

FOR-PROFITS UNDER FIRE: THE FALSE CLAIMS ACT AS A REGULATORY CHECK ON THE FOR-PROFIT EDUCATION SECTOR

*Gayland O. Hethcoat II**

INTRODUCTION

Their presence is pervasive throughout the United States: On posters at bus stops, in television commercials, and in pop-up ads on the Web, for-profit institutions of higher education strive to sell themselves to a public that has long equated education with success.¹ Ranging from cosmetology schools to schools that grant degrees in business administration and criminal justice, for-profits often exploit as selling points the factors that distinguish them from traditional public and private nonprofit colleges and universities. Evening, weekend, and online courses are increasingly a staple of for-profits' curricula. The courses themselves function not to provoke intellectual debate for its own sake as much as to equip students with skills directly transferable to the workplace. In a word, for-profits offer flexibility—the key for many Americans to educating themselves and rising above the dregs of a downturned economy.

Undoubtedly, for-profits—which totaled about 2,900

* J.D., University of Miami; B.S., Virginia Commonwealth University. The author thanks Jennifer H. Arlen, the Norma Z. Paige Professor of Law at New York University School of Law.

¹ This article generally uses “institution” to refer to all institutions of higher education and “for-profit” to refer to proprietary, or profit-seeking, institutions of higher education. See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-948T, FOR-PROFIT COLLEGES: UNDERCOVER TESTING FINDS COLLEGES ENCOURAGED FRAUD AND ENGAGED IN DECEPTIVE AND QUESTIONABLE MARKETING PRACTICES 1 n.1 (2010), available at <http://www.gao.gov/new.items/d10948t.pdf> (defining for-profits as “institutions of post-secondary education that are privately-owned or owned by a publicly traded company and whose net earnings can benefit a shareholder or individual”). For purposes of the False Claims Act, these distinctions are irrelevant.

institutions during the 2008–2009 academic year, making up more than forty percent of all institutions of higher education in operation²—fill an important niche in the education landscape. But at alarmingly disproportionate rates compared with their traditional counterparts, for-profits have been implicated in stories of promises that proved too good to be true. Take, for instance, the story of Traci Joyce. A forty-year-old with fifteen years of experience in the restaurant industry, Joyce enrolled in the for-profit California Culinary Academy with aspirations to become an executive chef.³ With \$130,000 worth of debt from the culinary program, however, Joyce was unable to find little more than butchering and catering jobs after graduation.⁴ She eventually returned to the pizzeria where she worked before culinary school.⁵ Rather than resume her former position as manager, though, she was demoted to working in the restaurant’s kitchen.⁶ Today, Joyce is one of thousands of plaintiffs in a class-action lawsuit against the California Culinary Academy in which the plaintiffs claim that the school “misrepresented its 98 percent job placement rate, exaggerated its prestige in the industry and suggested that it had a selective qualifying process.”⁷ A \$40 million settlement offer from the school is under court review as of this writing.⁸

The allegations against the California Culinary Academy are not anomalous. In 2010, an undercover Government Accountability Office (“GAO”) investigation revealed a damaging assessment of the industry. Of fifteen for-profits investigated, nearly one-third had encouraged fraudulent practices, such as the falsification of financial aid forms to qualify for federal aid.⁹ Likewise, all fifteen institutions had made deceptive or otherwise questionable statements—akin to those in the case against the California Culinary Academy—about such matters as accreditation and statistics regarding graduation,

² DANIEL L. BENNETT ET AL., *CTR. FOR COLL. AFFORDABILITY & PRODUCTIVITY, FOR-PROFIT HIGHER EDUCATION: GROWTH, INNOVATION AND REGULATION 13* (2010), available at http://www.centerforcollegeaffordability.org/uploads/ForProfit_HigherEd.pdf.

³ Stacy Finz, *For-Profit Colleges Face Lawsuits, U.S. Scrutiny*, S.F. CHRON., May 1, 2011, at 2, available at <http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2011/05/01/MN4G1J8PRR.DTL>.

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

⁷ *Id.* at 1.

⁸ *Id.*

⁹ U.S. GOV’T ACCOUNTABILITY OFFICE, *supra* note 1, at 7–8.

employment, and expected salaries.¹⁰ In short, the report confirmed that industry reform was in order.

Under the leadership of President Barack Obama, the Department of Education has heeded the call for reform. Shortly after the GAO issued its 2010 report, the Department released a comprehensive set of regulations designed to strengthen federal financial aid programs “by protecting students from aggressive or misleading recruiting practices, providing consumers with better information about the effectiveness of career college and training programs, and ensuring that only eligible students or programs receive aid.”¹¹ The regulations are not limited in application to for-profits, but the Department described the “rapid growth of enrollment, debt load, and default rates at for-profit institutions in recent years” as “prompt[ing]” the regulatory effort.¹²

Cognizant of these measures, this article advocates for the use of another tool in the larger undertaking of for-profit reform: the False Claims Act (“FCA”).¹³ This federal statute imposes liability on any person who makes a false or fraudulent claim for payment to the federal government,¹⁴ and allows private individuals to sue civilly on the government’s behalf and share in the recovery.¹⁵ With respect to for-profits, the FCA offers a potentially potent check on their handling of federal financial aid. Indeed, an increasing number of courts—in conflict with earlier courts—have been receptive to individual-led actions that challenged for-profits’ obtainment of financial aid.¹⁶ These courts’ interpretation of the statute, however, has engendered critical response, leading some in the education community to complain that educational institutions are now susceptible to “high litigation expenses and possible damage awards

¹⁰ *Id.* at 9–13.

¹¹ Press Release, U.S. Dep’t of Educ., Department of Education Establishes New Student Aid Rules to Protect Borrowers and Taxpayers (Oct. 28, 2010), available at <http://www.ed.gov/news/press-releases/department-education-establishes-new-student-aid-rules-protect-borrowers-and-tax>.

¹² *Id.*

¹³ This article focuses only on civil liability under the False Claims Act. For discussion of proposals to criminalize, at the federal level, “diploma mills” and “accreditation mills” that scheme to make a profit, see generally George Gollin et al., *Complexities in Legislative Suppression of Diploma Mills*, 21 STAN. L. & POL’Y REV. 1 (2010).

¹⁴ 31 U.S.C. § 3729(a)(1) (2006).

¹⁵ 31 U.S.C. § 3730 (2006).

¹⁶ See, e.g., *United States ex rel. Hendow v. Univ. of Phoenix*, 461 F.3d 1166 (9th Cir. 2006); *United States ex rel. Main v. Oakland City Univ.*, 426 F.3d 914 (7th Cir. 2005).

for inadvertent errors on the numerous applications for federal aid they must fill out annually.”¹⁷

This article counters that such criticisms are overbroad in that they fail to adequately consider both the FCA’s overall statutory structure and the sector of the education industry most vulnerable to a more expansive statutory interpretation: the for-profit sector. Part I of this article addresses the concerns about the industry and elaborates on recent regulatory developments. Part II provides an overview of the FCA and the extent to which it may be triggered by an educational institution agreeing to abide by various federal regulations to receive financial aid. Additionally, Part II discusses the split among the courts as to whether an institution that knowingly contravenes one or more of these regulations may be liable for fraud in an individual-led action. Part III espouses the FCA as an important third-party enforcement tool to regulate fraud in the for-profit sector and responds to the above-noted criticisms.

I. AN INDUSTRY RIPE FOR REFORM

Statistical data from the Department of Education paints a peculiar picture of the for-profit education sector. The Department’s latest numbers show that although students at for-profits represent only eleven percent of all higher-education students, they represent twenty-six percent of all loan borrowers and forty-three percent of all loan defaulters.¹⁸ More than a quarter of for-profits receive eighty percent of their revenues from taxpayer-funded federal financial aid.¹⁹ This extensive reliance on federal funds has been integral to the for-profit sector’s nearly six-fold enrollment growth since 1986.²⁰ Taken together, these figures have given consumers, taxpayers, and regulators legitimate reasons to question whether some for-profits are profiting on public money at the expense of students who are left

¹⁷ Rachel Perkins, Note, *Federal Funding and Fraud: The False Claims Act in Higher Education After Main v. Oakland City University*, 35 J.C. & U.L. 747, 747 (2009) (footnote omitted).

¹⁸ Press Release, U.S. Dep’t of Educ., *supra* note 11.

¹⁹ *Id.*

²⁰ BENNETT ET AL., *supra* note 2, at 10, 23 (“Federal student loan money is the lifeblood of the for-profit education industry.”); *see also* 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, 231–32 (2011). In absolute numbers, enrollment grew from approximately 300,000 students in 1986 to nearly 1.8 million students in 2008. BENNETT ET AL., *supra* note 2, at 10 (citation omitted).

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with large debt loads in an emaciated job market and degrees of questionable value. In harsher terms, the data suggests that some for-profits may be committing fraud.

Ordinarily, market pressure would respond adversely to the for-profit sector if it failed to live up to its promise to confer students with degrees that can be leveraged to secure employment. As the Government Accountability Office's recent investigation uncovered, however, a general lack of transparency with respect to graduation, employment, and loan-default statistics—in combination with concerted advertising and marketing campaigns—thwarts many student-consumers from exercising their purchasing power in an informed way.²¹ Furthermore, the lender providing most of the funds that keep for-profits afloat is the federal government; private third-party lenders, such as banks and student lenders like Sallie Mae, have largely refused to lend to for-profits, citing the high loan-default rates and bad credit scores of the typically lower-income students at these institutions.²² The extent to which the government exerts analogous market pressure thus turns on the regulatory system that it imposes on for-profits and the degree to which the government enforces this system.

Concerned about the interrelationship of enrollment growth, debt loads, and default rates at for-profits, the Department of Education has endeavored to rein in the excesses of the industry. The “most crucial”²³ tenet of the Department's reform is clarification of an existing regulation that requires for-profits to prepare their students for “gainful employment in a recognized occupation”²⁴ To determine whether an institution meets this obligation, the Department will assess whether the institution's graduates are paying sufficient amounts on their student loan balances and whether they are obtaining sufficient income to manage their debts.²⁵ If an

²¹ See generally U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 1 (describing how undercover applicants were provided unclear, misleading, or false information by various for-profits).

²² See DEANNE LOONIN, NAT'L CONSUMER LAW CTR., *PILING IT ON: THE GROWTH OF PROPRIETARY SCHOOL LOANS AND THE CONSEQUENCES FOR STUDENTS* 8–12 (2011), available at <http://www.studentloanborrowerassistance.org/blogs/wp-content/www.studentloanborrowerassistance.org/uploads/File/proprietary-schools-loans.pdf> (noting that private lenders ended their relationship with for-profit institutions following the subprime private student loan market crash in 2008).

²³ *For-Profit Schools*, N.Y. TIMES (Dec. 14, 2010), http://topics.nytimes.com/top/reference/timestopics/subjects/f/forprofit_schools/index.html?emc=eta2.

²⁴ 34 C.F.R. § 668.14(b)(26) (2010).

²⁵ See *For Profit Schools*, *supra* note 23.

institution does not satisfy certain targets for student loan repayment or ratios of debt to income, the institution will be foreclosed from participating in the government's financial aid programs or will have to disclose its shortcomings to students.²⁶ Adopted "after the most extensive public input in the Department's history," which included the submission of more than 90,000 written comments, the new regulations are scheduled to become effective on July 1, 2012.²⁷

Meanwhile, other new Department regulations went into effect in July of 2011. One such regulation targets the type of misrepresentations and omissions that the 2010 GAO report uncovered, and it further clarifies and expands upon for-profits' obligations to disclose graduation and job-placement rates.²⁸ Whereas the predecessor regulation only required an institution to disclose job-placement rates if the institution calculated them, the revised regulation imposes an affirmative duty on an institution to disclose such information to a prospective student for each program offered and elucidates the steps an institution must take in putting such information on the Web and in promotional materials.²⁹ Another revised regulation overhauls a ban on incentive compensation to admissions and financial aid personnel based on their enrollment of a student in the institution or in a financial aid program³⁰—a rule that has been the centerpiece of much False Claims Act litigation. In its new form, the regulation eliminates twelve safe harbors that the Department previously enacted, which "unscrupulous actors routinely rel[ied] upon . . . to circumvent the intent of the [statutory ban]."³¹

The federal government's scrutiny of the for-profit sector has not been without controversy. After the GAO revised its 2010 report,

²⁶ *See id.*

²⁷ Press Release, U.S. Dep't of Educ., Obama Administration Announces New Steps to Protect Students from Ineffective Career College Programs (June 2, 2011), available at <http://www.ed.gov/news/press-releases/gainful-employment-regulations>.

²⁸ *See* Program Integrity Issues, 75 Fed. Reg. 66,832, 66,838 (proposed Oct. 29, 2010) (to be codified at 34 C.F.R. pt. 668).

²⁹ Compare 34 C.F.R. § 668.41(d)(5)(i) (2010) (requiring an institution to disclose the job-placement rate for a program only "if it calculates such a rate" and otherwise allowing an institution to satisfy its disclosure obligation by gathering job-placement rates from "[s]tate data systems," "[a]lumni or student satisfaction surveys," or "[o]ther relevant sources"), with Program Integrity Issues, 75 Fed. Reg. at 66,949 (requiring an institution to disclose the job-placement rate for a program to a prospective student and publish this rate in promotional materials for prospective students and on the institution's website).

³⁰ *See* 34 C.F.R. § 668.14(b)(22)(i) (2010).

³¹ Program Integrity Issues, 75 Fed. Reg. at 66,872.

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the ranking Republican on the Senate Committee on Health, Education, Labor and Pensions said that the revisions raised “serious questions about the quality of rigor” of the investigation and requested a detailed explanation of each change.³² Subsequently, during the 112th Congress’s contentious budget battle, a bipartisan group of House legislators sought to prevent funding to the Department of Education to implement the new regulations.³³ Although this measure proved unsuccessful,³⁴ the for-profit sector has pressed onward in its fight against the regulations, increasing its lobbying efforts and even filing a lawsuit that challenges several of the regulations as unconstitutional and beyond the scope of the enabling statute.³⁵ These developments suggest that politics may restrain the government’s ability to bring pressure to bear on the for-profit sector.³⁶ A third-party enforcement mechanism accordingly is necessary to police those institutions in the industry that draw substantial funds from taxpayers yet encumber their students with debt and useless educational credentials. One such mechanism—the False Claims Act—provides the legal framework to fill enforcement gaps left by the government.

³² Tamar Lewin, *U.S. Revises Report on Commercial Colleges*, N.Y. TIMES (Dec. 8, 2010), <http://www.nytimes.com/2010/12/09/education/09gao.html?ref=for-profitschools>. The revised report “soften[ed] some of the [original report’s] findings but without changing its conclusion that the colleges visited had engaged in deception or fraud.” *Id.* The revisions included clarification that a college representative told an undercover applicant that she “could”—rather than “should”—take out the maximum amount of federal loans, regardless of her need for all the money, and that the applicant “could”—rather than “should”—put the extra money in a high-interest savings account. *Id.*

³³ See Chris Kirkham, *House Quashes Rules on Student Debt at For-Profit Colleges*, THE HUFFINGTON POST (Feb. 18, 2011), http://www.huffingtonpost.com/2011/02/18/for-profit-college-regulations_n_825322.html.

³⁴ See Chris Kirkham, *Budget Deal Allows Regulations to Move Forward on For-Profit Colleges*, THE HUFFINGTON POST (Apr. 9, 2011), http://www.huffingtonpost.com/2011/04/09/budget-deal-for-profit-colleges_n_847047.html.

³⁵ See *Career Coll. Ass’n v. Duncan*, No. 11-0138 (RMC), 2011WL 2690406 (D.D.C. July 12, 2011); see also Goldie Blumenstyk, *With Lawsuit, For-Profit Colleges Step Up Fight Against New Regulations*, CHRON. HIGHER EDUC. (Jan. 31, 2011), <http://chronicle.com/article/With-Lawsuit-For-Profit/126042/>.

³⁶ *Cf.*, e.g., Lewin, *supra* note 32 (noting the “highly partisan atmosphere” surrounding Senate committee oversight hearings regarding the for-profit sector and the Department of Education’s regulatory efforts).

II. THE LEGAL FRAMEWORK

Created in response to military contractor fraud during the Civil War, the False Claims Act serves as the federal government's primary enforcement tool against government-targeted fraud. The central pillar of the FCA is a provision that permits private individuals to act as "private attorneys general"³⁷ and bring fraud suits on the government's behalf. Traditionally, government contractors and health care providers that participate in federal health insurance schemes have been the subjects of these suits. More recently, though, educational institutions—particularly for-profits—that participate in federal financial aid programs have faced FCA litigation. The legal framework that has resulted is one in which federal district and circuit courts have reached conflicting decisions, which have yet to be resolved by the Supreme Court.

a. The False Claims Act and Its Qui Tam Provision

The FCA imposes liability for seven types of fraud.³⁸ One may incur liability, for example, if one "knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval" or if one "knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim."³⁹ In this context, "knowledge" refers to one's actual knowledge of information, deliberate ignorance with respect to the truth or falsity of information, or reckless disregard with respect to the truth or falsity of information.⁴⁰ Notably, the statutory definition expressly excludes specific intent to defraud.⁴¹ "Claim" under the FCA "means any request or demand, whether under a contract or otherwise, for money or property," regardless of whether the money or property is titled to the federal government.⁴² "Material" "means having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property."⁴³ If a defendant is ultimately deemed to have met these elements of liability, that person must pay the government a civil penalty between \$5,000 and

³⁷ *United States ex rel. Branch Consultants v. Allstate Ins. Co.*, 560 F.3d 371, 376 (5th Cir. 2009) (citation omitted).

³⁸ 31 U.S.C. § 3729(a)(1) (2006).

³⁹ *Id.* § 3729(a)(1)(A)–(B).

⁴⁰ *Id.* § 3729(b)(1)(A).

⁴¹ *See id.* § 3729(b)(1)(B).

⁴² *Id.* § 3729(b)(2)(A).

⁴³ *Id.* § 3729(b)(4).

\$10,000, plus treble damages and court costs.⁴⁴

The “most significant aspect”⁴⁵ of the FCA is its *qui tam*⁴⁶ provision. This provision incentivizes private individuals, called “relators,”⁴⁷ to serve the government as watchdogs against fraud, allowing them to share up to thirty percent of the recovery against a defendant.⁴⁸ For a court to have jurisdiction over a *qui tam* suit, a relator must be an “original source” of the information underlying the basis of the suit.⁴⁹ An original source is a person who, (1) prior to the disclosure of information in a public or media forum, voluntarily furnished to the government “information on which allegations or transactions in a claim are based,” or (2) “has knowledge that is independent of and materially adds to the publicly disclosed allegations or transactions, and who has voluntarily provided the information to the Government before filing an action”⁵⁰ Upon receipt of such information, the government must investigate the relator’s allegations while the relator’s complaint is under seal.⁵¹ Thereafter, the government generally may choose to intervene in the action, decline to intervene and allow the relator to proceed, or move to dismiss the action.⁵² Whatever course it chooses, the government will have a visible role to play in the ensuing proceeding.⁵³

b. The False Claims Act as Applied to Educational Institutions

The FCA recognizes various theories of liability for fraud. At its most fundamental level, the FCA recognizes liability on a mischarge or overcharge theory; that is, a person may be liable for

⁴⁴ *Id.* § 3729(a).

⁴⁵ Roberto M. Braceras & Karin Bell, *The False Claims Act and Universities: From Fraud to Compliance*, C. & U.L. MANUAL § 8.2.4 (2009).

⁴⁶ “*Qui tam*” is short for the Latin phrase *qui tam pro domino rege quam pro se ipso in hac parte sequitur*. This phrase translates into “who as well for the king as for himself sues in this matter.” BLACK’S LAW DICTIONARY (9th ed. 2009). The *qui tam* action developed at English common law, which granted access to the courts to citizens who alleged that both the King’s interest and their own interest had been harmed. Braceras & Bell, *supra* note 45, § 8.2.4.

⁴⁷ *See* Braceras & Bell, *supra* note 45, § 8.2.1.

⁴⁸ *See* 31 U.S.C. § 3730(b), (d) (2006).

⁴⁹ *Id.* § 3730(e)(4)(A).

⁵⁰ *Id.* § 3730(e)(4)(B).

⁵¹ *Id.* § 3730(a)–(b).

⁵² *See id.* § 3730(b).

⁵³ *See, e.g., id.* § 3730(c)(3) (allowing the government to receive all pleadings and deposition transcripts in a *qui tam* action even if it does not intervene).

mischarging or overcharging the government for a good or service.⁵⁴ Other, more attenuated, theories are also cognizable under the FCA. For example, liability may attach under a false certification theory, which posits that a claim “can be false where a party merely falsely certifies compliance with a statute or regulation as a condition to government payment.”⁵⁵ Similarly, liability may attach in the absence of an explicitly false claim under a promissory fraud or fraud-in-the-inducement theory.⁵⁶ This theory “holds that liability may attach to each claim submitted to the government under a contract, when the contract or extension of government benefit was originally obtained through false statements or fraudulent conduct.”⁵⁷

In the educational setting, the false certification and promissory fraud theories may have major implications given the nature of the procedure that an institution must follow to receive federal financial aid. To participate in the various financial aid programs enumerated under Title IV of the Higher Education Act of 1965⁵⁸—the Federal Pell Grant and Federal Perkins Loan Programs, among others—educational institutions, including for-profits, must sign a program participation agreement (“PPA”) with the Secretary of Education.⁵⁹ This agreement “conditions the initial and continued participation of an eligible institution” in a funding program on its compliance with various regulatory requirements—for example, the above-mentioned incentive-compensation ban.⁶⁰ Once the Department of Education determines that an institution is qualified to participate, a student then must request Title IV funding via a Free Application for Federal Student Aid (“FAFSA”).⁶¹ Upon the student’s approval, the government pays the student’s institution.

The foregoing process thus creates a situation where an educational institution is essentially one step removed from the release of federal money. The question that has divided the courts is

⁵⁴ Braceras & Bell, *supra* note 45, § 8.2.5(a).

⁵⁵ United States *ex rel.* Hendow v. Univ. of Phoenix, 461 F.3d 1166, 1171 (9th Cir. 2006).

⁵⁶ *Id.* at 1173.

⁵⁷ *Id.* The false certification and promissory fraud theories are “not so different” from each other, premising FCA liability on a finding of the same essential elements: “(1) a false statement or fraudulent course of conduct, (2) made with scienter, (3) that was material, causing (4) the government to pay out money or forfeit moneys due.” *Id.* at 1174.

⁵⁸ Higher Education Act of 1965, Pub. L. No. 89-329, 79 Stat. 1219 (codified as amended in scattered sections of 20 U.S.C.).

⁵⁹ 34 C.F.R. § 668.14(a)(1) (2010).

⁶⁰ *Id.* § 668.14(a)(1), (b)(22).

⁶¹ *See* 20 U.S.C. § 1091 (2006).

whether an institution that knowingly breaches its PPA—a document that, unlike a FAFSA, does not *directly* elicit payment by the government—can be liable for fraud under the False Claims Act. The FCA’s *qui tam* provision presents another layer in the analysis, as relators have been the primary parties to seek recovery against educational institutions.

c. The Developing—and Conflicting—Case Law

In the early 2000s, two Texas district courts were faced with the then-novel question of whether, under a false certification theory, for-profit educational institutions that participated in Title IV financial aid programs were liable under the FCA for knowingly violating their regulatory obligations in their PPAs.⁶² In both cases, *United States ex rel. Graves v. ITT Educational Services, Inc.*⁶³ and *United States ex rel. Gay v. Lincoln Technical Institute, Inc.*,⁶⁴ the facts were similar: The relators, who were admissions personnel at for-profits, alleged that the defendant-institutions engaged in fraud by paying admissions personnel on a commission basis. According to the relators, this conduct was contrary to the incentive-compensation ban that the institutions had stipulated to in their PPAs.⁶⁵

The courts responded skeptically to the relators’ arguments. For both courts, the fact that the FAFSA forms—which the relators did not allege “were false or contained false statements”⁶⁶—directly triggered the government’s payment to the defendants, rather than their PPAs, compelled dismissal of the relators’ claims.⁶⁷ As the *Graves* court explained, certification of compliance with the regulatory requirements codified in the PPA was “not an *express condition* of payment of specific claims or retention of payments,” but rather was a “*general statement* of adherence to all regulations or statutes governing participation in a program through which federal funds are received”⁶⁸ Accordingly, the relators alleged an

⁶² See *United States ex rel. Gay v. Lincoln Technical Inst., Inc.*, No. Civ.A. 301CV505K, 2003 WL 22474586 (N.D. Tex. Sept. 3, 2003), *aff’d per curiam*, F. App’x 286 (5th Cir. 2004); *United States ex rel. Graves v. ITT Educ. Servs., Inc.*, 284 F. Supp. 2d 487 (S.D. Tex. 2003), *aff’d per curiam*, 111 F. App’x 296 (5th Cir. 2004).

⁶³ *Graves*, 284 F. Supp. 2d at 487.

⁶⁴ *Gay*, 2003 WL 22474586 at *1.

⁶⁵ *Id.* at *1; *Graves*, 284 F. Supp. 2d at 491.

⁶⁶ *Graves*, 284 F. Supp. 2d at 496.

⁶⁷ See *Gay*, 2003 WL 22474586 at *4; *Graves*, 284 F. Supp. 2d at 496.

⁶⁸ *Graves*, 284 F. Supp. 2d at 496 (emphasis added).

insufficient basis of liability for fraud under the FCA, and the courts thus granted the defendants' motions to dismiss for failure to state a claim upon which relief can be granted.⁶⁹ In unpublished opinions, the Fifth Circuit Court of Appeals affirmed both cases.⁷⁰

Shortly after the *Graves* and *Gay* courts rendered their decisions, other federal appellate courts reached opposite conclusions in cases involving virtually the same facts. In *United States ex rel. Main v. Oakland City University*,⁷¹ the Seventh Circuit expressly rejected the lower court's ruling that "even wilful [sic] falsehoods in [a PPA] do not violate the Act, because the [PPA] requests a declaration of eligibility rather than an immediate payment from the Treasury."⁷² The FCA, the Seventh Circuit stated, simply "requires a causal rather than a temporal connection between fraud and payment."⁷³ Ultimately, the court held that the relator alleged a sufficient cause of action in contending that the defendant–nonprofit university had used a falsified PPA to make, or cause a student to make or use, a FAFSA that was "itself false because it represent[ed] that the student [wa]s enrolled in an eligible institution, which [wa]sn't true."⁷⁴ Subsequently, the Ninth Circuit adopted the Seventh Circuit's approach in *United States ex rel. Hendow v. University of Phoenix*.⁷⁵ Finding that the relators alleged actionable fraud under either a false certification or promissory fraud theory of liability, the court agreed with the Seventh Circuit that emphasis on certification of regulatory compliance as an express condition of payment of financial aid was misplaced: "[I]t is irrelevant how the federal bureaucracy has apportioned the statements among layers of paperwork."⁷⁶

Other courts have followed *Main* and *Hendow*. Recently, two

⁶⁹ See *Gay*, 2003 WL 22474586 at *4–5; *Graves*, 284 F. Supp. 2d at 502, 510.

⁷⁰ See *United States ex rel. Graves v. ITT Educ. Servs., Inc.*, 111 F. App'x 296 (5th Cir. 2004); *United States ex rel. Gay v. Lincoln Technical Inst., Inc.*, 111 F. App'x 286 (5th Cir. 2004).

⁷¹ *United States ex rel. Main v. Oakland City Univ.*, 426 F.3d 914 (7th Cir. 2005).

⁷² *Id.* at 916 (emphasis added).

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *United States ex rel. Hendow v. Univ. of Phoenix*, 461 F.3d 1166, 1176 (9th Cir. 2006). Prior to *Hendow*, a district court in the Ninth Circuit relied on *Main* to reject a nonprofit university's motion to dismiss a relator's claim that the university knowingly violated an accreditation requirement in its PPA. See *United States v. Chapman Univ.*, No. SACV 04-1256JVSRCX, 2006 WL 1562231 (C.D. Cal. May 23, 2006).

⁷⁶ *Hendow*, 461 F.3d at 1174 (quoting *Main*, 426 F.3d at 916).

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district courts in the Eleventh Circuit relied on these decisions in cases in which the relators, who worked in various positions at for-profits, alleged that the defendant-institutions knowingly breached the regulatory obligations in their PPAs.⁷⁷ These alleged breaches involved not just the incentive-compensation ban, but also a requirement that an institution make employment statistics available to prospective students if the institution advertises job placement rates.⁷⁸ In *United States ex rel. Powell v. American Intercontinental University, Inc.*,⁷⁹ for example, the court denied the defendants' motion to dismiss and subsequent motion for an interlocutory appeal to resolve the apparent circuit split.⁸⁰ In denying the latter motion, the court surveyed the receptive judicial treatment that the *Main-Hendow* line of decision received in contrast to the *Graves-Gay* line of decision, which the court found amounted to "two district court opinions of limited precedential and persuasive value."⁸¹ These opinions, in the court's view, were not enough to create a "substantial difference of opinion as to whether courts should distinguish between conditions of eligibility for government funding and conditions of payment for purposes of an FCA claim."⁸² As the court's opinion indicates, *Main* and *Hendow* appear to represent the predominant analytical approach.⁸³

III. THE FALSE CLAIMS ACT AS A REGULATORY CHECK ON THE FOR-PROFIT EDUCATION SECTOR

The courts that adopted the *Main-Hendow* framework wisely interpreted the False Claims Act, which is broadly "intended to reach all types of fraud, without qualification, that might result in financial

⁷⁷ See *United States ex rel. Gatsiopoulos v. Kaplan Career Instit.*, No. 09-21720-CIV, 2010 WL 5392668 (S.D. Fla. Dec. 22, 2010); *United States ex rel. Powell v. Am. Intercontinental Univ., Inc.*, No. 1:08-CV-2277-RWS, 2010 WL 2245574 (N.D. Ga. June 2, 2010); see also Tamar Lewin, *Scrutiny Takes Toll on For-Profit College Company*, N.Y. TIMES (Nov. 9, 2010), <http://www.nytimes.com/2010/11/10/education/10kaplan.html?emc=eta1> (discussing the *Gatsiopoulos* litigation).

⁷⁸ See *Gatsiopoulos*, 2010 WL 5392668 at *5.

⁷⁹ *United States ex rel. Powell v. Am. Intercontinental Univ., Inc.*, 756 F. Supp. 2d 1374 (N.D. Ga. 2010).

⁸⁰ *Id.* at 1381.

⁸¹ *Id.* at 1380.

⁸² *Id.*

⁸³ *But cf.* Braceras & Bell, *supra* note 45, § 8.5.2 (citing cases outside the educational setting in which "courts have opted not to adopt the reasoning of *Oakland City University* and its progeny").

loss to the Government.”⁸⁴ This framework appreciates that the program participation agreements that for-profit and other educational institutions sign with the federal government are designed to protect consumers and safeguard against the abuse of taxpayer dollars. If, however, the overly formalistic *Graves–Gay* framework prevailed, for-profits would be at much greater liberty to disregard the obligations in their PPAs.⁸⁵ Institutions would have little incentive to police themselves, and compliance thus would turn largely on external government enforcement, which, as noted, may be difficult to predict depending on the political climate. In contrast, the jurisprudence of *Main* and *Hendow*, along with the *qui tam* provision of the FCA, gives for-profits reason to internally regulate their behavior to ensure compliance with their PPAs. Exemplifying this reasoning, one article encourages colleges and universities to enact institution-wide compliance programs, reporting protocols, centralized management systems for government-funded projects, and training programs to avoid exposure to fraud under *Main* and *Hendow*.⁸⁶

Nevertheless, despite the “axiomatic fit”⁸⁷ between the FCA and the relators’ allegations in the cases, the education community has responded critically to *Main* and *Hendow* and their progeny.⁸⁸

⁸⁴ *United States v. Neifert-White Co.*, 390 U.S. 228, 232 (1968) (footnote omitted).

⁸⁵ *See United States ex rel. Hendow v. Univ. of Phoenix*, 461 F.3d 1166, 1176 (9th Cir. 2006) (“In the context of Title IV and the Higher Education Act, if we held that conditions of participation were not conditions of payment, there would be no conditions of payment at all—and thus, an educational institution could flout the law at will.”).

⁸⁶ *See Braceras & Bell*, *supra* note 45, § 8.6.

⁸⁷ *Hendow*, 461 F.3d at 1168.

⁸⁸ *See, e.g., Braceras & Bell*, *supra* note 45, § 8.4 (describing *Main* and *Hendow* as holding that, “if a government payment would not have been made ‘but for’ a university’s false statement of compliance with a particular rule or regulation, then the university can be held liable—no matter how attenuated the relationship between the false statement and the subsequent claim for payment”); Tresa Baldas, *Universities Targeted by False Claim Act Suits*, NAT’L L.J., Sept. 10, 2007, at 6 (quoting an education attorney as describing *Main* as “a very dangerous and extreme expansion of the FCA [that] will impact not only colleges, but anyone who does business with the government”); Doug Lederman, *Inviting a Flurry of False Claims Cases*, INSIDE HIGHER ED. (Oct. 24, 2005), <http://www.insidehighered.com/news/2005/10/24/false#Comments> (quoting attorneys critical of *Main*); Mark L. Pelesh, *Tripping Up on the Paperwork*, INSIDE HIGHER ED. (Nov. 4, 2005), <http://www.insidehighered.com/views/2005/11/04/pelesh> (describing *Main* as an instance of “how even an eminent jurist[, Judge Easterbrook,] can be confused by

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The foremost concern, as the university expressed in *Main*, is that the causality test articulated by the court in that case “would treat any violation of federal regulations in a funding program as actionable fraud”⁸⁹ This concern is amplified by the traits that make educational institutions “an attractive target” for *qui tam* actions: They tend to be large and decentralized; they have a “broad pool of potential whistle-blowers,” ranging from students and professors to administrative staff; and they “are believed to have deep pockets”⁹⁰

Though the education community understandably may be more risk averse after *Main* and *Hendow*, its criticism is overblown. Importantly, the criticism overlooks the difference between a breach of contract and fraud. Although an institution could breach its PPA by accidentally violating one of the regulations therein, fraud would require an institution to breach its agreement with knowledge that it was violating the regulation. As the Seventh Circuit observed: “[F]raud entails making a false representation, such as a statement that the speaker will do something it plans not to do. Tripping up on a regulatory complexity does not entail a knowingly false representation.”⁹¹ One writer points out, moreover, that “[c]ritics of the recent change in the law are unable to point to any case where a college or university inadvertently, or even negligently, violated a Title IV regulation and were successfully sued under the False Claims Act.”⁹²

The education community presumably grasps the critical knowledge component that separates breach of contract from fraud. Most likely, its apprehension arises not from the repercussions of “tripping up on the paperwork,”⁹³ but from the prospect that under principles of vicarious liability a low- or mid-level institutional employee’s knowledge of a false claim may be imputed to the institution.⁹⁴ Some critics describe vicarious liability as “present[ing] a particular challenge, given the sheer number of employees and the

the complex regulatory system established by the Higher Education Act, with potentially significant negative consequences for colleges and universities”).

⁸⁹ United States *ex rel.* *Main v. Oakland City Univ.*, 426 F.3d 914, 917 (7th Cir. 2005).

⁹⁰ Braceras & Bell, *supra* note 45, § 8.1.

⁹¹ *Main*, 426 F.3d at 917.

⁹² Perkins, *supra* note 17, at 769.

⁹³ Pelesh, *supra* note 88.

⁹⁴ *See, e.g., Grand Union Co. v. United States*, 696 F.2d 888, 891 (11th Cir. 1983). Generally, an employee must be acting within the scope of his or her employment for the employee’s knowledge to be imputed to the employer. *See id.*

decentralized aspect of most universities.”⁹⁵ In their words:

Oversight is especially difficult for universities, where government-funded projects are often supervised and controlled by separate individual professors receiving federal grant money. Each professor, graduate student, and research assistant receiving some federal assistance is a potential source for an FCA claim. Add to this environment the great number of complex rules and regulations with which compliance must be “certified” before government funds are released—and certified by professors or other researchers who have little experience in government administration and contracting—and the task of avoiding exposure to the FCA seems almost insurmountable.⁹⁶

Whatever the merits of these concerns, they are not necessarily applicable to for-profits, which have significant operational differences from public and private nonprofit colleges and universities. Unlike the latter institutions, for-profits usually are not decentralized, employing standardized curricula and other efficiency-enhancing techniques.⁹⁷ They are also relatively small and enroll only about 600 students on average, while public and private nonprofit institutions enroll 7000 and 2000 students on average, respectively.⁹⁸ For-profits, furthermore, spend virtually nothing on research and public service; by contrast, public and private nonprofit institutions spend 14 percent and 12.5 percent, respectively, in these areas.⁹⁹ In sum, for-profits generally will have a much less convincing argument than their traditional counterparts that they should not be responsible for a rogue employee’s actions.

The FCA’s knowledge requirement is only one of the features built into the statute that guards against limitless liability. The *qui tam* nature of the challenges to for-profits’ activities is also an important consideration. As noted, a relator in such an action must be an “original source,” the jurisdictional criteria for which a party can neither waive nor concede.¹⁰⁰ Courts already have dismissed *qui tam* actions against for-profits where the relator did not meet these

⁹⁵ Braceras & Bell, *supra* note 45, § 8.4.

⁹⁶ *Id.*

⁹⁷ See BENNETT ET AL., *supra* note 2, at 28.

⁹⁸ *Id.* at 15.

⁹⁹ *Id.* at 25.

¹⁰⁰ See *Rockwell Int’l Corp. v. United States*, 549 U.S. 457, 467–70 (2007).

criteria.¹⁰¹ Conceivably, as the for-profit sector endures greater public attention as a result of the Department of Education's reforms, courts will analyze with extra scrutiny whether relators in *qui tam* actions against for-profits are an original source of the information underlying their allegations.

Similarly, the particularity requirement of Federal Rule of Civil Procedure 9(b) acts as a statutory restraint.¹⁰² The Third Circuit explained that "Rule 9(b) requires, at a minimum, that plaintiffs support their allegations . . . with all of the essential factual background that would accompany 'the first paragraph of any newspaper story'—that is, the 'who, what, when, where and how' of the events at issue."¹⁰³ As in suits that did not survive challenges to the relators being an original source, several courts dismissed *qui tam* actions against for-profits where the relators did not meet Rule 9(b)'s exacting standard.¹⁰⁴ In *United States ex rel. Gatsiopoulos v. Kaplan Career Institute*,¹⁰⁵ for example, the court held that although the relators sufficiently alleged that the defendant for-profit violated the incentive-compensation ban in its PPA, they failed to sufficiently allege that the institution violated various statutory and regulatory requirements regarding job placement rates, licensing requirements, graduation rates, and an "ability to benefit" test.¹⁰⁶

Beyond the statutory restrictions, the critics in the education community also overstate the breadth of potential liability under *Main* and *Hendow*. A large segment of the education industry has little reason to worry: As a matter of Eleventh Amendment sovereign immunity, state colleges and universities are not subject to *qui tam*

¹⁰¹ See, e.g., *United States ex rel. Lopez v. Strayer Educ., Inc.*, 698 F. Supp. 2d 633 (E.D. Va. 2010); *Schultz v. Devry Inc.*, No. 07 C 5425, 2009 WL 562286 (N.D. Ill. Mar. 4, 2009).

¹⁰² See FED. R. CIV. P. 9(b) ("In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally.").

¹⁰³ *In re: Rockefeller Ctr. Props., Inc. Sec. Litig.*, 311 F.3d 198, 217 (3d Cir. 2002) (citation omitted).

¹⁰⁴ See, e.g., *United States ex rel. Bott v. Silicon Valley Colls.*, 262 F. App'x 810 (9th Cir. 2008); *United States ex rel. Jajdelski v. Kaplan, Inc.*, No. 2:05-CV-01054-KJD-GWF, 2011 WL 2669485 (D. Nev. July 7, 2011); *United States ex rel. Gatsiopoulos v. Kaplan Career Instit.*, No. 09-21720-CIV, 2010 WL 5392668 (S.D. Fla. Dec. 22, 2010); *United States ex rel. Pilecki-Simko v. Chubb Instit.*, No. 06-3562, 2010 WL 1076228 (D.N.J. Mar. 22, 2010); *United States ex rel. Leveski v. ITT Educ. Servs., Inc.*, No. 1:07-cv-867-WTL-JMS, 2009 WL 3079526 (S.D. Ind. Sept. 23, 2009).

¹⁰⁵ *Gatsiopoulos*, 2010 WL 5392668 at *1.

¹⁰⁶ See *id.* at *4-7.

liability.¹⁰⁷ Although the question of community colleges' liability is unresolved, at least one federal court held that even community colleges are due sovereign immunity from *qui tam* liability where the college is an agency of the state rather than of the locality.¹⁰⁸ Private nonprofit institutions are not entitled to such immunity, but market incentives may mitigate their proclivity to engage in tactics that exposed other institutions to liability. Institutional rankings, for instance, usually treat stricter admissions policies more favorably than lax ones;¹⁰⁹ therefore, an institution puts its ranking and thus credibility at risk by admitting under- or unqualified students and financially rewarding its admission or financial aid personnel accordingly. For-profits, however—the subset of institutions most likely to absorb the impact of a more liberal regime under the FCA—cater to the very students that public and private nonprofit institutions often determine are unqualified to attend their institutions,¹¹⁰ and for-profits are also generally removed from pressures such as institutional rankings. For-profits consequently may be more apt to admit more students and, as the case law substantiates, violate the incentive-compensation ban in their PPAs.¹¹¹

¹⁰⁷ See *Vt. Agency of Natural Res. v. United States ex rel. Stevens*, 529 U.S. 765, 787–88 (2000) (holding that a “private individual has standing to bring suit in federal court on behalf of the United States under the False Claims Act, 31 U.S.C. §§ 3729–3733, but that the False Claims Act does not subject a State (or state agency) to liability in such actions”).

¹⁰⁸ See *United States ex rel. Diop v. Wayne Cnty. Comm. Coll. Dist.*, 242 F. Supp. 2d 497, 526–28 (E.D. Mich. 2003); see also *Perkins*, *supra* note 17, at 750–51.

¹⁰⁹ See, e.g., Robert Morse & Sam Flanigan, *Law School Rankings Methodology*, U.S. NEWS & WORLD REP. (Mar. 14, 2011), <http://www.usnews.com/education/best-graduate-schools/articles/2011/03/14/law-school-rankings-methodology-2012> (noting that a law school's acceptance rate will affect its selectivity assessment for ranking purposes).

¹¹⁰ See BENNETT ET AL., *supra* note 2, at 31 (“For many traditional public and private nonprofit colleges the percentage of students turned away is viewed as a source of prestige. The same cannot be said about for-profits, as they generally have less stringent admissions requirements In a sense, for-profits are willing to give a chance to many students that would likely be turned away from a traditional college or university.”).

¹¹¹ These statements, of course, are generalizations, which assume, for example, that an institution subject to a ranking system will accurately report its admission numbers. Suffice to say, the kind of “soft” factors, such as reputation, that many nonprofit institutions strive to protect from tarnishing do not weigh nearly as heavily for for-profits. In fact, internal training documents from several for-profits which were recently released to Congress question whether, in the race for profit, some institutions have any recognition for institutional standards at all. A

A final backstop is the federal government itself: “While the *qui tam* relator is empowered as a private prosecutor, it is not empowered to replace the government.”¹¹² Though it may choose not to intervene in a *qui tam* action, the government maintains substantial oversight authority. The government may dismiss an action, for example, “if the court and the Attorney General give written consent to the dismissal and their reasons for consenting.”¹¹³ In the for-profit educational context, these checks and balances mean that the government is unlikely to authorize baseless lawsuits. As the Department of Education tightens the rules governing gainful employment, incentive compensation, misleading advertising, and use of public funds, it is plausible that the government may deem *qui tam* actions against for-profits as interference with its enforcement policy and intervene as it sees fit. On the other hand, the government may perceive such litigation as an extra means to fight fraud in the industry and may be more amenable to it. The latter may be the government’s currently preferred approach, in light of its recent decision to join—for the first time ever—a *qui tam* action against a for-profit educational company, Education Management Corporation, in which the company is accused of committing fraud by knowingly violating the incentive-compensation ban in the company’s PPA.¹¹⁴ Irrespective of the course the government takes in this or any other given case, however, the foregoing considerations, when weighed

document from one institution described its target market for recruiters as follows: “We serve the UN-DER world, Unemployed, Underpaid, Unsatisfied, Unskilled, Unprepared, Unsupported, Unmotivated, Unhappy, Underserved!” Chris Kirkham, *For-Profit College Recruiters Taught to Use ‘Pain,’ ‘Fear,’ Internal Documents Show*, THE HUFFINGTON POST (Feb. 8, 2011), http://www.huffingtonpost.com/2011/02/08/for-profit-college-recruiters-documents_n_820337.html.

¹¹² United States *ex rel.* Dep’t of Def. v. Caci Int’l Inc., 953 F. Supp. 74, 77 (S.D.N.Y. 1995) (citations omitted).

¹¹³ 31 U.S.C. § 3730(b)(1) (2006).

¹¹⁴ Tamar Lewin, *Questions Follow Leader of For-Profit Colleges*, N.Y. TIMES (May 26, 2011), <http://www.nytimes.com/2011/05/27/education/27edmc.html?page-wanted=1&emc=eta1> [hereinafter Lewin, *Questions Follow*] (“Some for-profit executives are puzzled that the Justice Department is intervening in the case at a time when the ‘safe harbor’ in the law is about to be closed: under Education Department regulations that take effect in July, recruiters can no longer be compensated for each student they enroll, even if their enrollment numbers are not the sole basis for the pay.”); *see also* Tamar Lewin, *U.S. to Join Suit Against For-Profit College Chain*, N.Y. TIMES (May 2, 2011), <http://www.nytimes.com/2011/05/03/education/03edmc.html?ref=forprofitschools>. The litigation against Education Management Corporation is further distinctive in that at least two States, including Illinois, also have intervened, alleging violations of their state counterparts to the False Claims Act. Lewin, *Questions Follow, supra*.

together, make apparent that allegations that *Main* and *Hendow* “signal a significant expansion of FCA liability for universities”¹¹⁵ are exaggerated.

CONCLUSION

The fuel that has propelled the for-profit education sector’s growth—funds largely from federal student loans—has proved for all too many students to be a double-edged sword as they struggle to pay the debt for an education that they thought would yield economic improvement in their lives. Although there undoubtedly are law-abiding for-profit institutions that provide valuable educational services,¹¹⁶ fraud—as it is understood within the confines of the False Claims Act—is well demonstrated in the industry. Concerned that the industry has gone unchecked for too long, the Department of Education has embarked on an ambitious effort toward reform. Whether this effort will be successful, however, remains to be seen.

In the meantime, the FCA offers an important enforcement mechanism that private individuals, by way of the FCA’s *qui tam* provision, can use to ensure that for-profits follow the rules to which they bind themselves to receive government money. A number of courts, including the Seventh and Ninth Circuits, have been instrumental in strengthening this statute as an enforcement tool, concluding that as long as “a false statement is integral to a causal chain leading to payment, it is irrelevant how the federal bureaucracy has apportioned the statements among layers of paperwork.”¹¹⁷ The criticism of these courts’ decisions has been sharp, but it misses the mark by failing to account for the various features of the FCA that detect and deter meritless lawsuits. Additionally, the criticism neglects that these decisions will most likely affect the for-profit sector of the education industry—the sector, as experience has shown, in which fraud is particularly acute.

In sum, an institution that has knowingly violated the provisions of its agreement with the federal government to receive financial aid should be held accountable for its actions. Even if, as

¹¹⁵ Braceras & Bell, *supra* note 45, § 8.5.2.

¹¹⁶ See, e.g., 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, 515 (2009) (providing examples of “companies . . . that strive to both educate students for better careers and make a profit”).

¹¹⁷ United States *ex rel.* Main v. Oakland City Univ., 426 F.3d 914, 916 (7th Cir. 2005).

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one for-profit argued, these requirements are “nothing more than . . . hundreds of boilerplate requirements with which [the institution] promises compliance . . . fraud is fraud, regardless of how ‘small.’”¹¹⁸ Given the government’s recommitment to the rules that an institution must follow to obtain financial aid, the for-profit sector must collectively internalize this message— and must do so now more than ever.

¹¹⁸ United States *ex rel.* Hindow v. Univ. of Phoenix, 461 F.3d 1166, 1175 (9th Cir. 2006).