May 4, 2017

The Honorable Betsy DeVos
Secretary of Education
U.S. Department of Education
400 Maryland Avenue SW
Washington, DC 20202

Dear Secretary DeVos:

We write regarding a proposal from the Education Management Corporation (EDMC) for a change of ownership involving campuses of Argosy University, South University, and the Art Institutes. EDMC proposes to sell these schools to the Dream Center Foundation, which intends to place them in a newly-created subsidiary, Dream Center Education Holdings, LLC. The CEO of the new subsidiary, Brent Richardson, would provide a portion of the financing for the transaction through a family trust, as would Najafi Companies, the current co-owners of the University of Phoenix.

Congress has vested authority in you, as the Secretary of Education, to approve changes in ownership and control for institutions of higher education that wish to continue to participate in federal student loan and grant programs. Given the deeply troubling past performance of EDMC, the proposed transaction should not be rubber stamped behind closed doors. To ensure that the ultimate decision and conditions are in the public interest, we request that you solicit written comment on any proposed provisional program participation agreement and hold a public hearing prior to any final determination. Public hearings and comment periods are standard practice for other federal agencies when considering changes in ownership of regulated entities such as federal bank charters and telecommunications licenses.

While it is questionable that approval is warranted given the lack of demonstrated administrative capability of the new owners, your approval should be conditioned on a favorable determination on three separate questions: (1) whether the operations of the schools going forward are likely to avoid the predatory practices that plagued the company previously, (2) whether the claim of a nonprofit control structure is justified and will set and maintain a path for the schools that is in the best interests of students and taxpayers, and (3) whether taxpayers are adequately protected against financial insolvency that could trigger immense public costs.

The Schools Need to Break from Their Problematic Past

Over a decade or more, EDMC engaged in practices that provided low value for students and taxpayers, including:

- ***Emphasizing rapid growth over serving students***. In just the four years between 2006 and 2010, enrollment at EDMC schools nearly doubled from 80,000 to 158,000. In

2010, the company employed 5,669 recruiters but only 321 career services employees and 1,187 student services employees.[1] The U.S. Department of Justice accused EDMC of running a "high pressure sales business" rather than a school. In announcing a $95.5 million settlement of a federal lawsuit alleging that EDMC defrauded taxpayers, Attorney General Loretta Lynch said: "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."

- ***Targeting inexperienced customers***. Company recruiters, by focusing on high-need students with little or no family experience with paying for college, could minimize serious consideration of price or value by the customer. Internal documents show that EDMC recruiters were trained to avoid answering questions about tuition by focusing instead on the "out of pocket expense," which could be zero with federal aid. As a result, some EDMC schools received upwards of 90 percent of their revenue from federal aid.[2]

- ***Shortchanging teaching and learning***. Data from 2009 indicates EDMC spent less than a quarter of its revenue on instruction, less than the amount spent on marketing. Most of the revenue came from tuition paid by taxpayer-financed grants and loans.[3]

- ***Gaming the student loan default rate***. Rather than educate students well and place them in jobs so that they could repay their loans, EDMC hired firms to cajole former students into "forbearance" status on their federal loans, reducing the school's default rate but not addressing the real problem.[4]

- ***Encouraging additional debts that students would not be able to repay***. EDMC arranged for students to take out institutional loans in addition to federal loans, even though an estimated 42 percent were expected to default. After a coalition of state attorneys general cited the company for unfair and deceptive recruitment and enrollment practices, EDMC agreed to forgive debts totaling $102.8 million for more than 80,000 borrowers.

The EDMC schools need to change, revamping their entire approach to recruitment, pricing and instruction. A transfer of ownership could, theoretically, shift the schools' focus to become positive forces in their communities. Inexplicably, however, the purchaser seems unaware of the

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[1] United States Senate, Committee on Health, Education, Labor and Pensions, *For Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success*, 2012 (hereafter, Senate HELP). EDMC section available at https://www.help.senate.gov/imo/media/for_profit_report/PartII/EDMC.pdf

[2] In 2012, South University had an estimated 94 percent federal funds (Defense, Education, and Veterans combined) and the Art Institute of Phoenix 91 percent, according to data released by the U.S. Department of Education.

[3] Senate HELP.

[4] Senate HELP.

need for change, declaring that “the Dream Center will continue to operate these institutions as they have operated.” That is alarming and unacceptable.

Even if the Dream Center were aware, or becomes aware, of the need for a serious change in the operational model, its options may be severely limited by financing arrangements that require ongoing payments to financiers, including the CEO. The Dream Center could discover that it has acquired a predatory model of operations, but be bound by its financing to continue it, while the CEO of the schools, meanwhile, has a financial conflict of interest due to his partial financing of the purchase.

If the change of ownership is approved, it should be only on a provisional basis. The Secretary has wide latitude to condition provisional participation on conduct and outcome standards. To ensure that the EDMC schools operate in the best interest of students and taxpayers following their acquisition, any proposed provisional program participation agreement should include the following conditions:

1. No provisions in enrollment agreements forcing students to bring any disputes to private arbitration or banning class action lawsuits.

2. All marketing calls should be recorded and subject to federal and state monitoring.

3. Continue gainful employment regulation standards, disclosures and consequences to all programs for the duration of any financing arrangements for the transaction, plus two years. More than 150 EDMC programs failed the gainful employment standards.

4. Prevent unchecked federally-funded enrollment increases in programs that are not demonstrating value and market viability through the enrollment of students funded by employers, family earnings or savings, and private scholarship programs. For example, in programs offered online or in multiple locations (making rapid enrollment increases possible), federal aid to additional students could be dependent on enrolling at least 15 percent of students who are not using federal aid of any type.

5. If in the first three years the new owner wants Title IV funds to be disbursed by the "advanced payment" (rather than “reimbursement” method), require the new owner to demonstrate that it has set aside enough funds to cover refunds equal to at least 50% of Title IV receipts for the applicable schools in the prior fiscal year.

The Nonprofit Control Structure Must Be Real, Without Conflicts

The Dream Center is asking that the colleges it is purchasing be treated as nonprofit after the sale. The principle underlying the use of a nonprofit control structure is to change the enterprise’s behavior by altering the financial incentives. Eliminating financiers from institutional governance and requiring all revenue to be re-invested is what generally causes nonprofit institutions to be less focused on rapid growth and more inclined to spend resources on instruction and student support. That model would help shift EDMC schools from their past problematic behaviors. Indeed, EDMC web sites currently say "We're going non-profit...Invest in minds, not profits."[5]

The method of financing this purchase, however, combined with the planned governance structure, could negate the intended effect of the nonprofit control structure. The Dream Center plans to operate the schools through a partnership run by one of the financiers, with an employment contract that has not been disclosed, answerable to seven board members who have not been disclosed. The arrangement may well violate the Department's requirement that nonprofit schools be "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*" (emphasis added).

"Nonprofit" tells consumers that an institution has a control structure that, without a conflict of interest, can balance the school's need for money with its educational or charitable goals. If it allows schools with financial conflicts built into their governance to be treated as nonprofit institutions for purposes of federal higher education laws, the Department would be facilitating a deception of consumers and exposing taxpayers to heightened risk.

We ask that you examine the proposed EDMC transaction carefully to ensure that, if the former EDMC schools are to be treated as nonprofit institutions, they in fact have a control structure without financial conflicts of interest. No tentative or final approval of the change of ownership should be approved until the details of the proposed transaction, governance, and plan of operation are reviewed, including:

1. The governance structure of the Dream Center and the proposed governance of Dream Center Education Holdings, LLC.

2. The details of the employment agreement with Brent Richardson.

3. The terms and conditions of the financing arrangement with the Richardson Family Trust and the Najafi Companies.

4. The details of any other financing for the transaction.

5. Any existing, or plans for, real property purchases or lease agreements involving the EDMC campuses and people associated with the Dream Center.

Nonprofit institutions are awarded certain freedoms under the Higher Education Act because of the significant governance and spending restrictions by which they must legally abide as

[5] See, for example, https://www.artinstitutes.edu/orange-county.

nonprofit entities. The Department must ensure that institutions seeking the benefits of the nonprofit label actually have the accountability of a valid nonprofit control structure. As you gather more information regarding the Dream Center's plans and the contents of the agreements, we ask that you make the information public, and hold a public hearing, so that we and others can provide input based on a more complete record. There is no reason to conduct these reviews behind closed doors, denying the agency the benefit of outside expertise and analysis.

This proposed transaction presents an opportunity for the Department to prevent another repeat of scandalous mistreatment of students and taxpayers. Thank you in advance for your careful attention to this matter.

Sincerely,

Americans for Financial Reform
AMVETS
Association of the United States Navy
Blue Star Families
Center for Responsible Lending
Children's Advocacy Institute
Consumer Action
Consumer Federation of America
Consumer Federation of California
Consumers Union
David Halperin, Attorney
East Bay Community Law Center
Generation Progress
Higher Ed Not Debt
Ivy League Veterans Council
League of United Latin American Citizens
Maryland Consumer Rights Coalition
National Consumer Law Center (on behalf of its low-income clients)
Project on Predatory Student Lending of the Legal Services Center of Harvard Law School
Public Counsel
Public Law Center
Robert Shireman, The Century Foundation Senior Fellow
The Institute for College Access and Success
U.S. Coast Guard Chief Petty Officers Association & Enlisted Association
U.S. Public Interest Research Group
Veterans Education Success
Veterans for Common Sense
Veterans Student Loan Relief Fund
Vietnam Veterans of America

Young Invincibles

cc: Relevant accreditors, state agencies, Congressional committees, and federal officials