Background on Bogus Nonprofit Conversions

Provided to the National Advisory Committee on Institutional Quality and Integrity, U.S. Department of Education

Robert Shireman • The Century Foundation • 05.09.2018

While a for-profit has one clear goal—value for shareholders—nonprofits balance "a double bottom line" of making ends meet financially and pursuing their social impact. "In fact, no social enterprise can be viable, economically or legally, if its sole purpose is to make money."

— Arthur C. Brooks, president of the American Enterprise Institute

Source: *Social Entrepreneurship: A Modern Approach to Social Value Creation*, Upper Saddle River, N.J. : Pearson Prentice Hall, 2009, 66.

A student enrolling at a for-profit college is two hundred times more likely to end up filing a fraud complaint seeking a refund on their federal loans than a student enrolling at a nonprofit.

Source: Yan Cao and Tariq Habash, “College Complaints Unmasked,” The Century Foundation, November 8, 2017.

Student loan defaults are “remarkably concentrated among for-profit entrants. . . Among all new students entering the for-profit sector in 2004, nearly half had defaulted within 12 years. . . nearly four times the rate seen in other sectors.”

Source: Judith Scott-Clayton, “The looming student loan default crisis is worse than we thought,” Brookings Institution, January 11, 2018.

For-profits account for virtually all (98 percent) of the programs that fail the federal gainful-employment (debt-income) test even though they account for only two-thirds of the college rated programs.

Source: “Education Department Releases Final Debt-to-Earnings Rates for Gainful Employment Programs,” U.S. Department of Education, January 9, 2017.

Nearly every college that requires students to sign away their rights through forced arbitration is a for-profit.

Source: Tariq Habash and Robert Shireman, “How College Enrollment Contracts Limit Students’ Rights,” The Century Foundation, April 28, 2016.

Removing investors from power positions in schools reduces exploitative and predatory practices.

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"This sector, unlike public and nonprofit schools, must produce profit for owners and stockholders, which can create an incentive to evade compliance with obligations to students and taxpayers."

— Inspector General, U.S. Department of Education

Source: "Recommendations for the Reauthorization of the Higher Education Act," U.S. Department of Education, Office of Inspector General, March 1, 2018.

In education, customers "can easily be taken advantage of." Because of information asymmetries "it may be impossible to draw up a contract that guarantees that the expected quality in all its dimensions will be provided."

— Economist Gordon C. Winston

Source: "Subsidies, Hierarchy and Peers: The Awkward Economics of Higher Education," *Journal of Economic Perspectives* 13 (1) (1999): 13–36.

The evidence indicates that the "restriction on the right of managers and directors to share in their organization's profits blunts their incentive to seek profits, which decreases their incentives to take advantage of underinformed consumers."

— Economist Burton A. Weisbrod

Source: *The Nonprofit Economy*, 1988, Harvard University Press, Cambridge, MA, 1988, 158-9.

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By using nonprofits in industries like education, "the costs of monitoring for potential exploitation that would incur in a purely for-profit world are avoided."

Source: Helmut K. Anheier and Jeremy Kendall, "Trust and voluntary organisations: Three theoretical approaches," Working Paper 5, Centre for Civil Society, 2000.

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"By reducing incentives for the opportunistic behavior, nonprofits become the preferred suppliers in certain settings: they increase the probability—and the confidence of donors or buyers—that they're getting what they are paying for, tending to offset the contract failure inherent in such asymmetric markets."

— Economist Gordon C. Winston

Source: "Subsidies, Hierarchy and Peers: The Awkward Economics of Higher Education," *Journal of Economic Perspectives* 13 (1) (1999): 13–36.

"Because of the stigma now dogging for-profit colleges, nonprofit status has become a crucially important marketing tool."

Source: Patti Cohen, "Some Private Colleges Turn a Tidy Profit by Going Nonprofit," *New York Times*, March 3, 2015.

For-profit colleges want the "nonprofit" label but without properly separating moneymaking from corporate control.

At “covert” for-profit colleges, owners maintain control while cloaking profits as promises-to-pay, rent, and contracts.

Source: Robert Shireman, “The Covert For-Profit: How College Owners Escape Oversight through a Regulatory Blind Spot,” The Century Foundation, September 22, 2015.

The Grand Canyon deal “allows for-profit GCU to suck out the vast majority of nonprofit GCU’s income.” The terms mean the nonprofit “will be locked forever into its service contract” with the for-profit.

“It is a trustworthy-looking wrapper around a for-profit business.”

— Nonprofit law expert Brian Galle

Source: Brian Galle, “Conversions of For-Profit to Nonprofit Colleges Deserve Regulators’ Scrutiny,” Medium, April 3, 2018.

The “trustees” of nonprofit-label Remington College are employees of the financial advising firm used by the wealthy prior owner, who is now the school’s landlord and creditor.

Source: Robert Shireman, “The Covert For-Profit,” The Century Foundation, September 22, 2015.

For-profit Kaplan is now operating as the online “public” Purdue Global, an LLC that is exempt from state liability; exempt from state public records laws; exempt from state audit requirements; and exempt from state open meeting laws. The price for Purdue’s “ownership” of Kaplan’s operations is an indefinite contract that grants the for-profit company formal roles in governance.

Source: Robert Shireman, “There’s a Reason the Purdue-Kaplan Deal Sounds Too Good To Be True,” *Chronicle of Higher Education*, April 30, 2017.

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The owner of a small chain of schools in Arizona and Colorado took over a small nonprofit think tank, which then contracted to buy his college for $431 million and to rent the buildings from him for $5 million a year.

Source: Patti Cohen, "Some Private Colleges Turn a Tidy Profit by Going Nonprofit," *New York Times*, March 3, 2015.

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A Florida chain pays $14.6 million in annual rent to the school's former owner, who is the nonprofit's chancellor and major creditor. Board members include vendors paid by the college.

Sources: Patti Cohen, "Some Private Colleges Turn a Tidy Profit by Going Nonprofit," *New York Times*, March 3, 2015; David Halperin, "Should This College Operator Run a Key Federal Oversight Panel?" *Republic Report*, June 19, 2017.

The nonprofit purchase of the for-profit Art Institutes "is financially murky, documents show, backed by an outside investor and fraught with a potential conflict of interest."

Source: Molly Hensley-Clancy, "How The For-Profit College Art Institutes Found A Savior With Christian Roots," Buzzfeed News, August 4, 2017.

Keep in mind

1. Nonprofit and public oversight is effective in reducing exploitation in education.
2. But the nondistribution constraint--the restriction that makes nonprofits safer for consumers--must be *enforced.*
3. Accreditors and policymakers must not be complacent.

A look at history shows for-profit college scandals occurring again and again and again.

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Preying on the poor was a common scam in medical schools a century ago.

"A clerk . . . in the country store gets an alluring brochure which paints the life of the physician as the easy road to wealth. . . Such a boy falls an easy victim to the commercial medical school."

Source: Abraham Flexner, Medical Education in the United States and Canada (New York: Carnegie Foundation for the Advancement of Teaching, 1910), xv.

The Flexner report rated a majority of medical schools as defective with low admission standards, poor laboratory facilities, and minimal exposure to clinical material. "Flexner sounded the death knell for the for-profit proprietary medical schools in America."

Source: Thomas P. Duffy, "The Flexner Report--100 Years Later," *Yale Journal of Biology and Medicine*, 2011 Sep; 84(3): 269–276.

The first Federal Student Aid Program, 1934-43, aided one-eighth of all college students.

For-profits were not included, and there were no major scandals (even without an accreditation requirement).

Source: See Kevin P. Bower, Bower, K. (2004). "A favored child of the state: Federal Student Aid at Ohio Colleges and Universities, 1934-1943." *History of Education Quarterly*, 44(3), 364-387.

The 1944 GI Bill enabled millions of soldiers returning from World War II to enroll in college or job-training programs. At the same time, however, many for-profit trade schools took advantage of the vouchers by recruiting veterans into what turned out to be low-quality programs.

Source: David Whitman, "Truman, Eisenhower, and the First GI Bill Scandal," The Century Foundation, January 24, 2017.

"The Government was overcharged . . . particularly in profit schools. . . these schools enrolled...many veterans...in courses leading to occupational fields where the employment prospects were far from good. . . much of the training in profit schools was of poor quality."

— Eisenhower Administration report

Source: The President's Commission on Veterans' Benefits, "Veterans' Benefits in the United States," April 1956, 10.

In 1958, in creating the National Defense Education Act, President Eisenhower and Congress limited the funding to public and nonprofit institutions.

The historical record includes no reports of major scandals.

Ibid.

Federal officials thought that the abuses were a thing of the past:

> "[M]ost of the areas of abuse detected in the earlier World War II program were eliminated."
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> — Veterans Affairs chief testifying about the GI Bill for Vietnam veterans, 1971

"Educational Benefits Available for Returning Vietnam Era Veterans, Part I," Hearings before the Subcommittee on Readjustment, Education, and Employment, Senate Committee on Veterans' Affairs, 92nd Cong., 2nd Sess., March 23, 1972, 51.

However, the abuses returned with a vengeance:

> "[P]rivate profit making home study schools" used misleading advertisements and "sophisticated sales techniques" to take advantage of Vietnam veterans and servicemen, who subsequently dropped out at high rates.
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> — Congressional report, 1973

"Final Report on Educational Assistance to Veterans: A Comparative Study of Three G.I. Bills," Committee on Veterans' Affairs, U.S. Senate, Senate Committee Print No. 18, September 20, 1973, 93rd Cong., 1st sess., 171, 181.

Federal loans, newly available to for-profit colleges in the early 1970s, exacerbated abuses:

> "[T]he availability of federal loans and grants has worsened the shoddy recruitment, advertising, and enrollment practices of the proprietary schools industry.. . . allow[ing] marginal schools to add thousands of students to heir rolls without regard for proper career training."

Source: "Proprietary Vocational and Home Study Schools," Final Report to the Federal Trade Commission and Proposed Trade Regulation Rule, Federal Trade Commission, December 10, 1976, 318.

Boston Globe series, March 1974.

“Often the mere mention of the federal government to potential students implies, and is understood as, government inspection and approval of course content and job placement.”

For salespeople, “[t]he natural and logical reaction” to the wide availability of federal loans “was to oversell.”

Source: “Proprietary Vocational and Home Study Schools,” Final Report to the Federal Trade Commission and Proposed Trade Regulation Rule, Federal Trade Commission, December 10, 1976, 318-9.

Washington Post series, June 1974.

In 1976, the Ford Administration adopted reforms:

Aid could be cut off for any school where more than 60 percent of students use federal loans.

VA also required a market test of value: some students—at least 15 percent—paying for programs receiving GI Bill funds *without aid from any federal agency*.

Source: David Whitman, "Vietnam Vets and a New Student Loan Program Bring New College Scams," The Century Foundation, February 13, 2017.

In 1982, President Ford's Secretary of Health, Education, and Welfare thought the problem had been successfully addressed: "History apparently had judged our efforts to limit [student loan program] abuses to be successful."

Source: Caspar W. Weinberger, "Reflection on the Seventies," *Journal of College and University Law 8*, no. 4 (1981–82).

But by the mid-1980s, the abuses returned again. GAO found in 1984 that "83 percent of proprietary schools consistently failed to enforce academic progress standards" and, that of the 1,165 for-profit schools studied, "766 of them has misrepresented themselves during the recruitment process; 533 overstated job placement rates; 366 misrepresented scholarships; and 399 misrepresented themselves in advertising."

Source: David Whitman, "The Reagan Administration's Campaign to Rein In Predatory For-Profit Colleges," The Century Foundation, February 13, 2017.

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Trade Schools Cited for Abuses In U.S. Reports

By JOE DAVIDSON
Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON — Education Secretary William Bennett said many private trade schools cheat students and federal student-aid programs through "exploitative and deceitful practices."

In a letter to Sen. Edward Kennedy (D., Mass.), chairman of the Labor and Human Resources Committee, Mr. Bennett said several reports the department provided to the committee show a "pattern of abuse . . . that is shameful and tragic."

"You will find accounts of semiliterate high school dropouts lured to enroll in expensive training programs with false promises of lucrative jobs, only to have their hopes for a better future cruelly dashed," the secretary wrote. "You will read of falsified scores on entrance exams, poor quality training, and harsh refund policies."

"The pattern of abuses revealed in these documents is an outrage perpetrated not only upon the American taxpayer but, more tragically, upon some of the most disadvantaged, and most vulnerable, members of our society."

Jerry Miller, president of the Association of Independent Colleges and Schools, said he has a "growing concern" about Mr. Bennett's charges, but disagrees with him on the scope of the problem.

Mr. Miller, whose organization represents 680 one-year and two-year business schools, did agree with the portion of Mr. Bennett's letter that said, "The majority of private career schools seem to produce well-trained students who get jobs in their field of training and have low default rates on their loans."

However, the secretary's letter also said such proprietary schools "make up a disproportionate share of institutions with high rates of defaulted student loans." About 44% of the $3.6 billion budget for the guaranteed student loan program this fiscal year is allocated for payment on defaulted loans, a department spokesman said.

Mr. Bennett said his department is increasing investigative and enforcement activities for private trade schools, proposing new criteria for accrediting organizations

Source: *Wall Street Journal*, February 10, 1988, p. 33.

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For-profit schools, where almost every student was on federal aid, claimed that very high default rates were because of the students they enrolled.

Spreading the Blame

Mr. Burrell said it is unfair to compare his school's default rate, which he said was closer to 59 percent, to that of schools serving a smaller proportion of disadvantaged students. "Not everyone is academically inclined to go to a four-year university," he said. "And because of the populace we serve it is anticipated that it would be different than for New York University or something." (New York University's default rate is 7.8 percent.) The blame for the problem should be more evenly spread among the schools, the Federal Government and the lenders that award the loans, he said.

Source: Julie Johnson, "Loan Enforcers Focus on Trade Schools," *New York Times*, June 11, 1989.

In 1992, Congress adopted several reforms to curb abuses. At the signing ceremony, President George Herbert Walker Bush said: “[T]hese provisions will crack down on sham schools that have defrauded students and the American taxpayer.”

Source: David Whitman, “When George H.W. Bush ‘Cracked Down’ on Abuses at For-Profit Colleges,” The Century Foundation, March 9, 2017.

In 1997, after many colleges closed as a result of the 1992 reforms, the head of the for-profit college association, declared the problem solved: “[A] stronger group of schools is emerging to carry, at a high level of credibility, the mantle of training and career development.”

He became the president of ITT Tech.

Source: Stephen Burd, "The Subprime Student Loan Racket," *Washington Monthly*, Nov/Dec. 2009.

In 2002, in adopting regulations relaxing the ban on bounty payments to recruiters, the Secretary of Education said that abuses could not recur:

> **Abuses are "no longer possible today. . . most of those unscrupulous institutions were terminated . . . because of their high cohort default rates."**

Source: *Federal Register*, Vo. 67, No. 212, Nov. 1, 2002, p. 67054.

In June 2004, the CEO of Corinthian Colleges CEO also declared that it was a new day:

> **While there had been "justified concern about fraud and abuse perpetrated by certain for-profit institutions," there is no longer danger because such problems were "effectively addressed" by 1992 reforms.**

Source: "H.R. 4283, The College Access and Opportunity Act: Are Students at Proprietary Institutions Treated Equitably Under Current Law?" House Committee on Education and the Workforce, June 16, 2004, pp. 37-38.

The following month, the ITT Tech president resigned in the face of a federal probe of predatory recruitment practices.

Source: Elizabeth Farrell, “President of ITT Resigns; Company Denies Any Link to Shareholders’ Suit and Federal Inquiry,” *Chronicle of Higher Education*, July 13, 2004.

Two months later, a probe of the University of Phoenix revealed sales tactics that ranged “from illegal to unethical to aggressive.”

Source: Dawn Gilbertson, “Student-recruitment tactics at University of Phoenix blasted by feds,” *Arizona Republic*, Sept. 14, 2004.

In 2006, Congress eliminated the requirement that federally-funded online schools also have ground campuses. Explosive enrollment growth followed, along with abuses.

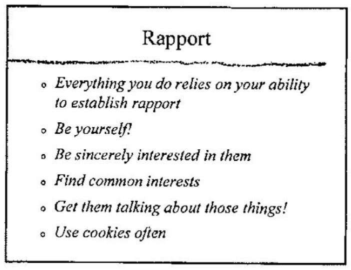
Source: See Chris Kirkham, “John Boehner Backed Deregulation of Online Learning, Leading to Explosive Growth at For-Profit Colleges,” *Huffington Post*, July 29, 2011 (updated January 23, 2012).

“Between 2001 and 2009, the Department of Education—with the enthusiastic support of the for-profit higher education industry—largely turned a blind eye to questions of problematic practices by for-profit colleges."

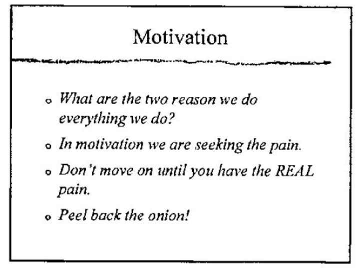
— Frederick M. Hess, Michael B. Horn, and Whitney Downs Hess

Source: "Introduction," in Frederick M. Hess and Michael B. Horn, eds., *Private Enterprise and Public Education*, Teachers College Press, 2013, p. 5.

Abuses escalated into the 2008-9 recession.

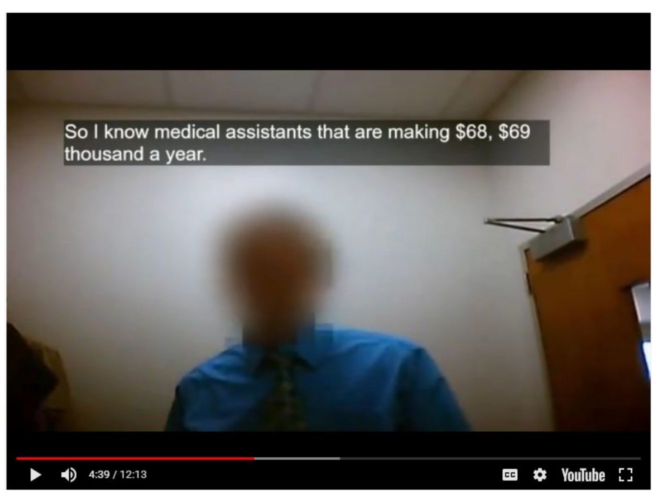

Rapport

- *Everything you do relies on your ability to establish rapport*
- *Be yourself!*
- *Be sincerely interested in them*
- *Find common interests*
- *Get them talking about those things!*
- *Use cookies often*

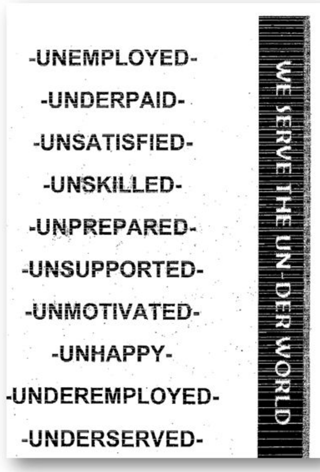

Motivation

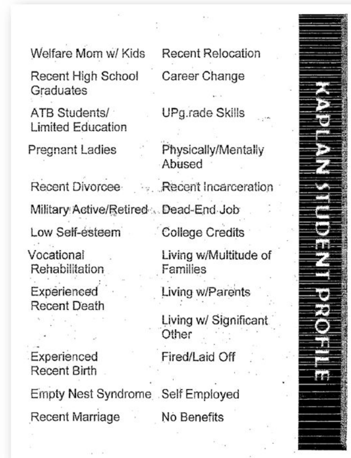
- *What are the two reason we do everything we do?*
- *In motivation we are seeking the pain.*
- *Don't move on until you have the REAL pain.*
- *Peel back the onion!*

Source: Slides from ITT Tech sales training materials, 2010.



Source: "Undercover Testing Finds Colleges Encouraged Fraud and Engaged in Deceptive and Questionable Marketing Practices," GAO, Aug 4, 2010.





Source: "Commitment Based Selling Admissions Training," Kaplan Higher Education, undated (from 2010-12 Senate investigation).

"Operating essentially as a recruitment mill, EDMC's actions were not only a violation of federal law but also a violation of the trust placed in them by their students - including veterans and working parents - all at taxpayer expense."

— Attorney General Loretta Lynch

Source: Department of Justice, "For-Profit College Company to Pay $95.5 Million to Settle Claims of Illegal Recruiting, Consumer Fraud and Other Violations," November 16, 2015.

NACIQI's leadership is needed to assure that nonprofits, at least, are safe for students and taxpayers.

State monitoring and oversight of nonprofit corporations is frequently minimal to nonexistent.

Source: Lloyd Hitoshi Mayer, "Fragmented Oversight of Nonprofits in the United States: Does it Work? Can it Work?" *Chicago-Kent Law Review*, 2016.

The IRS, meanwhile, “is badly underfunded” and has been crippled by an unrelated political issue. Further, IRS procedures “often presume that a nonprofit with substantial ties to a money-making business can be trusted with nonprofit status, as long as there is another regulator around to police the firm.”

Source: Brian Galle, “Conversions of For-Profit to Nonprofit Colleges Deserve Regulators’ Scrutiny,” Medium, April 3, 2018.

Education Department regulations do not allow exclusive reliance on an IRS designation for an institution to be considered nonprofit. To qualify as nonprofit, institutions must not allow profit-taking (“Is owned and operated by one or more nonprofit corporations or associations, no part of the net earnings of which benefits any private shareholder or individual”)

Sources: 34 CFR 600.2.

Department regulations further require institutions to “act with the competency and integrity necessary to qualify as a fiduciary” for the government “in accordance with the highest standard of care and diligence.”

Source: 34 CFR 668.82.

As gatekeepers to federal funds, accreditors are required to ensure that schools are complying with federal requirements as identified by the Department.

Sources: 34 CFR 602.16(a)(1)(x).

NACIQI should

1. Recommend that the Secretary place a moratorium on federal approval of conversions to nonprofit status until the Education Department's procedures can be updated to reflect the unreliability of IRS determinations.

NACIQI should

2. Inform accreditors that, in its reviews, NACIQI will assess whether accreditors are reviewing nonprofit colleges, and conversion requests, to ensure that college governance is not contaminated by contracts, promises-to-pay, or real estate deals that undermine the integrity of the nonprofit.

NACIQI should

2. Recommend that Federal Student Aid make public all requests for pre-acquisition review, and establish a process for public input.