



August 11, 2016

Eric Juhlin
Chief Executive Officer
Center for Excellence in Higher Education
4021 South 700 East, Suite 400
Salt Lake City, Utah 84107

Certified Mail
Return Receipt Requested
7012 1640 0000 0217 1312

**Re: Decision on Change of Ownership for:
Stevens Henager College, OPE 003674
CollegeAmerica Denver, OPE 025943
CollegeAmerica Arizona, OPE 031203
California College San Diego, OPE 021108**

Dear President Juhlin:

The Chicago/Denver School Participation Division of the U.S. Department of Education ("Department") has reviewed The Center for Excellence in Higher Education's ("CEHE") application for approval of a change in ownership or structure for the above named schools. This application results from a transaction that occurred as of December 27, 2012 ("the Transaction"), as further described below. Each of the above named schools ("the Colleges") submitted an electronic application ("eapp") for Change in Ownership by November 7, 2012 (California College of San Diego submitted their eapp on October 22, 2012). Temporary Provisional Program Participation Agreements were effective as of January 1, 2013, and extended for an initial one month period until January 31, 2013. Since the Colleges provided materially complete applications timely, their provisional participation has been extended on a month-to-month basis under their status as for-profit institutions since January 31, 2013 while the Department has evaluated the applications as provided in 34 C.F.R. 600.20(h).

CEHE was established as an Indiana public benefit corporation in December 2006, and was issued a 501(c)(3) tax exemption by the IRS. CEHE was established "to promote excellence in higher education by working with philanthropists and others interested in reforming American colleges and universities. Education reform, for these purposes, is defined as increasing access, reducing costs, and improving the quality of higher education with the goal to make universities, schools, departments and ultimately individual faculty members accountable for the quality and effectiveness of their work." CEHE 2015 Audited Financial Statements, Note 1. Prior to the Transaction, CEHE had operated for approximately six years without being engaged in delivering educational programs. As a result of the Transaction, the Companies (and thereby the

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Colleges) were merged into CEHE, and CEHE was transformed into an entity primarily delivering educational services. The Colleges have petitioned the Department to recognize their conversion to nonprofit status for the purposes of administration and oversight of their participation in the Title IV Student Financial Assistance programs, based on CEHE's 501(c)(3) exempt status which had been approved by the IRS many years prior to the Transaction.¹

When an institution experiences a change of ownership that results in a change of control, the institution's existing participation expires on that date. 34 C.F.R. §§ 668.14(g)(1), 668.26(a)(5). Institutions that provide a timely notice of a change of ownership and a materially complete application may continue to participate in the federal student aid programs authorized pursuant to Title IV of the Higher Education Act of 1965, as amended, 20 U.S.C. §1070 et seq. ("Title IV, HEA programs") under a temporary provisional program participation agreement which includes the same terms and conditions that were in effect prior to the change of ownership. 34 C.F.R. § 600.20(h).

This letter sets out the Department's decision concerning CEHE's requested approvals for the change of ownership and change to nonprofit status. As explained below, the Department is denying the applications with respect to recognizing the Colleges as nonprofit institutions for purposes of Title IV, HEA programs. The Department has enclosed new provisional program participation agreements ("PPAs") to approve the Colleges as for-profit entities for purposes of the Title IV, HEA programs. The Colleges will need to sign and return these new PPAs to the Department for counter-signature for the Colleges to continue participating in Title IV beyond the end of this month. The existing temporary PPAs will expire on August 31, 2016, as provided in 34 C.F.R. §600.20(h). If the Colleges do not enter into the new PPAs by that date, the Colleges will no longer be certified to participate in Title IV, HEA programs.

I. THE DEPARTMENT EMPLOYS A THREE-PRONG TEST FOR DETERMINING AN INSTITUTION'S NONPROFIT STATUS, INCLUDING AN INDEPENDENT EVALUATION OF ECONOMIC BENEFIT AND CONTROL

The Department regulations identify certain covered transactions for an institution that constitute a change of ownership that require the institution to apply and obtain approval from the Department to continue participating in the Title IV, HEA programs. These include instances where an institution is sold, merged with one or more eligible institutions, experiences a change in the owner of the controlling stock, has a transfer of assets that comprise a substantial portion of the educational business of the institution, or has a change in status as a for-profit, nonprofit, or public institution. 34 C.F.R. § 600.31(d). To establish eligibility and to continue participation in the Title IV, HEA programs, an institution must demonstrate to the Department that, after the change, the institution qualifies to be certified to participate under 34 C.F.R. Part 668, Subpart B pursuant 34 C.F.R. § 600.31(a)(3)(ii).

Redacted



Because the Colleges have applied to be considered nonprofit institutions, they must meet the Department's test for eligibility. The Department regulations define a nonprofit institution as an institution that:

- (i) Is owned and operated by one or more nonprofit corporations or associations, no part of the net earnings of which benefits any private shareholder or individual;
- (ii) Is legally authorized to operate as a nonprofit organization by each State in which it is physically located; and
- (iii) Is determined by the Internal Revenue Service to be an organization to which contributions are tax deductible under 26 U.S.C. §501(c)(3) of the Internal Revenue Code (26 U.S.C. § 501(c)(3)).

34 C.F.R. §600.2. A state authorization and IRS determination do not themselves confer nonprofit status for Title IV purposes. The Department must make an independent determination that the institution is "owned and operated by one or more nonprofit corporations or associations, no part of the net earnings of which benefits any private shareholder or individual."

CEHE provided documents and records in support of its application, and the Department requested additional documents and information in the course of its review.² Having reviewed the information provided by CEHE, the Department is denying the request to approve the Colleges' change to nonprofit status for participation in the Title IV, HEA programs. CEHE's acquisition of the Colleges did not present the traditional situation where an institution is acquired by a new owner and the former owner no longer plays a role in the continued operation of the institution. In the acquisition here, the Transaction was structured so that the Trust retained the benefit of a continued stream of Title IV revenues, and Mr. Barney obtained significant control of CEHE, and by extension, retained control of the Colleges.

For these reasons, the Department has determined that the Colleges do not meet the required definitional elements set forth in 34 C.F.R. § 600.2. Of particular concern are the following: that the financing of the Transaction results in financial benefit which inures to Mr. Barney's beneficial interests via the Trust; that lease payments to entities controlled by Mr. Barney provide additional economic benefit to him; and that Mr. Barney has retained control of the Colleges through his role [Redacted] as the sole member, [Redacted] [Redacted] and as Board Chairman of CEHE's Board.

² In response to the Department's request for additional information on June 13, 2016, CEHE provided information and documents on June 29, 2016, and notified the Department that it was designating all of the documents produced in response to the Department's June 13, 2016 request as privileged and confidential, asserting that they consisted of trade secrets and commercial or financial information. The Department advised CEHE that the Department's determination with regard to the designation and public release of the documents and information would be governed by the Department's responsibilities under the Freedom of Information Act. CEHE had provided documents prior to the June 29th submission that were also marked "Confidential."

II. THE TRANSACTION WAS STRUCTURED SO THAT THE COLLEGES' TITLE IV FUNDING WOULD CONTINUE TO BENEFIT THE CARL BARNEY LIVING TRUST, JUST AS IT HAD BEFORE THE MERGER

34 C.F.R. § 600.2 provides, in the definition of “nonprofit,” that “no part of the net earnings [shall] benefit any private shareholder or individual.” The Transaction that resulted in the change of the Colleges’ ownership was structured in such a way that an income stream of over \$400 million was intended to continue to flow to the Carl Barney Living Trust (“the Trust”), the former owner of the Colleges, just as an income stream flowed to the Trust while the Colleges operated in a for-profit status.

The Transaction was effectuated through the merger of the entities that owned and operated the Colleges and an affiliated service company into CEHE (*i.e.*, Stevens-Henager, Inc. (“SH”), CollegeAmerica Denver, Inc. (“CAD”), CollegeAmerica Arizona, Inc. (“CAA”), California College San Diego, Inc. (“CCSD”), and CollegeAmerica Services, Inc. (“CASI”). SH, CAD, CAA, CCSD and CASI are hereinafter collectively referred to as “the Companies,” or with reference to an individual entity as “the Company.” See CEHE 2012 Audited Financial Statements at Note 1. Before the Transaction, the Companies were all individually owned by the Trust, and Carl Barney is the Trustee of the Trust. The Companies were merged into CEHE pursuant to individual merger agreements (hereinafter collectively referred to as the “Merger Agreements,” or individually by their entity names). The parties to the various Merger Agreements are CEHE as “Purchaser,” the individual Companies, and the Trust as “Stockholder” of the Companies. See CEHE 2012 Audited Financial Statements at Note 6. The Merger Agreements for CASI, SH, and CAA provide for a total aggregate maximum merger consideration of \$431,000,000 as of December 27, 2012. Redacted

Redacted
Redacted To finance the Transaction, Redacted
Redacted the Trust purchased two notes from CEHE in the aggregate amount of \$431,000,000 (“Term Note A” and “Term Note B”).³ See CEHE 2012 Audited Financial Statements at Note 8. Redacted

Redacted

Redacted The Transaction was approved Redacted
Redacted on December 27, 2012. Redacted
Redacted there is no evidence that CEHE Redacted
Redacted conducted any valuation of the Colleges before entering into the Merger Agreement and resulting financing which obligated CEHE to \$431,000,000 in indebtedness to the Trust with \$419,000,000 of that amount representing goodwill. Redacted

Redacted

³ Term Note A was in the amount of \$200,000,000; Term Note B was in the amount of \$231,000,000.

Redacted



Redacted the equity of SH, CAA and CASI Redacted was sold, and as discussed below Redacted Mr. Barney indeed placed restrictions on CEHE: by Negative Covenants set forth in the Redacted Contingent Note Agreement; Redacted

Redacted Mr. Barney's control over CEHE was exercised as a CEHE member and CEHE Board Chair, and through the Trust as lender under various financing instruments (*i.e.*, Redacted the Contingent Note Agreement, and a series of notes Redacted .

As set forth above, the Transaction was financed [Redacted] whereby CEHE executed Term Notes A and B (collectively, the "Term Notes") effective as of December 31, 2012. The Notes provided for the accrual and quarterly payment of interest at the rate of 1% per annum ("Fixed Rate"), [Redacted] See CEHE 2012 Audited Financial Statements at Note 8. Significantly, the Notes also required quarterly mandatory prepayments of the greater of 75% of the Excess Cash Flow⁴ of CEHE, or 10% of CEHE's total revenues. [Redacted] Term Note A matured the earlier of December 31, 2017, or the first fiscal year in which CEHE has at least \$50,000,000 Change in Net Assets [Redacted] Term Note B matured the earlier of December 31, 2019, or the first fiscal year in which CEHE has at least \$75,000,000 Change in Net Assets [Redacted] See CEHE 2012 Audited Financial Statements at Note 8; CEHE 2015 Audited Financial Statements at Note 7.

Payments to the Trust under the Notes are essentially based on the excess of revenues over expenses -- the same way as net income in a for-profit entity. Instead of this excess being retained and allocated to CEHE's mission as would be expected in a nonprofit,⁵ the excess is distributed to the Trust under the guise of Note payments. In the notes to CEHE's December 31, 2012 financial statements, CEHE identified its "future minimum principal payments" to the Trust as follows:

2013- \$32 million
2014- \$36 million
2015- \$40 million
2016- \$44 million
2017- \$48 million
By December 2019 - \$231 million

See CEHE 2012 Audited Financial Statements at Note 8. [Redacted]

[Redacted]

⁴ [Redacted]

[Redacted]

⁵ The websites for each of the Colleges includes the following explanation of the Colleges' nonprofit status: "Nonprofit Difference -- Learn how a nonprofit college benefits you -- What does it mean to be a nonprofit college? In essence, it means that [College] can put your needs and your goals first. It means that *we can invest your tuition in your success and the success of your fellow students*. It means that we're uniquely set up to help you gain the competitive advantage in today's job market because we can focus on you, the student." (Emphasis added). While suggesting to students that their tuition is exclusively being used for educational services, the Colleges fail to mention that a portion of the tuition revenue is being paid to the Trust under the Notes.

Subsequent to the closing of the Transaction in December 2012, and with the agreement of the Trust, CEHE's obligation to the Trust under the Notes was modified ^{Redacted}

^{Redacted} On March 17, 2015, ^{Redacted} to cancel the ^{Redacted} the Term Notes, and to replace those instruments with a Contingent Note Agreement ("CNA") and Contingent Notes A and B. The CNA and the related Contingent Notes were executed effective as of March 23, 2015 and March 31, 2015 respectively. See CEHE 2015 Audited Financial Statements at Note 7. Pursuant to the CNA, the Note payments remained conditioned on CEHE's Excess Cash Flow, and eliminated the alternative calculation based on 10% of revenues, as well as the accrual and payment of interest. CNA at 4, 6 and ¶2.5.1 (75% of CEHE's Excess Cash Flow each quarter). ^{Redacted}

^{Redacted}

The CNA also contained a series of Negative Covenants, ^{Redacted} See CNA at ¶¶5.1-5.12. CEHE did not notify the Department of this significant debt restructuring with the Trust even though CEHE's application for the change of ownership for the original transaction was still under review.

CEHE's obligation for payments to the Trust was further modified in November 2015. CEHE 2015 Audited Financial Statements at Note 7. ^{Redacted}

^{Redacted}

^{Redacted}

on November 6, 2015, ^{Redacted}

^{Redacted}

^{Redacted} Contingent Note B was cancelled and Contingent Note A was restated and reduced to \$75,000,000. Restated Contingent Note A ^{Redacted} imposed the Fixed Rate ^{Redacted} interest accrual and quarterly payments, and retained the mandatory quarterly payments based on 75% of CEHE's Excess Cash Flows. CEHE 2015 Audited Financial Statements at Note 7. ^{Redacted}

^{Redacted}

^{Redacted} The note may have been written down to reduce long-term debt to improve the

⁶ ^{Redacted}

^{Redacted}

Colleges' composite score calculations under the Department's financial responsibility ratios⁷ or because the CEHE Board and Mr. Barney recognized that CEHE would not be able to satisfy the remaining obligation under the two notes. In either case, the significant reduction suggests that the initial consideration of \$431,000,000 (and the corresponding indebtedness) was highly inflated. Redacted

Redacted

The Department has determined that the payments under the Term, Contingent, and Restated Contingent Notes, which Redacted are essentially profit distributions to the Trust – substantially the same as it received when it was the sole shareholder of the Companies. The payment structure using contingent cash flow from the institutions' operating income, in combination with the continuing control exercised by Mr. Barney, is evidence of an entity that has not transitioned. Redacted the Restated Contingent Note, Redacted further demonstrates that the primary benefit of the Transaction was to be enrichment of the Trust. As such, this "Excess Cash" stream of income to benefit the Trust, in combination with the control exercised by Mr. Barney, precludes the Colleges from qualifying to participate in Title IV, HEA programs as nonprofit institutions under the Department's regulations.

Another element of economic benefit flows to Mr. Barney as a result of nine lease agreements between the Colleges and real estate entities owned or controlled by Mr. Barney. At the time of the Transaction, seven of those leases were already in place, with lease expiration dates ranging from 2015 to 2020. As set forth in the Colleges' and CEHE's audited financial statements for the relevant years, the campus leases provided the following stream of income to Mr. Barney's affiliated real estate companies during the period 2010-2015:

2010 - \$3,485,000

2011 - \$4,323,000

2012 - \$4,643,584 (presumably, this amount is primarily, if not entirely, for payments prior to the Transaction)

2013 - \$5,097,509

2014 - \$5,962,535

2015 - \$3,458,226

Redacted

⁷ In May 2015, CEHE was instructed to submit a Letter of Credit to the Department based upon CEHE's failed financial composite score calculated under the Department's financial responsibility regulations. Ultimately, CEHE posted cash (in three separate installments) in lieu of the LOC. CEHE's 2015 Audited Financial Statements (at Note 7) reflect that CEHE executed three promissory notes which were issued in June 2015 (\$9 million), September 2015 (\$2 million) and December 2015 (\$5 million), all including 5% interest payable quarterly and the notes mature in January 2017. These notes are payable to Redacted and presumably relate to the security requirement imposed by the Department.

Redacted

III. MR. BARNEY'S CONTINUING AND MULTIPLE CEHE ROLES DEMONSTRATE THAT THE COLLEGES CONTINUE TO BE SUBSTANTIALLY CONTROLLED BY MR. BARNEY

Mr. Barney is a CEHE member, he is Chairman of its Board, and he is a surety resource. Through the Trust and Redacted, he is CEHE's principal lender. Through affiliated real estate companies, he is landlord for several of the Colleges' campuses. As noted above, the Department's decision to approve the change of ownership to CEHE but deny the request to change the Colleges' status to nonprofit is based in part on this continuing control by Mr. Barney following the Transaction. See 34 C.F.R. § 600.31 (definition of "control"). Thus, the Colleges do not currently meet the Department requirement of being "owned and operated" by a nonprofit (34 C.F.R. § 600.2) because the Trust enjoys both an income stream and effective control through Mr. Barney's continuing involvement. As described below, this control is and has been effectuated through Redacted the CNA, the leases, Redacted as well as Mr. Barney's roles as lender (through the Trust), member, Board Chair, and landlord. Although Mr. Barney's control may have been reduced through certain later events, Redacted Redacted Mr. Barney's current control is still significant.

Ensuring Mr. Barney's ongoing control was an integral part of the Transaction from its inception. This is not surprising given the small size of CEHE in comparison to the Colleges, and the financing that was facilitated and provided by Mr. Barney. Redacted

Redacted

Redacted the CNA) included Negative Covenants which restricted CEHE's authority to manage its operations in areas which require the Trust's consent, providing further control for Mr. Barney as Trustee of the Trust. See

Redacted

8 Redacted

Redacted

Redacted

In addition, Redacted funds so CEHE could satisfy the financial responsibility surety triggered by the Colleges' failing composite score calculations. All of these controls remain in place, Redacted

Redacted

Thus, Mr. Barney, both individually and through the Trust, continues to exert significant control over CEHE's management and operations, and accordingly, the Department has determined that it is not operated by a nonprofit organization as required under 34 C.F.R. § 600.2.

IV. THE COLLEGES' CHANGE OF OWNERSHIP IS APPROVED WITHOUT APPROVAL OF NONPROFIT STATUS

The Department is approving the change of ownership from the Trust to CEHE, and approves the Colleges as for-profit institutions for purposes of their continued participation in the Title IV, HEA programs. CEHE may request approval for nonprofit status for the Colleges when it applies for recertification in the future, and the Department will continue to evaluate the relationship between CEHE and its former owner in connection with such a request. The for-profit status for the CEHE Colleges is for purposes of their participation in the Title IV, HEA programs. The Department does not take a position with respect to CEHE's non-profit 501(c)(3) status with the Internal Revenue Service.

The temporary PPAs under which the Colleges have been operating since the change of ownership in December 2012 continued the prior approval for those Colleges to participate under a for-profit status. The for-profit status for the continued participation of the Colleges is

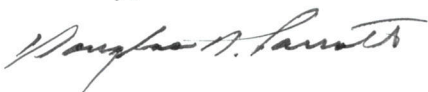
therefore unchanged. CEHE is reminded that the Colleges must meet the Title IV, HEA reporting and program eligibility requirements applicable to for-profit institutions, including the 90/10 eligibility requirements described in 34 C.F.R. §668.28 and the gainful employment program requirements set out in 34 C.F.R. Subpart Q. CEHE must also submit the gainful employment certifications required under 34 C.F.R. §414 for all of its certificate and degree programs that it would like to continue to have included in its federal student aid participation. These certifications must be submitted no later than the date CEHE returns the signed PPAs.

For the reasons set out above, the Department is denying the applications from CEHE for the four Colleges to participate in the Title IV, HEA programs as non-profit institutions. The temporary approvals for the Colleges will expire at the end of this month. The Department has included with this letter the provisional PPAs for the four Colleges. If CEHE wants the Colleges to continue to participate in Title IV, HEA programs without interruption, the PPAs should be signed and returned to the Department no later than August 31, 2016 for counter-signature.

The basis for this determination and the facts upon which it is based have been set out above. If CEHE has additional factual information about the above-referenced agreements and arrangements that it believes the Department should consider, CEHE should submit a request for reconsideration to this office that identifies those facts within 10 days of the date of this letter. The request should identify the relevant portions of the documents already provided to the Department, and include any additional documents that have not already been provided to the Department. Please note that a request for reconsideration will not stay the expiration of the temporary approvals which expire on August 31, 2016.

Please contact Earl Flurkey (312-730-1521) if you have any questions regarding the content of this letter.

Sincerely,



Douglas Parrott
Division Director

Enclosures:

Stevens Henager College (OPE 003674) Program Participation Agreement
CollegeAmerica Denver (OPE 025943) Program Participation Agreement
CollegeAmerica Arizona (OPE 031203) Program Participation Agreement
California College San Diego (OPE 021108) Program Participation Agreement

cc:

Stevens Henager College
CollegeAmerica Denver
CollegeAmerica Arizona
California College of San Diego
Accrediting Commission of Career Schools and Colleges