

TYPES NOT MAPPED YET April 06, 2022 | TTR not mapped yet | Aaron D. Lacey, Scott Z. Goldschmidt, Hope A. Watson

Department of Education moves to make owners, investors, and controlling parties responsible for college and university liabilities

On March 23, 2022, the U.S. Department of Education (“Department”) [announced](#) a significant new policy that, in some cases, will require owners, investors, and controlling parties of private colleges and universities to guarantee the regulatory liabilities of the school. This policy extends to all private institutions, including both proprietary and non-profit institutions of higher education, and will be of significant concern for any entity that presently owns or controls a private, postsecondary institution. Organizations contemplating an investment or acquisition in private higher education also will want to consider this development carefully.

The New Policy

As REGucation readers may be aware, institutions are required to enter into a written Program Participation Agreement (“PPA”) with the Secretary of Education that sets forth the [terms and conditions](#) for participation in the federal financial aid (“Title IV”) programs. The Department may terminate an institution’s Title IV eligibility if the institution is not performing its specified obligations.

Historically, the PPA has been signed by an authorized representative of the institution. Under the new policy, corporations or other legal entities that “have or could have a direct or indirect effect on the institution’s administrative capability or financial responsibility” may also be required to sign the PPA. There is a rebuttable presumption that the following entities would qualify as having a direct or indirect effect on an institution:

- Are the sole member of, or hold a 100 percent direct or indirect equity or voting interest in the institution;
- Hold less than a 100 percent interest but otherwise exercise (either directly or indirectly) substantial control over the institution; or
- Provide the audited financial statements or other financial submissions on behalf of the institution.

In addition to impacting owners and investors of proprietary institutions, this rebuttable presumption would also appear to capture hospitals, religious denominations, and other organizations that control private, non-profit institutions through direct ownership of the institution’s assets, or sole membership or other governance relationships, or that provide financial statements to the Department in support of the institution.

The Department has indicated that it will require controlling parties to co-sign the PPA in the following circumstances, among others:

- If the institution has had a financial responsibility composite score below 1.5 since its last certification (initial or recertification);
- If the institution is on provisional certification status by the Department;
- If the institution goes through a change of ownership;
- If the institution is on HCM2;

- If the Department has approved a significant number of borrower defense or false certification claims for the institution, or if there are a substantial number of these types of claims under review that, if approved, would result in the potential for significant liability;
- If the Department has recently identified systemic or significant audit or program review findings, or has unpaid liabilities resulting from an audit or program review; or
- If the institution or any of its principals or interest holders has consented to or has a judgment of fraud or misrepresentation entered against it by a federal or state court, foreign tribunal, or arbitration body.

In its announcement, the Department specifically states that by co-signing the PPA, such "entities (but not the individuals who sign as authorized representatives of the entities) agree to assume liability for financial losses to the federal government related to the institution's administration of the Title IV programs."

The new policy will be implemented for PPAs of private institutions issued on or after March 23, 2022, in the case of changes of ownership, initial certifications, and reinstatements, and on or after July 1, 2022, in the case of recertification. The Department also reserves the right to apply the new policy to PPAs issued prior to March 23, 2022, provided the agency has already communicated an additional signature requirement to the institution.

Observations

Of the examples provided by the Department that will require a co-signature, three immediately caught our attention.

- First, according to [Department data](#), just over 8% of institutions posted composite scores below 1.5 for fiscal years ending between July 1, 2019 and June 30, 2020. However, it is reasonable to expect that many institutions with historically strong composite scores may have fallen below 1.5 during the pandemic, or may soon fall below 1.5 in the absence of continued pandemic-related aid. Indeed, this concern has prompted repeated requests from the higher education lobby for composite score relief. Unfortunately, it appears that the Department instead will be seeking financial guarantees from parent entities.
- Second, the inclusion of changes in ownership is noteworthy insofar as it is the only example that does not necessarily involve an institution that is experiencing financial or compliance concerns. While changes in ownership at times involve the acquisition of a distressed institution, they also may involve two strong organizations with no financial or compliance concerns. Indeed, a new parent, owner or investor might even significantly strengthen an institution being acquired.
- Third, we note that the Department has suggested that owners or controlling parties of an institution on provisional certification status could be required to co-sign the PPA. This is of particular interest, given the Department's concomitant effort during the most recent round of negotiated rulemaking to expand significantly the circumstances in which institutions may be put on provisional certification status.

In reviewing the new policy, we also observed that there may not be perfect accord between the policy and the statutory authority upon which it is based. The Department's statutory authorization for imposing these new requirements is derived, in part, from [20 U.S.C.A. § 1099c \(e\)](#), which empowers the Secretary to require "the assumption of personal liability, by one or more individuals who exercise substantial control over such institution, as determined by the Secretary... for financial losses to the Federal Government, student assistance recipients, and other program participants for funds under this subchapter, and civil and criminal monetary penalties[.]" The same statute, however, also limits this authority, expressly stating that the Secretary "shall not" impose such liability on an institution that:

- Has not been subjected to a limitation, suspension, or termination action by the Secretary or a guaranty agency within the preceding 5 years;
- Has not had, during its 2 most recent audits of the institutions conduct of programs under this subchapter, an audit finding that resulted in the institution being required to repay an amount greater than 5 percent of the funds the institution received from programs under this subchapter for any year;
- Meets and has met, for the preceding 5 years, the financial responsibility standards under subsection (c); and
- Has not been cited during the preceding 5 years for failure to submit audits required under this subchapter in a timely fashion.

It would seem possible that an institution going through a change in ownership, or even on provisional certification, might nonetheless satisfy each of the criterion above. In such a case, it would appear that requiring an owner or controlling party to accept responsibility for the institution's liabilities might be in direct contravention of the statute.

We expect these and other issues will be discussed at length as the Department begins to put this new policy into effect. For our part, Thompson Coburn will be monitoring its implementation closely and expects to provide updates as additional information becomes available. We also anticipate continuing coverage of the many proposed rule packages expected from the Department this year.



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