

Date of Hearing: April 9, 2019

ASSEMBLY COMMITTEE ON HIGHER EDUCATION

Jose Medina, Chair

AB 1341 (Berman) – As Introduced February 22, 2019

[Note: This bill is doubled referred to the Assembly Committee on Business and Professions and will be heard by that Committee as it relates to issues under its jurisdiction.]

SUBJECT: Private postsecondary education: California Private Postsecondary Education Act of 2009

SUMMARY: Specifies that only an institution of higher education meeting the definition of nonprofit corporation or public institution of higher education, as specified, is exempt from the requirements imposed on an out-of-state private postsecondary educational institution.

Specifically, **this bill:**

- 1) Clarifies that the requirement for an out-of-state private postsecondary educational institution to register with the Bureau for Private Postsecondary Education (BPPE) and follow specified requirement does not apply to a higher education institution that grants undergraduate degrees, graduate degrees, or both, and that is either formed as a nonprofit corporation and is accredited by an agency recognized by the United States Department of Education (USDE), or is a public institution of higher education.
- 2) Defines a “Nonprofit corporation” to mean an institution to which contributions have been determined by the United States Internal Revenue Service (IRS) to be tax-deductible pursuant to Section 501(c) of the Internal Revenue Code (IRC), unless the Attorney General determines that the institution does not meet the definition of a nonprofit corporation.
- 3) Defines “public institution of higher education” to mean any of the following:
 - a) An institution that meets the definition of Section 66010 of the Education Code (described in “Existing Law”), including a district or campus of the California Community Colleges;
 - b) An institution operated by the United States government, a state, a local government, or Indian tribal government, as defined; and,
 - c) An institution that is an instrumentality of a state or local government if it meets all of the following:
 - i) Its employees are government employees;
 - ii) Its liabilities are payable to the same degree as if they were liabilities of the state or local government, in the state or local government jurisdiction where the institution is formed; and,
 - iii) It is subject to the same financial oversight and open public records laws as the state or local government, in the state or local government jurisdiction where the institution is formed.

- 4) Requires BPPE to not approve, verify an exemption, or contract for the complaint handling of an institution not previously either approved to operate by the bureau or verified by the Attorney General either as a nonprofit corporation or as a public institution of higher education until both of the following requirements occur:
 - a) The BPPE provides the public with notice of the application or request for approval, exemption, or complaint handling. The notice shall be posted on the bureau's internet website and included as an item listed on the agenda prepared for an advisory meeting of the bureau.
 - b) The Attorney General determines that the institution meets the definition of a nonprofit corporation or of a public institution of higher education. However, an institution shall not meet the definition of a nonprofit corporation if any of the following applies:
 - i) The Attorney General determines the institution has engaged in an activity in which the net earnings of the institution benefit any person. The Attorney General shall presume the institution has engaged in such an activity if it has engaged in a reportable incident, unless the Attorney General determines otherwise. A reportable incident is the reporting of any item under the following categories on United States IRS Form 990, Return of Organization Exempt from Income Tax, or a successor form:
 - A) An excess benefit transaction.
 - B) A transaction with a disqualified individual.
 - C) A prohibited shelter transaction.
 - D) An equity-based compensation arrangement.
 - E) Compensation based on revenues.
 - ii) The institution has either acquired assets from another entity or has previously operated as a for-profit institution, and the Attorney General determines that the assets, or a significant portion of the assets, were acquired for more than the value of the assets. Value, which shall include the value of any ongoing relationship, including any contract, agreement, lease, or other arrangement between the acquiring institution and the acquired institution or asset, as described in the Code of Federal Regulations, as specified, shall be demonstrated through one of the following:
 - A) A third-party valuation.
 - B) Independent financing of the acquisition based upon the asset acquired.
 - C) Full and open competition in the procurement of services or assets, as defined.
 - iii) One or more of the core functions of the institution are conducted by, under the control of, or subject to significant direction from, a person or entity that is not a

public institution of higher education and is not a nonprofit corporation. For these purposes, there shall be a conclusive presumption that a person or entity exercises significant direction if one or more of its employees or owners serves as an officer, member of the board, or person holding similar authority for the institution; and,

- iv) A substantial share of the assets of the institution are committed to a joint venture with a person or entity that is not a public institution of higher education and is not a nonprofit corporation, and the core functions of the venture are conducted by, under the control of, or subject to significant direction from that person or entity.
- 5) Specifies that, for the purposes of determining tax exempt status for this chapter, the BPPE and the Attorney General may consider the tax exempt status of an institution of higher education as determined pursuant to Section 501(c)(3) of the Internal Revenue Code. However, that status shall not be the sole factor for determining whether an entity is a nonprofit corporation.

EXISTING LAW:

- 1) Establishes the California Private Postsecondary Education Act of 2009 (Act) until January 1, 2021, and requires BPPE, within the Department of Consumer Affairs (DCA) to, in part, review, investigate and approve private postsecondary institutions (or institutions), programs and courses of instruction pursuant to the Act and authorizes BPPE to take formal actions against an institution/school to ensure compliance with the Act and even seek closure of an institution/school if determined necessary. The Act requires unaccredited degree granting institutions to be accredited by an accrediting agency recognized by the USDE by 2020. The Act also provides for specified disclosures and enrollment agreements for students, requirements for cancellations, withdrawals and refunds, and that the BPPE shall administer the STRF to provide refunds to students affected by the possible closure of an institution/school. (Education Code (EDC) Section 94800 et. seq.)
- 2) Requires an out-of-state private postsecondary educational institution to comply with specified requirements, including providing the bureau evidence of the institution's accreditation (EDC Section 94801.5)
- 3) Establishes that public higher education consists of the California Community Colleges, the California State University, and each campus, branch, and function thereof, and each campus, branch, and function of the University of California (EDC Section 66010)

FISCAL EFFECT: Unknown.

COMMENTS: *Need for the bill.* According to the author, "Rampant deceptive or unfair treatment of students is rare at legitimate nonprofit and public colleges because financial restrictions make it difficult for school leaders to profit from bad behavior. Being a nonprofit has traditionally required an institution to devote all of its revenues to its educational purpose, and prohibit any form of profit-taking, so that those in control are not tempted to take advantage of students or the public."

“These restrictions have been so effective in protecting students that state and federal laws frequently provide funding only to nonprofit and public institutions, or apply stricter guidelines if for-profit colleges seek access to taxpayer funds. Some for-profit colleges, however, are starting to use a “nonprofit” or “public” label to attract students who are suspicious of for-profit colleges, and to escape regulatory oversight.”

“Despite the poor record of some federally-funded for-profit colleges and scandals that have plagued the for-profit industry, Secretary of Education Betsy DeVos and the Trump administration refuse to admit that investor control of colleges is hazardous to students and taxpayers and require greater oversight and scrutiny. Therefore, California must step up and step in to protect our students and ensure that appropriate oversight remains. Legislation is necessary to protect Californians from for-profit colleges that are deceiving and misleading their students.”

Background. The Century Foundation published a report in September of 2015 titled “The Covert For-Profit.” Prompted by news of several conversions of for-profit colleges into nonprofits, The Century Foundation obtained IRS and USDE records and communications that called into question the legitimacy of some of these conversions. The Century Foundation wrote that “...through four case studies, based on hundreds of pages of documents obtained from government agencies, the examination reveals a dangerous regulatory blind spot, with the two federal agencies each assuming, wrongly, that the other is monitoring the integrity of the “nonprofit” claims of these colleges.”

Since “The Covert For-Profit” was released, several large national for-profit colleges that serve California students have transitioned, or begun the transition, to a nonprofit status. These colleges are:

- 1) *Grand Canyon University.* The CEO of Grand Canyon Education, Inc., a for-profit company traded on NASDAQ, also serves as the President of an affiliated nonprofit, Grand Canyon University, and about 60% of the tuition revenue that the “nonprofit” college receives flows through to the for-profit company. Grand Canyon University reported more than 7,000 California enrollments in 2016-17.
- 2) *Ashford University.* Owned by Bridgepoint Education, Inc., and based in San Diego, Ashford University has been sued by the California Attorney General for misleading prospective students. Meanwhile, the company announced in March 2018 that it would follow the Grand Canyon University approach to claiming nonprofit status. In fact, on February 15, 2019, Ashford University announced that it received determination from the Internal Revenue Service that it is exempt from federal income tax under Internal Revenue Code (IRC) Section 501 (c) (3). In 2018 Ashford University reported more than 35,000 students. State-specific figures are not available for Ashford University.
- 3) *Purdue University Global.* While claiming to be a “public” college because of its affiliation with Indiana’s public Purdue University, Purdue University Global (PUG) is actually a limited liability corporation for which the state refuses any financial responsibility, and which is exempt from state public records laws; exempt from state audit requirements; and exempt from state open meeting laws. The institution is jointly operated by Purdue and PUG, which was formerly owned by Kaplan Higher Education. Kaplan Higher Education, which is traded on the New York Stock Exchange, has formal roles in governing PUG and gets a

share of profits. Kaplan Higher Education reported more than 2,000 California enrollments in 2016-17.

AB 1341 triggers the Attorney General to determine whether an institution meets the definition of a nonprofit corporation or public institution of higher education, and explicitly specifies that an institution does not meet the definition of a nonprofit corporation if any of the following applies:

- 1) The Attorney General determines the institution has engaged in an activity in which the net earnings of the institution benefit any person.
- 2) The institution has either acquired assets from another entity or has previously operated as a for-profit institution, and the Attorney General determines that the assets, or a significant portion of the assets, were acquired for more than the value of the assets.
- 3) One or more of the core functions of the institution are conducted by, under the control of, or subject to significant direction from, a person or entity that is not a public institution of higher education and is not a nonprofit corporation.
- 4) A substantial share of the assets of the institution are committed to a joint venture with a person or entity that is not a public institution of higher education and is not a nonprofit corporation, and the core functions of the venture are conducted by, under the control of, or subject to significant direction from that person or entity.

Nonprofit status. The vast majority of public and private universities and colleges are tax-exempt entities as defined by IRC Section 501(c)(3) because of their educational purposes—purposes that the federal government has long recognized as fundamental to fostering the productive and civic capacity of its citizens—and/or the fact that they are state governmental entities. In turn, states generally grant tax-exempt status to organizations, including universities and colleges, which qualify as tax-exempt entities under federal law.

Income from activities that are substantially related to the purpose of an institution's tax exemption, charitable contributions received, and investment income are not subject to federal income tax. The federal tax code classifies tax-exempt colleges and universities and their foundations as public charities. Consequently, they have historically not been subject to tax on investment income, payout requirements, or other rules that apply to private foundations.

The IRS requires all private universities and public charitable foundations that support public universities to submit an IRS Form 990 each year. Institutions are required to report on their mission, revenues, expenditures, endowments, salaries and benefits of top officials, charitable gifts, lobbying activities, and more. This information is made available to the public.

Arguments in support. The Century Foundation wrote in support of this bill, noting that, "...the problem solved by AB 1341 is that for-profit colleges are trying to fool consumers and regulators by laying claim -- illicitly -- to the "nonprofit" and "public" labels, capitalizing on, but ultimately destroying, the good reputation of public and nonprofit schools. It is unfortunate that state action is necessary to stop this abuse. But the failure of oversight at the federal level, combined with some cynically opportunistic for-profit school owners and executives who have taken advantage of the situation, has made state action essential."

“Students enrolling at nonprofit colleges on average are more likely to graduate or transfer, more likely to get a job, and typically earn more than students enrolling at for-profit colleges. They are twice as likely to make progress in repaying their student loans, and are far less likely to default, especially the longer you track: twelve years after college, more than half of for-profit students have defaulted, triple the rate of nonprofit borrowers... AB 1341 would ensure that colleges that hold themselves out as nonprofit or public actually are holding themselves to the standards that consumers and taxpayers expect of nonprofit or public entities.”

A coalition of student, veteran, civil rights, and higher education advocates jointly wrote to the committee, noting that “...leaders of nonprofit institutions are required to devote schools’ revenues to its educational purpose, and they are prohibited from taking a profit. Rampant deceptive or unfair treatment of students has been rare at legitimate nonprofit and public colleges because the financial restrictions placed on nonprofits are designed to make it difficult for school leaders to profit from bad behavior... The federal government’s failure to recognize that investor control of colleges requires greater oversight and scrutiny puts Californians at risk. AB 1341 would prevent these covert for-profit institutions from evading state oversight and deceiving students.”

Arguments in opposition. Ashford University wrote to the committee in opposition, noting that “...institutions work to change their status to become non-profit institutions for a variety of reasons. For example, students, faculty and staff that wish to participate in academic and co-curricular opportunities with other institutions are penalized because of the institution’s tax status. Other benefits of becoming a non-profit institution include the elimination of shareholder profits on the P&L, the ability to receive tax deductible support for student tuition, and better opportunities for student transfer of credit. As such, converting to non-profit status expands educational opportunities for both our faculty and our students. Moreover, nonprofit status may lead to more affordable tuition for students.”

“Critics contend that for-profit institutions wish to convert to nonprofit status to avoid compliance with federal regulations such as Gainful Employment rules. This may be the case with some institutions, but not for all. Ashford is currently in compliance with all federal regulations. Under the Gainful Employment rule last year, for example, Ashford had no programs determined to “fail” this regulation. Evading Gainful Employment requirements, or any other current regulation, would simply not be a motivation for Ashford to consider restructuring as a nonprofit.”

“[This] measure places additional requirements around newly formed nonprofit institutions, such as requiring the institution to pursue a competitive procurement process for services or assets. Institutions with existing relationships with entities that are uniquely positioned to provide desired services should have the opportunity to pursue services from those entities, particularly if they have an agreement that is consistent with market norms than if they were force to go out and bid for the same services.”

REGISTERED SUPPORT / OPPOSITION:

Support

California Conference of the American Association of University Professors
California Low-Income Consumer Coalition
Center for Public Interest Law
Children's Advocacy Institute
Consumer Federation of California
Consumer Reports Advocacy
Housing and Economic Rights Advocates
Public Advocates, Inc.
Public Counsel
Public Law Center
SEIU California
The Century Foundation
The Institute for College Access and Success
Veterans Education Success
Veterans Legal Clinic

Opposition

Ashford University

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