Conflicts of Interest in the University Business Environment

John R. Przypyszny
Drinker Biddle & Reath LLP
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BACKGROUND

Student lending practices, and other common university business relationships began coming under increased scrutiny in 2006, when the New York Attorney General and Congress raised concerns about the effects of conflicts of interest in the student lending system. Thereafter, Congress and U.S. Department of Education ("USDOE") also began to scrutinize the different types of relationships between student lenders and institutions.

The focus on student lending conflicts of interest has expanded to other university-vendor business relationships, including study abroad programs, student health insurance, affinity credit cards, and more recently food service contracts. While many of the investigations of these relationships began with the New York Attorney General's Office, other states attorney generals have followed New York's lead.

This outline provides a summary of some of the more significant developments that have occurred in the State of New York, which has been the nexus for state attorney general investigations of university-vendor relationships. It also provides a detailed summary of recent federal legislation and regulations addressing conflicts of interest involving the administration of Title IV student aid funds. The conclusion of the outline provides several different frameworks for assessing conflicts on interest that might potentially arise from a university's business relationships.

NEW YORK ATTORNEY GENERAL

I. NYS Attorney General Investigation

A. The NYS Attorney General's Office has used its investigatory and enforcement powers in the area of consumer protection to broadly investigate the business relationships among institutions and vendors. To date, the Attorney General's Office has publicly investigated the following vendor relationships/areas:

- Student lenders
- Athletic co-branding lenders
- Study abroad program providers
- Affinity credit cards

B. The NYS Attorney General's Office has announced publicly its intention to also investigate:

- Banking
- Health insurance
- Textbook/book stores
- Food-service

II. Deceptive Acts or Practices

The NYS Attorney General has relied upon the following laws in connection with its investigation efforts:

A. New York Executive Law 63(12**)**

- Authorizes the Attorney General to bring a special proceeding against a person or business committing repeated or persistent fraudulent or illegal acts.
- Any conduct which violates state or federal law or regulation is actionable under this provision.
- Fraud has been interpreted broadly and requires only a showing that the action has a potential to deceive.

B. New York General Business Law § 349: Deceptive Act and Practices

- The elements of a deceptive acts or practices claim are:
  - (i) An act or practice that was "consumer-oriented";
  - (ii) The practice was deceptive or misleading in a material respect; and
  - (iii) Injury
- A deceptive act is one that involves information that is important to consumers and likely to affect their choice of, or conduct regarding, a product.
- The deceptive act must mislead the consumer in a material way. Courts apply a "reasonable consumer" standard.

- There can be no claim for deceptive acts or practices when the alleged deceptive practice was fully disclosed.

C. New York General Business Law § 350: False Advertising

- The advertising must be misleading in a material respect, and cause injury.
- Advertising in the furnishing of any service in New York Advertising that fails to reveal material facts is actionable.

D. New York Legislation on Lending Relationships

Following initiation of NY AG investigation and initial settlement agreements, New York passed the Student Lending Accountability, Transparency and Enforcement Act ("SLATE"), New York Educ. Law § 13-B (2007). Highlights include:

- Prohibits (a) lenders from making gifts to covered institutions and their employees in exchange for any advantage or consideration provided to the lending institution related to educational loan activities, including revenue sharing and (b) institutions and their employees from soliciting, accepting or receiving gifts from lending institutions for any advantage related to educational loan activities, including revenue sharing.
- Bans an institution's employees from receiving any renumeration for serving as a member of a lending institution's advisory board.
- Prohibits employees and/or agents of the lender from posing as covered institution employees, including staffing the covered institution's financial aid offices with employees of the lending institution.
- Bans lending institutions and covered institutions from agreeing to certain quid-pro-quo high-risk loans that would prejudice potential borrowers.
- Requires any covered institution that makes available a preferred lender list to potential borrowers to disclose the process by which the covered institution selects lending institutions for such preferred lender list and requires that the list contain a statement that borrowers have the right to select the education loan of their choice.
- Requires lending institutions to disclose to covered institutions, upon request, the historic default rates of the borrowers from the covered institution, the interest rates charged to borrowers and the number of borrowers obtaining each interest rate.

- Authorizes the Department to impose a civil penalty on any covered institution, covered institution employee or lending institution that violates any provision of SLATE.

- Establishes a student lending education account where any monies received as civil penalties shall be deposited.

HIGHER EDUCATION OPPORTUNITY ACT

On August 14, 2008, President Bush signed the Higher Education Opportunity Act (HEOA) into law. The HEOA reauthorized the Higher Education Act of 1965, as amended, and included a number of provisions aimed at regulating conflicts of interest relating to lending practices and the award of federal financial aid funds. These provisions are outlined below.[1]

I. Code of Conduct (HEOA § 493)

A. In order to be eligible to participate in the Title IV student aid programs, institutions must have in place a code of conduct. The code of conduct must be published on the institution's website and on an annual basis, the institution must inform all of the institution's officers, employees or agents with responsibilities related to the Title IV program of the institutions code of conduct.

B. The Code of Conduct must, as a minimum, prohibit the following:

- Conflicts of interest with the responsibilities of officers and employees involved in student aid programs.

- Revenue sharing arrangements with any lender.

- The solicitation or acceptance of gifts from a lender, guarantor, or servicer by anyone with responsibilities over student loans at the institution. Gift is defined under the Act.

- Receipt of any fees, payments or other financial benefits for consulting services by anyone with responsibilities over student loan programs.

- The assignment of a first-time borrower's loan to a particular lender or delay of loan certifications.

- The acceptance of funds to be used for private loans in exchange for providing concessions to a private lender.

[1] Unless otherwise specified, these provisions became effective on August 14, 2008.

- The acceptance by the institution of assistance with call center or financial aid office staffing(not including training, etc.).

- Any employee with student loan responsibilities serving on a lender/guarantor's advisory board of commission for compensation or anything of value.

II. Institutional Disclosures Related to Preferred Lender Agreements (HEOA. §152, §153, and §493)

A. Two separate provisions of HEOA require specific disclosures by institutions with preferred lender lists. Most important requirements are related those required as part of the institution's Program Participation Agreement ("PPA") and those disclosures must be made in print or other medium. The second provision requires that the disclosures be included on the institution's website and in other informational materials.

B. As a requirement of the institution's PPA, the institution with preferred lender relationships must, at least annually, compile, maintain and make available to students and families, in print or other medium, any list of the specific lenders under Title IV and for private educational loans that the institution recommends or promotes.

C. Any institution that has a preferred arrangement must disclose all financial aid options available to students. As part of these disclosures, the institution must state that federal Title IV funds are available, and that a federal loan may offer better terms than a private loan.

D. A preferred lender list must disclose why each lender is on the list, and include the method and criteria used for choosing preferred lenders, including:

- payment of origination or other fees for borrowers;

- competitive terms and conditions, including interest rates;

- servicing;

- benefits beyond standard terms.

E. The list must also include a statement that students are not required to borrow from a preferred lender.

F. The list must disclose any other lenders with whom the preferred lenders are affiliated. At least three of the lenders on the list must be FFEL lenders who are not affiliated to each other, and if the school endorses private loans, at least two of the lenders listed must be unaffiliated (to each other).

G. An institution may not deny or delay a student's loan certification if the student chooses a non-preferred lender. A statement to this effect must be included on the institution's website and in any publications, mailing, or electronic messages regarding financial aid opportunities that are distributed to prospective or current students or their families.

J. List must be compiled with care and without prejudice for the sole benefit or students and their families.

K. Department is also in process of preparing a model disclosure form that institutions will be required to complete regarding their preferred lending relationships.

III. Private Loans (HEOA §153, § 1011, and § 1021(b)).

A. The HEOA includes a complicated combination of provisions that require institutions to make a series of disclosures regarding private loans. As part of these disclosures, an institution must inform borrowers of private loans that they may qualify for Title IV funds, and that those funds may be offered on more favorable terms than private loans. These provisions essentially provide the U.S. Department of Education with jurisdiction over certain private loan practices.

B. The Private Student Loan Transparency and Improvement Act (Title X of the HEOA) also amends the Truth in Lending Act ("TILA") to:

- Extend TILA protections to all private student loans;
- Prevent private educational lenders[2] from offering gifts to an institution or its employees in exchange for any advantage with regard to the provision of private loans to the institution's students;
- Effective February 14, 2010 (or effective date of regulations) , prohibit a private lender from using an institution's name, logo, mascot or other representation to market its loans;

[2] A "private educational lender" is: a financial institution . . . that solicits, makes or extends private education loans; a Federal credit union. . . that solicits, makes, or extends private education loans, or any other person engaged in the business of soliciting, making, or extending private educational loans. HEOA § 1011.

- Prohibit an institution's financial aid personnel from receiving anything of value for serving on a lender's advisory board (though they may have reasonable expenses reimbursed);

- Prohibiting private lenders from penalizing borrowers for prepaying loans;

- Require any private lender with a preferred lender arrangement with an institution to provide an annual report to the institution which includes a copy of the disclosures required when a loan is approved for each type of private loan the lender plans to offer at the institution.

IV. Textbooks (HEOA § 112)

The HEOA requires that, effective July 1, 2010, textbook publishers provide the faculty in charge of choosing course materials with certain information about the book, including the price and description of substantial changes from previous editions. College bookstores may request, from institutions, information regarding the upcoming course schedule, and the number of students enrolled in each course. In addition, institutions will be required to provide certain information, including ISBN and price, on its course schedule. They are also encouraged to provide information on used textbooks, textbook rentals, and selling back textbooks.

V Federal Regulations

Prior to the enactment of the HEOA, the Department of Education promulgated a set of regulations related to conflicts of interest in the administration of Title IV Funds. The regulations regulate activities by institutions, their financial aid officials, and lenders. Though these regulations will be amended to reflect changes made by the HEOA, and we believe to the extent that there is a conflict, the provisions of HEOA control. However, the regulations remain currently in effect. The regulations pertaining to preferred lender relationship and prohibited lender inducements to institutions are set forth at 34 C.F.R. §682.200 and §682.212.

A. With respect to conflicts, the regulations prohibit a lender from providing certain types of inducements to an institution in order to secure Title IV loan volume, including:

- Payments, prices or additional financial funds, including payments to be placed on preferred lender lists.

- Referral or processing fees to third parties, including to an institution.

- Solicitation of institutional employees to be on lender advisory boards.

- Payment of conference or training expenses for an institutions employee.

- Entertainment expenses for an institution's employees – including meals – except if meal or reception provided to all attendees at a conference.

- Philanthropic activities undertaken in exchange for secure loan volume or placement on preferred lenders lists, including scholarships, grants or financial contributions.

- Staffing services, except on short term, emergency basis.

B. But under the regulations lenders can:

- Provide assistance to institutions comparable to that provided by Secretary as part of Direct Loan program.

- Provide institutions with exit counseling assistance.

- Provide an institution's employees with meals, beverages and receptions that are reasonable in cost and scheduled in conjunction with permissible meeting or conference and provided to all attendees.

- Provide students with reduced origination fees and interest rates.

- Provide marketing items of nominal value (usually less than $25).

C. Regulations also address institutional preferred lending practices:

- Institutions may provide students with such lists, but must include at least 3 unaffiliated lenders. Affiliated lenders are those under common ownership and control, including subsidiaries.

- Institutions must not include lenders that have provided benefits to school in exchange for being placed on it.

- Institutions must disclose the method and criteria for selection on the list and provide comparative information.

- Institutions must include prominent statement indicating that students are not required to use list.

FRAMEWORK FOR REVIEW OF UNIVERSITY BUSINESS RELATIONSHIPS

I. Types of Business Relationships to Review

A. Given continued scrutiny by the Attorney Generals of New York and other states of university business practice, institutions should consider reviewing all of their business arrangements for potential conflicts of interest, particularly in the following areas:

- Bookstore arrangements
- Food-service arrangements
- Pouring rights
- Computer hardware arrangements
- Study abroad arrangements
- Banking relationships
- Affinity credit card arrangements
- Athletic equipment/apparel agreements
- Health insurance
- Pension/benefit plan relationships
- Direct student services
- Cell phone arrangements
- Linen providers
- Refrigerator rentals

II. Best Practice Recommendations

Colleges and universities should consider developing a list of "best practices" used by the University in performing an internal review of certain relationships with vendors and other business partners. The following represents a list of areas that St. John's university has developed to consider when undertaking a review of these relationships (*Best practices List courtesy of Joseph Oliva, General Counsel of St. John's University*).

A. Evaluate Risk. Not all risks are created equal. Certain factors may make an arrangement, policy or practice more susceptible to scrutiny from an ethical or regulatory standpoint.

1. Vulnerable consumer population

- *e.g.*, borrowers not capable of evaluating competing loan products.

2. Direct versus attenuated impact

- Expenditures paid directly by students to vendors likely to be more scrutinized than institutional expenditures.

3. Nature and magnitude of impact

4. Exclusivity/Preference arrangements

5. Personal inurement

B. Implementing and Enforcing a Vendor Selection Process

- Institutions should use, whenever possible, an RFP process in which the merits of competing vendors are fully vetted. This will enable the institution to demonstrate its review of articulated and objective factors in reaching a decision.

- Formal process, not informal internal discussion of competing vendors.

C. Continuously Evaluate Incumbent Providers

- Institutions should continuously examine arrangements to ensure that they remain in-sync with the changing marketplace.

- Vendor selection processes, when possible, should examine incumbent provider as well as new ones.

D. Contract Provisions

- Institutions should seek provisions in vendor contracts permitting termination with no penalty in the event of substandard performance.

- Price controls on products that students or employees purchase, *e.g.*, bookstores, and pouring rights.

- Prohibit high pressure marketing directed at students or employees.

E. Promote Transparency

- Where possible, institutions should seek to disclose all material factors that may directly or indirectly affect the consumer's decision.

- Royalty relationships.

F. Scrutinize Personal Benefits to Institutional Personnel

An institution should ensure that its conflict of interest policies enable it to be aware of and evaluate personal benefits received by institutional personnel from vendors or other service providers. While the safest course of action may be to prohibit personal benefits entirely, if the institution chooses to permit some level of personal benefits, it should ensure that service provider relationships are approved by disinterested decision makers who do not receive personal benefits in connection with the relationship. Whenever possible, personal benefits should be justified by factors benefiting the ultimate consumer population.

G. Evaluate Existing Regulations

- Institutions should pay special attention to arrangements in areas that have already received regulatory or legal attention in other contexts such as credit card marketing prohibitions and/or policy requirements in most states.

H. Code of Conduct Implementation

- Preferred lender lists
- Check all departments
- Evaluate conflict of interest questionnaires
- Regular training
- Scrutinize giveaways
- Review direct marketing

III. ACE Working Paper on Conflict of Interest

In its Working Paper on Conflict of Interest, the American Council on Education states that "transactions once deemed acceptable may now be subject to questions about whether, for example, they are at arms's length." (ACE Working Paper on Conflict on Interest found at www.acenet.edu) ACE states that "increased public scrutiny puts a greater premium than before on institutions taking a thoughtful and systematic approach to identifying and addressing conflicts on interest" The paper provides a useful framework for evaluating university conflict of interests, both at the individual and institutional level. The paper suggests that each institution develop a conflict of interest policy and provides guidance on how to assess whether a business relationship might result, or be perceived to result in, a conflict of interest. In assessing such relationships, ACE suggests that the institution ask the following questions:

- Does the transaction entail a conflict between the institution's financial interests and academic values?

- Does the transaction entail receipt by the institution of financial benefit that may affect or appear to affect the quality or price of goods or services offered to students or other institutional constituents?

- Does the transaction entail the actuality or perception that the institution is profiting to the detriment of students or other constituents?

- Does the transaction entail actual or perceived institutional endorsement of a product, service or company, such as through use of the institution's name, seal, logo, or trademarks, that could inappropriately influence purchasing decisions of students or other constituents?

- What management tools are appropriate?

- Would disclosure of the collateral benefit alleviate any actual or apparent conflict of interest?

- How can the institution conduct appropriate review of institutional conflicts of interest, including whether what if any circumstances the institution should recuse itself from reviewing its own conflict of interest.