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Recent Department of Education Regulations May Result in Increased Litigation Against For-Profit Higher Education Institutions

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The Department of Education ("DOE") released new regulations, published on November 1, 2016, which may adversely affect for-profit higher education institutions across the nation. One of the new rules undoubtedly will lead to significant and increased litigation. This new rule prohibits institutions participating in the government's Direct Loan Program from enforcing arbitration provisions. Participants will be prohibited from enforcing provisions that prevent class actions by students. Moreover, the institutions will be prohibited from requiring its students to submit to internal institution grievance procedures before bringing "borrower defense" claims, such as deceptive practices, misrepresentation, and fraud claims.

Historically, institutions included mandatory arbitration provisions in their student enrollment contracts. Such provisions not only precluded full-blown litigation, but also barred class actions suits by students. This new regulation will give students – either individually or as a class – greater access to the court system to pursue misrepresentation and fraud claims against their schools.

The new rules also have an impact on the causes of action that qualify as "borrower defenses." Whereas formerly these defenses included only those causes of actions which could be brought under applicable state law, the DOE's new regulations create a federal standard which encompasses all of the following: an educational institution's breach of the contract with the student, a contested judgment entered against the school for an act or omission relating to the borrower's loan, and a substantial misrepresentation made by the institution.

These new regulations, which go into effect in July of 2017, represent the latest blow to for-profit higher education institutions delivered by the DOE. In 2015, the DOE levied a $30 million fine against Corinthian College and a California Court concluded that the now-defunct school misrepresented job placement statistics. Just a few months ago, ITT Tech, a for-profit school with nearly 40,000 students and more than 120 campuses, closed its doors after the DOE pulled federal funding following repeated allegations of deceptive practices. Additionally, the DOE recently stripped the Accrediting Council for Independent Colleges and Schools ("ACICS") – the largest accrediting agency of for-profit colleges and universities – of its authority after a federal panel concluded that it failed in its oversight of its educational institutions.

Indeed, these rules will likely open the flood-gates of lawsuits by students to recover monetary damages from schools accused of misrepresentation and deceptive practices. With the prohibition of the arbitration provisions, class claims against such institutions will likely soar in 2017.

Despite the anticipated increase in class action lawsuits, institutions may guard against potential exposure by relying on common class action defenses. For example, institutions may be able to successfully argue that the students cannot satisfy the "commonality" and "predominance" requirements under Federal Rule 23. Many students in a putative class may not have relied on the same alleged representations to their detriment and students who can show reliance may have varying damages that require numerous mini-trials.

In sum, institutions should evaluate their risks in light of the new regulations and take necessary steps to guard against a potential class action suit in 2017.

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