# ENABLING CLASS LITIGATION AS AN APPROACH TO REGULATING FOR-PROFIT COLLEGES

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## I. INTRODUCTION

*We're asking companies that get up to 90 percent of their profits from taxpayer dollars to be at least 35 percent effective . . . . This is a perfectly reasonable bar and one that every for-profit program should be able to reach.*

—Arne Duncan, Secretary of Education[1]

*The aim of the regulations was to punish bad actors, but the effect is to punish institutions that serve poor students.*

—Donald Graham, CEO and Chairman of Graham Holdings[2]

The above quotes from two of the primary players in the for-profit college industry highlight the industry's polarizing and divisive regulatory issues. This industry has seen unprecedented growth in recent years, increasing enrollment by 225% from 1998–2008.[3] In fact, for-profit

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1. Press Release, U.S. Dep't of Educ., Obama Administration Announces New Steps to Protect Students from Ineffective Career College Programs (June 2, 2011), *available at* http://www.ed.gov/news/press-releases/gainful-employment-regulations [hereinafter ED Announces Gainful Employment Regulations].

2. Tamar Lewin, *Scrutiny Takes Toll on For-Profit College Company*, N.Y. TIMES (Nov. 9, 2010), http://www.nytimes.com/2010/11/10/education/10kaplan.html?pagewanted=all&_r=0.

3. MAJORITY STAFF OF S. COMM. ON HEALTH, EDUC., LABOR AND PENSIONS, 112TH CONG., FOR PROFIT HIGHER EDUCATION: THE FAILURE TO SAFEGUARD THE FEDERAL INVESTMENT AND ENSURE STUDENT SUCCESS 19 (Comm. Print 2012) [hereinafter HELP REPORT], *available at* http://www.gpo.gov/fdsys/pkg/CPRT-112SPRT74931/pdf/CPRT-112SPRT74931.pdf.

colleges received $32 billion in federal grants and loans from 2009–2010.[4] This number accounted for about 25% of all federal student aid distributed despite the industry enrolling only 10–13% of all college students (about 2.4 million students).[5] The prominence and growth of for-profit colleges is highlighted by one for-profit college's recent entry into a Division I athletic conference.[6]

However, recent reports of fraudulent and deceptive recruiting,[7] and high student default rates have plagued the industry, culminating in the release of a negative Senate report by the Health, Education, Labor, and Pensions Committee ("HELP Report").[8] One such report was an undercover U.S. Government Accountability Office ("GAO") report of fifteen for-profit colleges that found that each school made questionable or deceptive recruiting statements.[9] Additionally, the HELP Report found that the average tuition at for-profit colleges exceeds that of their respective public school counterparts (for certificate programs, associate's degrees, and bachelor's degrees).[10] For example, a bachelor's degree in business administration at the for-profit Alta College in Colorado costs $80,466 compared to $60,704 at the University of Colorado Boulder.[11] Moreover, the Education Department recently released the three-year cohort default rate from 2009, measured by the percentage of student borrowers who entered repayment and defaulted within the past three years for a given school. The three-year default rate was 22.7% in the for-profit college sector compared to only 11% in public colleges and 7.5% for nonprofit private colleges.[12]

These revelations have resulted in calls to curtail or completely eliminate lending to for-profit colleges.[13] Supporters of for-profit colleges

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4. *Id.*

5. *Id.*

6. Tim Rohan, *For-Profit University's Shift to Division I Stokes Debate*, N.Y. TIMES (Nov. 29, 2012), http://www.nytimes.com/2012/11/30/sports/ncaafootball/for-profit-universitys-shift-to-division-i-stokes-debate.html?ref=forprofitschools&_r=0.

7. *See, e.g.*, 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 PRACTICES 7 (2010) [hereinafter GAO DECEPTIVE RECRUITING].

8. HELP REPORT, *supra* note 3.

9. GAO DECEPTIVE RECRUITING, *supra* note 7, at 7–13.

10. HELP REPORT, *supra* note 3, at 40–41.

11. *Id.* at 213.

12. Press Release, U.S. Dep't of Educ., First Official Three-Year Student Loan Default Rates Published (Sept. 28, 2012), *available at* http://www.ed.gov/news/press-releases/first-official-three-year-student-loan-default-rates-published [hereinafter First Official Three-Year Student Loan Default Rates].

13. *E.g.*, Osamudia R. James, *Predatory Ed: The Conflict Between Public Good and For-Profit Higher Education*, 38 J.C. & U.L. 45, 47 (2011) ("[F]ederal loan monies are better spent to support

counter that they educate students from "disadvantaged backgrounds" who are "historically underserved by more traditional institutions of higher education."[14] Supporters also point to the fact that although the average default rates are higher at for-profit colleges, many individual for-profit colleges actually have lower cohort default rates than public and private nonprofit colleges.[15] Finally, further regulation would restrict access to higher education for these underserved demographic groups,[16] "deny[ing] access and opportunity to the very students who stand to benefit the most from postsecondary education."[17] These arguments highlight the controversial issue: At what point should the government seek to protect taxpayer money and restrict access to higher education?

After release of these reports and increased media scrutiny, for-profit colleges experienced a flood of litigation. Students have sued claiming such things as breaches of contracts, torts, and violations of consumer protection statutes.[18] However, many of these lawsuits have been subjected to motions to compel individual arbitration.[19] Qui tam lawsuits under the False Claims Act have attacked the industry,[20] and for-profit colleges have been forced to fend off shareholder lawsuits.[21]

Mr. Graham's company presents a good example of the current trends and issues in the industry. The Washington Post Company, renamed

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programs administered through the nonprofit sector . . . .").

14. Letter from APSCU to Arne Duncan, Sec'y of the U.S. Dep't of Educ. (Mar. 13, 2014) [hereinafter APSCU Letter], *available at* http://www.apscu.org/news-and-media/sector-news/upload/APSCU-Letter-to-Sec-Duncan-31314.pdf.

15. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-600, PROPRIETARY SCHOOLS: STRONGER DEPARTMENT OF EDUCATION OVERSIGHT NEEDED TO HELP ENSURE ONLY ELIGIBLE STUDENTS RECEIVE FEDERAL STUDENT AID 18 (2009) [hereinafter GAO STUDENT DATA REPORT].

16. *See* Anthony J. Guida Jr. & David Figuli, *Higher Education's Gainful Employment and 90/10 Rules: Unintended "Scarlet Letters" for Minority, Low-Income, and Other At-Risk Students*, 79 U. CHI. L. REV. 131, 132 (2012) (arguing that legislative and regulatory policies directed at for-profit colleges have "restricted minority and at-risk students' access to higher education").

17. APSCU Letter, *supra* note 14.

18. *E.g.*, Defendants' Motion to Compel Arbitration and Motion to Dismiss Plaintiffs' Class Action Claims at 2, Asbell v. Educ. Affiliates, Inc., No. 3:12-CV-579, (M.D. Tenn.), 2012 WL 6656945 ("The Complaint includes claims for breach of contract, breach of good faith and fair dealing, violation of the Tennessee Consumer Protection Act, fraud in the inducement, and fraudulent misrepresentation.").

19. *Id.* at 8 (arguing that the students had signed mandatory arbitration agreements and explicit class action waivers in their enrollment agreements).

20. *E.g.*, United States *ex rel.* Hoggett v. Univ. of Phoenix, No. 2:10-cv-02478-MCE-KJN, 2012 U.S. Dist. LEXIS 93812, at *1 (E.D. Cal. July 5, 2012).

21. *E.g.*, *In re* ITT Educ. Servs., Inc. Sec. & S'holder Derivatives Litig., 859 F. Supp. 2d 572, 575–76 (S.D.N.Y. 2012).

Graham Holdings in November 2013,[22] entered the for-profit college industry in 2000 via its wholly owned subsidiary, Kaplan, Inc.[23] Between 2000 and 2010, Kaplan's enrollment grew from roughly 23,000 to over 110,000 with Kaplan accounting for 61.7% of the $4.7 billion in revenue that the Washington Post Company reported.[24] However, Kaplan faced a backlash after reports of deceptive recruiting and recruiters being advised to uncover the "pain and fears" of potential recruits.[25] Kaplan also encountered negative publicity for the fact that it earned 87.9% of its revenue from federal financial aid in 2010, spent $373 million on marketing, and recorded $212 million in profits in 2009.[26] The public and consumers have since recoiled from Kaplan, and by March 2012, its enrollment had dropped by about 36,000 students.[27] Total student enrollment as of December 31, 2012, was down 12% compared to the previous year.[28] Additionally, the stock price for the Washington Post Company lost roughly 20% of its value between 2010–2012.[29] Kaplan has recognized its problems and instituted additional programs to help students succeed, explaining some of the drop in enrollment. The HELP Report even recognized Kaplan's "commitment to becoming a company far more focused on student success" even though the commitment "has come at a financial cost to Kaplan."[30]

The Education Department responded to the public outcries and unveiled controversial regulations in 2011.[31] Specifically, the "gainful employment" regulations and the incentive compensation ban have generated significant criticism from both sides, with some arguing that the

22. Roger Yu, *Washington Post Co. Changes Name to Graham Holdings*, USA TODAY (Nov. 18 2013, 2:22 PM), http://www.usatoday.com/story/money/business/2013/11/18/washington-post-company-name-change/3627501/.

23. HELP REPORT, *supra* note 3, at 592.

24. *Id.* at 592–94.

25. *Id.* at 605–06.

26. *Id.* at 595, 598.

27. *Id.* at 594–95.

28. Wash. Post Co., Current Report (Form 8-K) at 4 (Feb. 22, 2013).

29. WPO (now called GHC) had a value of over $500 in early 2010 and had fallen to below $400 in 2012. Graham Holdings Company (GHC), YAHOO! FINANCE, http://finance.yahoo.com/echarts?s=GHC+Interactive#symbol=ghc;range=20100104,20121231;compare=;indicator=volume;charttype=area;crosshair=on;ohlcvalues=0;logscale=off;source=; (last visited Apr. 20, 2014).

30. HELP REPORT, *supra* note 3, at 621–22.

31. ED Announces Gainful Employment Regulations, *supra* note 1; Press Release, U.S. Dep't of Educ., Department of Education Establishes New Student Aid Rules to Protect Borrowers and Taxpayers (Oct. 28, 2010), *available at* http://www.ed.gov/news/press-releases/department-education-establishes-new-student-aid-rules-protect-borrowers-and-tax [hereinafter ED Announces Incentive Compensation Regulations].

regulations do not go far enough,[32] and others arguing that the regulations go too far and will irreparably harm student access to higher education.[33] However, two recent court decisions[34] and the reintroduction of proposed gainful employment regulations[35] have left the future regulation of for-profit colleges in flux. President Obama has formally announced the goal that America will have "the highest proportion of college graduates in the world" by 2020.[36] For-profit colleges will continue to play a prominent role in higher education, especially considering that they offer a disproportionate number of nontraditional, minority, or lower-income students better access to higher education.[37]

For-profit college regulation will play a critical role in the future of not only higher education, but also the nation's fiscal health. Given both the government's ultimate responsibility for most of the roughly $32 billion that the industry receives through federal financial aid[38] and the devastating effects that a default on tens of thousands of dollars in student loans can

32. *E.g.*, Jean Braucher, *Mortgaging Human Capital: Federally Funded Subprime Higher Education*, 69 WASH. & LEE L. REV. 439, 484 (2012) (calling the "overly cautious" gainful employment regulations a "small victory").

33. *E.g.*, Grant MacQueen, Note, *Closing Doors: The Gainful Employment Rule as Over-Regulation of For-Profit Higher Education That Will Restrict Access to Higher Education for America's Poor*, 19 GEO. J. ON POVERTY L. & POL'Y 309, 325–28 (2012) (arguing that the gainful employment rule will result in "A) tighter admissions standards at proprietary institutions, B) limited spaces in programs with poor job placement, C) better job placement services from proprietary institutions, and D) harm to the poorest Americans seeking higher education").

34. *See* Ass'n of Private Sector Colls. & Univs. v. Duncan (*Duncan I*), 681 F.3d 427, 435 (D.C. Cir. 2012) (invalidating portions of the incentive compensation ban, misrepresentation, and state authorization regulations); Ass'n of Private Colls. & Univs. v. Duncan (*Duncan II*), 870 F. Supp. 2d 133, 137 (D.D.C. 2012) (invalidating the gainful employment regulations).

35. Press Release, U.S. Dep't of Educ., Obama Administration Takes Action to Protect Americans from Predatory, Poor-Performing Career Colleges (Mar. 14, 2014), *available at* http://www.ed.gov/news/press-releases/obama-administration-takes-action-protect-americans-predatory-poor-performing-ca.

36. Barack Obama, U.S. President, Remarks on the American Graduation Initiative (July 14, 2009), *available at* http://www.whitehouse.gov/the_press_office/Excerpts-of-the-Presidents-remarks-in-Warren-Michigan-and-fact-sheet-on-the-American-Graduation-Initiative.

37. Arthur Kim, Note, *Could a Self-Regulatory Organization Work? An Examination of For-Profit Higher Education and One Potential Solution*, 101 GEO. L.J. 467, 482 (2013) ("[F]or-profit-educational institutions disproportionately serve minority and working-class populations that community colleges and traditional schools do not accommodate."). In fact, Secretary Duncan has recognized that for-profit colleges will play a "vital role" in higher education. Andrea Fuller, *Duncan Says For-Profit Colleges Are Important to Obama's 2020 Goal*, CHRON. HIGHER EDUC. (May 11, 2010), http://chronicle.com/article/Duncan-Says-For-Profit/65477. *See also* Program Integrity: Gainful Employment, 75 Fed. Reg. 43,616, 43,617 (July 26, 2010) (to be codified at 34 C.F.R. pt. 668) ("The President's goal cannot be achieved without a healthy and productive higher education for-profit sector.").

38. HELP REPORT, *supra* note 3, at 19.

have on a student's financial wellbeing, it is imperative that we find a solution to the mounting debt problem. However, it is equally important that in doing so we do not jeopardize student access to quality education. The government must find the optimal balance between maximizing student opportunity and access while limiting potentially catastrophic defaults. Part II briefly reviews the market and growth of the sector. Part III addresses the current regulatory environment and the extensive commentary regarding its failure. Part IV highlights the use of arbitration agreements in the context of student lawsuits. Part V argues that the Education Department should condition federal financial aid on allowing student collective actions against for-profit colleges. Part VI concludes.

## II. THE GROWTH AND MARKET OF FOR-PROFIT COLLEGES

For-profit schools have had a prominent place in America since the 1800s.[39] The industrial growth at the beginning of the 1900s led to an even greater demand of for-profit colleges that trained students in new technologies.[40] However, the rise of the modern public research university curtailed further growth of for-profit colleges.[41] This "golden era" of American higher education[42] included the passage of the Higher Education Act of 1965 ("HEA").[43] The HEA was the first federal action with the purpose of increasing access to higher education for low-income students and opened federal financial aid to both public and private colleges.[44]

With the 1972 amendments to the HEA making for-profit college students eligible for federal financial aid, the for-profit college industry once again began to rise to prominence.[45] We have since seen a transformation in the for-profit college sector. In 1991 only one for-profit

39. *See* RICHARD S. RUCH, HIGHER ED, INC.: THE RISE OF THE FOR-PROFIT UNIVERSITY 56 (George Keller ed., 2001).

40. David W. Breneman, Brian Pusser & Sarah E. Turner, *The Contemporary Provision of For-Profit Higher Education: Mapping the Competitive Market*, *in* EARNINGS FROM LEARNING: THE RISE OF FOR-PROFIT UNIVERSITIES 3, 5 (David W. Breneman, et al. eds., 2006).

41. *Id.*

42. *Id.*

43. Higher Education Act of 1965, Pub. L. No. 89-329, 79 Stat. 1219 (codified as amended in scattered sections of 20 U.S.C.).

44. Elise Scanlon & Michale S. McComis, *Accreditation and Accountability: The Role of For-Profit Education and National Accrediting Agencies*, *in* FOR-PROFIT COLLEGES AND UNIVERSITIES: THEIR MARKETS, REGULATION, PERFORMANCE, AND PLACE IN HIGHER EDUCATION 109, 110 (Guilbert C. Hentschke et al. eds., 2010).

45. Breneman, Pusser & Turner, *supra* note 40, at 6. *See also* HELP REPORT, *supra* note 3, at 153–54 ("For-profit colleges became eligible to receive Federal student aid loans and grants through the U.S. Department of Education in 1972.").

college was publicly held.[46] Now at least 76% of for-profit college students are enrolled in a for-profit college that is either publicly traded or owned by a private equity firm.[47] The new landscape of for-profit colleges is quite different from the traditional, small, one-location trade schools that used to make up the industry.[48] This part addresses the changing landscape of for-profit colleges and the new market forces that have driven the growth of the industry.

### A. THE MARKET: FOR-PROFIT HIGHER EDUCATION

For-profit colleges have taken full advantage of the changing economy and regulatory environment of the 1990s and 2000s to experience unprecedented growth and expansion. For the 2009–2010 academic year, they received $32 billion, accounting for 25% of the total federal financial aid dispersed.[49] This share of financial aid was up from only 12.2% in 2000–2001.[50] A major factor behind this growth is the ease with which for-profits have been able to access capital to expand due to the shift to public or private equity ownership.[51] Although for-profit colleges traditionally existed as small vocational schools, by 2009 76% of students enrolled in a for-profit college attended a school owned by either a private equity group or a publicly traded company.[52] The most stunning example is the flagship of for-profit colleges: University of Phoenix. After University of Phoenix's IPO in 1994 as part of the Apollo Group, Inc., it grew from just 25,100 students in 1995 to 455,600 in 2010, making it larger than the California State University system and second in size only to the State University of New York system.[53]

An interesting aspect of the industry is that at first glance, one would suspect that for-profit colleges would struggle because they do not receive

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46. RUCH, *supra* note 39, at 63.

47. HELP REPORT, *supra* note 3, at 17. Demonstrating the rise of publicly traded for-profits, 1.4 million students (63% of all students attending for-profits) currently are enrolled in fifteen publicly traded for-profits. *Id.* at 37.

48. *See* RUCH, *supra* note 39, at 53 (describing traditional for-profit colleges in large cities as private teachers offering instruction in, among other things, skilled trades).

49. HELP REPORT, *supra* note 3, at 30.

50. *Id.*

51. *Id.* at 37.

52. *Id.* at 39 (63% in publicly traded companies; 13% in schools owned by private equity firms).

53. Robin Wilson, *For-Profit Colleges Change Higher Education's Landscape*, CHRON. HIGHER EDUC. (Feb. 7, 2010), http://chronicle.com/article/For-Profit-Colleges-Change-/64012/. However, enrollment has since seen a dramatic decline and as of August 31, 2012, was around 350,000. Apollo Grp., Inc., Annual Report (Form 10-K) at 6 (Oct. 22, 2012), *available at* http://www.sec.gov/Archives/edgar/data/929887/000092988712000107/apol-aug312012x10xk.htm.

the subsidies that public and private nonprofit colleges receive; thus, for-profit colleges must pass on to students the full cost of tuition and profits needed to attract investors.[54] However, for-profit colleges have intrinsic advantages that allow them to meet the increasing student demand for higher education. For-profit colleges can respond quickly to meet the demands of a locality while state and local governments are likely to be slow; this is true even when governments want to add public institutions.[55] They can cut costs by utilizing online courses, common syllabi, inexpensive facilities,[56] and cheaper faculty.[57] Also, for-profit colleges can rapidly update their curricula to meet employer and student demands because they typically do not use tenured faculty, whereas traditional colleges are unable to rapidly adjust.[58] One article has highlighted how for-profit colleges were able to expand to meet the growing needs of the health profession field: from 2000–2009 enrollments in health profession programs tripled in for-profit colleges while only increasing by a factor of 1.4 in public and nonprofit private colleges.[59]

Initially, for-profit colleges were able to expand because they cater to nontraditional, minority, or low-income students, a largely "untapped market" by traditional public and nonprofit private colleges.[60] For-profit colleges typically target a different student population than traditional nonprofit colleges. A recent GAO report found that 56% of students at for-profit colleges are nontraditional students (age 25 and older), and 76% are financially independent.[61] Additionally, for-profit colleges have a higher percentage of minority students compared to public and nonprofit private colleges.[62] However, they have begun to shift toward competing with traditional public and nonprofit private colleges by vastly increasing their

54. The subsidies that are not provided to for-profits include direct subsidies and tax favored treatment. Sarah E. Turner, *For-Profit Colleges in the Context of the Market for Higher Education*, *in* EARNINGS FROM LEARNING: THE RISE OF FOR-PROFIT UNIVERSITIES, *supra* note 40, at 51, 54.

55. *Id.* at 62.

56. For instance, for-profit colleges often lease office building space and do not need student accommodations such as dormitories. *Id.* at 53.

57. David W. Breneman, *The University of Phoenix: Icon of For-Profit Higher Education*, *in* EARNINGS FROM LEARNING: THE RISE OF FOR-PROFIT UNIVERSITIES, *supra* note 40, at 71, 79–83.

58. RUCH, *supra* note 39, at 19–21.

59. David J. Deming, Claudia Goldin & Lawrence F. Katz, *The For-Profit Postsecondary School Sector: Nimble Critters or Agile Predators?*, 26 J. ECON. PERSP. 139, 149–50 (2012).

60. Guilbert C. Hentschke, Vicente M. Lechuga & William G. Tierney, *For-Profit Colleges and Universities in a Knowledge Economy*, *in* FOR-PROFIT COLLEGES AND UNIVERSITIES: THEIR MARKETS, REGULATION, PERFORMANCE, AND PLACE IN HIGHER EDUCATION, *supra* note 44, at 1, 8.

61. GAO STUDENT DATA REPORT, *supra* note 15, at 7.

62. *Id.* at 7–8 (approximately 50%).

full degree programs.[63] For example, Apollo now has a larger new degreed enrollment percentage of bachelor's degrees than associate's degrees.[64] There are many reasons why a potential student would choose a for-profit education instead of a public or nonprofit private college. For instance, some of the advantages discussed above—such as tailored curricula, flexible hours, and more online classes—can make for-profit colleges more attractive to working students.[65] Furthermore, students wishing to pursue a two year degree might find community colleges too overcrowded.[66] Finally, students may pursue a for-profit college degree because for-profits generally have low admissions standards.[67]

Additionally, for-profit colleges benefited from the depressed economic environment because of the lowered opportunity cost of returning to school.[68] This increase in demand for higher education was only further compounded by the decrease in the ability of traditional public schools to supply higher education.[69] State budget deficits have led to lower allocations of subsidies for higher education, which in turn decrease the advantages that subsidies give to public colleges.[70] While community colleges may be able to theoretically provide that supply, decreasing state subsidies limit their ability to expand.[71]

Perhaps most surprisingly, for-profit colleges have been able to maintain a growing market share despite having higher tuition rates than comparable public programs for associate's and bachelor's degrees.[72] Moreover, for-profit colleges typically have a higher tuition rate compared to similar private nonprofit programs for associate's degrees, although the

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63. *See* HELP REPORT, *supra* note 3, at 37 ("Between 2004 and 2010, the amount of AA degrees awarded by for-profit colleges increased 77 percent and the amount of BA degrees awarded increased 136 percent.").

64. Apollo Grp., Inc., Annual Report (Form 10-K) at 6 (Oct. 22, 2010), *available at* http://www.sec.gov/Archives/edgar/data/929887/000092988712000107/newdegreedenrollment.jpg.

65. *See* Joe Nocera, *Why We Need For-Profit Colleges*, N.Y. TIMES MAG. (Sept. 16, 2011), http://www.nytimes.com/2011/09/18/magazine/why-we-need-for-profit-colleges.html?pagewanted=all ("A well-run for-profit college could teach its nonprofit counterparts a thing or two about efficiency and innovation.").

66. *Id.*

67. Deming, Goldin & Katz, *supra* note 59, at 144–45 ("[B]eyond requiring a high school degree, for-profit institutions are almost always nonselective and open admissions.").

68. Turner, *supra* note 54, at 64.

69. *See id.* at 65 (arguing that for-profit universities are more likely than their public counterparts to provide enrollment opportunities during economic downturns).

70. *Id.* at 58.

71. *Id.* at 64.

72. GAO DECEPTIVE RECRUITING, *supra* note 7, at 16 (finding the tuition at fourteen out of fifteen for-profit colleges surveyed to be higher than that of the nearest public institution regardless of the degree pursued).

cost is lower for bachelor's degrees.[73] For example, the HELP Report found that the cost of an associate's degree at University of Phoenix in business was $24,500 compared to only $4,087 at the local community college.[74] Additionally, the cost of a bachelor's degree in business at University of Phoenix was $74,575 compared to only $44,200 at the University of Arizona but was $142,716 at the nonprofit private Prescott College.[75] The higher tuition is one of the contributing factors to higher default rates. A larger percentage of students are forced to borrow money at for-profit colleges.[76] Ninety-six percent of students at for-profit colleges borrowed money compared to only 57% of students at four-year nonprofit private colleges, 48% of students at four-year public colleges, and 13% of students at community colleges.[77]

Finally, given all of the factors contributing to for-profit college growth and easy access to capital, the market supply can be considered competitive. Although there are high barriers of entry because of things like accreditation and state authorization, no for-profit college dominates the market.[78]

### B. MARKET FAILURE AND GOVERNMENT INTERVENTION

The standard argument in support of government financial aid for higher education is that without intervention, the costs would be prohibitively high and supply would be too low to meet the optimal level of higher education. Higher education can act as a public good, meaning it can contribute positive effects that are nonrivalrous and nonexcludable,[79] and produce positive externalities.[80] Without government intervention, the fear is that higher education would be underproduced because the market does

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73. *Id.*

74. HELP REPORT, *supra* note 3, at 293–94.

75. *Id.*

76. *Id.* at 128–29.

77. *Id.*

78. "The postsecondary education market in the United States is highly fragmented and competitive, with no single private or public institution enjoying a significant market share." ITT Educ. Servs., Inc., Annual Report (Form 10-K) at 6 (Feb. 22, 2013), *available at* http://www.sec.gov/Archives/edgar/vprr/13/9999999997-13-005320.

79. *E.g.*, Brian Pusser, *Higher Education, the Emerging Market, and the Public Good*, *in* THE KNOWLEDGE ECONOMY AND POSTSECONDARY EDUCATION: REPORT OF A WORKSHOP 105, 107–08 (Patricia Albjerg Graham & Nevzer G. Stacey eds., 2002).

80. *See* William G. Tierney, *The Public Good in a Changing Economy*, *in* FOR-PROFIT COLLEGES AND UNIVERSITIES: THEIR MARKETS, REGULATION, PERFORMANCE, AND PLACE IN HIGHER EDUCATION, *supra* note 44, at 172 (discussing arguments that postsecondary education is a public good).

not take into account these positive effects.[81] Higher education can lead to "greater levels of productivity, higher rates of consumer spending, increased tax revenues, enhanced workforce preparation, and decreased public expenditures for social services."[82] The public benefits also include greater civic engagement and increased voting rates.[83] Additionally, higher education provides private benefits to the students, such as higher wages.[84]

However, the positive results from higher education are never guaranteed, which leads to difficulty in obtaining private loans for higher education.[85] Higher education without government intervention could result in increased wealth inequalities because lower-income students would not be able to afford the costs of higher education or receive adequate loan financing.[86] Hence, another justification for government intervention has been increasing social mobility and access to higher education.[87]

Ideally, for-profit colleges would supplement the market supply of traditional colleges to meet the demands of students. However, there is currently a market failure because too many students are consuming higher education without receiving an adequate return on their investment, resulting in a high default rate. The extent of the market failure is exceptionally difficult to determine because of the intangible measurements of higher education. Defaults on federal student loans hurt the government and taxpayers because they are ultimately responsible for the unpaid balance.[88] Defaults also harm students by permanently affecting their credit scores amongst other severely negative consequences.[89]

Evidence of market failure comes from the data: within three years of entering repayment, 22.7% of for-profit college student borrowers have defaulted, compared to only 11% of public college student borrowers and 7.5% of nonprofit private student borrowers.[90] For-profit college students represent 47% of all student loan borrowers in default despite being a much

81. *See* Pusser, *supra* note 79, at 107–08 ("Public goods are presumed to be underproduced in markets . . . .").

82. *Id.* at 118.

83. *Id.*

84. *Id.*

85. JOHN CREEDY, THE ECONOMICS OF HIGHER EDUCATION: AN ANALYSIS OF TAXES VERSUS FEES 3 (1995) ("The prospect of uncertain future higher earnings does not provide collateral for a loan.").

86. *Id.*

87. *Id.*

88. GAO STUDENT DATA REPORT, *supra* note 15, at 12.

89. *Id.*

90. First Official Three-Year Student Loan Default Rates, *supra* note 12.

lower percentage of total student borrowers.[91] Additionally, although there is limited data, the Education Department "estimates that 46.3 percent of all dollars lent to for-profit students who entered repayment in 2008 will default,"[92] compared to only 31.1% for two year public and nonprofit colleges.[93] This has led many to compare the for-profit college default problem to the subprime mortgage crisis.[94]

Supporters of the industry argue that the higher default rates are a natural part of educating a different socioeconomic group than traditional colleges.[95] This makes it difficult to accurately assess just how much more poorly for-profit college students are performing. The GAO report does, however, recognize that these characteristics "contribute to higher default rates."[96] Interestingly, one recent study by the Education Department concluded that the percentage of students who received Pell Grants, which are awarded based on financial need, explained 23% of the variance for loan repayment rates.[97] Because student demographics do not completely explain the higher default rates, evidence points toward for-profit colleges contributing to student defaults.

For-profit colleges also have exceptionally high dropout rates. Recent data collected in the HELP Report shows that 54% of students at thirty surveyed for-profit colleges left without attaining a degree.[98] One program had a dropout rate of 84%.[99]

Furthering the market failure are the problems associated with information asymmetries. Well-functioning markets assume that the parties are rational and informed.[100] However, in the for-profit higher education sector both assumptions are problematic. Higher education inherently has an information problem and is difficult to evaluate. Standard economic arguments identify three primary types of goods: search goods, experience goods, and credence goods.[101] A search good is one whose quality a

91. HELP REPORT, *supra* note 3, at 132–33.

92. *Id.* at 133–34.

93. *Id.* at 134.

94. *E.g.*, Braucher, *supra* note 32, at 477–80.

95. Kelly Field, *Government Vastly Undercounts Defaults*, CHRON. HIGHER EDUC. (July 11, 2010), http://chronicle.com/article/Many-More-Students-Are/66223/.

96. GAO STUDENT DATA REPORT, *supra* note 15, at 19–21.

97. Ass'n of Private Colls. & Univs. v. Duncan (*Duncan II*), 870 F. Supp. 2d 133, 150 (D.D.C. 2012).

98. HELP REPORT, *supra* note 3, at 83.

99. *Id.* at 86.

100. Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 7 (2008).

101. Christopher Lubienski & Peter Weitzel, *Choice, Integration, and Educational Opportunity: Evidence on Competitive Incentives for Student Sorting in Charter Schools*, 12 J. GENDER RACE &

consumer can easily discern before purchase,[102] whereas an experience good requires the consumer to purchase and consume the product before discerning its quality.[103] Finally, a credence good's quality may never actually be known to the consumer without additional outside information.[104] For-profit higher education most likely falls somewhere between an experience good and a credence good because many outside factors such as employment and the economy can dictate whether or not the education was of a certain quality and successful.[105] While some disclosure requirements have helped with this problem, there is still information asymmetry. The fact that some for-profit colleges have capitalized on this problem through aggressive and deceptive recruiting has aggravated the results.[106] The GAO recently sent undercover students to fifteen for-profit colleges and found that four used outright fraud and all fifteen used some form of deception.[107] Because for-profit colleges have a legal obligation to make profits for their shareholders, they have incentives to aggressively recruit students by capitalizing on the information asymmetry created by the intangible and vague benefits of a higher education degree.[108] Any proposed solutions need to find a way to realign incentives such that for-profit colleges do not benefit from deceptive recruiting.

The problem of information asymmetry is also an answer for why for-profit colleges are not self-regulating: a for-profit college should want to limit enrollment to students who will likely succeed so that it can then profit from increased demand because a successful school should attract more students.[109] However, if students are not aware of a problem and cannot collect adequate information to differentiate for-profit colleges,

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JUST. 351, 365 (2009).

102. *Id.* at 365–66.

103. *Id.* at 366.

104. *Id.*

105. *Cf. id.* at 367 (discussing how charter schools did not market in a way that suggests they have search good characteristics).

106. *See* Richard Posner, *The Controversy over For-Profit Colleges*, BECKER-POSNER BLOG (June 20, 2010), http://www.becker-posner-blog.com/2010/06/the-controversy-over-forprofit-collegesposner.html (stating that a possible explanation for what is occurring at for-profit colleges is that "just as in the case of the marketing of mortgage loans during the housing bubble of the early 2000s, the for-profit colleges use aggressive advertising to attract students from low-income families that lack financial sophistication and ability to evaluate the benefits of attending a for-profit college"); Braucher, *supra* note 32, at 451–52.

107. GAO DECEPTIVE RECRUITING, *supra* note 7, at 7.

108. Program Integrity: Gainful Employment, 75 Fed. Reg. 43,616, 43,618 (July 26, 2010) (to be codified at 34 C.F.R. pt. 668).

109. *See* Posner, *supra* note 106 ("The big puzzle is why . . . the for-profit college market is not self-regulating . . . .").

these schools will have no incentive to differentiate themselves. If there are inadequate antifraud protections for students, then a for-profit that truthfully advertises good student results cannot differentiate itself from a for-profit that deceptively recruits. A different possibility is that students know the risks but prefer to gamble in hopes of achieving a higher salary after graduation,[110] or that consumers are simply making irrational decisions and being overly optimistic.[111]

## III. REGULATORY ENVIRONMENT

Although the for-profit college industry has undergone a dramatic shift in recent years in its structure to primarily large publicly held companies, the regulatory regime did not have any corresponding changes barring a few instances of deregulation.[112] High default rates and reports of unscrupulous recruiting, however, have led to many commentators clamoring for more regulations to correct the market failure.[113] In response to increasing public pressure and evidence of abuse, the Education Department created a rulemaking committee[114] that implemented several new regulations, including eliminating the incentive compensation safe harbors[115] and the gainful employment regulations.[116] This part addresses the regulatory environment that led to the market failure. It will then analyze the political pressures affecting new regulations and conclude with the recent results in the *Duncan* lawsuits.[117]

### A. THE TRIAD

The regulatory structure of higher education adheres to the idea of a "triad" of regulatory bodies: the federal government, states, and

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110. *Id.*

111. James Audette, Note, *Defining "Gainful Employment" and Other Reforms in Federal Educational Lending*, 38 J.C. & U.L. 167, 168 (2012).

112. For example, in 2002 the incentive compensation ban was amended to include a series of safe harbors. Ass'n of Private Sector Colls. & Univs. v. Duncan (*Duncan I*), 681 F.3d 427, 437–38 (D.C. Cir. 2012).

113. *See, e.g.*, Stephen Burd, *The Art of Spin Career-College Style*, HIGHER ED WATCH (May 18, 2010), http://higheredwatch.newamerica.net/node/31942 ("[W]e hope that the Obama administration moves forward with its proposal to eliminate the safe harbors.").

114. Negotiated Rulemaking Committees; Establishment, 74 Fed. Reg. 24,728, 24,728 (May 26, 2009) (to be codified at 34 C.F.R. ch. VI).

115. ED Announces Incentive Compensation Regulations, *supra* note 31.

116. ED Announces Gainful Employment Regulations, *supra* note 1.

117. Although there were multiple changes to the regulatory scheme, such as addressing state authorization, I will mainly address the status of the two regulations having the largest effects: the gainful employment and incentive compensation ban regulations.

accreditation agencies.[118] In theory, each is meant to serve a different purpose and role in the regulatory regime.

1. Accreditation

Authorized private accreditation agencies must approve for-profit colleges for the college to qualify for federal financial aid.[119] Accreditation agencies were designed to serve as a form of peer review and as the gatekeepers of federal financial aid.[120] Ideally, these accrediting agencies would ensure educational quality[121] and help facilitate improvements in educational quality through the sharing of information and innovative practices amongst peers.[122] However, the effectiveness of this leg of the triad has come under scrutiny.[123] Reports of conflicts inherent in the self-reporting and peer review nature of these accreditation agencies have furthered these doubts.[124] Additionally, some fear that these conflicts are aggravated by the threat of accreditation shopping (that is, schools threaten to take their fees to a different accreditation agency if the current agency attempts to apply more stringent standards).[125] Moreover, while it seems that accreditation agencies have not been able to adequately control educational quality, industry representatives have also recognized that accreditation agencies do not actively monitor for fraud.[126] For the above reasons, accreditation agencies have not been able to correct the market failure and information asymmetries facing students.

2. State Authorization

The HEA requires that for-profit colleges also receive state authorization to receive federal financial aid.[127] This prong of the triad is

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118. Mark L. Pelesh, *Markets, Regulation, and Performance in Higher Education*, *in* FOR-PROFIT COLLEGES AND UNIVERSITIES: THEIR MARKETS, REGULATION, PERFORMANCE, AND PLACE IN HIGHER EDUCATION, *supra* note 44, at 92.

119. 20 U.S.C. § 1058(b)(1)(D) (2012); HELP REPORT, *supra* note 3, at 141.

120. HELP REPORT, *supra* note 3, at 141.

121. Pelesh, *supra* note 118, at 92.

122. Kim, *supra* note 37, at 478.

123. *Id.* at 479–80.

124. Some compare the situation to the credit rating agencies during the mortgage crisis. For-profit colleges have representatives on the boards of the accrediting agencies, and the agencies depend on fees from the accredited schools to survive. HELP REPORT, *supra* note 3, at 143.

125. *Id.*

126. Kelly Field, *Lawmakers Focus Ire on Accreditors for Abuses at For-Profit Colleges*, CHRON. HIGHER EDUC. (Aug. 4, 2010), http://chronicle.com/article/Lawmakers-Focus-Ire-on-Accr/123771/ (highlighting a director of a for-profit college accreditation agency recently acknowledging before Congress that accreditation was not designed to detect fraud and that students should rely on "the other parts of the triad" for fraud detection).

127. 20 U.S.C. §§ 1001(a)(2), 1002(b)(1)(B) (2012).

designed to ensure that states provide adequate supervision and consumer protection.[128] However, state authorization and supervision has largely been inconsistent.[129] This inconsistency has only been exacerbated by state budget cuts.[130]

Recently, some states have taken a more active role in policing for-profit colleges and alleged student abuses.[131] Maryland and California have increased state scrutiny of for-profit colleges.[132] Furthermore, some states have joined federal litigation seeking to recover state grants and loans that were distributed to students at for-profit colleges.[133] However, there is still no uniformity among state regulations and the states have not adequately empowered consumers.

3. Federal Regulation

The final leg of the triad is federal regulation by Congress and the Education Department.

a. The 90/10 Rule

One of the key regulations is what came to be known as the "90/10 rule."[134] Although many view it as a very low standard, this rule requires schools to receive 10% of their revenue from funds other than Title IV federal financial aid.[135] This rule was enacted as part of the 1992 HEA amendments in response to a simultaneous growth in for-profit colleges and fraud similar to what is allegedly occurring today.[136] It was designed with the idea that the education would be of a high enough quality that some students would be willing to pay out of pocket instead of relying

128. HELP REPORT, *supra* note 3, at 150–53.

129. Kim, *supra* note 37, at 478–79 (discussing the inconsistent and limited scope of state licensing as a way to create standards and to regulate academic institutions).

130. HELP REPORT, *supra* note 3, at 151 ("In a number of States, oversight has eroded over time due to a variety of factors, including State budget cuts and the influence of the for-profit college industry with State policymakers.").

131. David Harrison, *For-Profit Colleges Face More State Scrutiny*, PEW CHARITABLE TRUSTS (Apr. 19, 2011), http://www.pewstates.org/projects/stateline/headlines/for-profit-colleges-face-more-state-scrutiny-85899375086.

132. *Id.*

133. United States v. Educ. Mgmt. Corp., 871 F. Supp. 2d 433, 458–59 (W.D. Pa. 2012) (discussing state law claims in a federal False Claims Act lawsuit for violating the incentive compensation ban).

134. HELP REPORT, *supra* note 3, at 10.

135. 20 U.S.C. § 1094(a)(24) (2012).

136. Scanlon & McComis, *supra* note 44, at 113–15. A "recurrent theme was purported fraud and abuse" during the congressional hearings for the 1992 amendments. Pelesh, *supra* note 118, at 94–95. Although the original rule was 85/15, *id.*, it has since been increased to 90/10.

solely on federal financial aid.[137]

Although the 90/10 rule has been in existence in some form or another for over two decades, it remains highly controversial. One side argues it needs to be more stringent, while the opposing side argues that it does more harm than good. The HELP Report was critical of the fact that 37% of for-profit colleges had over 80% of their revenues from Title IV funds, with some receiving over 85%.[138] The HELP Report also cited the negative consequences of schools actively fighting to stay under the 90% line: schools raise tuition above the maximum amount that a student can borrow and aggressively recruit military veterans.[139] Many commentators have agreed that increasing federal loan availability has caused for-profit colleges to aggressively seek military veterans to exploit a "loophole" instead of trying to recruit students who could pay upfront costs.[140] In fact, this issue has received some congressional attention, although no law has been passed.[141]

Conversely, the opposing side has also articulated a compelling narrative for why the 90/10 rule is actually detrimental to higher education. The primary problem with the 90/10 rule is that for-profit colleges serve low-income students who simply do not have the funding available to cover upfront costs.[142] The recent recession has resulted in more students being unable to contribute to their education, as well as reductions in state aid (which would count toward the 10%).[143] This forces for-profit colleges to either raise tuition above the federal financial aid maximum (so students are forced to contribute their own money), or stop serving the most

137. HELP REPORT, *supra* note 3, at 155.

138. *Id.* at 160. For example, the Apollo Group (owner of the University of Phoenix) reported a share of 85.3% in 2010. *Id.*

139. Tuition grants from the Department of Defense and the Department of Veterans Affairs are not counted as federal funding for the purposes of the 90/10 rule. *Id.* at 170.

140. *E.g.*, Amanda Harmon Cooley, *The Need for Legal Reform of the For-Profit Educational Industry*, 79 TENN. L. REV. 515, 559 (2012); Matthew A. McGuire, Note, *Subprime Education: For-Profit Colleges and the Problem with Title IV Federal Student Aid*, 62 DUKE L.J. 119, 147–48 (2012); Vasanth Sridharan, Note, *The Debt Crisis in For-Profit Education: How The Industry Has Used Federal Dollars to Send Thousands of Students into Default*, 19 GEO. J. ON POVERTY L. & POL'Y 331, 348–49 (2012).

141. Press Release, Congresswoman Jackie Speier, Representatives Introduce Bipartisan, Bicameral Bill to Reform For-Profit Coll. Indus. Treatment of Military and Veteran Educ. Benefits (Feb. 16, 2012), *available at* http://speier.house.gov/index.php?option=com_content&view=article&id=587:representatives-introduce-bipartisan-bicameral-bill-to-reform-for-profit-college-industry-treatment-of-military-and-veteran-education-benefits&catid=1:press-releases&Itemid=14.

142. *See* Guida & Figuli, *supra* note 16, at 148 ("The 90/10 rule is fundamentally in conflict with the goal of educating low income students.").

143. *Id.* at 148–51.

financially needy students, both of which are undesirable outcomes and perverse to the rule's original purpose.[144] Some for-profit colleges argue that lowering tuition would in fact be impossible because more students could cover all of the costs with federal financial aid instead of having to contribute some of their own money, which could lead to a violation of the 90/10 rule.[145]

Although both sides offer compelling reasons for the 90/10 rule's existence or demise, it is clear that it does nothing to solve the information asymmetries or end aggressive recruiting. Moreover, it could actually incentivize deceptive recruiting because for-profit colleges will be competing for the limited amount of students who can contribute to the 10 percent.[146]

b. The Cohort Default Rule

Another significant rule enacted as part of the 1992 HEA reforms was a rule governing the "cohort default rate."[147] The cohort default rate is calculated based on the percentage of borrowers that enter repayment in a given year and how many of those borrowers default within the next three years.[148] Any defaults that occur after the cohort period ends do not count, and so long as the student has made a payment within the past 270 days, the student is not considered to have defaulted.[149] Although originally more stringent, the current cohort default rule provides that if a for-profit college[150] has a student cohort default rate of 30 percent or higher for three

144. *Id.*

145. *E.g.*, Corinthian Colls., Inc., Annual Report (Form 10-K) at 52 (Aug. 24, 2012), *available at* http://www.sec.gov/Archives/edgar/data/1066134/000104746912008511/a2210652z10-k.htm ("As Congress increases available Title IV aid, we are often effectively required to increase tuition prices in order to maintain compliance with the 90/10 Rule; conversely, ED's 'gainful employment' regulations (if revived on appeal or further ED rulemaking) could require us to reduce tuition prices in order to limit the debt burden of our students. Our institutions may not be able to comply with both rules.").

146. This could be an extension of the problems currently plaguing military recruiting.

147. Pelesh, *supra* note 118, at 98; HELP REPORT, *supra* note 3 at 174–75 & n.698.

148. GAO STUDENT DATA REPORT, *supra* note 15, at 10 (discussing the cohort default rate based on a two-year time period). Although initially only examining two years, the HEA has been amended such that "in 2014, colleges will be required to demonstrate that no more than 30 percent of students default on Federal student loans within *3* years of entering repayment on their loans." HELP REPORT, *supra* note 3, at 175. *Accord* Goldie Blumenstyk, *Business Is up in Keeping Default Rates Down*, CHRON. HIGHER EDUC. (July 11, 2010), http://chronicle.com/article/Business-Is-Up-in-Keeping/66226/#analysis (discussing the effects of extending the cohort default period from two to three years).

149. GAO STUDENT DATA REPORT, *supra* note 15, at 13–14; Blumenstyk, *supra* note 148.

150. The cohort default rate also applies to traditional public and nonprofit private colleges. *See* GAO STUDENT DATA REPORT, *supra* note 15, at 13 (comparing the cohort default rates between for-profit and nonprofit colleges).

straight years, measured by including students who entered repayment within the past three years, then the school will be ineligible for federal financial aid.[151] A for-profit college will also lose eligibility if its cohort default rate is greater than 40 percent in any given year.[152]

However, given that the cohort default rate only tracks students for three years after entering repayment, many have been critical of default management strategies employed by for-profit colleges to avoid crossing the 30 percent threshold.[153] The HELP Report alleged that for-profit colleges have used forbearance and deferment to reduce their cohort default rates regardless of whether or not this is the right option for the student.[154] Some for-profit colleges have been reported to hire companies specifically specializing in the task of default management, during which the companies encourage students to enter forbearance.[155] This is an effective strategy because students who enter forbearance or deferment during the cohort period are considered not to be in default and, thus, do not contribute to a higher cohort default rate.[156] While the cohort default rate was undoubtedly enacted with good intentions, it appears that the current loopholes do not effectively police high default rates and do not incentivize schools to limit information asymmetries.

c. Incentive Compensation Ban

Also in response to for-profit college scrutiny, in 1992 Congress added the incentive compensation ban to the HEA.[157] This ban, which applies to all higher education schools, forbids schools from "provid[ing] any commission, bonus, or other incentive payment based directly or indirectly on success in securing enrollments."[158] It was designed to "eliminate deceptive recruiting practices and to protect federal student aid funds from fraud and abuse"[159] by taking away any incentive a recruiter

151. 20 U.S.C. § 1085(a)(2)(A)–(B) (2012).

152. 34 C.F.R. § 668.187(a)(1) (2013).

153. *See, e.g.*, Blumenstyk, *supra* note 148 ("[D]efault management also features business models laced with inherent conflicts of interest that can allow colleges to game the system and do a disservice to students.").

154. HELP REPORT, *supra* note 3, at 176. *See also* Blumenstyk, *supra* note 148 ("The fear is that colleges and the companies they hire can have a 'very limited view of success' that involves staving off high default rates only during the period measured . . . .").

155. *See* Blumenstyk, *supra* note 148 ("Forbearances are notoriously easy to get.").

156. GAO STUDENT DATA REPORT, *supra* note 15, at 14.

157. Higher Education Amendments of 1992, Pub. L. No. 102-325, § 490(a)(3), 106 Stat. 448, 627 (codified as amended at 20 U.S.C. § 1094(a) (2012)).

158. 20 U.S.C. § 1094(a)(20) (2012).

159. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-10, HIGHER EDUCATION: STRONGER FEDERAL OVERSIGHT NEEDED TO ENFORCE BAN ON INCENTIVE PAYMENTS TO SCHOOL RECRUITERS 1

may have to enroll students who could not graduate or find employment after graduating.[160] However, the statute was ambiguous as to whether or not this applied to salary raises,[161] and in 2002, safe harbors were enacted that allowed incentive compensation in certain situations, including a salary raise that was not based solely on the number of students recruited and not adjusted more than twice a year.[162] Also important to note, the statute allows schools to fire or demote recruiters on the sole basis of not meeting expected recruiting numbers.[163]

d. Federal Monitoring and Enforcement

The Education Department is responsible for monitoring and enforcing these regulations.[164] Each for-profit college must register with the Education Department via a renewable Program Participation Agreement ("PPA"), in which the school promises to abide by a number of regulations.[165] The Education Department is authorized to settle, suspend, or terminate the federal financial aid of a school for violating the regulations.[166] The detection mechanisms consist of annual independent audits (conducted by "an independent certified public accountant or a government auditor") and reviews of high-risk programs conducted by the Education Department.[167] However, the GAO found the audits and program reviews to be ineffective at detecting incentive compensation violations.[168] Although the Education Department has the power to fine colleges for each violation,[169] this action has rarely been taken, and when it has, it has been applied inconsistently (in other words, whether or not to impose a fine and if so, applying differing methods for calculating fines).[170] The Education Department also has the ability to fine a for-profit college if

(2010) [hereinafter GAO STRONGER OVERSIGHT NEEDED].

160. Ass'n of Private Sector Colls. & Univs. v. Duncan (*Duncan I*), 681 F.3d 427, 436 (D.C. Cir. 2012).

161. *See* Defendants' Brief in Support of Their Motion to Dismiss and Alternative Motion to Strike at 5, United States v. Educ. Mgmt. Corp., 871 F. Supp. 2d 433 (W.D. Pa. 2012) (No. 2:07-cv-461-TFM), 2011 WL 4809963 (stating that the 1992 incentive compensation ban "notably did not include 'salary' as one of the prohibited types of compensation").

162. *Duncan I*, 681 F.3d at 437–38.

163. United States v. Corinthian Colls., 655 F.3d 984, 993 (9th Cir. 2011).

164. *See* GAO STRONGER OVERSIGHT NEEDED, *supra* note 159, at 2 (noting that the Education Department "is responsible for monitoring schools participating in federal student aid programs and enforcing compliance with the incentive compensation ban").

165. 34 C.F.R. § 668.14(a)(1) (2013).

166. GAO STRONGER OVERSIGHT NEEDED, *supra* note 159, at 17.

167. *Id.* at 3; 34 C.F.R. § 668.23(a)(1) (2013).

168. GAO STRONGER OVERSIGHT NEEDED, *supra* note 159, at 35–36.

169. 34 C.F.R. § 668.84(a)(1) (2013).

170. GAO STRONGER OVERSIGHT NEEDED, *supra* note 159, at 37–41.

it "substantially misrepresents" information provided to students.[171] However, this power too has suffered from a lack of enforcement as the Education Department has "fallen short" in its enforcement duties.[172]

### B. NEW REGULATIONS

*Schools that cannot meet these very reasonable standards are on notice: invest in your students' success, or taxpayers can no longer invest in you.*

—Arne Duncan, Secretary of Education[173]

Following the reports of deceptive recruiting and high default rates, combined with the ineffectiveness of the 90/10, cohort default rate, and incentive compensation regulations, the Education Department supplemented these federal regulations with the gainful employment and new incentive compensation regulations.[174]

#### 1. The Political Climate

The increased scrutiny sparked an avalanche of lobbying from the for-profit college sector. The for-profit college sector already had a relationship with many leaders in Congress[175] and has successfully lobbied Congress in the past due to its organization, finances, and lack of a clear opposition group.[176] The potential impact of the proposed rules led to an even larger increase in lobbying from for-profit schools.[177] Representative John Kline,

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171. GAO DECEPTIVE RECRUITING, *supra* note 7, at 6 (citing 34 C.F.R. § 668.71–.75). Also note that the Education Department recently passed new regulations strengthening the misrepresentation regulations but portions were remanded by the D.C. Circuit. Ass'n of Private Sector Colls. & Univs. v. Duncan (*Duncan I*), 681 F.3d 427, 449–52 (D.C. Cir. 2012).

172. Patrick F. Linehan, Note, *Dreams Protected: A New Approach to Policing Proprietary Schools' Misrepresentations*, 89 GEO. L.J. 753, 788–89 (2001).

173. Press Release, U.S. Dep't of Educ., Five Percent of Career Training Programs Risk Losing Access to Federal Funds; 35 Percent Meet All Three Standards Under Gainful Employment Regulation (June 26, 2012), *available at* http://www.ed.gov/news/press-releases/five-percent-career-training-programs-risk-losing-access-federal-funds-35-percen [hereinafter ED Announces Results].

174. *See* Ass'n of Private Colls. & Univs. v. Duncan (*Duncan II*), 870 F. Supp. 2d 133, 141 (D.D.C. 2012) (discussing the gainful employment regulation); HELP REPORT, *supra* note 3, at 60 (discussing the incentive compensation ban).

175. Thomas B. Edsall, *Controversial Industries Have Backed Boehner*, WASH. POST (Jan. 29, 2006), http://www.washingtonpost.com/wp-dyn/content/article/2006/01/28/AR2006012801009.html (profiling for-profit college industry donations made to Representative John Boehner during his bid to become majority leader).

176. Carolyn Kleiner Butler, *Commercial Schools Lobby for Relaxation of Rules*, N.Y. TIMES (July 27, 2005), http://www.nytimes.com/2005/07/27/education/27lobby.html (quoting an opposing advocate as saying "I don't have the money to compete").

177. Diane Bartz, *Analysis: For-Profit Schools Attack Reform Rule by Lobbying*, REUTERS (Jan. 12, 2011, 8:57 PM), http://uk.reuters.com/article/2011/01/12/us-congress-forprofit-

who leads the influential House Education and Labor Committee, has stated that he opposes more stringent regulations and laws.[178] In fact, in 2011, the House passed a measure that would block the Education Department from using any funds to enforce the new gainful employment rule in a vote that included 58 Democrats breaking party lines to approve this bill.[179]

Additionally, even with the staggering amount of money that the industry spent on lobbying in 2010,[180] the for-profit college sector also had a direct impact on the rulemaking process. The sector was arguably able to exercise what many refer to as the "information capture" phenomenon to lessen the stringency of the regulations.[181] The Education Department received over 90,000 written comments for the gainful employment regulations, which is the most public input it has ever received.[182] Of the 90,000, an estimated 60,000 supported the for-profit industry (often sent as part of letter-writing campaigns organized by the industry) and 20,000–30,000 were from consumer protection groups.[183] However, there were also accusations of rulemaking improprieties committed by supporters of more stringent regulations, including insider trading allegations and errors in the GAO reports.[184] Because of this heightened pressure from industry groups and the pending threat of a lawsuit (which eventually occurred), coupled

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idUKTRE70B6T020110112.

178. Diane Bartz, *UPDATE 2: New U.S. House Education Chair Backs For-Profits*, REUTERS (Dec. 10, 2010, 5:08 PM), http://www.reuters.com/article/2010/12/10/congress-education-forprofit-idUSN1011473320101210.

179. Nick Anderson, *Democrats Join GOP in Voting to Block Tighter Regulation of For-Profit Schools*, WASH. POST (Feb. 19, 2011), http://www.washingtonpost.com/wp-dyn/content/article/2011/02/18/AR2011021807474.html.

180. Chris Kirkham, *For-Profit Colleges Mount Unprecedented Battle for Influence in Washington*, HUFFINGTON POST, http://www.huffingtonpost.com/2011/04/25/for-profit-colleges_n_853363.html (last updated June 25, 2011, 6:12 AM) (stating that the for-profit college sector spent $8.1 million on lobbying in 2010).

181. For a detailed explanation of information capture, see Wendy E. Wagner, *Administrative Law, Filter Failure, and Information Capture*, 59 DUKE L.J. 1321, 1329–34 (2010).

182. ED Announces Gainful Employment Regulations, *supra* note 1.

183. Mary Pilon, Jonathan Weisman & Brody Mullins, *A 'Short' Plays Washington*, WALL ST. J. (Jan. 25, 2011), http://online.wsj.com/article/SB10001424052748704637704576082390767952996.html.

184. Complaint ¶ 3, Career Coll. Ass'n v. Duncan, 796 F. Supp. 2d (D.D.C. 2011), *aff'd in part, rev'd in part sub nom.* Ass'n of Private Sector Colls. & Univs. v. Duncan (*Duncan I*), 681 F.3d 427 (D.C. Cir. 2012) (No. 1:11-cv-00138), 2011 WL 182900. For additional details on Steve Eisman's short of the for-profit college sector and connection with the Education Department, see Pilon, Weisman & Mullins, *supra* note 183. For information about the GAO revising its report on recruiting by changing some of the wording but not its overall conclusion regarding deception and fraud, see Tamar Lewin, *U.S. Revises Report on Commercial Colleges*, N.Y. TIMES (Dec. 8, 2010), http://www.nytimes.com/2010/12/09/education/09gao.html.

with the allegations of rulemaking improprieties committed by supporters, the enacted gainful employment regulations were less stringent than what was initially proposed. Even the Education Department recognized it as being a more "lenient,"[185] less stringent version.[186]

2. Two New Key Regulations

Two regulations with potentially the largest impact on the for-profit college sector are the elimination of the safe harbors for incentive compensation[187] and the gainful employment regulations.[188]

The new incentive compensation ban eliminated the twelve safe harbors previously established and prohibited any sort of payment (including raises) based "directly or indirectly" on enrolling students.[189] However, this change does not affect whether or not schools can still fire recruiters for not meeting a quota.[190] This regulation was largely upheld as within the power of the Education Department by the D.C. Circuit.[191]

The gainful employment regulations have provoked the most controversy because they provide a concrete cutoff that some for-profit colleges would fail. These regulations introduced two debt measures that a school must meet:

1) The program's students must have an annual repayment rate of at least 35 percent; and
2) The program's annual loan payment must be either
   a. less than or equal to 30 percent of discretionary income; or
   b. less than or equal to 12 percent of annual earnings.[192]

A for-profit college that failed all three debt measures for three out of the past four years would be ineligible for federal funding.[193] Additionally,

185. Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. 34,386, 34,400 (June, 13, 2011) (to be codified at 34 C.F.R. pt. 668).

186. Cooley, *supra* note 140, at 558 ("Given the intense industry pressure on the Department in this area, as evidenced by APSCU's lawsuit based on the *weaker* final regulations, it is unsurprising that the proposed regulations were significantly revised.").

187. 34 C.F.R. § 668.14(b)(22) (2013).

188. 34 C.F.R. § 668.7 (2013).

189. 34 C.F.R. § 668.14(b)(22)(ii)(A) (2013).

190. HELP REPORT, *supra* note 3, at 204.

191. Ass'n of Private Sector Colls. & Univs. v. Duncan (*Duncan I*), 681 F.3d 427, 448–49 (D.C. Cir. 2012) (remanding for a better explanation regarding two aspects of the safe harbors: payments for successful student graduations and the possible negative effects on diversity outreach programs).

192. 34 C.F.R. § 668.7(a)(i)–(ii) (2013).

193. 34 C.F.R. § 668.7(i) (2013).

a program faces mandatory disclosures should it fail all three debt measures for one year and in consecutive years.[194] The Education Department recently announced that 5% of programs failed all three gainful employment metrics while 35% met all three.[195] However, the for-profit college sector also challenged these regulations in court. Although the district court largely upheld the Education Department's interpretation, it invalidated all three debt measures because the repayment rate was chosen arbitrarily and the remaining two debt measures could not be severed.[196] Although the two debt measures were based on expert studies, the repayment rate was invalid because the 35 percent minimum was selected only because 25% of the programs would fail this prong of the test.[197] There was no expert testimony or industry standard to justify the chosen rate.[198] Because all of the debt measures were vacated, this also vacated the mandatory disclosure requirements if a program failed the debt measures.[199] However, the court did sever and uphold the remaining disclosure requirements.[200] These require schools to disclose to prospective students "the occupation that the program prepares students to enter, the on-time graduation rate for students completing the program, the tuition and fees charged, and the placement rate and median loan debt for students completing the program."[201] The Education Department in March 2014 proposed a revised gainful employment rule largely similar to the original rule except using a cohort default rate measurement in place of the arbitrary repayment rate.[202]

## IV. LAWSUITS AGAINST THE INDUSTRY

Although the for-profit college sector faces many types of lawsuits, this part addresses one of the most prevalent types: student lawsuits.

### A. STUDENT LAWSUITS, CLASS ACTIONS, AND COMPELLED ARBITRATION

Students have a variety of options if for-profit college recruiters defraud them. The most common claims that students file are breaches of

194. 34 C.F.R. § 668.7(j) (2013).

195. ED Announces Results, *supra* note 173.

196. Ass'n of Private Colls. & Univs. v. Duncan (*Duncan II*), 870 F. Supp. 2d 133 at 153–54, *motion to amend judgment denied*, 930 F. Supp. 2d 210 (D.D.C. 2013).

197. *Id. at* 153.

198. *Id.* at 154.

199. *Id.* at 154 n.7.

200. *Id.* at 155–57.

201. *Id.* at 155–56 (citing 34 C.F.R. § 668.6(b) (2012)).

202. Kelly Field, *Revised 'Gainful Employment' Rule Breaks Little New Ground*, CHRON. HIGHER EDUC. (Mar. 14, 2014), http://chronicle.com/article/Revised-Gainful/145329/.

contracts, torts, or violations of state consumer protection statutes. However, several commentators have highlighted the weaknesses inherent in defrauded student lawsuits.[203]

1. Weaknesses in Current Litigation Options

Much of the extensive commentary on recourses for defrauded students has focused on the challenges that students face in bringing a successful claim. Tort allegations (specifically misrepresentation and fraud claims) tend to run into problems of alleging the requisite scienter.[204] Additionally, a theme seen throughout these cases is that judges "are reluctant to impose a duty of care upon educational institutions for their student outcomes,"[205] with some courts acknowledging policy concerns of "open[ing] the floodgates of litigation to any student dissatisfied with their employment prospects, notwithstanding the fact that the student's own efforts and abilities are a significant factor."[206]

Contract allegations concerning deceptive and false recruiting practices also run into similar problems. Although breach of contract claims avoid the scienter element, students still have to allege that a specific enough promise existed, which can prove to be problematic.[207] Finally, although some consumer protection statutes provide adequate coverage and even specifically target proprietary schools, students still encounter difficulties, and there are inconsistent standards across the states.[208]

However, it should be noted that although difficult, some student lawsuits have been successful. For instance, a student in Missouri

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203. *See* Linehan, *supra* note 172, at 764–78 (demonstrating the problems students face when alleging violations of tort law, breaches of contracts, and violations of consumer protection statutes); Aaron N. Taylor, *"Your Results May Vary": Protecting Students and Taxpayers Through Tighter Regulation of Proprietary School Representations*, 62 ADMIN. L. REV. 729, 763–68 (2010) (same). *But see* Charlie Shelton, *Private Actions Against Proprietary Schools*, 40 RUTGERS L. REC. 81, 110 (2012–13) ("[T]he current legal regime covers the vast majority of students who have a bona fide complaint.").

204. Taylor, *supra* note 203, at 764.

205. *Id.* at 765.

206. Jamieson v. Vatterott Educ. Ctrs., Inc., 259 F.R.D. 520, 536 (D. Kan. 2009).

207. Taylor, *supra* note 203, at 767 ("[I]nstitutions are allowed to make misrepresentations that are clear in their implications, but vague enough to evade legal obligation."); Linehan, *supra* note 172, at 773–74 ("The requirement . . . that a school's promises be specifically enumerated obstructs contract actions where a school's representations are general and lack detail, or where a representation does not take the form of a promise."). *See also* Rebecca E. Reif, Note, *Knowledge Is Power: Reform of For-Profit Educational Institutions on an Individual and Institutional Level*, 61 DRAKE L. REV. 251, 272 (2012) ("Savvy school representatives and recruiters are also able to quickly adapt their methods to avoid liability.").

208. Taylor, *supra* note 203, at 767–78; Linehan, *supra* note 172, at 775–78.

successfully sued the for-profit college Vatterott under a state consumer protection statute.[209] The jury awarded the student about $27,000 in actual damages and $13,000,000 in punitive damages (although this number was later reduced to just over $2,000,000).[210]

2. Compelled Individual Arbitration and Class Action Waivers

Moreover, recent Supreme Court decisions have aggravated the deficiencies of the current legal recourses for students. The HELP Report found that twenty-one of the twenty-seven schools examined used mandatory arbitration clauses.[211] Typically, students that had signed mandatory arbitration clauses would still bring class action complaints and challenge the arbitration agreement as unconscionable. For instance, in *Leask v. Corinthian Colleges, Inc.*, former students filed a class action in state court, and in response to a motion to compel individual arbitration, the plaintiffs argued that the arbitration agreements were unconscionable.[212] They targeted the class action waiver as unconscionable based on the California Supreme Court's holding in *Discover Bank v. Superior Court*, which applied a favorable unconscionability analysis to class action waivers in arbitration agreements.[213] Although the court did compel arbitration, it found the class action waiver unconscionable and allowed the plaintiffs to pursue class certification in arbitration.[214]

However, the recent decision in *AT&T Mobility LLC v. Concepcion*[215] limits the reach of this argument. In *Concepcion*, the Court considered California's *Discover Bank* rule, which California courts frequently used to

209. Nick DeSantis, *Jury Awards Former Student $13-Million in Suit Against Vatterott College*, CHRON. HIGHER EDUC. (June 19, 2013), http://chronicle.com/blogs/ticker/jp/jury-awards-former-student-13-million-in-suit-against-vatterott-college.

210. *Id.*; Post-Trial Order and Amended Judgment at 12, Kerr v. Vatterott Educ. Ctrs., Inc., No. 1216-CV12385 (Cir. Ct. Mo. Sept. 27, 2013), *available at* https://www.courts.mo.gov/fv/c/1216-CV12385-+Post+Trial+%26+Amended+JUDEN_FINAL.pdf?l=SMPDB0017_CT16&di=4112351.

211. HELP REPORT, *supra* note 3, at 203.

212. *E.g.*, Plaintiff's Opposition to the School's Motion for an Order Compelling Arbitration at 4–11, Leask v. Corinthian Colls., Inc., No. 1-07-CV-10233 (Cal. Super. Ct. June 2, 2008), 2008 WL 5395260.

213. *Id.* at 9–11; Discover Bank v. Superior Court, 113 P.3d 1100, 1109–10 (Cal. 2005), *abrogated by* AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740 (2011).

214. Order Granting Petition to Compel Arbitration and Ruling at 2, Leask v. Corinthian Colls., Inc., No. 1-07-CV-102335 (Cal. Super. Ct. Sept. 2, 2008), 2008 WL 4453312. The parties stipulated to remain in court and eventually settled with those individual plaintiffs in the matter for a confidential amount. Declaration of Jacquelyn K. Wilson in Support of Ex Parte Application for Order to Seal Record at 2, Leask v. Corinthian Colls., Inc., No. 1-07-CV-102335 (Cal. Super. Ct. May 6, 2009).

215. *Concepcion*, 131 S. Ct. at 1753 ("California's *Discover Bank* rule is preempted by the FAA.").

find arbitration agreements with class action waivers unconscionable.[216] The Court held that this rule limiting the enforceability of class action waivers in arbitration agreements was preempted by the Federal Arbitration Act ("FAA").[217] Additionally, in *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, the Court held that, when the contract is silent on the topic of class arbitration, parties had to actually agree to class arbitration for it to be imposed instead of bilateral arbitration.[218] Although the facts of *Concepcion* did not deal with for-profit colleges, the holding impacts student litigation because many of the primary for-profit colleges use enrollment agreements containing mandatory arbitration clauses with class action waiver implications.[219] Moreover, *Stolt-Nielsen* is applied in the for-profit college context to limit class actions when the college and the students do not explicitly agree to class litigation in their arbitration agreements.[220]

Students without the benefit of the *Discover Bank* rule encountered problems challenging class action waivers and arbitration agreements even before *Concepcion*. For example, in *Montgomery v. Corinthian Colleges, Inc.*, students in a class action against the for-profit college Everest were compelled to individual arbitration after bringing a class action alleging breach of contract, violation of the state consumer protection statute, and unjust enrichment claims.[221] The students had signed eleven pages of an enrollment agreement with the last page including a mandatory arbitration and class action waiver clause.[222] Applying Illinois state law to the students' claim that the class action waiver was unconscionable, the court found there was insufficient procedural unconscionability because the students were not misled and there was an opt-out provision within thirty days.[223] Moreover, the court found insufficient substantive unconscionability because the amount in question for each plaintiff was over $10,000; therefore, it would not be cost-prohibitive for plaintiffs to bring individual claims.[224]

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216. *Id.* at 1745–46.

217. *Id.* at 1753.

218. Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 559 U.S. 662, 684 (2010) ("[I]t follows that a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so." (emphasis in original)).

219. HELP REPORT, *supra* note 3, at 203.

220. *See, e.g.*, Mensch v. Alta Colls., Inc., Am. Arb. No 11-516-00995-09 (2010) (Baker, Arb.).

221. Montgomery v. Corinthian Colls., Inc., No. 11 C 365, 2011 U.S. Dist LEXIS 31651, at *3 (N.D. Ill. Mar. 25, 2011).

222. *Id.* at *3–6.

223. *Id.* at *9–13.

224. *Id.* at *13–19.

After *Concepcion*, the situation has only become more dire for students seeking class litigation. For-profit colleges have continued to compel individual arbitration.[225] For example, in *Ferguson v. Corinthian Colleges*, former students filed a class action claiming that they were deceived about the true tuition costs, accreditation, and career prospects.[226] They alleged seven causes of action covering breach of contract, fraud, and violations of the state consumer protection statutes.[227] However, discussing *Concepcion*'s liberal policy favoring arbitration,[228] the court held that each student had to individually arbitrate because they had signed binding arbitration agreements with class action waivers in their enrollment agreements.[229] In a similar class action complaint against Bridgepoint, a motion to compel arbitration was granted.[230] The court refuted that the class action waiver was unconscionable and explicitly recognized that "[i]n light of *Conception*, the Court does not find that the adhesive nature of the agreement weighs strongly in favor of procedural unconscionability."[231] Finally, and perhaps most illuminating, one court explicitly stated while compelling individual arbitration that "the Court would likely have found that the Arbitration Agreements at issue here unconscionable pursuant to the [state's unconscionability] analysis if it were issuing this decision pre-*Concepcion*."[232] These cases highlight the practical elimination of student class actions against for-profit colleges.[233] Although students can still proceed through individual arbitration (and have had some noted success[234]), for the reasons discussed below, enabling class actions will have positive effects.

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225. *E.g.*, The School's Motion to Compel Individual Arbitration and Stay Proceedings at 11, Sims v. Westwood Coll., No. 12-cv-0396 (N.D. Ill. Feb. 23, 2012), 2012 WL 2282442 ("Therefore, the arbitration must proceed individually between Plaintiff and the School, as there is no agreement to arbitrate as a class.").

226. Ferguson v. Corinthian Colls., 823 F. Supp. 2d 1025, 1029 (C.D. Cal. 2011), *rev'd in part* 733 F.3d 928 (9th Cir. 2013).

227. *Id.* at 1027.

228. *Id.*

229. *Id.* at 1028, 1032.

230. Rosendahl v. Bridgepoint Educ., Inc., No. 11cv61 WQH (WVG), 2012 U.S. Dist. LEXIS 26139, at *33 (S.D. Cal. Feb. 28, 2012).

231. *Id.* at *20.

232. Bernal v. Burnett, 793 F. Supp. 2d 1280, 1287 (D. Colo. 2011).

233. Furthermore, for-profit colleges have even civilly pursued attorneys trying to organize class actions. Rhodes Colls., Inc. v. Johnson, No. 3:10-CV-0031-D, 2012 U.S. Dist. LEXIS 24623, at *1 (N.D. Tex. Feb. 27, 2012) (alleging defamatory posts on the lawyer's website about the for-profit college). This further disincentivizes lawyers from pursuing class action litigation.

234. *See* Staff Reports, *Arbitrator Samuel G. Jackson Awards Anna Berkowitz and Father Martin $217,000*, PASADENA NOW (June 17, 2013), http://www.pasadenanow.com/main/arbitrator-samuel-g-jackson-awards-anna-berkowitz-and-father-martin-217000 (profiling an arbitration award against a for-profit college for $217,000 based on fraud).

## V. ARE THERE ANY SOLUTIONS?

Congress should enact a modified version of a bill recently introduced by Senator Al Franken: the Arbitration Fairness for Students Act.[235] Congress should mandate that all for-profit colleges agree in their Program Participation Agreements (in which schools make a series of promises in order to receive federal financial aid) to allow student class litigation or arbitration as a condition to receiving federal loans.[236]

### A. ALLOWING CLASS ACTIONS

*So, not only do these colleges prey on vulnerable students through aggressive and deceptive marketing, but they also bar them from suing them, adding insult to injury.*

—Senator Tom Harkin[237]

Theoretically, if the federal regulations were doing a sufficient job policing the for-profit college sector, there would be few meritorious justifications for student class action lawsuits, and freedom to contract for arbitration principles would apply. However, federal regulations have not been effective, and current political forces appear unwilling to allow comprehensive changes through new federal regulations. Fraudulent and deceptive recruiting are two of the primary reasons for the current market failure and oversupply of for-profit education to students who would otherwise have not attended for-profit colleges and defaulted. Moreover, normal causes of action for students to redress these violations are typically difficult to prove and do not adequately align recruiter and student

235. Arbitration Fairness for Students Act, S. 3557, 112th Cong. (2012) (forbidding all colleges (both for-profits and traditional nonprofits) from including binding arbitration agreements in enrollment forms). Note that the HELP Report also recommended eliminating mandatory arbitration. HELP REPORT, *supra* note 3, at 203.

236. There is some precedent for Congress prohibiting arbitration agreements in specific industries. For example, Dodd-Frank recently had the Consumer Financial Protection Bureau conduct a study on arbitration agreements. Mike Ferullo, *CFPB to Scrutinize Forced Arbitration in Financial Product Disputes; Seeks Input*, BLOOMBERG BNA, Apr. 25, 2012, at 3. Senator Franken draws a comparison to the prohibition of mandatory arbitration agreements between a motor vehicle franchisee and a manufacturer. 158 CONG. REC. S6458 (2012) (statement of Sen. Al Franken) (referring to the Motor Vehicle Franchise Contract Arbitration Fairness Act codified at 15 U.S.C § 1226 (2012)). However, this Note will not proceed with this comparison because that example had other policy justifications not present in this industry. Although it is a good example of Congressional action targeting a specific industry, in that situation there were state established administrative boards and more extensive state laws providing further justifications for ending arbitration without jeopardizing efficiency. S. REP. NO. 107-266, at 2 (2002).

237. Press Release, Senator Al Franken, Sen. Franken Continues Fight for Consumer Fairness, Introduces Legislation to HELP Students Hold Colleges, Universities Accountable (Sept. 20, 2012), *available at* http://www.franken.senate.gov/?p=hot_topic&id=2206.

incentives.[238] The elimination of class actions only serves to further this market failure. Thus, Congress should require that class actions be available in this sector to realign incentives of for-profit colleges and eliminate deceptive recruiting.

1. Benefits of Class Actions in the For-Profit College Sector

Not only will class actions help students recover, but they will also serve a more overarching purpose by forcing for-profit colleges to internalize the costs of deceptive recruiting instead of leaving the negative externalities of excess defaults to the government and students.[239]

Before *Concepcion*, class action waivers were regularly considered unconscionable in some jurisdictions.[240] Many of the policy justifications established in *Discover Bank v. Superior Court* for allowing class actions apply to a universal ban of these waivers in the for-profit college sector. *Discover Bank* recognized that individual actions may be impractical when the defrauded amount is too small to justify bringing an individual claim.[241] Although courts in the for-profit college sector have rejected this justification because the claims can be thousands of dollars,[242] this is still a valid justification. As seen above, many of these claims are exceptionally difficult to prove. So, even with higher possible recoveries, it may still be difficult to retain an attorney because of the low success rate—which leads to a low expected recovery. Furthermore, for-profit students often come from low-income and underprivileged communities, and they can lack the necessary familiarity with the legal system to adequately "exercise their legal rights."[243] Allowing class actions will enable students who otherwise would not have brought legal actions to recover damages. This will force for-profit colleges that use deceptive recruiting to internalize more of the harm they impose on the market.

One interesting aspect is that some commentators propose making the

238. *See supra* Part IV.A.1.

239. *See* Myriam Gilles & Gary B. Friedman, *Exploding the Class Action Agency Costs Myth: The Social Utility of Entrepreneurial Lawyers*, 155 U. PA. L. REV. 103, 105 (2006) (discussing how the most important aspect of a class action lawsuit is forcing the wrongdoer to internalize the negative externalities).

240. *Concepcion* specifically held that the FAA preempted California's class action waiver rule established in *Discover Bank v. Superior Court*. AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740, 1753 (2011).

241. Discover Bank v. Superior Court, 113 P.3d 1100, 1105–06 (Cal. 2005), *abrogated by* AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740 (2011).

242. *E.g.*, Montgomery v. Corinthian Colls., Inc., No. 11 C 365, 2011 U.S. Dist. LEXIS 31651, at *5 (N.D. Ill. Mar. 25, 2011) (claiming as high as $27,000).

243. Linehan, *supra* note 172, at 778.

underlying claims more amenable to former students, including creating a federal private right of action. For example, one commentator proposed providing a private student right of action under the Education Department's "substantial misrepresentation" enforcement powers.[244] However, I do not argue for taking such a significant step, and instead propose only to address the initial step of allowing class litigation to proceed without compelling mandatory individual arbitration. Barring mandatory arbitration agreements with class action waivers will allow former students to confront the class certification stage, in which an evaluation of the merits of the underlying claim (even if difficult to prove as in this situation) is largely not called into question.[245] Allowing this necessary first step in the process to develop should adequately force for-profit colleges to internalize more of the costs of deceptive recruiting without having to resort to a change as drastic as creating a new federal cause of action. This is an important step toward providing a more balanced deterrent against deceptive recruiting than the current regulatory system applies.

In fact, there already has been some success in achieving restitution for students and changing the recruiting methods of for-profit colleges through the class action mechanism. For example, one case highlighted by proponents of reform involved former students suing the California Culinary Academy, which is owned by the publicly traded Career Education Corporation, alleging fraud and similar claims.[246] After surviving many rounds of litigation, including the court denying a motion to compel arbitration because the court found the arbitration clause to be unconscionable,[247] the school eventually settled for $40 million.[248]

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244. *Id.* at 790. *See also* Reif, *supra* note 207, at 282–85 (discussing a federal private cause of action).

245. Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184, 1194–95 (2013) ("Merits questions may be considered to the extent—but only to the extent—that they are relevant to determining whether the Rule 23 prerequisites for class certification are satisfied."). *See also* Jamieson v. Vatterott Educ. Ctrs., Inc., 259 F.R.D. 520, 545 (D. Kan. 2009) ("In determining the propriety of a class action, the question is not whether the plaintiffs have stated a cause of action or will prevail on the merits, but whether the requirements of Rule 23 are met." (quoting Shook v. El Paso County, 386 F.3d 963, 968 (10th Cir. 2004))).

246. Cooley, *supra* note 140, at 538–39; Class Action Complaint for Damages, Restitution, and Injunctive Relief at 1–12, Amador v. Cal. Culinary Acad. Inc., No. CGC-07-467710 (Cal. Super. Ct. Sept. 28, 2007).

247. Tentative Ruling: Defendant's Motion to Compel Arbitration at 1–2, Amador v. Cal. Culinary Acad. Inc., No. CGC-07-467710 (Cal. Super. Ct. Feb. 27, 2008).

248. Matt Smith, *California Culinary Academy Settles Lawsuit with Students for Millions*, SF WEEKLY (May 4, 2011), http://www.sfweekly.com/2011-05-04/news/california-culinary-academy-tuition-loan-lawsuit-matt-smith/.

Although the school did not admit wrongdoing, it has altered some of its admissions policies to "ensure that students understand that [the school is] not promising any specific job outcomes or salaries."[249]

Furthermore, allowing class actions will "aid . . . legitimate business enterprises by curtailing illegitimate competition."[250] Because the market of for-profit college suppliers is highly competitive and because of the inherent ambiguities in valuing an education, for-profit colleges that do recruit deceptively can gain a clear edge over competitors that do not. Additionally, it is difficult to imagine a scenario in which a student would choose a for-profit college based on a class action waiver or on the leniency of the arbitration.[251] Although one court stated that because "there is a competitive market for education programs," the students "could have chosen to pursue their education elsewhere,"[252] those plaintiffs did not remember signing the arbitration agreements.[253] Furthermore, the HELP Report found that a majority of the for-profit colleges examined were using arbitration agreements.[254] So even if students were deciding based on the existence and terms of the arbitration agreements and class action waivers, it is unlikely that a student could find an adequate substitute. Empowering students to bring class actions will have the added benefit of helping legitimate for-profits and ending the incentives of otherwise legitimate for-profit colleges to deceptively recruit in order to maintain their market share.

Finally, class actions increase negative publicity of for-profits and draw attention to deceptive recruiting in a much more public fashion than bilateral arbitration. For example, in a recent SEC filing, Corinthians College highlighted seven student class actions.[255] This negative attention would further serve to force for-profit colleges that deceptively recruit to internalize those costs because it could impact future student and investor

249. Terence Chea, *Culinary School Grads Claim They Were Ripped Off*, ASSOCIATED PRESS (Sept. 4, 2011, 5:24 PM), http://news.yahoo.com/culinary-school-grads-claim-were-ripped-off-203350240.html.

250. Discover Bank v. Superior Court, 113 P.3d 1100, 1105 (Cal. 2005), *abrogated by* AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740 (2011).

251. *See* Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373, 427 (2005) (discussing the author's disbelief that a consumer will be aware of a class action waiver or "pay more today for the right to litigate collectively tomorrow").

252. Bernal v. Burnett, 793 F. Supp. 2d 1280, 1288 (D. Colo. 2011).

253. *Id.* at 1283.

254. HELP REPORT, *supra* note 3, at 203.

255. Corinthian Colls. Inc., Quarterly Report (Form 10-Q) at 11–13 (May 4, 2011), *available at* http://www.sec.gov/Archives/edgar/data/1066134/000119312511124313/d10q.htm.

decisions, while at the same time helping for-profit colleges that do not deceptively recruit to even the playing field.

2. Potential Costs

Of course there is a reason that freedom to contract for bilateral arbitration is a useful tool—there are costs associated with an increase in class action litigation. One common argument is that mandating class action availability will negate the benefits of "discretion in designing arbitration processes . . . to allow for efficient, streamlined procedures tailored to the type of dispute."[256] Additionally, because the potential damages will be much greater because many more students will be included in the class than would have filed individual arbitrations, some argue that the costs will simply be passed on to future students through higher tuition.[257] Although these are both valid concerns and costs of litigation will likely rise, the magnitude of the increase is not guaranteed to be high.

First, class actions have a high likelihood of succumbing to a motion to dismiss, and these lawsuits are not costing for-profit colleges in settlements.[258] Most for-profit college students are enrolled in large publicly traded companies that are unlikely to succumb easily to the threat of a class action lawsuit.[259] Second, if class actions are allowed, the students still have to meet the strict civil procedure rules concerning pleading and class certification. For example, in *Jamieson v. Vatterott Educational Centers, Inc.*, the court denied class certification for student breach of contract and misrepresentation claims.[260] Although the court recognized that the claims satisfied the numerosity, commonality, typicality, and adequacy of representation requirements, the court rejected class certification because these claims failed the predominance requirement.[261] Finally, as discussed previously, even if the claims survive

256. AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740, 1749 (2011).

257. *See* Andrew L. Sandler & Victoria Holstein-Childress, *Supreme Court and Congress Focus on Mandatory Pre-Dispute Arbitration Agreements: The Debate Continues*, 27 No.1 WESTLAW J. CORP. OFFICERS & DIRS. LIAB., July, 5, 2011, at 8 (2011) (arguing that the increased litigation costs of eliminating arbitration agreements in any context must be allocated somewhere and the most likely ending location is the consumer).

258. *See* Gilles & Friedman, *supra* note 239, at 158–59.

259. See Taylor, *supra* note 203, at 756 (recognizing that the for-profit college industry is "dominated by five publicly-traded entities").

260. Jamieson v. Vatterott Educ. Ctrs, Inc., 259 F.R.D. 520, 547–48 (D. Kan. 2009). *But see* Ind. Bus. Coll. v. Hollowell, 818 N.E.2d 943, 951–52 (Ind. Ct. App. 2004) (affirming state trial court's certification of class action under state class action rules regarding former students' fraud allegations).

261. *Jamieson*, 259 F.R.D. at 545–48. The court did remand to allow for a further hearing on an

the class certification stage, student causes of actions against for-profit colleges are difficult to prove.

Furthermore, some argue that class actions are a less efficient substitute than consumer actions brought by a state attorney general.[262] Although we have seen a trend toward increasing state scrutiny and lawsuits,[263] we do not want to leave deterrence duties solely to the whims of the political process given the strength of industry political groups, the lack of state resources, and the inconsistencies of enforcements across the states.[264]

These same opponents argue that class members often only receive "pennies on the dollar."[265] This argument is part of one of the consistently highlighted problems with the use of class actions: entrepreneurial lawyers act in their own financial self-interest thereby inflicting high agency costs.[266] The driving force behind this is the potential for exceptionally high attorney's fees in class actions,[267] which leads to attorney abuse and frivolous lawsuits. This is a legitimate concern in this industry given the increasing scrutiny and public attention paid to for-profit colleges.[268] However, the benefit should not be measured solely by how much consumers recovered but also by the large deterrent effect the threat of class actions will have.[269] This is especially true in this industry because of

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excessive tuition class certification claim. *Id.* at 548.

262. Brief for Amici Curiae the States of South Carolina and Utah in Support of Petitioner at 4–6, AT&T Mobility, LLC v. Concepcion, 131 S. Ct. 1740 (2011) (No. 09-893).

263. For a recent action brought by Massachusetts against a for-profit college under a state consumer protection statute, see Complaint, Massachusetts v. Sullivan & Cogliano Training Ctrs., Inc. No. 13-0357B (Mass. Super. Ct. Apr. 3, 2013), *available at* http://www.mass.gov/ago/audioandvideo/s-and-c-complaint.pdf. *See also* Complaint for Civil Penalties, Injunction and Other Equitable Relief, California v. Corinthian Schs., Inc. (Cal. Super. Ct. 2007), *available at* http://ag.ca.gov/cms_attachments/press/pdfs/2007-07-31_Complaint_for_Final_Judgment_072407.pdf (alleging violations of the state consumer protection statutes for deceptive business practices). Corinthians later settled this case for $6.5 million with $5.8 million going to students in the form of restitution. Press Release, Cal. Dep't of Justice, *Brown Reaches Multi-Million Settlement with Corinthian Vocational School* (July 31, 2007), *available at* http://oag.ca.gov/news/press-releases/brown-reaches-multi-million-settlement-corinthian-vocational-school.

264. *See* Linehan, *supra* note 172, at 777 (arguing that state enforcement of consumer protection statutes is inadequate because of budget constraints and possible pressures on elected prosecutors).

265. Brief for Amici Curiae, *supra* note 262, at 2–3.

266. *See* Gilles & Friedman, *supra* note 239, at 103–04.

267. Brief of the Center for Class Action Fairness as Amicus Curiae in Support of Petitioner at 9–11, AT&T Mobility, LLC v. Concepcion, 131 S. Ct. 1740 (2011) (No. 09-893).

268. *Cf.* United States v. ITT Educ. Servs., Inc., No. 1:07-cv-0867-TWP-MJD, 2012 U.S. Dist. LEXIS 40646, at *52–53 (S.D. Ind. Mar. 26, 2012) (awarding nearly $400,000 to defendant for-profit college in attorney's fees and sanctions against the plaintiff attorney in the context of a qui tam False Claims Act lawsuit).

269. Gilles & Friedman, *supra* note 239, at 155 ("The goal of forcing defendants to internalize the

the information asymmetries and failure of the current federal regulatory scheme. The possible costs to for-profit colleges are justified here because of the fact that the current regulatory scheme does not correct their incentive to engage in deceptive recruiting since the federal government and students are the ones assuming the risks of a future default. A robust class action system will force schools that deceptively recruit to better internalize those costs. Moreover, as discussed above, the potential costs may not be exceptionally high given that the challenges in proving the merits of the underlying claim will mitigate the magnitude of any settlement.

Another potential weakness is that requiring class action availability in the for-profit college sector may unfairly target these colleges. Nonprofit higher education institutions are not immune from misrepresentations or potential fraud, which is highlighted by the recent litigation against law schools.[270] In fact, Senator Franken's Arbitration Fairness for Students Act would apply to all higher education institutes receiving federal student loans. However, nonprofit colleges do not have as extensive of a history of deceptive recruiting as for-profit colleges.[271] Also, the magnitude of market failure and high default rates show why the for-profit college sector is more in need of realigning incentives. This is explained by the primary difference between for-profit colleges and traditional colleges: the goal of maximizing shareholder value.

3. Class Arbitration Should Be an Option

Class arbitration could develop into an effective tool. Indeed, class arbitration is a fair and efficient method of deciding class actions.[272] There is also evidence that class arbitration takes less time than class litigation.[273] Thus, there is nothing inherently counterproductive to realigning incentives

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social costs of their actions requires that the class action remain a viable instrument in any given case. Collective action waivers, then, are exercises in pure social disutility.").

270. Sarah Anjum, Note, *Students as Consumers: Finding and Applying a Workable Standard when Institutions Fail to Give the "Benefit of the Bargain,"* 43 U. TOL. L. REV. 151, 171 (2011) (discussing liability in the context of consumer protection statutes); Sophia Pearson & Phil Milford, *New York, Chicago Law Schools Among Group Sued by Graduates over Job Data*, BLOOMBERG (Feb. 1, 2012, 4:20 PM), http://www.bloomberg.com/news/2012-02-01/new-york-chicago-law-schools-among-group-sued-by-graduates-over-job-data.html.

271. *See* GAO DECEPTIVE RECRUITING, *supra* note 7, at 7 ("[A]ll 15 colleges made some type of deceptive or otherwise questionable statement to undercover applicants, such as misrepresenting the applicant's likely salary after graduation and not providing clear information about the college's graduation rate.").

272. AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740, 1758 (2011) (Breyer, J., dissenting).

273. *Id.* at 1759.

by also allowing class arbitration. However, it should be noted that for-profit colleges will likely avoid class arbitration because it increases the opportunity for large damages with less judicial review and fewer safeguards.[274]

Although it is likely that for-profit colleges will completely eliminate the arbitration option should Congress mandate class action availability, class arbitration should still be an option should the parties agree to it.

## VI. CONCLUSION

In response to the possible gainful employment regulations and negative press, some of the largest for-profit colleges have already enacted changes to ensure only qualified students enroll. University of Phoenix instituted a three-week orientation program that students must pass before continuing. Kaplan also instituted a four to five week grace period in which students can attend classes before deciding to continue. These changes, combined with increasing student awareness, have resulted in new student enrollment declining by nearly half at University of Phoenix and Kaplan.[275] Furthermore, even for-profit colleges that have not instituted these types of changes still have seen student enrollment decrease, which indicates students are becoming more knowledgeable and seeking other alternatives.[276] Allowing class action lawsuits will only serve to further this trend by directly disincentivizing deceptive recruiting by forcing for-profit colleges to internalize more costs.

It is up to the government to find the optimal level between student choice and access to higher education, while still ensuring that taxpayer money is invested wisely. Enabling class actions will incentivize for-profit colleges to limit deceptive recruiting without destroying the for-profit college market, as some of the more stringent regulations proposed by commentators would do. This will eventually result in lower default rates because for-profit colleges will no longer entice students who may not have otherwise attended and would have been better off not attending. For-profit colleges help reach a societal goal by increasing the opportunity to graduate

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274. *Id.* at 1752 n.8 (majority opinion); Gilles, *supra* note 251, at 410 ("It is bad enough, from the corporate perspective, to engage in 'bet-the-company' class action litigation without having to sacrifice the appellate rights and other safeguards that attend judicial proceedings, including interlocutory appeals of class certification decisions.").

275. Alan Scher Zagier, *For-Profit Colleges Respond to Increased Scrutiny*, FOX NEWS (Aug. 6, 2011) http://www.foxnews.com/us/2011/08/06/for-profit-colleges-respond-to-increased-scrutiny/.

276. A. Ananthalakshmi, *Education Stocks Battered as Fewer Students Signing Up*, REUTERS (Jan. 10, 2011, 1:01 PM), http://www.reuters.com/article/2011/01/10/us-education-idUSTRE7064OD20110110.

from college and by adapting the traditional education model to be more "tailored, flexible, and innovative" for those students "most poorly served by more traditional educational institutions,"[277] and this change will realign incentives to maximize student access while still protecting taxpayer dollars.

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277. APSCU Letter, *supra* note 14.

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