

Federal District Court Strikes Down Department of Education's "Gainful Employment" Requirement for Proprietary Colleges

Introduction

On June 30, 2012, the United States District Court for the District of Columbia handed down a decision in *Association of Private Colleges and Universities v. Duncan*. The court invalidated the "debt measure rule" of the "gainful employment" regulations issued by the US Department of Education (the "Department") covering federal financial aid issued to students of for-profit postsecondary schools on the grounds that a portion of such rule was arbitrary and capricious.

Under the Department of Education's "debt measure rule" in its "gainful employment" regulations, a for-profit postsecondary school will (as the culmination of an escalating series of sanctions) fail to qualify for federal financial aid for its students if, subject to certain transition rules, it does not satisfy any of the three following tests with respect to its former students in any three out of four consecutive years:

- At least 35 percent of former students must be current in their loan repayments or have repaid their loans in full;
- On average, student loan repayments may not constitute more than 30 percent of the borrower's discretionary income; and
- On average, student loan repayments may not constitute more than 12 percent of the borrower's total income.

The District Court held that the first standard was arbitrary and capricious, and invalidated the entirety of the gainful employment regulation (other than a reporting requirement).

Background

The Association of Private Colleges and Universities (the "Association"), a trade organization of for-profit postsecondary schools, challenged regulations issued by the Department of Education (the "Department") in 2010 relating to federal loan and grant programs as they apply to students of such schools. Title IV of the Higher Education Act provides for such loans and grants. In order to accept funds made available under Title IV for tuition payments, a school must satisfy certain requirements under the statute designed to ensure that these schools prepare their students for "gainful employment in a recognized occupation." To that end, the Department issued three rules:

- **Debt Measure Rule.** The first rule requires that (i) at least 35 percent of former students must be current in repaying their student loans or have repaid their loans in full, (ii) on average, at most, 30 percent of former students' discretionary income may be consumed by loan repayments, or (iii) on average, at most, 12 percent of former students' annual earnings may be consumed by loan repayments. If a program satisfies any one of these standards, it is considered to provide training that leads to gainful employment in a recognized occupation.

- Reporting and Disclosure Rule. A second rule requires schools to disclose to prospective students certain facts about the programs in which the students wish to enroll, including the occupation the program prepares the students to enter, on-time graduation rates, tuition and fees, placement rate, and median student loan amounts. It also requires schools to disclose to the Department, information necessary for the Department to calculate student debt levels.
- Program Approval Rule. A third rule requires a school to notify the Department in advance of when the school intends to add a program that is intended to prepare students for gainful employment in a recognized occupation. The Department then has a period of time to decide whether to review the program for compliance with these rules.

The Decision

The Association sued the Department to strike down these rules on two grounds that have their basis in the federal Administrative Procedures Act and Supreme Court precedents: (i) that the rules exceeded the authority granted the Department by Title IV and (ii) that they were arbitrary and capricious. The court considered the Debt Measure Rule first. The Association argued that the Debt Measure Rule should be struck down on the grounds that (i) measuring “gainful employment in a recognized occupation” by the loan repayment rate or debt-to-income ratio as defined in that clause in the Debt Measure Rule, exceeded the Department’s authority under the statute and (ii) the Department promulgated the rule in an arbitrary and capricious manner. The court rejected the first argument. Since “gainful employment in a recognized occupation” is not defined by the statute, the Department has authority to provide a reasonable definition and issue a rule in furtherance of that definition. Citing sources ranging from other statutes to old dictionaries, the court found that the phrase “gainful employment in a recognized occupation” encompassed the ability to find “decently paying” jobs. The court rejected the Association’s argument that the Debt Measure Rule transformed the clause from a requirement to “prepare” students for gainful employment into a requirement that the program “lead” to gainful employment.

The court also found the rule was not so significant in scale as to violate the US Supreme Court’s so-called “elephant in a mousehole” test, which expresses the view that Congress does not intend in a cryptic fashion to delegate authority to an agency to effect major changes to a regulatory scheme (such as to regulate tobacco as a “drug” under the Food, Drug, and Cosmetic Act). (The court said the rule was more akin to looking for a “rat in a rathole.”) Finally, the court said the rule did not impermissibly favor high-paying jobs.

However, the court took a decidedly different turn when it considered the “arbitrary and capricious” test. Under the federal Administrative Procedures Act, an agency must “articulate a satisfactory explanation for its action including a ‘rational connection between the facts found and choices made,’” even though an agency is to be given a high degree of deference when it formulates a rule. The Association argued that the Debt Measure Rule did not pass the test because it represented a sharp departure from the Department’s previous standard of what constituted gainful employment and because it did not actually assess whether a program prepares its students for gainful employment in a recognized occupation as much as reflect students’ demographics or broader economic conditions.

The Association also contended that the Department had not shown that the tests reflected reasoned decision-making by it. The court found that the debt-to-income tests (clauses (ii) and (iii) of the definition above) were based on expert studies and industry practices, objective criteria on which the Department could reasonably rely. The Administrative Procedures Act was thus satisfied. However, the debt repayment test (clause (i)) was devised simply to identify the worst-performing quarter of all educational

programs. The test was therefore arbitrary, in that twenty-five percent was no better or worse than any other percentage the Department could have chosen. Accordingly, the court struck down this test. The court then also struck down the debt-to-income tests because they were intertwined with the debt repayment test and could not be severed from it.

The court went on to vacate (i) the reporting portion of the Reporting and Disclosure Rule and (ii) the Program Approval Rule, because they existed to support the debt repayment test which the court had just invalidated. The court did, however, uphold the disclosure portion of the Reporting and Disclosure Rule without much explanation because the rule “comfortably” fell within the Department’s authority to make necessary or appropriate rules to administer its programs, was not arbitrary and capricious, and could be severed from the debt repayment test rule. Unless the Department appeals, it will likely have to begin the rulemaking process anew in order to promulgate a replacement for the debt repayment test.

Conclusion

While the court struck down most of the Department’s “gainful employment” regulation, the future of the regulation remains unclear. The decision could be appealed, or the Department could start a new rule-making process designed to result in a new rule whose formulation can be better justified in the manner required by the court. Any new rule could be similar to that rejected by the court; it could also be less or even more restrictive.

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