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Mortgaging Human Capital: Federally Funded Subprime Higher Education

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Mortgaging Human Capital: Federally Funded Subprime Higher Education

Jean Braucher*

Abstract

The for-profit higher education sector, primarily funded by federal student aid dollars, produces both the highest debts and defaults and lowest completion rates for its students. In response, the U.S. Department of Education (DOE) has promulgated the Gainful Employment Rule to require for-profit colleges and universities to meet either repayment or debt-to-income benchmarks to remain eligible to receive federal Higher Education Act funding. This Article describes the business model of the career colleges and their rapid growth over the last decade, the history of proprietary school regulation, the limited remedies for overindebtedness of former students, and the tests imposed by the DOE rule. Although weakened after a massive lobbying effort, the Gainful Employment Rule as promulgated still promises to put some of the worst performing for-profit programs out of the business of operating on a federal dole. This Article compares the bubbles in for-profit higher education and subprime mortgages, both of which involved federal encouragement of high risk-taking to achieve the American Dream. It concludes by questioning the federal policy of relying on for-profit schools to meet national higher education goals.

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I. Introduction

For-profit colleges have expanded rapidly in the last decade, using primarily federal student grant and loan funds for their revenue.¹ As will be detailed here, these schools, also known as

1. See *infra* Part II.D (discussing for-profit colleges' disproportionate reliance on federal funds). Not included in the analysis of this Article are for-profit institutions that do not receive federal student aid and *thus* do not report under these programs. See Stephanie Riegg Cellini and Claudia Goldin, *Does Federal Student Aid Raise Tuition? New Evidence on For-Profit Colleges*, NBER Working Paper No. 17827 (2012), available at <http://www.nber.org/>

career or proprietary colleges, produce on average significantly higher debt burdens and default rates for former students than other sectors of higher education, indicating many of the for-profit colleges do not achieve their mission of preparing students for “gainful employment.”² Because so many former students of these institutions will not be able to repay, it is appropriate to classify for-profit higher education as involving fringe credit.³ Even though much of the credit is in the form of federal student loans with reasonable interest rates,⁴ the label “subprime higher education” accurately captures the nature of the risk to individual students. Some students in addition take out private loans to go to for-profit colleges, further upping the risk of default.⁵ Furthermore, the demographic profiles of those taking

papers/w17827 (in a study based on data from agencies in five states, Florida, Michigan, Missouri, Tennessee, and Wisconsin, estimating that exclusion from federal data of for-profit schools not participating in federal student aid programs may result in understatement by half of the number of for-profit postsecondary schools and by about 37% of enrollment in the for-profit sector). This Article focuses on the for-profit schools that rely on revenue from federal student aid programs and the resulting overindebtedness, so not too much is lost by not including in the analysis new data from five states about schools that are mostly non-degree granting vocational programs and thus not part of the federal drive to attain universal higher education. See *infra* note 223 and accompanying text. At any rate these data were made public too late to be taken into account here.

2. See *infra* Parts II.E, III.B (discussing high dropout and loan default rates at for-profit colleges, and discussing the Gainful Employment Rule).

3. See *infra* Part II.E (discussing difficulty in loan repayment experienced by former students of for-profit schools).

4. COLLEGE BOARD, TRENDS IN STUDENT AID 15 (2011) [hereinafter TRENDS IN STUDENT AID 2011] (reporting interest rates on various federal loans ranging from 3.4% to 6.8% in 2011–2012). There have been huge changes in the mix of higher education loans in recent years: as of July 1, 2010, the federal government stopped guaranteeing educational loans made by private lenders in favor of providing direct federal student loans. *Id.* at 8–9. Also, the private student loan market shrank dramatically after the financial crisis of 2008, from \$22.1 billion in 2007–2008 to \$6 billion in 2010–2011. See *id.* at 4, 10.

5. See Project on Student Debt, PRIVATE LOANS: FACTS AND TRENDS 1 (July 2011) (reporting that 42% of for-profit students used private loans in 2007–2008, up from 12% in 2003–2004, and compared to 25% of students at private nonprofit four-year schools in 2007–2008, 14% of students at public four-year schools, and 4% of students at public two-year schools), available at http://projectonstudentdebt.org/files/pub/private_loan_facts_trends.pdf. Although private student loans have dropped sharply since 2007–2008, students who use them pay higher interest rates than on federal loans; furthermore, for-profit schools have responded to the decline in the private student loan supply by

out student loans to go to for-profit schools—disproportionately poor, minority, single parents, and military personnel—are similar to the targets of other fringe credit providers, such as payday lenders and the purveyors of subprime mortgages involved in the mortgage crisis.⁶ The limited academic preparation of many career college students contributes to the high-stakes gamble of taking on large educational debt.⁷

making loans themselves. See TRENDS IN STUDENT AID 2011, *supra* note 4, at 9, 13; see also *infra* Part II.D (explaining that schools cannot receive more than 90% of their revenue from federal higher education aid programs, so making loans to their own students is a way to comply with this federal restriction).

6. See Program Integrity: Gainful Employment, 75 Fed. Reg. 43,616, 43,654 (proposed July 26, 2010) [hereinafter Proposed Gainful Employment Rule Analysis] (discussing argument of the for-profit industry that their high default rates are due to enrolling different types of students, particularly low-income students, and rejecting it on the basis that the industry's own assessment found that differences in student characteristics accounted for only about half of the difference in defaults) (to be codified at 34 C.F.R. § 668); *id.* at 43,655 (discussing responsibility of institutions to recruit and enroll students who can succeed at their institutions and quoting a blog post of Judge Richard Posner comparing aggressive marketing of for-profit colleges to vulnerable low-income persons lacking in financial sophistication to the marketing of mortgage loans during the housing bubble); see also Complaint and Prayer for Declaratory and Injunctive Relief ¶ 21, Career Coll. Ass'n v. Duncan, Docket No. 1:11-cv-01314 (July 20, 2011), available at <http://www.apscu.org/iMISPublic/Content/ContentFolders/WhatsHot/GainfulEmploymentComplaint-07202011-StampedCopy.pdf> (emphasizing that career colleges serve “nontraditional students” and giving these statistics about their students: “76% live independently without parental support, 63% are over 24 years old, 54% delayed postsecondary education after high school, 45% have parents who did not go to school beyond high school, 47% have dependent children, 40% are minorities, and 31% are single parents”); Steven Eisman, Subprime Goes to College, Presentation at the Ira Sohn Conference (May 26, 2010), available at <http://www.scribd.com/doc/32066986/Steve-Eisman-Ira-Sohn-Conference-May-2010> (comparing the bubble in subprime mortgages with the growth in the for-profit college sector); Steven Eisman, Subprime Goes To College, Testimony Before the U.S. Senate Committee on Health, Education, Labor and Pensions, (June 24, 2010), available at <http://help.senate.gov/imo/media/doc/Eisman.pdf>; MAMIE LYNCH ET AL., THE EDUCATION TRUST, SUBPRIME OPPORTUNITY: THE UNFULFILLED PROMISE OF FOR-PROFIT COLLEGES AND UNIVERSITIES (Nov. 2010) available at http://www.educacion2020.cl/index.php?option=com_docman&task=doc_download&gid=141&Itemid=55 (discussing poor results for minority and low-income students who attend for-profit institutions).

7. See Complaint and Prayer for Declaratory and Injunctive Relief, *supra* note 6, ¶¶ 6–7 (arguing that the DOE's Gainful Employment Rule, 34 C.F.R. § 668.7 (2011), targets “the quality of a school's enrollees” rather than the quality of its programs and creates “massive disincentives” to serving “low-income, minority, and other traditionally underserved student populations” who

Lately there is much discussion of whether higher education in general is “worth it.”⁸ The answer is likely to be no for much of subprime higher education, as will be detailed below. Under a principle of “worst things first,” for-profit colleges deserve regulatory and enforcement attention. That other higher education could benefit from reform, too, is not grounds for ignoring the need for targeted regulation of for-profit colleges.⁹ At

are “the most at risk” of not meeting new regulatory tests based on repayment and debt-to-income ratios); *infra* Part III.B (discussing the tests under the new Gainful Employment Rule).

8. See e.g., Pew Research Center, *Is College Worth It?: College Presidents, Public Assess Value, Quality and Mission of Higher Education*, SOCIAL & DEMOGRAPHIC TRENDS, May 16, 2011, available at <http://www.pewsocialtrends.org/files/2011/05/higher-ed-report.pdf> (presenting evidence that, despite growing dissatisfaction with the price, both rates of employment and incomes increase with a college education, as well as health, happiness, rates of marriage, sense of personal intellectual development and other forms of personal satisfaction, and prospects of graduates’ children). The dissatisfaction with the price is in part a matter of decreased public subsidy, particularly for public universities. See *infra* Part IV.B (discussing the recent decline in subsidies resulting from state budget crunches). Concerning the difference between the sticker price and the price paid in different sectors of higher education, for-profit higher education has a higher net price than public university education and much of private nonprofit higher education. Price, however, must be distinguished from cost; the cost of for-profit education is relatively low, compared to prime higher education, which involves significant public and philanthropic support. See *id.* (discussing the fact that despite the high price to students, the production cost of education at for-profit schools is relatively low).

9. There is a great deal of variation within the various sectors of higher education, whether for-profit, public, or private nonprofit. See Amanda Harmon Cooley & Aaron Cooley, *From Diploma Mills to For-Profit Colleges and Universities: Business Opportunities, Regulatory Challenges, and Consumer Responsibility in Higher Education*, 18 S. CAL. INTERDISC. L.J. 505, 506–07 (2009) (discussing variations in form and success within the for-profit sector); see also Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43,654 (discussing variations in default-completion ratios within sectors); 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 18–19 (2009) (noting that some proprietary schools have low loan default rates). Nonetheless, targeted regulation of the for-profit sector based on loan repayment and debt-to-income ratios can be justified in light of these schools’ different missions. The Pew Report discusses the difference in the missions of the schools through the lens of what their presidents’ say about them: “Seven-in-ten heads of four-year public and private colleges emphasize intellectual and personal growth, while about two-thirds of the heads of two-year and for-profit colleges emphasize career preparation.” Pew Research Center, *supra* note 8, at 15. Career preparation is

a minimum, that regulation should put the worst performers out of the business of living on federal funds, which is what the U.S. Department of Education (DOE) plans to do under its new Gainful Employment Rule,¹⁰ scheduled to go into effect July 1, 2012.¹¹ This rule will not eliminate the waste of taxpayer dollars or the human pain to former students caused by this industry,¹² but it is a start. In addition, it is worth noting that the growing problem of student loan overindebtedness generally, in the public and nonprofit sectors as well as in the for-profit sector, has been underexplored in the legal literature. Many more legal scholars could profitably turn to critical analysis of the student-loan debt problem in its multiple manifestations, particularly the need for preventative regulation as well as after-the-fact remedies.¹³ This Article is a first effort to analyze the current state of regulation of career colleges' eligibility for federal student aid funds.

While students' risk in the pursuit of subprime higher education has become reasonably well-known through media coverage,¹⁴ it is not necessarily so well understood that there is a

not easy to measure, but it is simple compared to measuring intellectual and personal growth. See Creola Johnson, *Credentialism and the Proliferation of Fake Degrees: The Employer Pretends to Need a Degree: The Employee Pretends to Have One*, 23 HOFSTRA LAB. & EMP. L.J. 269, 288–93 (2006) (discussing the instrumentalism that can overtake loftier goals; as a result the goal of career colleges may not be anything more than providing a credential, a goal that may be shared by student and institutional provider alike).

10. Gainful Employment in a Recognized Occupation, 34 C.F.R. § 668.7 (2011) [hereinafter Gainful Employment Rule].

11. See Program Integrity: Gainful Employment—Debt Measures, 76 Fed. Reg. 34386, 34387 (June 13, 2011) [hereinafter Gainful Employment Rule Analysis] (explaining that the regulation aims to “protect students by removing eligibility [for federal loans] from the worst performing programs that fail the minimum requirements”) (codified at 34 C.F.R. § 668).

12. See *infra* notes 168, 190 and accompanying text (concerning consequences to former students who default on student loans).

13. Some excellent work has been done on the need for debt relief for former students and the lack of a compelling justification for treating them worse than debtors on other types of credit. See *e.g.*, John A.E. Pottow, *The Nondischargeability of Student Loans in Personal Bankruptcy Proceedings: The Search for a Theory*, 44 CAN. BUS. L.J. 245, 266, 276 (2006) (arguing that “there are no compelling empirical data to buttress the myth that students defraud creditors any more than other debtors” and advocating “the adoption of an income-contingent model of debt repayment” that would dry up the market for “sub-prime schools [that] target a financially vulnerable client base”).

14. See, *e.g.*, Tamar Lewin, *Student Loan Default Rates Rise Sharply in*

federal policy of fostering career colleges using student aid funds. This is not just a de facto policy resulting from the considerable talent of the for-profit sector in sucking up federal student aid dollars. Rather, the policy is by federal design. For example, after noting a recent tripling in for-profit college enrollment, DOE stated in July of 2010 “[t]his trend is promising and supports President Obama’s goal of leading the world in the percentage of college graduates by 2020. The President’s goal cannot be achieved without a healthy and productive higher education for-profit sector.”¹⁵

Regulation of for-profit colleges has been very light, and a planned step-up in federal oversight under the Gainful Employment Rule—assuming it is not blocked as a result of an industry lawsuit¹⁶—will still be weak, as DOE concedes.¹⁷ The

Past Year, N.Y. TIMES, Sept. 12, 2011, at A14 (noting that for-profit colleges have led the way in recent default rate increases and that although they enrolled about 10% of the nation’s undergraduates, they accounted for almost half the defaults); Melissa Korn, *For-Profit Schools Increasingly Find the Party Is Over*, WALL ST. J., Aug. 23, 2011, at B1 (discussing student resistance to debt and risk).

15. Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43,617, 43,641. President Obama has frequently decried the nation’s decline in the rate of college education compared to other nations. *See, e.g.*, President Barack Obama, Speech at the University of Texas at Austin (Aug. 9, 2010), <http://www.whitehouse.gov/the-press-office/2010/08/09/remarks-president-higher-education-and-economy-university-texas-austin> (lamenting decline in one generation from first place to twelfth). *See also infra* note 219 (concerning U.S. rate of college graduation in relation to other nations). While DOE claims to have a policy of supporting for-profit education, this could be seen as making the best of a congressional mandate to provide federal student aid to this sector. *See infra* note 113 and accompanying text (concerning proprietary schools becoming eligible to receive federal student aid funds in 1972); *infra* Part IV.B (questioning reliance on for-profit higher education to meet national education goals).

16. Complaint and Prayer for Declaratory and Injunctive Relief, *supra* note 6, ¶¶ 1–13 (seeking, *inter alia*, to enjoin enforcement of the Gainful Employment Rule).

17. *See* Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43,657 (concerning the history of “barest minimum enforcement” of statutory requirement that for-profit colleges prepare students for gainful employment in a recognized occupation; colleges have been required to check a box so stating); *id.* at 43,620 (in proposed regulation, targeting schools at which “it becomes unambiguous that a program’s debt levels are excessive”). That proposed regulation was later watered down. *See* Gainful Employment Rule Analysis, *supra* note 11, at 34,393–95 (June 13, 2011) (lowering required repayment rates for eligibility to 35%) (codified at 34 C.F.R. § 668); *infra* Part III.B.

rule focuses on students' ability to repay their student loans and thus avoids direct quality regulation, which is difficult at best,¹⁸ and at any rate not authorized by the Higher Education Act.¹⁹ This Article questions the federal policy of relying on career colleges to increase the level of higher education in the population. It also seeks to highlight the irony of setting low performance standards for the for-profit schools while providing insufficient debt relief for the substantial numbers of their former students who do not benefit from the education and who end up with unmanageable federal and private student loans and lack of access to a bankruptcy discharge.²⁰ If career colleges cannot be expected to reduce their default rates to the levels of other sectors of higher education, their former students should not be hounded to the grave for repayment. In its Gainful Employment Rule, set to go into effect July 1, 2012, DOE takes the position that high levels of federal student loan default are tolerable; the rule allows schools to remain eligible to receive federal student aid funds if

18. See Marc T. Law & Sukkoo Kim, *Specialization and Regulation: The Rise of Professionals and the Emergence of Occupational Licensing Regulation*, 65 J. ECON. HIST. 723, 732–36 (2005) (discussing difficulty of regulation to ensure quality under conditions of asymmetric information, in which the seller understands quality better than the consumer); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-150, FOR-PROFIT SCHOOLS: EXPERIENCES OF UNDERCOVER STUDENTS ENROLLED IN ONLINE CLASSES AT SELECTED COLLEGES 2 (2011) (stating that undercover investigators who attempted to enroll in 15 for-profit colleges, including the largest five, were able to enroll in twelve with fictitious high school graduation credentials and that at six of these colleges, instructors gave credit for plagiarized, unresponsive, or incorrect assignments).

19. See 20 U.S.C. § 1232a (2006) (depriving DOE of any authority over curricula or administration of institutions of higher education); see also GAO-09-600, *supra* note 9, at 8 (noting that under the Higher Education Act, DOE does not determine the quality of higher education, which is left to accrediting agencies). Accrediting agencies, however, are not necessarily regulating quality of the for-profit schools well. See TOM HARKIN, CHAIRMAN, S. COMM. ON HEALTH, EDUC., LABOR, AND PENSIONS, EMERGING RISK?: AN OVERVIEW OF GROWTH, SPENDING, STUDENT DEBT AND UNANSWERED QUESTIONS IN FOR-PROFIT HIGHER EDUCATION 2–3 (2010) [hereinafter HARKIN, EMERGING RISK?] (noting the practice of for-profit schools buying small regionally accredited schools and expanding dramatically, in particular into virtual education, under the same accreditation). Higher education accreditation should be examined by legal scholars; a detailed critique of its operations is beyond the scope of this Article.

20. See *infra* Part III.C (discussing the lack of sufficient debt relief for student loans, particularly in bankruptcy); see also 11 U.S.C. §§ 523(a)(8), 1328(a)(2) (2006) (excepting educational loans from the bankruptcy discharge absent “undue hardship”).

they maintain repayment rates of only 35% over three out of four years, meaning the rest of the former students are not repaying any principal.²¹ The agency does so despite explicitly recognizing the high risk for any individual student.²² If federal policy is to continue promoting this personal risk-taking, it is time for Congress to amend the Bankruptcy Code to return to the approach of making student-loan debt dischargeable, perhaps with a delay after leaving school.²³

This Article describes the business model of for-profit colleges in Part II. In Part III, it explains the federal government's role in promoting them and also situates the current government position in the sweep of federal policy concerning for-profit higher education and student loans over the last half century. Finally, Part IV compares and contrasts the boom in subprime higher education to that in subprime mortgages. The dollar volume of loans for subprime higher education does not approach that of subprime mortgages,²⁴ but the human cost of both credit complexes is high.²⁵ There are many other similarities. These include, as already mentioned, high risk of default and the demographics of the borrowers. Also striking is how both types of loan have been promoted as a way to achieve the American Dream,²⁶ yet the dream too often has proven unattainable.²⁷ The

21. See Gainful Employment Rule, *supra* note 10; *infra* Part III.B (discussing the Gainful Employment Rule).

22. See Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43,622 (noting “while higher education generally brings higher earnings, there is no guarantee for the individual”).

23. See *infra* Part III.C.

24. See U.S. Census Bureau, Table 1192 Mortgage Debt Outstanding by Type of Property and Holder: 1990–2010 (2012), <http://www.census.gov/compendia/statab/2012/tables/12s1192.pdf> (last visited Apr. 10, 2012) (showing that total U.S. mortgage debt outstanding is about ten times total student-loan debt) (on file with the Washington and Lee Law Review).

25. See *infra* notes 168, 190, 211.

26. LYNCH ET AL., *supra* note 6, at 1.

27. See *id.* (noting that homeownership is “the cornerstone of the American Dream”). Lynch states that:

[t]he developing showdown between for-profit colleges and the government is another example of how the aspirations of the underserved and the unfulfilled promise of the American Dream combine with lax regulation to make the rich, richer and the poor, poorer.

Article ends by advocating stronger regulation that puts more nonperforming for-profit institutions out of the business of living on a federal dole, as DOE plans to do but not as aggressively as it should.²⁸

The subprime higher education bubble appears to be deflating as the industry hunkers down to ride out a long period of economic doldrums.²⁹ Student loan defaults in this sector have spiked,³⁰ but this is not the industry's prime problem now. When borrowers default on federal student loans, the colleges typically already have the money;³¹ the bailout is prepackaged. The current problem for the industry is declining enrollments and thus a decline in new revenue.³² The word is getting out about the poor results of many career colleges and, at least for a time, fewer people are being suckered into a bad bet (and the colleges appear to be deliberately reducing recruitment to avoid enforcement actions and more aggressive regulation in the short term).³³ But many former students still have to cope with the consequences of unmanageable debt. They gambled on the dream of a better life by getting a college education and ended up worse off, too often with huge nondischargeable debts and no improvement in job prospects. Beyond that, there is the question whether it is wise policy to try to achieve national educational goals by funneling federal dollars into for-profit institutions that specialize in evading regulation. Cutbacks in federal funds flowing to these institutions may be the simplest route to reform. Stronger regulation is needed to prevent a resurgence of the for-profit sector as the economy recovers.

28. *Infra* Parts III.B, IV, and V.

29. *See infra* Part II.G (discussing recent declining enrollment at for-profit colleges).

30. *See infra* notes 96–97 and accompanying text (reporting that from the 2008 to the 2009 fiscal year, the cohort default rate for for-profit schools increased from 11.6% to 15%); *infra* Part II.E (discussing higher default rates and lower graduation rates at for-profit colleges).

31. Federal student aid funds are disbursed while students are in school. Often 100% of the funds have been disbursed by the time the student has completed 60% of the semester, even if the student subsequently withdraws. 34 C.F.R. § 668.22(e)(2)(ii) (2011).

32. *See infra* Part II.G (discussing recent declining enrollment at for-profit colleges).

33. *Infra* Part II.G.

II. The Business Model of For-Profit Colleges

For-profit colleges built their business model on rapid growth,³⁴ fueled by aggressive recruiting³⁵ and high use of federal student aid (both grants and loans) to pay high tuition and fees.³⁶ This model has produced large student debt burdens and high defaults.³⁷ The defaults are symptomatic of an underlying pathology: although the mission of career colleges is to improve employability and earnings, placement in good jobs has not lived up to recruiters' claims.³⁸

A. Enrollment Growth

As noted at the outset, enrollment in the for-profit higher education sector rose rapidly in the last decade: from the fall of 2000 to the fall of 2009, full-time enrollment in degree-granting, for-profit schools grew from 366,000 to 1.5 million, an increase from 4% to 11% of full-time college students.³⁹ When part-time students are also included, the growth was from 3% to 9% of all college students.⁴⁰ Indeed, headcounts of both full-time and part-time students show that the number of individuals involved is much larger than the number of full-time students or full-time

34. See *infra* Part II.A (discussing enrollment growth at for-profit colleges over the last decade).

35. See *infra* Part II.B (discussing aggressive and misleading recruitment tactics used by for-profit school).

36. See *infra* Part II.C, D (discussing high net prices of for-profit colleges and their disproportionate reliance on federal funds).

37. See *infra* Part II.E (discussing higher debt-loads and default rates for students at for-profit colleges).

38. See *infra* Part II.B, E (discussing deceptive claims by recruiters about graduation rates, employment, and earning prospects after graduation from for-profit school, and high default and low repayment rates, in part driven by low graduation rates at these schools).

39. SANDY BAUM & KATHLEEN PAYEA, TRENDS IN FOR-PROFIT POSTSECONDARY EDUCATION: ENROLLMENT, PRICES, STUDENT AID AND OUTCOMES 1 (2011), http://advocacy.collegeboard.org/sites/default/files/11b_3376_Trends_Brief_4Pass_110414.pdf.

40. *Id.*; see also COLLEGE BOARD, TRENDS IN COLLEGE PRICING 25 figs.17A, 17B (2010) [hereinafter TRENDS IN COLLEGE PRICING 2010], http://www.naicu.edu/docLib/20101027_CollBd2010Pricing.pdf (showing full-time and part-time enrollments in the various sectors from 2000 to 2009).

equivalents (FTEs).⁴¹ In 2009–2010, 3.3 million undergraduates and 431,000 graduate students attended for-profit schools.⁴² By 2011–12, based on further growth, the for-profit sector was enrolling about 13% of all full-time students.⁴³

It is a misconception that for-profit schools operate mostly in the sphere of shorter or part-time programs.⁴⁴ Students in the for-profit sector are primarily enrolled in four-year degree programs (61% in fall 2009), with 24% of this sector's students in two-year institutions and 15% in less-than-two-year schools.⁴⁵ In addition, most students at for-profit colleges go to school full-time, at an even higher rate than college students as a whole.⁴⁶ Among undergraduates in the for-profit sector, 77% are enrolled full-time (as of fall 2009), while for all undergraduates, 64% are full-time students.⁴⁷ For-profit graduate programs also grew rapidly in recent years, with their share of degrees rising from 1% to 7% of all graduate degrees awarded in the decade ending in the academic year 2007–2008.⁴⁸

41. BAUM & PAYEA, *supra* note 39, at 1 (noting that 62% of postsecondary students enrolled full-time).

42. NAT'L CTR. FOR EDUC. STATISTICS, POSTSECONDARY INSTITUTIONS AND PRICE OF ATTENDANCE IN THE UNITED STATES: 2010–11; DEGREES AND OTHER AWARDS CONFERRED: 2009–10; AND 12-MONTH ENROLLMENT: 2009–10, at 14 tbl.6 (2011) [hereinafter NCES, POSTSECONDARY INSTITUTIONS], <http://nces.ed.gov/pubs2011/2011250.pdf> (counting enrollment by headcount, which means counting part-time students the same as those going to school full-time, and showing 3.3 million undergraduates and 431,000 graduate students at for-profit colleges in 2009–10); *id.* at 15 tbl.7 (counting full-time-equivalent enrollment and showing 2.3 million undergraduates and 246,000 graduate students at for-profit institutions).

43. COLLEGE BOARD, TRENDS IN COLLEGE PRICING 7 (2011) [hereinafter TRENDS IN COLLEGE PRICING 2011], http://trends.collegeboard.org/downloads/College_Pricing_2011.pdf.

44. *See* BAUM & PAYEA, *supra* note 39, at 1 (breaking down for-profit school enrollment in the fall of 2009 by program duration, full-time or part-time, and undergraduate students as compared to total number of students enrolled).

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.*

B. Aggressive Recruiting

Recruiting by for-profit colleges has ranged from aggressive to deceptive and even fraudulent. In a 2010 study, investigators from the Government Accountability Office (GAO) posed as prospective students and registered to receive information on web sites; they quickly received numerous telephone calls, as many as twenty-four in the first twenty-four hours and 182 within a month.⁴⁹ The GAO investigators also posed as in-person applicants and found that all fifteen for-profit schools they visited engaged in “deceptive or otherwise questionable statements,” such as misinformation about accreditation, questionable information about graduation rates, misrepresentations that students were guaranteed employment upon completion and at salaries that few could actually expect to garner, and deceptive information about the duration and cost of the colleges’ programs.⁵⁰ Although some schools’ representatives gave accurate, helpful, and reasonable information, advising applicants of risks, the investigators encountered argumentative and scolding recruiters, marketing techniques that required applicants to enroll before getting information, and overall hard-sell tactics.⁵¹

The worst practices found by the GAO involved encouragement to falsify information on federal financial aid forms (four of the fifteen schools visited).⁵² Schools’ recruiters also attempted to lead applicants to believe that student loans would not be collected and aided them in cheating on application tests

49. GREGORY D. KUTZ, MANAGING DIR., FORENSICS AUDITS AND SPECIAL INVESTIGATIONS, U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-10-948T, TESTIMONY BEFORE S. COMM. ON HEALTH, EDUC., LABOR, AND PENSIONS, FOR-PROFIT COLLEGES, UNDERCOVER TESTING FINDS COLLEGES ENCOURAGED FRAUD AND ENGAGED IN DECEPTIVE AND QUESTIONABLE MARKETING PRACTICES 3, 14–16 (2010) (describing “flood of calls” to four fictitious prospective students who registered on websites). The for-profit college industry attacked this GAO study, leading to a reinvestigation and revision of the study; the revised results are discussed in the text above and in the report. *Id.* at 9, 8 tbl.1, 12, app. I at 19–27.

50. *Id.* at 9–11.

51. *Id.* at 12–14.

52. *Id.* at 7–8, 12.

(by coaching or permitting extra time or a retest to get a higher score).⁵³

A practice that is prohibited by law is providing commissions or other incentive payments to recruiters based “directly or indirectly” on success in enrolling students.⁵⁴ Despite the prohibition on incentive-based compensation, allegations have surfaced of continuance of the practice: for example, four states and the U.S. Department of Justice joined as intervenors in a whistleblower lawsuit against Education Management Corporation alleging continued use of incentive-based commissions.⁵⁵

C. High Net Price

To compare tuition and fees of various sectors, one has to take into account the difference between published prices and what students pay after grant aid from all sources, public and private. The sticker price is not the price paid by most students, as will be detailed below. Although average published prices for tuition and fees are up across the board in recent years, inflation-adjusted net prices actually declined in the five years from 2005–2006 to 2010–2011 due to increases in federal and institutional grant aid.⁵⁶ In 2011–2012, net prices were still down compared to those five years earlier at private nonprofit four-year and public two-year institutions, while they increased slightly at public four-year schools, but much less than published prices.⁵⁷ Only about a

53. *Id.* at 12.

54. 20 U.S.C. § 1094(a)(20) (2006). *See* Career College Assn. v. Duncan, 796 F. Supp. 2d 108 (D. D.C. 2011) (upholding regulation barring incentive compensation to recruiters).

55. *See* Joint Complaint in Intervention by the United States of America, and the States of California, Florida, Illinois, and Indiana ¶¶ 1–11, United States *ex rel.* Washington v. Educ. Mgmt. Corp., Civ. No. 07-461 (W.D. Pa. 2011) (alleging violations of the False Claims Act, 31 U.S.C. § 3729, and Title IV of the Higher Education Act, 20 U.S.C. § 1094); U.S. Dep’t of Justice, *U.S. Files Complaint Against Education Management Corp. Alleging False Claims Act Violations*, JUST. NEWS, Aug. 8, 2011, <http://www.justice.gov/opa/pr/2011/August/11-civ-1026.html> (providing background on *Educ. Mgmt. Corp.*, Civ. No. 07-461 (W.D. Pa. 2011)).

56. TRENDS IN COLLEGE PRICING 2010, *supra* note 40, at 4, 8.

57. TRENDS IN COLLEGE PRICING 2011, *supra* note 43, at 4 (noting that at

third of college students pay the full published prices at nonprofit and public institutions.⁵⁸

The average published tuition and fees for full-time undergraduates in 2011–2012, gathered by the College Board, were:

Public two-year	\$2,963
Public four-year (in state)	\$8,244
Private for-profit	\$14,487
Private nonprofit four-year	\$28,500 ⁵⁹

Again, these published prices are not the same as what students actually pay. Here is the College Board's estimated net average payment for tuition and fees for 2011–12, once grant aid and federal tax credits and deductions are taken into account:

Public two-year	(\$810) ⁶⁰
Public four-year (in state)	\$2,490
Private for-profit	\$4,700
Private nonprofit four-year	\$12,970 ⁶¹

Students received on average the following estimated annual amounts in grant aid from all sources in 2011–2012: \$3,770 at two-year public schools, \$5,750 at public four-year colleges, and

public four-year institutions in the period 2006–2007 to 2011–2012, inflation-adjusted published prices increased by an average of 5.1% per year, while inflation-adjusted net prices at these schools increased on average by 1.4% a year).

58. *Id.* at 8; *see also* TRENDS IN COLLEGE PRICING 2010, *supra* note 40, at 3 (indicating some of that third who do not receive grant aid receive federal tax credits and deductions that help to cover expenses); COLLEGE BOARD, TRENDS IN STUDENT AID 2011, *supra* note 4, at 21 (noting increase in tax savings in the form of education tax credits and deductions from \$6.6 billion in 2008 to \$14.7 billion in 2009, both in 2009 dollars, and also noting that the income ceiling for the tax credit went up from \$120,000 to \$180,000 for joint filers).

59. TRENDS IN COLLEGE PRICING 2011, *supra* note 43, at 3; *see also id.* at 7 (noting that although the College Board provides information on for-profit colleges' average published and net prices, these should be interpreted with caution because they are based on a small sample compared to the data on prices at public and nonprofit schools).

60. The figure is negative because grant aid and tax subsidies on average exceed tuition and fees; the excess can go to other expenses, such as books and room and board.

61. TRENDS IN COLLEGE PRICING 2011, *supra* note 43, at 15 fig. 7.

\$15,530 at private nonprofit four-year schools.⁶² The College Board did not report an average amount of grant aid for students at for-profit schools, and it urges caution in interpreting its pricing information for these schools because of difficulty in obtaining data and the resulting small sample size.⁶³

Grant aid at for-profit schools has been lower on average because they do not offer much institutional grant aid.⁶⁴ In 2007–2008, for example, full-time undergraduate students at for-profit colleges received on average about \$140 in institutional grant aid, compared to over \$7,000 at private nonprofit colleges.⁶⁵ Total grant aid from all sources for full-time dependent students at for-profit schools averaged \$3,610, with 75% of the grant aid being federal grants, compared to \$7,050 in grants on average in 2007–2008 at four-year public colleges, only 25% of it federal.⁶⁶ It should be remembered that public universities typically have lower published and net tuition and fees to begin with than for-profit institutions.⁶⁷ At private nonprofit institutions in 2007–2008, grant aid for fulltime dependent students ranged widely across the four quartiles of pricing, with average grants in each group, from lowest- to highest-priced schools, as follows: \$7,700, \$14,550, \$17,620, \$21,860.⁶⁸ Overall, the average net price at either a two-year or a four-year public school was significantly lower than at a for-profit school, and even at private nonprofit colleges, the average net price is lower or only moderately higher in the lower two quartiles of pricing.⁶⁹ Private nonprofit schools

62. *Id.* (noting that these figures are estimates based on prior years and available information but not full financial aid data). No figure was given for grant aid at for-profit schools. *See supra* note 59 (concerning difficulty of obtaining data).

63. *Id.*

64. BAUM & PAYEA, *supra* note 39, at 4 fig. 3 (showing that in 2007–2008, 73% of grant aid at four-year nonprofit schools and 34% at four-year public schools came from institutional sources, while only 7% of grant aid at for-profit schools was from institutional sources).

65. *Id.* at 4

66. *Id.* at 4 fig. 3, tbl.4.

67. *See supra* notes 59–61 and accompanying text.

68. BAUM & PAYEA, *supra* note 39, at 4 tbl.4.

69. *Id.* (showing the following net average prices, including all expenses, in 2007–2008: \$6,480 for two-year public schools, \$9,030 for public four-year schools in-state, \$16,510 for for-profit institutions, and the following four average net prices, by pricing quartile, for private nonprofit schools: \$12,030,

received only 9% of their grant aid from the federal government in 2007–2008.⁷⁰ Even at nonprofit schools with the highest sticker price, need-based grant aid for low-income students often makes this a cheaper option, and one that comes with better outcomes for those qualified for admission.⁷¹

D. Reliance on Federal Grant Aid and Student Loans

A key feature of the for-profit college business model is maximum use of federal student aid, both grants and loans. “In 2009, the five largest for-profit institutions received 77% of their revenues from federal student aid programs.”⁷² They are permitted to get up to 90% of revenue from Title IV, Higher Education Act funds.⁷³ The rest can be taken from other federal

\$17,400, \$20,570, and \$24,140).

70. *Id.* at 4 fig. 3.

71. Some elite private nonprofit colleges have set family income levels below which students pay nothing for their education. At Yale University, for example, undergraduates from families with annual income under \$65,000 pay nothing. See YALE, FINANCIAL AID, <http://admissions.yale.edu/financial-aid> (reporting, additionally, that 57% of undergraduates received need-based financial aid from the university).

72. Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43,618; see also *supra* note 1 (explaining that the analysis throughout this Article does not include for-profit schools that are not reported in federal data because they do not participate in federal student aid programs).

73. 20 U.S.C. § 1094(a)(24) (2006). In a previous version of this percentage cap, instituted in 1992, schools could receive no more than 85% of their revenue from Higher Education Act Title IV funds. See U.S. GEN. ACCOUNTING OFFICE, GAO/HEHS-97-104, REPORT TO THE CHAIRMAN, H.R. SUBCOMM. ON HUMAN RES., COMM. ON GOV'T REFORM AND OVERSIGHT, PROPRIETARY SCHOOLS: MILLIONS SPENT TO TRAIN STUDENTS FOR OVERSUPPLIED OCCUPATIONS 6 (1997) (discussing the “85-15” rule of the Higher Education Act). The 90/10 rule was put into effect by the 1998 HEA Amendments (Pub. L. No. 105-244), replacing its predecessor, the 85/15 rule, which was authorized by the 1992 HEA Amendments (Pub. L. No. 102-235). A further reduction of the 90/10 rule's impact occurred under the Higher Education Opportunity Act of 2008, 122 Stat. 3078 (codified as amended at 20 U.S.C. § 1001–1161 (2006)), which changed the 90/10 rule from an institution eligibility test to a condition for program participation and allowed additional resources to be counted as institutional revenue. 20 U.S.C. § 1094(a)(24) (2006). Institutions that do not comply with the rule are now allowed to continue participation in the federal aid programs for two years. Kathleen S. Tighe, Inspector Gen., Dep't of Educ., Statement Before the S. Comm. on Health, Educ. Labor, and Pensions 4–5 (June 24, 2010), <http://help.senate.gov/imo/media/doc/Tighe.pdf>. (explaining the operation of the

programs, such as those for veterans, or from private student loans,⁷⁴ meaning that the schools do not necessarily have any skin in the game as far as outcomes for students. With the decline of availability of private student loans, for-profit schools have increased their institutional lending to their own students, and if institutional lending is combined with increased tuition, schools can pass the 90% test without reducing the amount of federal aid they receive.⁷⁵

The 11% of all full-time equivalent (FTE) postsecondary students enrolled in for-profit schools in 2008–2009 received 24% of federal Pell Grants.⁷⁶ They also received 28% of the unsubsidized and 25% of the subsidized Stafford loans, compared to 6% and 8%, respectively, for the 27% of all FTE students at public two-year institutions.⁷⁷ The federal funds going to for-profit schools in 2009 amounted to “more than \$4 billion in Pell grants and \$20 billion in federal student loans.”⁷⁸

90/10 Rule and stating that the 2008 changes “made it easier for the institutions to meet the 90/10 Rule”).

74. See Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43,618 (noting that federal funds other than Title IV HEA funds can be counted toward the 10% minimum, including veterans’ education benefits and federal job training funds).

75. See *supra* note 5 (discussing for-profit schools responding to reduced private lending by making loans themselves); see also Eisman, Subprime Goes to College, Presentation at the Ira Sohn Conference, *supra* note 6, at slide 25 (discussing raising tuition and forcing students to get non-federal aid to make up the difference as a way to pass the 90/10 rule).

76. BAUM & PAYEA, *supra* note 39, at 3 tbl.2. The College Board reported that the percentage of FTEs in the for-profit sector a year later, in 2009–2010, had risen to 12%, with 25% of Pell Grant dollars going to them, and since expenditures on Pell Grants rose from \$18.1 billion in 2008–2009 to \$30.4 billion in 2009–2010, that would put the total Pell Grant dollars going to for-profits in the latter year at \$7.6 billion. TRENDS IN STUDENT AID 2011, *supra* note 4, at 4,16, 22.

77. BAUM & PAYEA, *supra* note 39, at 3 tbl.2; COLLEGE BOARD, TRENDS IN STUDENT AID 4 (2010).

78. KUTZ, *supra* note 49, (in highlights, page prior to page 1).

E. Higher Debts and Higher Default Rates; Lower Graduation and Repayment Rates

For-profit college students take out more loans than students in public or private nonprofit institutions and fail to repay at higher rates, despite the premise of career college education that its mission is to add income that will allow students to repay student loans.⁷⁹ Among completers of bachelor's programs in 2007–2008, for example, the median student debt (on federal and non-federal loans) of for-profit college graduates (including nonborrowers) was \$31,157, compared to \$16,175 at private nonprofit schools and \$6,998 for public institutions.⁸⁰ For completers of two-year associate's degree programs the same year, the disparity was particularly pronounced, with the median debt being zero at public schools, while it was \$18,415 at for-profit schools and \$10,000 at private nonprofit institutions.⁸¹ The zero debt median at public two-year programs is due to the very low tuition at many community colleges, so that students can often pay as they go from income and grants. By comparison, tuition at two-year for-profit programs is typically nearly as expensive per year as at four-year for-profit programs.⁸² The GAO investigation discussed above noted that a comparison of nearby for-profit and public two-year programs reveals instances of for-profit programs that are six to thirteen times more expensive.⁸³ Another useful comparison is the percentage of students in the various sectors who receive bachelor's degrees who are more than \$30,000 in debt; in 2007–2008, the figure was 57% of for-profit four-year degree recipients, while it was 25% at private nonprofit schools and 13% at public schools.⁸⁴ Only 4% of bachelor's degree

79. See Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43657 (discussing industry spokesman's argument that "the students receiving loans will, in almost every case, be enabled to repay them out of the added income").

80. *Id.* at 43,647 tbl.A-1.

81. *Id.*

82. NAT'L CTR. FOR EDUC. STATISTICS, DIGEST OF EDUCATION STATISTICS tbl.347 (2010), http://nces.ed.gov/programs/digest/d10/tables/dt10_347.asp (showing median tuition and fees for 2009–2010 at for-profit schools of \$14,212 for four-year schools and \$13,548 for two-year schools).

83. KUTZ, *supra* note 49, at 17.

84. See Proposed Gainful Employment Rule Analysis, *supra* note 6, at

recipients at for-profit colleges had no debt that year, while the debt-free figure was 38% at public universities and 28% at private nonprofits.⁸⁵ At the associate degree level in 2007–2008, only 5% of public college graduates had debt of \$20,000 or more, while 42% of for-profit graduates had debt that high;⁸⁶ of public two-year graduates that year, 62% had no debt, compared to only 2% with no debt among private for-profit associate degree graduates.⁸⁷

Former students of for-profit colleges also have high default and low repayment rates, in part driven by low graduation rates.⁸⁸ Avoiding default is not the same as repaying. Many students become delinquent without being counted as defaulting, and others get deferments and forbearances, which also are not counted as defaults. A study of student-loan borrowers in all higher education sectors who entered repayment in 2005 found that over the next five years, 37% repaid on time, 23% postponed repayment by deferment or forbearance and thus avoided default, 26% were delinquent without being counted as in default, and 15% defaulted, under program definitions that generally do not count a delinquency as a default for at least 270 days.⁸⁹ In sum,

43,650. The College Board reported similar figures a year later: among dependent four-year degree completers in 2009, nearly two-thirds of those who graduated from for-profit schools had debt of \$28,000 or more, while the same statistic was 14% at public schools and 25% at private nonprofit schools. TRENDS IN STUDENT AID 2011, *supra* note 4, at 18 fig. 9A. Furthermore, the differences in completion rates were striking: 64% of students at public four-year schools and 71% at private nonprofits, but only 15% of students at for-profit schools (for 2003–2004 beginning postsecondary dependent students who last attended a four-year institution and who received a bachelor's degree by 2009). *Id.* at 18.

85. TRENDS IN FOR-PROFIT POSTSECONDARY EDUCATION, *supra* note 39, at 5 & Table 6.

86. Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43,650.

87. TRENDS IN FOR-PROFIT POSTSECONDARY EDUCATION, *supra* note 39, at 5 & tbl.6.

88. See Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43,654 (concerning low relative completion rates for students at four-year for-profit schools compared to the other sectors' four-year schools).

89. See Alisa F. Cunningham & Gregory S. Kienzl, *Delinquency: The Untold Story of Student Loan Borrowing*, INST. FOR HIGHER EDUC. POL'Y, Mar. 2011, at 4–6, 8 (summarizing results concerning payment on time, deferment and forbearance, delinquency, and default for debtors who entered repayment in 2005 and were followed for five years while also noting that student-loan debtors are not generally considered in default until 270 days to 360 days of delinquency).

looking at all sectors together, the debtors who went into default or delinquency exceeded those who paid on time, not counting those who got deferments or forbearances.

When these figures are broken down by higher education sector, differences are dramatic in a comparison of those who attended four-year for-profits as opposed to four-year nonprofit and public institutions. Combined delinquencies and defaults after five years for those who entered repayment in 2005 were as follows: private nonprofits (28% total, broken down 20% delinquent/8% in default), public (34% total, broken down 24% delinquent/10% in default); and for-profit (53% total, broken down 29% delinquent/24% in default).⁹⁰ The figures are closer in a comparison of two-year institutions, with combined delinquencies and defaults of: public (60% total, broken down 36% delinquent/24% in default) and for-profit (63% total, broken down 27% delinquent/36% in default).⁹¹ There is generally less delinquency and default among borrowers who complete degrees as opposed to those who do not,⁹² and students at for-profit four-year programs leave within three years without enrolling elsewhere at more than three times the rate of students at public and private nonprofit four-year programs.⁹³ While students at public two-year schools leave without a degree at a higher rate than students at for-profit two-year schools,⁹⁴ most two-year public school students do not have to incur student-loan debt.⁹⁵

Each fiscal year, the government has published official national student loan two-year “cohort default rates,”⁹⁶ which

90. *Id.* at 23.

91. *Id.*

92. *Id.* at 24 (showing, for example, 35% total delinquency and default for graduates of for-profit schools, compared to a 64% for those who left without a degree).

93. Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43,655 tbl. C (showing 34% rate for-profits, 10.8% for publics, and 10.0% rate for private nonprofits of leaving four-year schools within three years without enrolling elsewhere); *see also supra* note 84 (concerning five-year graduation rates of students at four-year schools in all three sectors).

94. *Id.* Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43,655 (showing that 34.1% of students at public two-year program leave within three years without a degree and without enrolling elsewhere, compared to 26.6% of students in for-profit two-year programs).

95. *See supra* notes 81, 87 and accompanying text.

96. *See* Press Release, U.S. Dept. of Education, Default Rates Rise for

have risen in recent years for all sectors. From fiscal year 2008 to fiscal year 2009, the overall cohort default rate, published by the government in September 2011, rose from 7% to 8.8%. In the for-profit sector, the increase was from 11.6% to 15%.⁹⁷ These figures are primarily useful for showing trends and comparing sectors because, as discussed above, they are based on program definitions of default that exclude delinquencies, deferments, and forbearances, and they count only defaults on loans that came due in one fiscal year and defaulted by the end of the next fiscal year, but not defaults that occur later.⁹⁸

Other measures better capture the risk of attending for-profit institutions. For every 100 students who completed a program at a public or nonprofit school in 2007–2008, there were four former students who entered repayment in 2008 and defaulted the next year, while at for-profit institutions, there were 18 defaulters per 100 completers, that is, more than four times as many defaulters as in the other sectors.⁹⁹ When only four-year programs are considered, the defaulters to completers ratio was 25 per 100.¹⁰⁰ Another measure is how many borrowers are repaying any principal on their loans within three years after leaving school: the figures for fiscal years 2006 through 2009 were 80% of borrowers who attended public schools, 88% who attended nonprofit institutions, and only 55% in the case of career colleges.¹⁰¹ Looking at the same period and applying a test of percentage of institutions in the sector that had at least a 35% repayment rate, the figures were 89% for four-year public and nonprofit institutions, 73% for public two-year institutions, and less than 60% for all for-profit schools.¹⁰² The 35% repayment

Federal Student Loans (Sept. 12, 2011), *available at* <http://www.ed.gov/news/press-releases/default-rates-rise-federal-student-loans> (noting that official FY 2009 national student loan cohort default rate is a snapshot of the borrowers whose repayments came due between Oct. 1, 2008, and Sept. 30, 2009, indicating the percentage that defaulted before Sept. 30, 2010, and not including defaults after that time).

97. *Id.*

98. *Supra* notes 89, 96 and accompanying text.

99. Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43,652.

100. *Id.* at 43,653–54 (noting that this default to completion ratio indicates “substantial barriers to providing value to enrollees”).

101. *Id.* at 43,654.

102. *Id.*

measure has been given a central role in the new gainful employment regulation,¹⁰³ discussed in Part III.B below.

F. Less Spending on Instruction

For-profit colleges spend the least on instruction in dollars and percentage of overall expenditures.¹⁰⁴ The disparity is greatest among four-year institutions, with about 21% of all expenditures by for-profit schools used for instruction, compared to 25% at public schools and 33% at nonprofits in 2008–2009.¹⁰⁵ The expenditures per FTE student at four-year schools in that year, total and for instruction (in parentheses), were as follows in the various sectors: \$12,654 (\$2,633) at for-profit colleges, \$36,707 (\$7,462) at public schools, and \$46,080 (\$15,143) at nonprofits.¹⁰⁶ While they spent less on instruction, for-profit four-year schools spent more on categories that include executive salaries and investor returns, the latter being something public and nonprofit schools do not have to fund.¹⁰⁷ For-profit schools also increased their expenditures on lobbying as the DOE considered new regulation; whether or not as a result, the proposed regulation was watered down.¹⁰⁸

103. See Gainful Employment Rule, *supra* note 10.

104. Table 378, National Center for Education Statistics, 2010 Tables and Figures (Nov. 2010) http://nces.ed.gov/programs/digest/d10/tables/dt10_378.asp. The table shows that in 2008–2009, for-profit degree-granting schools spent 23.66% of all expenditures on instruction, 20.81% at four-year schools and 32.56% at two-year schools; per FTE student, they spent \$12,654 total and \$2,633 on instruction at four-year schools and \$13,498 total and \$4,394 on instruction at two-year schools. *Id.*

105. *Id.* at tbls.373, 375.

106. *Id.*

107. *Id.* (showing that at four-year institutions in 2008–2009, public schools spent about 18% of total expenditures on academic support, student services, and institutional support, while nonprofits spent about 26% and for-profits spent about 71%); see also Nancy Lewis, *For-Profit Enrollment Grew 50-Fold from 1980–2009*, YOUTH TODAY (May 26, 2011), http://www.youthtoday.org/view_article.cfm?article_id=4805 (quoting an NCES commissioner on the point that the support categories include executive compensation and returns to shareholders).

108. Eric Lichtblau, *With Lobbying Blitz, Profit-Making Colleges Diluted New Rules*, N.Y. TIMES, Dec. 10, 2011, at A1 (describing how the industry’s “ferocious response” produced a “much weakened final plan”); Paul Blumenthal, *Regulations Lead to Lobbying Surge by the For-Profit College Industry*,

G. Recent Declining Enrollment

For-profit colleges have been reporting declining enrollments since late 2010.¹⁰⁹ This seems to be due to a combination of decreased interest by prospective students but also reduced recruiting by this sector as it attempts to ride out negative publicity, increased attention by regulators and other public officials, and the bad economy.¹¹⁰

III. The Weak Regulatory Framework and Lack of Relief for Debtors

A. History of Federal Support for For-Profit Institutions

The Higher Education Act of 1965 (HEA) established the Guaranteed Student Loan Program.¹¹¹ Originally, only students

SUNLIGHT FOUNDATION BLOG (Mar. 10, 2011, 11:45 AM), <http://sunlightfoundation.com/blog/2011/03/10/regulations-lead-to-lobbying-surge-by-the-for-profit-college-industry/> (last visited Apr. 10, 2012) (reporting tripling of lobbying expenditures from 2009 to 2010) (on file with the Washington and Lee Law Review); Bennett Roth, *For-Profit Colleges Field Team of Top Lobbyists*, ROLLCALL (May 2, 2011), http://www.rollcall.com/issues/56_114/-205206-1.html (last visited Apr. 10, 2012) (concerning hiring of many top lobbyists to stop or roll back the proposed Gainful Employment Rule) (on file with the Washington and Lee Law Review).

109. See Korn, *supra* note 14 (discussing declines in enrollments of up to 45% because of industry decisions to reduce aggressive recruiting and in addition due to student resistance to debt and risk); Rachel Wiseman, *Enrollments Plunge at Many For-Profit Colleges*, CHRON. OF HIGHER EDUC., Sept. 2, 2011, at A33.

110. Alan Scher Zagier, *Tracking Trends: For-Profit Colleges Respond to Increased Scrutiny*, COMMUNITY COLLEGE WEEK, (Aug. 22, 2011), <http://www.ccweek.com/news/templates/template.aspx?articleid=2688&zoneid=3> (last visited Apr. 10, 2012) (discussing declining enrollment and revenue at for-profit colleges, at least partly by industry design because of increased regulatory scrutiny) (on file with the Washington and Lee Law Review); see also Robert Schroeder, *Lobbying Up, Earnings Down at For-Profit Colleges*, MARKET WATCH (Oct. 27, 2011, 10:54 AM), <http://www.marketwatch.com/story/lobbying-up-earnings-down-at-for-profit-schools-2011-10-27> (last visited Apr. 10, 2012) (on file with the Washington and Lee Law Review); see also *supra* Part II.B and *infra* Part III.

111. Higher Education Act, Pub. L. No. 89-329, 79 Stat. 1219 (1965) (codified at 20 U.S.C. §§ 1001 et seq. (2006)). The Student Aid and Fiscal Responsibility Act of 2009, signed into law in 2010 as part of the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, eliminated future federally guaranteed student loans and replaced them with direct federal student loans

at public and nonprofit schools were eligible to receive Title IV HEA funds.¹¹² Proprietary school students became eligible for this federal aid in 1972.¹¹³ Changes in 1979 made private student-loan lenders more willing to lend to students at for-profit schools by removing a federal interest subsidy limit and thus encouraging lenders to take the risk.¹¹⁴ As a result, proprietary schools grew, fueled by revenue from federal student grant and loan funds, and by the late 1980s they had become the focus of congressional oversight attention and class action litigation alleging that these schools were aggressively recruiting the poor and the homeless from welfare lines and laundromats and using help-wanted ads promising better jobs to get students to enroll.¹¹⁵ As today, the risk of default on student loans was compared to a recent financial meltdown; in the earlier era, it was the savings and loan crisis,¹¹⁶ and today, it is the mortgage crisis.¹¹⁷ In other words, we have been here before in witnessing the burgeoning of a for-profit higher education sector that focused more on harvesting federal student aid dollars than on delivering results to students.¹¹⁸

starting July 1, 2010. *See Student Aid and Fiscal Responsibility Act of 2009*; FINAID, <http://www.finaid.org/educators/20090715hr3221.phtml> (last visited Apr. 10, 2012) (on file with the Washington and Lee Law Review); *see also supra* note 4.

112. U.S. GEN. ACCOUNTING OFFICE, GAO/HEHS-97-104, *supra* note 73, at 5.

113. *Id.*; *see also* Education Amendments of 1972, Pub. L. No. 92-318, 86 Stat. 235, 375.

114. Nicholas R. Johnson, *Phoenix Rising: Default Rates at Proprietary Institutions of Higher Education and What Can Be Done to Reduce Them*, 40 J.L. & EDUC. 225, 229 (2011); *see also* Armstrong v. Accrediting Council for Continuing Educ. & Training, Inc., 168 F.3d 1362, 1364 (D.C. Cir. 1999) (noting amendments to the Higher Education Act).

115. Cathy Lesser Mansfield, *The Federal Trade Commission Holder Rule and Its Applicability to Student Loans—Reallocating the Risk of Proprietary School Failure*, 26 WAKE FOREST L. REV. 635, 636–38 (1991) (describing aggressive and deceptive recruiting and failure to follow through on promises of a better life to the economically vulnerable and citing congressional oversight hearings and complaints in class action litigation).

116. *Id.* at 639.

117. *See* Proposed Gainful Employment Rule Analysis, *supra* note 6; *infra* Part IV.A.

118. Hearing on Waste, Fraud and Abuse in the For-Profit Education Section Before the Sen. Comm. On Health, Education, Labor & Pensions 1 (2010) (statement of Margaret Reiter, former supervising deputy attorney general in the Consumer Law Section of the California Attorney General's Office) ("By the mid 1990's, I thought, naively it turns out, that we had turned

The problems with proprietary schools in the 1980s led to new regulation using cohort default rates (CDR).¹¹⁹ Effective in 1991, schools were barred from receiving federal student aid funds if their CDR met or exceeded a 25% rate for three consecutive years.¹²⁰ The CDR is a snapshot measure, until recently based on the number of students who entered student loan repayment in one fiscal year who had defaulted by the end of the next school year.¹²¹ Large numbers of the earlier for-profit schools were put out of business by the withdrawal of federal student aid dollars in the 1990s due to failure to meet the CDR limit for three years.¹²² The for-profit schools in that earlier era were largely small and thus local and often focused on nondegree training for a trade, albeit with poor results.¹²³

As trade schools closed down in the 1990s, the for-profit sector morphed into its current form. The new for-profit sector is characterized by large institutions offering conventional college degrees and organized as publicly traded companies,¹²⁴ with ever-

the corner on fraud and abuse in the proprietary school industry.”).

119. Student Loan Default Prevention Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388 (codified as amended at 20 U.S.C. §§ 1001 et. seq.).

120. U.S. GEN. ACCOUNTING OFFICE, GAO/HEHS-99-135, STUDENT LOANS: DEFAULT RATES NEED TO BE COMPUTED MORE APPROPRIATELY 4 (July 1999) (noting context of study focusing on depressive effect on the CDR of excluding students placed into deferment or forbearance).

121. *Id.* at 5. In 2008, Congress increased the three-year maximum default rate from 25% to 30%, effective in 2011. Higher Education Opportunity Act, Pub. L. No. 110-313, § 436(a)(1) (2008). It also changed from a two-year to a three-year cohort default rate. *Id.* § 436(e); see also U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-600, *supra* note 9, at 13.

122. See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-600, *supra* note 9 at 11 (stating that from 1991 to 1999, 1,580 proprietary schools and 1,846 schools total were subject to sanctions based on their default rates).

123. U.S. GEN. ACCOUNTING OFFICE, GAO/HEHS-97-104, *supra* note 73, at 5 (noting in 1997 that “[m]ost proprietary schools are small, enrolling fewer than 100 students, and offer occupational training lasting 2 years or less”).

124. See HARKIN, EMERGING RISK?, *supra* note 19, at 2 (noting concentration of growth in enrollment at for-profit schools at those run by 14 publicly-traded companies); see also *supra* Part II.A (concerning move into degree-granting programs, particularly bachelor's degrees); James Coleman & Richard Vedder, *For-Profit Education in the United States: A Primer*, CENTER FOR COLLEGE AFFORDABILITY AND PRODUCTIVITY, May 2008, at 21, available at <http://www.policyarchive.org/handle/10207/bitstreams/20592.pdf>. (showing initial public offerings by eight of the largest for-profit college companies between 1988 and 2003, with six occurring in the 1990s).

increasing sophistication in rent-seeking and regulatory evasion.¹²⁵ CDR regulation has proven insufficient to shut down the worst current performers. Not only does the CDR use a short time horizon, although recently extended from two to three years,¹²⁶ but it is also subject to manipulation because it excludes students who are in deferment or forbearance, which schools can help their students to pursue in the short term to keep CDR down.¹²⁷ Only recently has DOE focused on positive repayment as a test for eligibility for federal student aid funds, as will be discussed next.

B. New Gainful Employment Rule

On June 13, 2011, DOE published its final Gainful Employment Rule (GER), culminating a two-year regulatory process.¹²⁸ DOE published a proposed rule on July 26, 2010,¹²⁹ and it then received 90,000 comments, 75% of them negative.¹³⁰

125. See Blumenthal, *supra* note 108 (concerning tripling in lobbying expenditures from 2008 to 2009); see also Eisman, *supra* note 6, at 25–26 of PowerPoint presentation (concerning manipulations of cohort default rates, discussed *supra* at notes 119–20 and accompanying text and *infra* at notes 126–27 and accompanying text, and of 90/10 rule, discussed *supra* at notes 73–75 and accompanying text).

126. See *supra* note 121.

127. U.S. GEN. ACCOUNTING OFFICE, GAO/HEHS-99-135, *supra* note 120, at 3–8, 10–12 (reporting doubling of the rate of deferment and forbearance from 1993 to 1996 and examining the problem of CDR methodology allowing manipulation but finding in 1999 that proprietary schools were not doing so disproportionately and in fact had lower deferment and forbearance rates than other schools); Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43651 (discussing how some colleges work hard to keep their default rates down by assisting former students to use deferment and forbearance options).

128. Gainful Employment Rule Analysis, *supra* note 11, at 34388; Office of Postsecondary Education; Notice of Negotiated Rulemaking for Programs Authorized Under Title IV of the Higher Education Act of 1965, as Amended, 74 Fed. Reg. 46399 (Sep. 9, 2009) (announcing the beginning of the process).

129. Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43,616.

130. Gainful Employment Rule Analysis, *supra* note 11, at 34390 (noting that in addition to giving the figures in the text, the DOE stated that many comments were not specific, stated only general opposition or support for the proposed rule, appeared generated by petition drives and letter-writing campaigns, and expressed general support for making sure that student loans are affordable).

Meanwhile, many members of Congress, prompted by heavy industry lobbying, also opposed the rule and sought to deny DOE funds to implement it.¹³¹ Given this backdrop, it is perhaps surprising that any rule was promulgated, but DOE pressed on, simplifying the rule, reducing its requirements, and setting an effective date of July 1, 2012,¹³² but with no program ineligibility as a consequence prior to 2015.¹³³ A leading for-profit industry trade association, however, brought suit on July 20, 2011, to block the GER, arguing *inter alia* that DOE lacks authority to make the rule.¹³⁴ DOE addressed its authority to issue the rule in its final regulatory analysis, relying on the section of the HEA that defines an eligible program to include one that provides “training to prepare students for gainful employment in a recognized profession.”¹³⁵ DOE also pointed to broad congressional delegations of administrative power, under which the Secretary of Education “is authorized to prescribe such rules and regulations as the Secretary determines necessary or appropriate to administer and manage the functions of the Secretary or the Department,”¹³⁶ and may “make, promulgate,

131. See Complaint and Prayer for Declaratory and Injunctive Relief, *supra* note 6, ¶ 12 (stating that “289 Members of the House of Representatives—231 Republicans and 58 Democrats—voted in February 2011 to deny the Department [of Education] any funds to implement the Gainful Employment regulations” (citation omitted)); see also *supra* note 108 (concerning heavy lobbying by the industry).

132. Gainful Employment Rule Analysis, *supra* note 11, at 34386.

133. Mark Kantrowitz, *Summary and Analysis of Gainful Employment Final Rule*, FINAID.ORG (June 2, 2011), available at <http://www.finaid.org/educators/20110602gainfulemployment.pdf> (noting that given use of tests that require failing three out of four years, there will be no immediate loss of eligibility and that 2015 is the earliest that a program could lose eligibility).

134. Complaint and Prayer for Declaratory and Injunctive Relief, *supra* note 6, at 54 (seeking declaratory and injunctive relief), ¶ 5 (arguing that the regulatory tests “are beyond the Department’s statutory authority” in light of detailed statutory requirements concerning maximum student debt levels and loan default rates).

135. 20 U.S.C. § 1002(b)(1)(A) (2006); see also Gainful Employment Rule Analysis, *supra* note 11, at 34392. The phrase “gainful employment” is also found in 20 U.S.C. §§ 1001, 1088 (2006).

136. 20 U.S.C. § 3474 (2006); see also Gainful Employment Rule Analysis, *supra* note 11, at 34392.

issue, rescind, and amend rules and regulations” for DOE programs, including the federal student aid programs.¹³⁷

As finally promulgated, the GER sets up two tests, and only if a program fails both of these tests for three out of four years does it lose eligibility to receive Title IV Higher Education Act (HEA) student aid funds, which include both federal grants and federal student loans.¹³⁸ The first test concerns the repayment rate of former students, and the second focuses on the debt-to-income (DTI) ratios of completers of programs.¹³⁹

The student loan repayment rate of a program is not the same as the rate of former students not in default. This is because default is defined narrowly as not meeting DOE requirements: those not counted as in default include former students who get deferments and forbearances, and also those who are delinquent but not yet in default (defined as up to a year of delinquency).¹⁴⁰ Under the repayment test, schools will remain eligible to receive federal student aid if 35% of their former students are repaying at least some principal on their loans (even \$1).¹⁴¹ This is a reduction from the proposed rule, which set 45% repayment as the threshold for no consequences, with a restricted eligibility category below that.¹⁴² The final rule adopted a simplified approach, in that it eliminated the use of two tiers, with a restricted category and enhanced disclosure requirements between 35% and 45% repayment; the final rule sets 35% as the sole repayment test and places no restrictions on those passing this test or one of the alternative DTI ratios, discussed below.¹⁴³ Even below 35% repayment (as well as missing the DTI ratios), a program suffers only enhanced disclosure requirements by missing for a year or two.¹⁴⁴ The formula for the 35% repayment test has some additional leeway built in. Schools can choose

137. 20 U.S.C. § 1221e-3 (2006); *see also* Gainful Employment Rule Analysis, *supra* note 11, at 34392.

138. Gainful Employment Rule Analysis, *supra* note 11, at 34388.

139. *Id.*

140. *Id.* at 34408–10 (discussing who is counted as repaying).

141. Gainful Employment Rule, *supra* note 10 (setting up a complex formula to make this calculation).

142. *See* Gainful Employment Rule Analysis, *supra* note 11, at 34393–95.

143. *Id.* at 34395, 34400; *see also supra* note 10.

144. 34 C.F.R. § 668.7(j) (2011).

between two-year and four-year repayment periods,¹⁴⁵ and they can also include as repaying former students who are not paying principal but are in a public-service repayment program¹⁴⁶ and up to 3% of students making income-contingent or income-based repayment.¹⁴⁷ Some loans are excluded entirely from the formula—those loans in deferment because the students are continuing their educations or are in the military and also those of students who have died or who have been discharged by the Secretary of Education for total and permanent disability or are under consideration for that type of discharge.¹⁴⁸

Alternatively, a program can remain eligible under either part of a two-pronged DTI test. The typical annual student loan payment, including private student loans, of completers of programs must be 12% or less of annual earnings or 30% or less of discretionary income; programs may choose either mean or median figures using either test.¹⁴⁹ The inclusion of only completers of programs is obviously quite forgiving to the for-profit industry, given their high noncompletion rates.¹⁵⁰ The final rule kept the DTI ratios of the proposed rule, which had already been increased by 50% each from research-based and industry-used standards, thus providing leeway to withstand various criticisms of these standards.¹⁵¹ DOE described these DTI ratios

145. *Id.* § 668.7(a)(2)(iv)–(v), (b)(1)(ii) (2011).

146. *Id.* § 668.7(b)(3)(B) (2011).

147. *Id.* § 668.7(b)(3)(C) (2011).

148. *Id.* § 668.7(b)(4) (2011).

149. *Id.* § 668.7(c)(2) (2011) (concerning inclusion only of program completers); *id.* § 668.7(c)(3) (using either median or mean for both the annual loan payment and income figures). The repayment rate test does not include private student loans, but the DTI ratios do. 34 C.F.R. § 668.7(b)(1), (c)(4)(i) (2011).

150. *See supra* notes 84, 92–93 and accompanying text (discussing much lower completion rate at for-profit schools and association generally of non-completion with higher rates of delinquency and default on student loans).

151. Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43620. The proposed rule discusses how DOE started with a DTI ratio of 20% of discretionary income, based on the research of economists Sandy Baum and Saul Schwarz about the outer boundaries of manageable student debt, and then added an alternative standard from industry underwriting based on 8% of annual earnings, before in addition increasing each of these by 50% to the 30%/12% DTI tests. *Id.*; *see also* Gainful Employment Rule Analysis, *supra* note 11, at 34394–95 (noting reliance on Sandy Baum and Saul Schwartz, *How Much Debt is Too Much? Defining Benchmarks for Manageable Student Debt*, a 2006

as establishing “thresholds above which it becomes unambiguous that a program’s debt levels are excessive.”¹⁵²

A particularly controversial aspect of the DTI tests is that they depend on harvesting actual income of school’s graduates from Social Security Administration (SSA) or other federal data.¹⁵³ Schools are permitted to correct the students on the list,¹⁵⁴ but the for-profit industry objected that schools may not challenge the annual earnings figures obtained from the SSA (a restriction based on privacy concerns about revealing former students’ income) and argued that the lack of a meaningful opportunity to contest this data violates constitutional due process standards.¹⁵⁵

A program loses eligibility to receive HEA student aid grants and loans only if it does not pass the repayment test or a DTI test for three out of four years, which means that passing either type of test in two out of four years is sufficient.¹⁵⁶ Furthermore, DOE’s final rule includes a transition year in which there will be limited impact on program eligibility; the maximum ineligibility based on debt measures for the three fiscal years 2012, 2013, and 2014 is for programs with a combined total of students not exceeding 5% of the students completing programs in 2014 in that category of institution.¹⁵⁷ Beyond that transitional year (with the first year of ineligibility occurring in 2015),¹⁵⁸ DOE estimated based on historical data that the 35% repayment rate identifies

study for the College Board).

152. Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43620.

153. 34 C.F.R. § 668.7(c)(3) (2011).

154. *Id.* § 668.7(e) (2011).

155. Complaint and Prayer for Declaratory and Injunctive Relief, *supra* note 6, ¶¶ 9, 61, & 114; *see also* 34 C.F.R. § 668.7(e)(1)(iv) (2011). DOE has responded by permitting institutions to do their own surveys, which must meet National Center for Education Statistics standards, if they fail the DTI ratios using SSA data. *See* Gainful Employment Rule Analysis, *supra* note 11, at 34428; 34 C.F.R. § 668.7(g)(3) (2011).

156. *See supra* notes 138, 143–44 and accompanying text.

157. 34 C.F.R. § 668.7(k) (2011); *see also id.* § 668.7(a)(2)(i)(A) (incorporating definition of 34 C.F.R. § 668.8(e)(3), so that the rule also applies to certain certificate programs of schools in other categories than for-profit); Gainful Employment Rule Analysis, *supra* note 11, at 34386 (concerning applicability to certificate programs of public and nonprofit schools).

158. *See* Kantrowitz, *supra* note 133.

approximately the lowest-performing quarter of programs subject to the GER.¹⁵⁹ As a projection, this assumes that schools would not improve performance at all in response to the new rule. In addition, even without improvement, some of the bottom quarter of programs would still remain eligible, given that programs only need to pass the 35% repayment rate for three out of four years or alternatively pass a DTI test. DOE aimed only to identify “the poorest performing programs” and to set “minimum standards” that “provide flexibility, specifically allowing programs an opportunity to improve their performance” before losing eligibility.¹⁶⁰

Even after losing eligibility, programs may be able to regain it. The GER provides that an ineligible program may reestablish eligibility after the end of the third fiscal year following the fiscal year in which it lost it.¹⁶¹ Showing that the DOE anticipates attempts at evasion of sanctions, ineligibility extends not only to a program but to another program of the same institution that is “substantially similar to the ineligible program” in part based on offering “the same credential level.”¹⁶²

DOE has multiple public policy goals. While recognizing the need for a “healthy and productive” for-profit sector to increase the education level of the population, it was also concerned about devaluation and oversupply of credentials, with resulting labor oversupplies leading to unemployment or decline in wages and inability of graduates to support themselves and their families while also repaying student loans.¹⁶³ In addition, DOE articulated goals of protecting taxpayers and students.¹⁶⁴ The agency noted that standards are needed to “protect taxpayers against wasteful spending on educational programs of little or no value that also

159. Gainful Employment Rule Analysis, *supra* note 11, at 34395–96 (noting that under the final rule’s definition of the 35% repayment rate, about 26% of programs across all sectors, public, nonprofit, and for-profit, would not meet that test). Only certain certificate programs at public and nonprofit schools are subject to GER. *See supra* note 157.

160. *Id.* at 34388.

161. 34 C.F.R. § 668.7(l)(2)(ii) (2011).

162. *Id.*

163. Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43617.

164. *Id.* at 43618.

lead to high indebtedness for students.”¹⁶⁵ Another concern was that the stigma of default by former students from disadvantaged neighborhoods sends “an unfortunate message to others—that seeking an education can have disastrous results.”¹⁶⁶

Focusing particularly on students and their need for protection, the agency noted that they “often lack the necessary information to evaluate their postsecondary education options” and may be misled or manipulated by “skillful marketing, resulting in significant student loan debts without meaningful career opportunities” and “false information or assurances regarding future employment prospects and program costs.”¹⁶⁷ DOE thus identifies market failures based on asymmetries in information and sophistication as well as industry use of framing strategies in recruitment.

Students who take on high-risk student-loan debt and lose the gamble face dire consequences. DOE summarized as follows:

Former students who default on Federal loans cannot receive additional title IV aid for postsecondary education. Their credit rating is destroyed, undermining their ability to rent a house, get a mortgage, or purchase a car. To the extent they can get credit, they pay much higher interest. In some States, they may be denied certain occupational licenses. And, increasingly, employers consider credit record in their hiring decisions.¹⁶⁸

The agency also distinguished public and private nonprofit education on the grounds that “for-profit institutions are legally obligated to make profitability for shareholders the overriding objective.”¹⁶⁹ The for-profit institutions thus are driven to maximize revenue from federal education programs, leading to the need for regulatory checks in light of the weak market policing provided by student choices that are too frequently uninformed, naïve, or the result of manipulation. In sum, DOE has a strong set of public policy rationales for its minimalist new

165. *Id.*

166. *Id.* at 43622.

167. *Id.* at 43618, 43622.

168. *Id.* at 43622.

169. *Id.* This is true in the sense that officers of for-profit institutions have fiduciary obligations to maximize shareholder returns within the bounds of the law.

regulation, including consumer protection and wise use of taxpayer dollars.

C. Lack of Sufficient Debt Relief in Bankruptcy or Otherwise

The minimum standards approach to federal regulation of for-profit schools stands in stark contrast to the very tough approach of bankruptcy law toward student-loan debtors who cannot afford to repay. Career colleges complain that they are being held to standards that are too high,¹⁷⁰ yet their students shoulder student loans that are nondischargeable in bankruptcy, absent “undue hardship on the debtor and the debtor’s dependents.”¹⁷¹ Under the prevailing judicial interpretation of what “undue hardship” means, there is a rigorous three-part test: the debtor is unable to support a “minimal” standard of living for the debtor and the debtor’s dependents if required to repay student loans, this state of affairs is likely to persist for a significant part of the student debt repayment period, and the debtor must have made good faith efforts to repay the student debt.¹⁷² The debtor bears the burden of proof by a preponderance of the evidence on each of these tests, and otherwise the debt is nondischargeable.¹⁷³ To challenge nondischargeability, a student-loan debtor must bring an adversary proceeding in bankruptcy, essentially a lawsuit within the umbrella of the bankruptcy case and thus an expensive venture, dependent as it is on elaborate factual proof that many debtors, particularly some of the worst off, have no hope of funding.¹⁷⁴

170. Complaint and Prayer for Declaratory and Injunctive Relief, *supra* note 6.

171. 11 U.S.C. §§ 523(a)(8), 1328(a)(2) (2006).

172. *Brunner v. New York State Higher Educ. Serv. Corp.*, 831 F.2d 395, 396 (2d Cir. 1987).

173. *Rifino v. United States*, 245 F.3d 1083, 1087–88 (9th Cir. 2001).

174. See Rafael I. Pardo & Michelle R. Lacey, *The Real Student-Loan Scandal: Undue Hardship Discharge Litigation*, 83 AM. BANKR. L. J. 179, 183 (2009) (“Debtors who have filed for bankruptcy in the first instance as a result of financial distress must somehow find the resources to litigate a full-blown lawsuit in order to prove that their predicament qualifies them for relief from their student loans.”); see also 11 U.S.C. App. Rule 7001(6) (2006) (providing that a proceeding to determine the nondischargeability of a debt is an adversary proceeding).

Another problem in bankruptcy is that unlike many other nondischargeable debts, student loan claims are not given priority status, which would allow debtors to repay them in Chapter 13 ahead of general unsecured debts.¹⁷⁵ The bankruptcy courts have attempted creative approaches to make Chapter 13 work for student-loan debtors despite lack of clear statutory authority to pay these loans ahead of other unsecured debts.¹⁷⁶

The nondischargeability of student-loan debt absent undue hardship is permanent, a life sentence, but it has not always been thus. Student loans were dischargeable until 1976, when Congress made them dischargeable five years after they became due, absent undue hardship. Then in 1990, the waiting period was extended to seven years and in 1998 to an infinite ban, in each instance preserving the “undue hardship” exception.¹⁷⁷ In 2005, a major overhaul of the Bankruptcy Code left in place permanent nondischargeability, absent undue hardship, and added private student loans, not just federally guaranteed loans or direct federal loans, to the student loan nondischargeability

175. See 11 U.S.C. § 507 (2006) (listing priority debts and not including student loans); *id.* §§ 1322(a)(2), (4) (providing for full payment of priority claims in Chapter 13 to the extent the debtor can afford from projected disposable income).

176. See, e.g., *In re Abaunza*, 452 B.R. 866 (Bankr. S.D. Fla. 2011) (holding that an above-median-income debtor did not discriminate unfairly by paying more to a student loan creditor than to other unsecured creditors where the latter received their entitlements under the disposable income test of 11 U.S.C. § 1325(b) and the student loan was paid from discretionary income in excess of disposable income under the means test); *In re Harding*, 423 B.R. 568 (Bankr. S.D. Fla. 2010) (disallowing the debtor to separately classify student-loan debt in order to pay it ahead of other unsecured debt but enjoining the student loan creditor from charging late fees, collection fees, and penalties during the Chapter 13 case); *In re Boscaccy*, 442 B.R. 501 (Bankr. N.D. Miss. 2010) (following *Harding*); *In re Webb*, 370 B.R. 418 (Bankr. N.D. Ga. 2007) (permitting separate classification and regular monthly payments to student loan creditors during the case, even though general unsecured creditors were being paid 1% of their claims).

177. Pardo & Lacey, *supra* note 174, at 180–81 (concerning dischargeability of student loans until 1976 and then adoption of a five-year waiting period); Pottow, *supra* note 13, at 248–50 (concerning imposition of a five-year waiting period for discharge, absent undue hardship, in the Education Amendments of 1976, a provision that was moved to the Bankruptcy Code, 11 U.S.C. § 523(a)(8), in 1978, effective in 1979, with extension of the waiting period from five years to seven years in 1990 and then in 1998 to an infinite-year bar).

category.¹⁷⁸ The nondischargeability of student loans after a waiting period in the years from 1976 to 1998 depended on a theoretical argument that former students might abuse the discharge by going to school and then filing in bankruptcy before getting a lucrative job, despite lack of evidence that this was actually happening.¹⁷⁹ In 2005, nondischargeability was extended to private student loans, not just direct or federally guaranteed loans, where protection of the public fisc is part of the rationale (as with certain tax debts that are made nondischargeable).¹⁸⁰ Of course, nondischargeability of private student loans could be seen as a way of promoting such credit by giving creditors who extend it more favorable treatment in bankruptcy; an example along these lines for another type of credit is the Chapter 13 rule against writing down home loans to collateral value, a rule that was originally written to promote home loans¹⁸¹ but during the mortgage crisis has stood in the way of principal reduction to reduce foreclosures and stabilize the housing market.¹⁸² Satisfying a lobbying interest is another possible explanation for extending nondischargeability to private student loans. With rising student loan defaults in the current prolonged high unemployment period, however, private student loans might be an appropriate first target for reform to provide debt relief by making them dischargeable again as they were until 2005. Reinstating a five-year or seven-year waiting period for a discharge of even federal student loans would also be desirable.

178. Pottow, *supra* note 13, at 250.

179. *Id.* at 250–56.

180. 11 U.S.C. § 523(a)(1) (2006).

181. See *Nobelman v. Am. Sav. Bank*, 508 U.S. 324, 332 (1993) (Stevens, J., concurring)

At first blush it seems somewhat strange that the Bankruptcy Code should provide less protection to an individual's interest in retaining possession of his or her home than of other assets. The anomaly is, however, explained by the legislative history indicating that favorable treatment of residential mortgagees was intended to encourage the flow of capital into the home lending market.

182. Jean Braucher, *Humpty Dumpty and the Foreclosure Crisis: Lessons From The Lackluster First Year of the Obama Administration's Home Affordable Mortgage Program (HAMP)*, 52 ARIZ. L. REV. 727, 781–85 (2010) (discussing the need for principal reduction to mitigate foreclosure losses by all concerned).

The term “mortgage” works metaphorically as applied to educational loans in light of the high and permanent bar to bankruptcy discharge currently in place. To the extent of nondischargeability of this debt in bankruptcy or otherwise, human capital is mortgaged for life. The situation of overindebted student-loan borrowers is actually worse than that of homeowners who cannot afford their loans. While home loans backed by some collateral value cannot be written down in Chapter 13, late payments can be made up over time in a Chapter 13 plan, something for which there is no clear and easy provision concerning student loans.¹⁸³ In addition, homeowners who lose their homes during or after Chapter 7 or Chapter 13 do not remain personally liable on the debt after bankruptcy. A homeowner can give up the home, get a bankruptcy discharge, and move on. A college education is different in that it cannot be surrendered. There is no comparable release from personal indebtedness on student loans after bankruptcy to that for homes, absent an adversary proceeding that establishes undue hardship.¹⁸⁴

Because bankruptcy relief is difficult to come by, often debt relief under DOE programs is more promising. The first tier of relief for a student-loan debtor is to change repayment programs to make the payment more affordable, whether through longer term, graduated payments, or an income-contingent or income-based plan.¹⁸⁵ Loan consolidation, under a weighted average interest rate, may also bring down the monthly total payment.¹⁸⁶

183. See 11 U.S.C. § 1322(b)(2), (5) (2006) (prohibiting cramdown of loans secured only by a principal residence but providing for cure of arrearages); see also *In re Labib-Kiyarash*, 271 B.R. 189 (9th Cir. B.A.P. 2001) (holding that 11 U.S.C. § 1322(b)(5) can be used to cure long-term student loans but only if there is no unfair discrimination against other unsecured creditors); *supra* notes 175–76 and accompanying text (concerning lack of priority status for student loans, which makes separately classifying them and paying them ahead of unsecured creditors of debatable legality).

184. See *supra* 171–74 and accompanying text.

185. See Repaying A Loan, <http://www.ombudsman.ed.gov/repayment.html> (last visited Apr. 10, 2012) (discussing six repayment options) (on file with the Washington and Lee Law Review).

186. See Understanding Loan Consolidation: Is it the Right Move for You?, <http://www.ombudsman.ed.gov/consolidation.html> (last visited Apr. 10, 2012) (discussing possibility that a single payment on a consolidated loan may be lower than the total of payments on multiples loans) (on file with the

Deferments and forbearances are available for a variety of circumstances, although this relief is temporary.¹⁸⁷ Debts may be discharged by the Secretary of Education for total and permanent disability or death.¹⁸⁸ If student-loan debtors simply stop payment, they will be subject to collection,¹⁸⁹ so it is important for students to seek solutions other than default. DOE explains:

The common consequences of default include large fees—collection costs that can add 25% to the outstanding loan balance—and interest charges; struggles to rent or buy a home, buy a car, or get a job; collection agency actions, including lawsuits and garnishment of wages; and the loss of tax refunds and even Social Security benefits.¹⁹⁰

Unfortunately, DOE relief is only available on loans under federal student loan programs. Private students loans are not covered by DOE debt relief programs. The new Consumer Financial Protection Bureau (CFPB) has jurisdiction over private student loans,¹⁹¹ and both prevention of and remedies for overindebtedness are needed. As of early 2012, the CFPB's advice to private student-loan borrowers who could not make payments was to contact their loan servicers to see what private relief programs may be offered.¹⁹² The agency also issued a Notice and Request for Information Regarding Private Education Loans and Private Education Lenders in connection with a study of private student loans that it is required to submit to Congress by July 2012.¹⁹³

Washington and Lee Law Review).

187. Get Payment Relief, <http://www.ombudsman.ed.gov/relief.html>. (last visited Apr. 10, 2012) (on file with the Washington and Lee Law Review).

188. Cancel or Discharge a Loan, <http://www.ombudsman.ed.gov/cancellation.html> (last visited Apr. 10, 2012) (on file with the Washington and Lee Law Review).

189. Defaulted Loans, <http://www.ombudsman.ed.gov/loandefault.html> (last visited Apr. 10, 2012) (concerning consequences of default) (on file with the Washington and Lee Law Review).

190. Gainful Employment Rule Analysis, *supra* note 11, at 34387; *see also supra* note 168 and accompanying text.

191. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, Title X (2010).

192. Student Debt Repayment Assistance, <http://www.consumerfinance.gov/students/repay/> (last visited Apr. 10, 2012) (on file with the Washington and Lee Law Review).

193. Request for Information Regarding Private Education Loans and

IV. Assessing the Government's Role

A. The Analogy to Subprime Mortgages

There are some obvious similarities between the subprime mortgage crisis and the problem of subprime higher education. In both cases, there has been heavy selling of the American Dream, whether the dream is of owning a home or becoming a college graduate.¹⁹⁴ Furthermore, predatory lending has been a feature of each phenomenon, involving a lack of care about or analysis of ability to pay and benefit.¹⁹⁵ The poor, minorities, and the unsophisticated were targeted by both subprime complexes.¹⁹⁶ Both phenomena have led to high debt, high default rates, and long-term impact on borrowers' financial well-being and access to and cost of future credit.¹⁹⁷

The Dodd–Frank Wall Street Reform and Consumer Protection Act¹⁹⁸ provides for regulation to make sure that packagers of mortgages and other securitizers have “skin in the game” for risky loans.¹⁹⁹ There has been a similar problem of subprime higher educational institutions having little or no stake

Private Educational Lenders, 76 Fed. Reg. 71329 (Nov. 17, 2011), *available at* <http://www.regulations.gov/#!documentDetail;D=CFPB-2011-0037-0001> (seeking comments for report on private education loans and lenders required under section 1077 of Dodd–Frank); *see also* Rick Hackett, *Chime In On Private Student Loans*, THE CONSUMER FINANCIAL PROTECTION BUREAU BLOG (Nov. 16 2011), <http://www.consumerfinance.gov/blog>.

194. *See* LYNCH ET AL., *supra* note 6, at 1.

195. *See id.* at 1–2 (discussing problem of educational institutions that “prey on our underserved population” and criticizing “access without success”); *see also* KATHLEEN C. ENGLE & PATRICIA A MCCOY, THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS 21–25 (2011) (concerning predatory lending during the mortgage bubble).

196. *See* ENGLE & MCCOY, *supra* note 195, at 21; *see also supra* note 6.

197. *See* ENGLE & MCCOY, *supra* note 195, at 142–48 (describing how subprime lending hit fragile neighborhoods and led to default and, as the economic consequences unfolded, also led to rising unemployment and poverty); *see also supra* Part II.E; *supra* notes 168, 190 and accompanying text (concerning high rates of default on student loans to attend for-profit schools and resulting consequences).

198. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

199. *See id.* § 941(b); *see also* 15 U.S.C. § 78o-11(c)(1)(B) (2006) (calling for a “securitizer” to retain at least 5% of the “credit risk for any asset”).

in their students' success. The career colleges have a nearly perfect system of avoiding skin in the game. When students get federal grant aid and student loans to attend college, the schools get paid up front and do not bear the loss when former students default later after leaving school.²⁰⁰ Some for-profit colleges give or arrange for private student loans on top of federal student aid, but this may be primarily to avoid problems with the 90% limit on revenues from Federal HEA funds.²⁰¹ To evade that limit, for-profit colleges can raise tuition, provide private student loans of just over 10%, and not care much if they collect on the private loans.²⁰² Another strategy is enrolling some military and former military personnel whose loans do not come from federal higher education funding and thus don't count for purposes of the 90% limit on revenue from federal student aid funds.²⁰³

Lack of effective regulation enabled the bubbles in both subprime mortgages and subprime higher education. The cluelessness of credit rating agencies about the risks of subprime mortgages²⁰⁴ is analogous to the lack of effective oversight of for-profit colleges by educational accrediting organizations, which the career colleges have worked to capture and manipulate.²⁰⁵ Taxpayers paid for a bailout of subprime mortgage lenders and investors,²⁰⁶ but in the case of subprime higher education, the

200. Federal student aid funds are disbursed while students are in school; one method is per enrollment period, and under this method, once the student has completed 60% of a period (such as a quarter or semester), 100% of the funds are disbursed, even if the student later withdraws. 34 C.F.R. § 668.22(e)(2)(ii) (2011).

201. See *supra* Part II.D (discussing for-profit college reliance on federal grant aid and student loans).

202. See *supra* Part II.D.

203. Hollister K. Petraeus, *For Profit Colleges, Vulnerable G.I.'s*, N.Y. TIMES (Sept. 21, 2011), <http://www.nytimes.com/2011/09/22/opinion/for-profit-colleges-vulnerable-gis.html> (last visited Apr. 10, 2012) (on file with the Washington and Lee Law Review).

204. See ENGLE & MCCOY, *supra* note 195, at 47–51 (discussing poor judgment of rating agencies during the subprime mortgage bubble and the incentives to rate mortgaged-back securities highly given an arranger-pays compensation system).

205. See HARKIN, *EMERGING RISK*, *supra* note 19, at 2; see also Eisman, *supra* note 6, at 29–30 (comparing higher education accrediting agencies to credit rating agencies and discussing trend of for-profit schools acquiring schools that are accredited to get their accreditation and also sit on the boards of agencies).

206. See ENGLE & MCCOY, *supra* note 195, at 111–16 (discussing passage of

prepayment of federal grant and loan funds to the colleges makes for a prepackaged bailout,²⁰⁷ leaving students and taxpayers at risk. In this way, the federal role in subprime higher education is even worse than in the subprime mortgage crisis because the government is directly pumping taxpayer dollars into institutions that it knows are generating low completion rates and high debts for students.²⁰⁸

As has already been suggested,²⁰⁹ there is also an interesting comparison in the treatment of unmanageable debt in bankruptcy for mortgages as opposed to student loans, with student-loan borrowers actually getting less relief. Home-mortgage debt is dischargeable so that the borrower is not personally liable, but it must generally be paid in full to retain a home.²¹⁰ However, a debtor who is willing to give up a home can discharge home-mortgage debt. Student loans are nominally unsecured, but they are effectively secured by human capital and by nondischargeability; the law does not provide the release from personal liability on student loans that is available with home loans. One cannot give back a worthless education and thus walk away from it. A debtor can be hounded to the grave for student-loan debt, no matter its ineffectiveness in improving the debtor's income or other prospects. Unless the debtor can prove facts to meet the test for an undue hardship discharge, student-loan debt, including private student-loan debt, remains nondischargeable for life.²¹¹

While subprime higher education is worse than subprime mortgages both in the prepackaging of the bailout and in the long-term indenture of former students, often with no way out,

the Emergency Stabilization Act of 2008 in October of that year, creating the \$700 billion Troubled Asset Relief Program, and the continued panic in financial markets until large sums of TARP funds were paid to major financial institutions to infuse them with capital). Nearly all those funds have been repaid. See Jeff Bater and John Kell, *With Fifth Third Out, Banks have Repaid 99% of TARP*, WALL ST. J. (Mar. 17, 2011), <http://online.wsj.com/article/SB10001424052748704261504576205142438418336.html> (last visited Apr. 10, 2012) (on file with the Washington and Lee Law Review).

207. See *supra* note 200 and accompanying text.

208. See *supra* Part II.E.

209. *Supra* Part III.C.

210. 11 U.S.C. § 1322(b)(2), (5) (2006).

211. See *supra* notes 171–74, 177–84 and accompanying text.

there is one way in which the student loan problem is not as bad as the mortgage crisis. It is not as big.²¹² While private student loans are securitized and high risk, the risk seems to be relatively transparent to investors.²¹³ Losses to taxpayers on federal student loans are substantial,²¹⁴ but even if they get much worse, as seems likely, the risk is not nearly as large as in the risk in the mortgage bailout, although ultimately nearly all of that money was repaid by the banks.²¹⁵

B. The Questionable Policy of Relying on For-Profit Higher Education as the Means to Expand to Universal Higher Education

In the post-war decades from the 1950s to the 1970s, it became common to think in terms of elite, mass, and universal higher education.²¹⁶ These three categories roughly map onto three tiers of the California higher education system—the University of California (elite); the California State Universities

212. Total U.S. mortgage debt outstanding is about ten times total student-loan debt. See U.S. Census Bureau, *supra* note 24; Dennis Cauchon, *Student Loans Outstanding Will Exceed \$1 Trillion This Year*, USA TODAY (Oct. 25, 2011 1:23 PM), <http://www.usatoday.com/money/perfi/college/story/2011-10-19/student-loan-debt/50818676/1> (last visited Apr. 10, 2012) (stating that total student-loan debt is expected to reach \$1 trillion by the end of 2011) (on file with the Washington and Lee Law Review). FinAid.org, which estimated the total student debt volume slightly more conservatively as still short of \$1 trillion as of February 2012, maintains a student-loan debt clock showing the growing volume at a site “intended for entertainment purposes only.” *Student Loan Debt Clock*, FINAID, <http://www.finaid.org/loans/studentloandebtclock.phtml> (last visited Apr. 10, 2012) (on file with the Washington and Lee Law Review).

213. Matt Wirz, *What Hedge Funds Can Teach College Students*, WALL ST. J. (Nov. 12, 2011), <http://online.wsj.com/article/SB10001424052970204224604577030562170562088.html> (last visited Apr. 10, 2012) (concerning rising risk associated with bonds backed by bundled student loans as default rates rose in the bad economy) (on file with the Washington and Lee Law Review).

214. Proposed Gainful Employment Rule Analysis, *supra* note 6, at 43622 (noting that the government covers the cost of defaults on federal student loans, \$9.2 billion in 2009, loans which then had a net present value of \$1 billion based on historical collections on defaulted loans).

215. See *supra* note 206 (concerning the \$700 billion TARP bailout in October 2008, which has nearly all been repaid).

216. Martin Trow, *Reflections on the Transition from Mass to Universal Higher Education*, 99 DAEDALUS 1 (1970), available at <http://www.stor.org/pss/20023931>.

(mass); and community colleges (universal).²¹⁷ Obviously, private nonprofit universities and colleges also have a role to play in each of these categories. The categories can also be described in terms of percentages of the population with degrees; up to 15% (elite), 16%–50% (mass), or above 50% (universal).²¹⁸

The federal government has embraced for-profit higher education as part of a push for a higher national rate of college graduation, currently stuck at the high end of the mass range.²¹⁹ Reliance on the for-profit sector as part of the overall plan for American higher education goes back at least to 1972, when Congress made proprietary schools eligible to receive federal student aid funds.²²⁰ Political explanations are apparent, including the massive lobbying of the for-profit industry²²¹ and ideological commitment to “private” solutions, even if heavily dependent on federal government funding.²²² Whether there are sound public policy justifications for reliance on for-profit education is a much harder question to answer. A recent study of trends in college spending expressed skepticism that expansion of the private sector, including nonprofit and for-profit colleges, will go far enough: “Most would say not: to make the huge increases in access and degree production that are needed in the future, we need to rekindle public willingness to invest in higher education,

217. Chris Armbruster, *On Cost-Sharing, Tuition Fees and Income Contingent Loans for Universal Higher Education: A New Contract Between University, Student and State?* 6 POL’Y FUTURES IN EDUC. 3, (2008), available at <http://ssrn.com/abstract+910001>.

218. *Id.* at 7.

219. *See supra* note 163 and accompanying text. In 2007, 40.4% of the U.S. population aged 25–34 had college degrees, associate and higher, making the United States tenth among the OECD countries. Patrick J. Kelly, *Closing the College Attainment Gap Between the U.S. and Most Educated Countries, and Contributions to be Made by the States*, Nat’l Ctr. for Higher Educ. (Apr. 2010), available at <http://www.nchems.org/pubs/docs/Closing%20the%20U%20S%20%20Degree%20Gap%20NCHEMS%20Final.pdf>. Canada, Korea, and Japan had the top three rates in the same 25–34 population, with college degree rates of 55.8%, 55.5%, and 53.7%, respectively. *Id.* The attainment level in the United States has largely leveled off, with persons 35–44 in 2007 showing a slightly higher level of college degree attainment, 42.2%. *Id.*

220. *See supra* note 113.

221. *See supra* note 108.

222. *See supra* Part II.D.

even as we increase cost effectiveness and reduce the trend toward higher tuitions.”²²³

A primary public policy reason for reliance on for-profit schools could be a hope of reducing the cost of production, in part by making students largely pay their own way with student loans. So a key question, for which there seems to be insufficient data due to lack of information about the for-profit sector’s finances, is whether for-profit schools really produce educated citizens with degrees at lower cost than alternatives, taking into account both the low graduation rates of for-profits, federal grant and loan aid subsidies to them, and default rates of their former students. Three-quarters of American higher education students go to public institutions.²²⁴ All public institutions are subsidized, but the subsidies have been declining as state and local governments faced budget crunches, even as more students attended these schools.²²⁵ In 2009, community colleges educated 6.5 million students, the largest single sector of higher education with more than a third of students nationwide,²²⁶ and the cost of the education on average was about \$10,000 per FTE student, no more than the average amount spent on elementary and secondary education.²²⁷ As community colleges added students, they also lost public subsidies and did not raise tuition as much as the cuts, resulting in cost-cutting affecting the education itself.²²⁸ In addition, more than another third of higher education

223. DONNA M. DESROCHERS & JANE V. WELLMAN, TRENDS IN COLLEGE SPENDING 1999–2009: WHERE DOES THE MONEY COME FROM? WHERE DOES IT GO? WHAT DOES IT BUY? 45 (2011), available at http://www.deltacostproject.org/resources/pdf/Trends2011_Final_090711.pdf; see also Cellini and Goldin, *supra* note 1 (raising a challenge to the for-profit sector based on the lower tuition at for-profit schools that do not receive federal student aid; however their data are perhaps of limited relevance to a goal of universal higher education in that the for-profit schools they studied that did not participate in federal student aid programs were typically non-degree-granting vocational programs).

224. *Id.* at 11 fig.2 (showing total public enrollment of nearly 77% of undergraduates in 2009).

225. *Id.* at 32–33 figs.13 & 14.

226. *Id.* at 10 fig.1.

227. *Id.* at 7; see also *Extracts on Key Issue Areas From “Trends in College Spending, 1999–2009”* at 1 (2011) [hereinafter *Extracts*], <http://www.deltacostproject.org/resources/pdf/trendsissu Highlights.pdf> (last visited Apr. 10, 2012) (on file with the Washington and Lee Law Review).

228. *Extracts, supra* note 227, at 3.

is provided by public institutions with programs through the doctoral or masters' level.²²⁹ These schools lost even more subsidy and adjusted by raising tuition but managed to maintain expenditures on education by cutting elsewhere in their budgets.²³⁰

Taking on a mortgage for a university education has become a common feature of late adolescent life in America, and for-profit college graduates have the highest debt.²³¹ In 2010, total student-loan debt volume rose above that of credit card debt for the first time, as a result of increases in the former and decline in the latter in the wake of credit constriction brought on by the Great Recession.²³² College freshmen reported record levels of stress as they worried about their career prospects in relation to the debt they were incurring.²³³ The implications for household finance of entering adult life with an educational mortgage are profound, even for those who do not obviously fail. Among borrowers for postsecondary education, 48% say having to repay student loans makes it harder to pay bills and make ends meet and 25% say it is harder to buy a home.²³⁴ Predictably, these effects are worse for students with higher debts and lower success rates in completing programs, as is the case for those who attend for-profit schools.²³⁵ Under a principle of worst things first, it makes sense to get

229. DESROCHERS & WELLMAN, *supra* note 223, at 7 (noting that public four-year institutions protected educational spending even as revenues declined and that tuition rose to replace lost revenues from other sources).

230. *Id.*

231. *See supra* notes 79–80 and accompanying text.

232. *See* Mary Pilon, *Student-Loan Debt Surpasses Credit Cards*, WALL ST. J. (Aug. 9, 2010 1:13 PM), <http://blogs.wsj.com/economics/2010/08/09/student-loan-debt-surpasses-credit-cards/> (last visited Apr. 10, 2012) (reporting that in 2010 there was \$826.5 billion in credit-card debt outstanding and \$829.79 billion in student loans) (on file with the Washington and Lee Law Review); *see also* U.S. Census Bureau, Table 1188: Credit Card-Holders, Number, Spending, and Debt (2012), <http://www.census.gov/compendia/statab/2012/tables/12s1188.pdf> (last visited Apr. 10, 2012) (showing total credit card debt outstanding of \$886 billion in 2009 and \$838 billion projected for 2012). Total student-loan debt was expected to exceed \$1 trillion in 2011 or soon after. *See supra* note 212.

233. HIGHER EDUCATION RESEARCH INSTITUTE, THE FRESHMAN SURVEY: NATIONAL NORMS FALL 2010 (Jan. 2011) *available at* http://www.heri.ucla.edu/PDFs/pubs/briefs/HERI_ResearchBrief_Norms2010.pdf

234. *See* Pew Research Center, *supra* note 8.

235. *See supra* Part II.E.

tougher on for-profit colleges, shutting down access to federal student aid funds for those with the lowest repayment rates and highest debt-to-income ratios to minimize these schools' negative effects.

V. Conclusion

The growth of predatory for-profit higher education has been dramatically fueled in the last decade by an infusion of federal dollars in the form of federal grant aid and student loans. The for-profit sector is offering subprime higher education characterized by high price and high risk of producing only overindebtedness. The idea of a subprime higher education sector captures well many of its features as well as the similarities to subprime mortgages, in terms of cost, risk, value, and the population targeted by marketing. Looking back on the housing bubble, we can see that the push for expanded homeownership went too far. Many of those who bought homes with subprime mortgages became owners in name only; in reality, they had no equity and effectively ended up paying very high rent or defaulting and taking a blow to their credit scores. It would have been better if regulation had prevented the bubble. A very similar argument can be made about subprime higher education. Just as some of the new homeowners would have been better off remaining renters, some people would be better off not going to for-profit colleges. Predatory lending will not get us to universal college education. The federal funds going to this sector would be best used at the highest performing for-profit schools or otherwise at community colleges or other public institutions. Shutting down more predatory for-profit colleges is a sound strategy to contain the damage to students and the waste of federal resources, but the political challenge of doing so should not be underestimated. In this difficult context, DOE's first step with the overly cautious Gainful Employment Rule is a small victory.