets.[14] Then the previous owner would enter into a debtor-debtee relationship or into revenue-sharing agreements to supposedly recoup the value of the intangible assets. Valuating tangible assets for market value and evaluating these transactions as arm's-length is a much more reasonable task for the Department than reviewing intangible assets for the same. Further, if a new nonprofit owner of an institution has to borrow money or enter into a longer-term payment plan in order to pay for multiple buildings, that is reasonable. It is not so reasonable if the new owner has to borrow money to pay for something as amorphous as "goodwill."

Additionally, I urge the Department to continue implementing the GAO's findings and recommendations and to establish formal interagency communication and interaction with the Internal Revenue Service (IRS) when reviewing conversions.[15]

The Department should keep the current threshold of reviewing changes in ownership and control at 25 percent.

Changes in ownership, especially which result in a change in control, are often high-risk transaction, which require the Department's scrutiny. In this proposal, the Department has strengthened its reviews of changes in ownership and control in recent years and has also tried to increase transparency of changes in ownership and control with the current proposal of a 90-day

[12] *See* Eligibility NPRM, *supra* n.1 at §600.2.
[13] *See id.* at pg. 45437.
[14] *See e.g.*, "Dubious Conversions of For-Profit Colleges: Decoding the GAO Report," Robert Shireman, January 27, 2021, https://tcf.org/content/commentary/dubious-conversions-profit-colleges-decoding-gao-report/?session=1
[15] *See* GAO Conversions Report, *supra* n.3; *see also* Scott Letter, *supra* n.10.

notification period[16] when a 5 percent ownership interest change has occurred.[17] However, I am concerned about the Department's proposal to change the threshold for when the Department must review changes in ownership and control from the current 25 percent to the proposed 50 percent.

While the Department has proposed an exception in §600.31(c)(3)(iv) to address the concerns raised of owners avoiding scrutiny, the Department should keep the threshold of reviewing changes in ownership as-is, at 25 percent.[18] The Department itself recognizes that there are very few changes in ownership that result in changes in control when the change results in a gain of 25 percent of the ownership interest in an institution. I am also concerned that owners might try to purposefully avoid scrutiny by acquiring an ownership interest just below the 50 percent threshold. Further, I am concerned that even at or below 25 percent, an owner or a group of owners could exert effective control over an institution, as long as no other owner or group of owners has a similarly large ownership share. As such, keeping the current threshold of 25 percent would help address the concerns raised of owners avoiding scrutiny and presumably would not change the burden to the Department considerably.

The Department should consider including additional conditions in TPPPAs.

Institutions that undergo change in ownership operate under a TPPPA while the Department reviews the change. Under existing regulations, the Department has broad flexibility to insert conditions into TPPPAs; however, historically, TPPPAs have simply extended the terms and conditions of the PPA that were in effect for the school before its change of ownership.[19] I am encouraged by the Department's current proposal to 1) clarify that the Department is able to withdraw Title IV eligibility based on a review of a change in ownership and 2) ensure that the Department can add conditions to an institution's TPPPA when a prospective owner of the institution does not have sufficiently acceptable audited financial records.[20] As such, I encourage the Department to include additional financial and regulatory conditions into TPPPAs.

When for-profit institutions covert to nonprofit status, the Department should continue to consider the institution a for-profit institution until the Department has made a decision on the conversion. The Department contemplates this issue in Section 3.3 of the NPRM; however, it is not reflected specifically in the proposed statutory text.[21] As such, the Department should require that the institution continue to comply with those regulations which apply to for-profit institutions, such as Gainful Employment and the 90/10 regulations, while the change in ownership and conversion is undergoing review by the Department. These requirements should be included in §600.20 and added to the institution's TPPPA.

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[16] *See* Eligibility NPRM, *supra* n.1 at §600.20(g)(1)(i).
[17] *See id.* at §600.21(a)(6)(i).
[18] *See id.* at §600.31.
[19] *See* Federal Student Aid Handbook, Dep't of Educ., available at https://fsapartners.ed.gov/knowledge-center/fsa-handbook/2020-2021/vol2/ch5-updating-application-information.
[20] *See* Eligibility NPRM, *supra* n.1 at §600.20.
[21] *See id.* at pg. 45478.

The Department should also consider whether it would be appropriate to add financial conditions, such as heightened cash monitoring (HCM) under §§668.162(d)(1) or (d)(2) (known as HCM1 and 2, respectively). I am especially concerned about situations in which 1) the institution was already facing considerable financial issues prior to the change in ownership and 2) the new owner of the institution does not have any experience in higher education. In both of those cases, the protection that comes from a letter of credit, which acts like a *post hoc* recoupment mechanism, is not sufficient to address the potential risks faced by the change in ownership. Including financial conditions such as HCM1 or HMC2 in TPPPAs will allow the Department to monitor how the institution performs as the Department reviews the change in ownership.

Pell Grants for Incarcerated Individuals

In 1994, Congress barred incarcerated individuals from accessing Federal Pell Grants,[22] leading to a precipitous drop in the number of prison education programs (PEPs) in operation. This action severely limited access to postsecondary education among justice-impacted individuals.

The *FAFSA Simplification Act of 2020* restored Pell eligibility for incarcerated students and established quality guardrails for PEPs.[23] This restoration marked an important expansion of educational opportunities for incarcerated individuals. Accordingly, I applaud the Department's proposal to supplement statute to support Pell Grant access for incarcerated individuals. The unique nature of correctional facilities requires all stakeholders involved in prison education to prioritize the needs of incarcerated students.

I commend the Department and negotiators for reaching consensus. The proposed rule seeks to protect incarcerated students and their Pell Grant funds by creating a framework for institutions to successfully implement PEPs. By proposing robust guardrails for programs and their oversight entities (most often, departments of corrections), the Department makes clear its commitment to ensuring that PEPs are operating in the best interest of their students. These guardrails will protect incarcerated students from wasting their Pell Grants on low-quality programs that do not promote the education and workforce advancements of an individual while incarcerated.

While I fully support the proposed rule, it is important that the Department consider related issues to ensure the program is administered in ways that are most advantageous to the students they seek to serve. First, to successfully maximize the number of students participating in PEPs, the Department must ensure that institutions receiving Pell Grants on behalf of incarcerated students are prepared to address the nuances and barriers inherent in the correctional environment. Additionally, over the next few years as the Department collects and analyzes its first set of data which highlight the key metrics necessary to determine if a PEP is operating in the best interest of these students, the agency should work with stakeholders to continue

[22] *See* Violent Crime Control and Law Enforcement Act of 1994, P.L. 103-322, §20411 (1994).
[23] *See* FAFSA Simplification Act; Title VII, Division FF of P.L. 116-260 (2020).

enhancing such data. The Department should also consider developing mechanisms to require disclosure of any involvement of third-party vendors with PEPs, such as online program management providers and education technology providers to serve as a guardrail that ensures these programs are operating in a way that supports students' success. Finally, I urge the Department to ensure incarcerated students understand their postsecondary options during incarceration and after release, which should include providing information on applying for the FAFSA, rehabilitating defaulted loans, and enrolling in programs after re-entry.

Conclusion

Two fundamental principles drive these proposed rules: protecting student borrowers and taxpayers and holding institutions accountable. I commend and support many aspects of the proposals the Department has put forward. As the Department works to finalize these regulations, I appreciate your consideration of these recommendations. I also encourage the Department to robustly enforce all of the proposed requirements to ensure that all students benefit from these protections and that we conduct vigorous oversight over institutions.

Sincerely,

ROBERT C. "BOBBY" SCOTT
Chairman