



December 22, 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: #7013 3020 0000 7223 5759

**Re:   Reconsideration 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:

I have reviewed the Center for Excellence in Higher Education's ("CEHE") August 21, 2016 request for reconsideration ("Reconsideration Request") of the Department's August 11, 2016 decision letter ("Decision" or "Decision Letter") which denied the application of the above named institutions ("the Colleges") to convert to nonprofit status. In response to the Department's request, on September 30, 2016, CEHE provided supplemental information and documents. ("CEHE September 2016 Response"). Upon review of the Decision Letter, the Reconsideration Request, and related materials, to include the CEHE September 2016 Response, the Reconsideration Request to recognize the Colleges as nonprofit institutions is hereby denied.

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's request for conversion of the Colleges to nonprofit status results from a merger transaction that occurred as of December 31, 2012 ("the Transaction"). As a result of the Transaction, CEHE acquired the Colleges and a services company owned by five separate corporations ("Acquired Corporations") that had previously been owned by the Carl Barney Trust ("Barney Trust"). The Colleges had historically operated as proprietary, for-profit institutions. Prior to the Transaction, CEHE was a philanthropic organization engaged in educational reform; following the Transaction, CEHE was transformed into an entity primarily delivering educational services through the Colleges.

**Federal Student Aid**  
An OFFICE of the U.S. DEPARTMENT of EDUCATION

830 First St., N.E. Washington, D.C. 20202  
StudentAid.gov

**I. The Decision to Deny the Colleges' Conversion to Nonprofit Status was not Based on any Improper Motive or Agenda**

In its Reconsideration Request, CEHE characterizes the Decision as "assign[ing] malicious motives to perfectly moral and lawful activities," and CEHE echoes this theme throughout the Reconsideration Request. *See, e.g.*, Reconsideration Request at 3. Despite CEHE's characterization, the Department's decision to deny the conversion to nonprofit status depends on the structure and impact of the Transaction in the context of the regulatory requirements for a nonprofit institution set forth in 34 C.F.R. § 600.2. A transaction can be perfectly "moral and lawful," yet an institution may not qualify as a nonprofit under the Department's regulations. In a similar vein, CEHE excoriates the Decision as politically motivated, asserting that "evidence shows that the Decision is driven by an agenda" of a former Department official, as well as Congressional pressure. Reconsideration Request at 3-4. That the Decision reached a determination that may appear consistent with the views of some who have criticized the for-profit industry does not provide "evidence" that the Decision was reached to champion (or even to mollify) those critical voices. There were two potential outcomes for the Decision: approve the conversion (or approve it with conditions), or deny it. On either side of those choices there are critics and proponents. The Decision was driven by neither, and neither is this decision on the Reconsideration Request.

CEHE alights on a phrase in the Decision Letter which referred to the Transaction as not "traditional" in that the Colleges were not acquired by a new owner with the former owner no longer playing a role in the continued operation of the institution. Reconsideration Request at 3. The Decision's use of the word "traditional" was descriptive, but not material. The Decision was based on a full analysis of the Transaction (and its execution), including voluminous documents CEHE provided in response to multiple requests from the Department. The Department concluded that nonprofit status was not warranted because of numerous factors in combination, not because the Transaction was "not traditional." Nor does the Decision imply that Mr. Barney's continued involvement is "wrong" or "bad." *See* Reconsideration Request at 3. The Decision simply concludes that his control and the continuing stream of revenue flowing to him, coupled with other factors discussed fully in the Decision and below, precludes the Department from approving the Colleges as nonprofit institutions.

**II. The Transaction Resulted in Continued Financial Benefit to Mr. Barney and the Trust**

**A. There was no Independent Determination of Value by the CEHE Board**

Without regard to either CEHE's or Barney's motivation in entering into the Transaction, or in structuring it, the Transaction was structured so that the Trust retained the benefit of a continued stream of Title IV revenues, and Mr. Barney retained control of the Colleges by obtaining significant control of CEHE. The financing of the Transaction results in financial benefit which inures to Mr. Barney's beneficial interest via the Trust; lease payments to entities controlled by Mr. Barney provided additional economic benefit to him; Mr. Barney has retained control of the Colleges through his role originally as the sole member, and now as one of three

members of CEHE, and as Board Chairman of CEHE's Board; and Mr. Barney retained additional control through the covenants contained in various note agreements with the Trust.

To challenge the determination set forth in the Decision Letter, CEHE has provided argument and additional documents, both attached to its Reconsideration Request, and in response to the Department's September 15, 2016 request for supplemental documents. Having reviewed all of the supplemental material, CEHE has provided no evidence or argument from which I can conclude that the denial of the Colleges' conversion to nonprofit status should be changed.

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. An institution's state authorization and Internal Revenue Service ("IRS") determination do not themselves confer nonprofit status for Title IV purposes. This is because the IRS determination of tax exempt status for an institution reflects an initial approval of an entity from a limited application process, or could reflect an approval that may have pre-dated the entity's ownership and operation of the institution. IRS review of the entity's tax exempt status takes place on an ongoing basis, with later reviews and/or compliance audits to examine whether tax exempt status should be revoked.

In prior years the Department primarily depended on the state approval and the IRS's designation of the owner's tax exempt status in determining whether an institution qualified for nonprofit status under the HEA and the Department's regulations. For an institution that was approved to participate in the Title IV programs as a proprietary, for-profit institution that applied to convert to a non-profit institution, the Department would also accept the state and IRS designations, but included a transition requirement for the institution to continue to meet the 90/10 revenue requirement for one additional year. This requirement was used to mitigate the possibility that the conversion was intended to evade the application of the 90/10 rule.

Since that time, additional requirements have been established by regulation for proprietary institutions that offer programs to prepare students for gainful employment in recognized occupations, so that proprietary institutions may have greater incentives to convert to a non-profit status that exempts degree programs from the gainful employment requirements. In response to this change, the Department has determined that a more detailed examination of an institution is needed before approving it for non-profit status.

With respect to the Colleges, CEHE had obtained its tax exempt status (as a public charity) in 2007, five years before the Transaction. See Decision Letter at n.1. Following the Transaction, CEHE sought classification as an educational institution under 26 U.S.C. § 170(b)(1)(A)(iii), by submitting a letter from its counsel with a summary description of the Transaction and limited documentation. See CEHE September 2016 Response at Exhibit 5. In its response to CEHE's request, the communication from the IRS does not indicate a thorough review of the Transaction, or even of the submitted documentation. The response noted that CEHE had been determined to be a public charity in September 2007 under § 170(b)(1)(A)(vi) of the Internal Revenue Code, and simply stated that it had "updated your public charity status in our records as you requested." The IRS also stated that CEHE's exempt status under 501(c)(3) "wasn't under consideration." Letter from IRS to Ofer Lion, dated July 25, 2014.

Especially given CEHE's substantial changes in mission and operating size from the public charity that was granted tax exempt status in 2007, where substantial control shifted to the party from whom the Colleges were acquired, the Decision reflected the appropriate independent determination of whether the Colleges were "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." This is a determination that the Department must make based on its independent review of each nonprofit conversion, with a detailed review of the individual facts and circumstances present in each. The Department's review has three principal and interrelated elements: the institution's ownership, its operation and control, and who reaps the financial benefit from the institution's operation. These elements involve consideration of myriad facts, including the structure of the transaction, the financing of the transaction, the value of the transaction, and the governance of the nonprofit entity. The Decision correctly determined, following a consideration of all of these factors, that the Colleges were not "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."

The details of the Transaction are set forth in the Decision Letter, and are not repeated in detail here. As discussed in the Decision Letter, a key element for the Department's determination was the nature of the financing for the Transaction, and whether it constituted an excess benefit or personal inurement to Mr. Barney or the Trust for purposes of the nonprofit status of the Colleges. The level of the CEHE Board's independent assessment of value prior to entering into the Transaction was properly considered in the Decision Letter. Rather than a straight asset or stock sale using bank (or a similar) financing from an unrelated party, Redacted

Redacted the Trust purchased two notes from CEHE in the aggregate amount of \$431,000,000 ("Term Note A" and "Term Note B"). The Transaction was approved Redacted

Redacted When analyzing the existence of "fair value," the Department appropriately looked at both the Merger Agreements, and the Board minutes of that December 2012 meeting. Redacted

Redacted The limitations of that review are relevant to whether the Transaction was based on a valuation that results in benefit to the

Trust, rather than a fair determination of value. The Reconsideration Request attempts to obfuscate the Department's statements on the level of the due diligence by asserting that:

[T]he Department has misrepresented [CEHE attorney Jay] Mercer's characterization of the due diligence conducted by Mercer and the CEHE board when it contends that "the Merger Agreements state that CEHE performed 'limited due diligence review.'" The Department has construed Mercer's statement [relating to "minimal due diligence" recommended] to be exactly the opposite of what it says.

Reconsideration Request at 14. The Decision Letter is plainly not referring to "Mercer's statement" as reflected in either his Affidavit (Exhibit 17 to Reconsideration Request) or his Memorandum to the Board (contained in Exhibit 2 of the CEHE September 2016 Response) – both of these Mercer documents were provided to the Department *after* the Decision Letter was issued. It is clear that the Decision Letter quotes the Merger Agreements themselves, which clearly state that "the Purchaser acknowledges that it has completed *limited due diligence review* with respect to the Corporation and the College." <sup>Redacted</sup>

<sup>Redacted</sup> Mr. Mercer's current characterization of "substantial due diligence" – <sup>Redacted</sup>

<sup>Redacted</sup> – conflicts with his own assessment at the time of the Transaction: in his draft comments to the Merger Agreement, Mr. Mercer himself added the language in ¶5.9 about CEHE's "limited due diligence"; he added additional language to ¶5.9 (not included in the final agreement) about other limitations in CEHE's review of the Acquired Corporation's documents; he commented in reference to ¶6.4 about the "limited due diligence" being conducted. *See* CEHE September 2016 Response at Exhibit 3 ("JSM Draft"). The evidence is consistent with <sup>Redacted</sup> – the due diligence conducted by the CEHE Board prior to the Transaction was "limited."

The Internal Revenue Service ("IRS") evaluates nonprofit status by, *inter alia*, whether there is personal inurement to an insider, or whether there is excess benefit to a disqualified person. *See generally*, "Nonprofit Law Guide" (contained in Exhibit 2 to the CEHE September 2016 Response). Mr. Mercer noted both of these issues in his due diligence process, and in his communications to the CEHE board. His focus was principally on the board member's potential liability resulting from these issues, rather than the impact of those issues on the resulting nonprofit status of the Colleges. The CEHE September 2016 Response contains documents relating to CEHE's August 28, 2012 board meeting (at Exhibit 2), and documents relating to CEHE's due diligence in October 2012 (Exhibit 3). Notably, Mr. Mercer expresses concern about private inurement and excess benefit to Mr. Barney resulting from the proposed transaction. *See, e.g.*, CEHE September 2016 Response at Exhibit 2 (board meeting agenda); CEHE September 2016 Response at Exhibit 3 (Memorandum to CEHE Board).

The foundation of the IRS rulings relied upon by CEHE is that fair value is actually determined by the nonprofit board so as to avoid an excess benefit. *See* discussion in Section II B., *infra*. Indeed, that concept is reflected in Mr. Mercer's agenda for the August 2012 board meeting and the minutes of that meeting, where he apparently advised that the valuation "is very important" in determining whether there was an excess benefit. CEHE September 2016 Response at Exhibit 2. While the CEHE Board was considering the potential acquisition, CEHE



understood that it was buying “hard assets in the form of real estate, equal to about 10% of the value, as well as another 5% of tangible assets. The remainder will come in the form of goodwill ...” *Id.* (August 28, 2012 Board Minutes). In a follow-up memorandum to the CEHE Board (undated, but included in the August 2012 materials in Exhibit 2 to the CEHE September 2016 Response), Mr. Mercer sets forth his “assumption” that Barney would “contribute as a charitable gift the value of the goodwill of the colleges,” and that “CEHE will purchase the tangible assets at fair market value.” Clearly, this is not what happened, and there is no documentary evidence submitted by CEHE to explain how this fundamental assumption was altered, resulting in a \$431 million purchase price, of which \$419 million was goodwill.

The Decision Letter notes that “there is no evidence that CEHE – as opposed to Mr. Barney – 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.” Decision Letter at 4. The Reconsideration Request challenges this conclusion, and for the first time,<sup>1</sup> CEHE explains that its Board retained Blue & Company to provide “an independent evaluation of Barrington’s appraisal.” Reconsideration Request at 14. For whatever reason, when CEHE submitted its Reconsideration Request, it failed to provide the actual the Blue & Company Summary Appraisal Review Report (“Blue Review”)(it submitted just the cover, the table of contents, and the curriculum vitae of its analysts). Yet, it relies on that review to support the fair value of the Transaction, and accordingly, the Department requested the Blue Review along with other referenced documents on September 15, 2016. The Blue Review was transmitted along with other requested materials on September 30, 2016. (Exhibit 1 to CEHE September 2016 Response).

The Blue Review is not an independent appraisal of the Colleges’ value, but rather, a summary review of work performed by another valuation company (Barrington Resources) for the Trust. Redacted

Redacted  
Re – because it is not clear whether the CEHE Board ever actually examined the valuations prepared by Barrington Research (hereinafter “Barrington Valuations”). Redacted  
Redacted

Redacted None of the Board minutes produced to the Department reflect a specific examination – by the individual CEHE Board members, or the Board as a whole – of either the Barrington Valuations or the Blue Review. Attached as Appendix B to the Blue Review is a set of power point slides apparently prepared by Barrington and identified as “Presentation to *College America* Board of Directors Valuation Presentation.” (Emphasis added). Although the Blue Review (at page 1) suggests that this presentation was to the CEHE Board, it does not appear so from the face of the slide presentation. The Blue Review also erroneously states that

<sup>1</sup> In its September 15, 2016 specific request for the Blue Review, the Department noted that the Report should have been provided in response to the Department’s request (on June 13, 2016) for any appraisals related to the merger consideration as required by the Merger Agreements. In the CEHE September 2016 Response, CEHE contended that the Blue Review was not responsive to the June request. In any event, the Blue Review has now been submitted, and has been reviewed for purposes of evaluating the Reconsideration Request.

the Barrington Valuations ("the appraisal") was prepared for the CEHE Board; as stated above, and in the Valuations, Barrington was engaged by the Trust, not CEHE.

The record, even as supplemented by the CEHE September 2016 Response, reflects no substantive value analysis or discussion by the CEHE Board of the fact that the Transaction would result in \$419,000,000 of goodwill. At most, it appears that a board conference call was held on November 15, 2012 and reflects that CEHE's executive director (Frederic Fransen) reported to the CEHE Board "on various aspects of CEHE's due diligence including a review of the appraisal conducted by Blue & Co. and a compensation review of the CEO of College America . . . . In both cases, the reviews supported the underlying assumptions about the appropriateness of the transaction." CEHE September 2016 Response, Exhibit 4. Significantly, the summary of the conference call states that "no materials were prepared prior to the meeting," leading to the reasonable assumption that Mr. Fransen's "report" on the due diligence efforts did not include providing the Blue Review itself, or other related documents, to the CEHE board members.

Even if CEHE board minutes had reflected an actual review, discussion and analysis of the Blue Review by its board members, such a review would not have provided the CEHE board with a basis upon which to independently determine the fair value of the Transaction to establish the merger consideration. As noted above, the Blue Review is just a summary review of Barrington's conclusions. It did not provide the CEHE Board with an independent valuation. Moreover, the Blue Review makes it clear that its "summary review" was only of the Barrington power point slides ("the Presentation"), not the Barrington Valuations themselves. The Blue Review notes that it requested "the underlying valuation report" from CEHE and from Barrington, but did not receive it. Blue Review at 3, 10. It also appears that, beyond the Presentation, Blue's analysts had no other documentation specifically referring to the Acquired Companies and the Colleges – the financial information available to Blue appeared to be limited to what was in the slides. Blue Review at 3, 10. The Blue Review also notes certain issues with the Presentation that required "further scrutiny" and "considering the nature and amount of information included in a presentation format *as opposed to a fully-contained appraisal report* as defined by [the Standards for Valuation Services], we cannot draw any conclusions as to the effect of the underlying information that we did not receive." Blue Review at 5 (emphasis added); *see also* Blue Review at 10-11. The Blue Review further notes that the "analyses used in this report are based on estimates, assumptions, and other information provided to us by the representatives of the owners of the Company [defined as College America], Barrington and legal counsel." *Id.* at 6. The Blue Review concludes that "excluding those points noted previously," the conclusion of value stated in the Barrington Presentation "is likely fairly stated and consistent with fair market value." Yet the conclusion comes with an unambiguous caveat: "However, we requested additional information and have not received that as of the date of this report. The information requested, but not received as of the date of this report *may have had a significant impact on our conclusion.*" (Emphasis added). Based upon a review of this additional information, the Department can reasonably conclude that the CEHE board, in agreeing to a \$431,000,000 Transaction (of which \$419,000,000 represented goodwill), did not independently make a determination of the Transaction's fair value.

**B. The Note Agreements do not Constitute True Debt Obligations, Particularly Given Barney's Ongoing Control of the Colleges**

Another factor considered in the Decision Letter is that the obligations under the various (and evolving) note agreements with the Trust do not actually constitute evidence of a legitimate debt. CEHE argues that the Decision ignores how loans and lease payments are "classified" on financial statements and balance sheets pursuant to Generally Accepted Accounting Standards and Financial Accounting Standards Board standards. Reconsideration Request at 10. These classifications clearly are not determinative of nonprofit status, and scores of tax cases<sup>2</sup> have analyzed (in both the profit and nonprofit context) whether a payment pursuant to a debt instrument is a true debt or an equity interest, without regard to how it is characterized on the entity's financial statements.

As set forth above, Redacted 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"), with a Floating Rate adjustment as defined in the Notes. Notes at ¶2. 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 Flow<sup>3</sup> of CEHE, or 10% of CEHE's total revenues. Notes at ¶5.1. 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 (as defined in the NPA). Term Note A at ¶4. 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 (as defined in the NPA). See CEHE 2012 Audited Financial Statements at Note 8; CEHE 2015 Audited Financial Statements at Note 7.

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 on two separate occasions. On March 17, 2015, the CEHE Board canceled Redacted and the Term Notes, and replaced those instruments with a Contingent Note Agreement ("CNA") and Contingent Notes A and B. 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,

<sup>2</sup> See, e.g., *Graffia v. C.I.R.*, 106 T.C.M. (CCH) 261, 2013 WL 4789771106, \*15 (T.C. 2013), *aff'd*, 580 F. App'x 474 (7th Cir. 2014) (and cases cited therein) (conditional nature of the supposed obligation lends additional support to Tax Court conclusion that the obligation, which was to be repaid from profits of the business, was not a true debt); *Principal Life Ins. Co. v. U.S.*, 70 Fed.Cl. 144, 160 (2006) (identifying some of the factors that courts have employed in distinguishing between debt and equity in determining whether notes received by shareholders transferring property to their controlled corporation are viewed as true debt versus disguised equity). See also, *Restland Memorial Park of Dallas v. United States*, 509 F.2d 187 (5th Cir. 1975); *Rose Hills Memorial Park Association v. United States*, 463 F.2d 425 (Ct. Cl. 1972), *cert. den.*, 414 U.S. 822; and *Knollwood Memorial Gardens v. Commissioner*, 46 T.C. 764 (1966) (and cases cited therein).

<sup>3</sup> Pursuant to the definitions of the NPA, "Excess Cash Flow" is measured by the Change in Net Assets ("CNABIDA") less certain identified expenses.



6 and ¶2.5.1 (75% of CEHE's Excess Cash Flow each quarter). Redacted

Redacted

CEHE's obligation for payments to the Trust was further modified in November 2015. CEHE 2015 Audited Financial Statements at Note 7. On November 6, 2015 (as discussed in the Decision Letter), Redacted

Redacted

Contingent Note B was canceled and Contingent Note A was restated and reduced to \$75,000,000. Restated Contingent Note A re-imposed the Fixed Rate and Floating Rate 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

at ¶2.1 (erroneously designated as ¶3.1), ¶3, and ¶4.1(a) (erroneously designated as ¶5.1(a)) (emphasis added). The significant reduction reasonably suggests that the initial consideration of \$431,000,000 (and the corresponding indebtedness) was highly inflated. The Decision reasonably concluded that CEHE's obligations under the Term, Contingent, and Restated Contingent Notes, which are and were contingent on CEHE "making money," did not have the classic hallmarks of debt. As such, the Transaction results in a situation where the net income of the Colleges inures to the benefit of the Trust (and to Mr. Barney via the real estate leases).

In its Reconsideration Request, CEHE argues that the Decision misapplies the law and ignores "controlling" IRS precedent. Reconsideration Request at 3, 6-10. Although the revenue rulings can provide guidance on the issues relevant here, those rulings are not "controlling" on the Department's determination of nonprofit status under its own regulations.<sup>4</sup> An institution that participates in Title IV, HEA programs is a fiduciary of the Department's funds. The 501(c)(3) designation by the IRS results in an entity being tax exempt, and contributions being deductible by the donor, but funds from the federal fisc are not directly involved. In any event, the authority cited by CEHE does not warrant granting the Reconsideration Request.<sup>5</sup> CEHE

<sup>4</sup> Indeed, revenue rulings are not even regarded as precedential or controlling in the Tax Court: they "merely represent the position of the Commissioner of Internal Revenue on a particular issue." *Estate of Beyer v. Comm'r of Internal Revenue*, 112 T.C.M. (CCH) 356 (T.C. 2016) (citing *Alumax, Inc. v. Comm'r*, 109 T.C. 133, 163 n.12 (1997), *aff'd*, 165 F.3d 822 (11th Cir. 1999)).

<sup>5</sup> CEHE's reliance on the Transaction Exemption, which provides a *rebuttable* presumption that a transaction is not an excess benefit transaction, simply does not apply here. See Reconsideration Request at 9 (citing Treasury Regulation §53.4958-6, *Comm'r of Internal Revenue v. Johnson*, 267 F.2d 382 (1<sup>st</sup> Cir. 1959), *United Cancer Council, Inc. v. Comm'r of Internal Revenue*, 165 F.3d 1173 (7<sup>th</sup> Cir. 1999)). In the first instance, the Department is not bound by regulatory presumptions imposed on the Commissioner of the IRS. Even if the Transaction Exemption is considered however, CEHE could not establish its entitlement to the Exemption. For an entity to take advantage of the presumption of fair market value, the tax-exempt organization must establish fair value by "appropriate data of comparability." §53-4958-6(a)(1) and (c)(2), including independent appraisals of value. In *United Cancer* (cited in the Reconsideration Request at 6), the entity that was the subject of the IRS's focus was an outside fundraising firm – not an insider like Mr. Barney. The Seventh Circuit found that inurement (the only basis upon which the Tax Court upheld the IRS's revocation of the charity's exemption) did not apply because the

argues that the Department has approved other conversions where the former for-profit owner "remained involved," relying on Revenue Ruling 76-91 and 76-441. Reconsideration Request at 6.<sup>6</sup> Mr. Barney did not simply "remain involved." By virtue of his roles as lender (via the negative covenants as described in the Decision Letter), and as a CEHE member, and as Chairman of CEHE's Board, Mr. Barney has the type of control over CEHE that is inconsistent with a true debtor-creditor relationship. See Decision Letter 9-10. CEHE does not contest Mr. Barney's level of control, it just argues that the IRS regularly allows nonprofits to be founded and controlled by a single individual or family. Reconsideration Request at 7. The IRS also regularly examines whether revenue inures to the person or family in control.

CEHE also argues that negative covenants are "customary in commercial lending." Reconsideration Request at 10-11. Again, CEHE misses the point of the Decision. The Department's denial of nonprofit status was not based solely on the negative covenants, or even the fact that Mr. Barney retains control of the Colleges by virtue of the combined power of the negative covenants, his position as a CEHE member, and his position as Board Chair.<sup>7</sup> Rather, it is the combination of all of the factors cited in the Decision Letter: Barney's pervasive control; the lack of an independent fair market valuation by the CEHE Board in agreeing to the \$431 million Merger Consideration; the fact that the various note agreements and notes do not reflect a true debt obligation; and the continuing flow of revenue to Mr. Barney and the Trust.<sup>8</sup>

---

fundraising firm, although its contract was advantageous, was not an insider. That is simply not the situation presented here. The *United Cancer* Court did however, leave open the question of private benefit for consideration by the Tax Court on remand. Nor does *Johnson* provide any support to CEHE. There, the First Circuit determined that "the bonds were true evidences of indebtedness and the voting rights only served as additional security for the payment of the purchase price and not to reserve to the sellers a proprietary interest in the business." 267 F.2d at 385. Again, that is not the situation here.

<sup>6</sup> These revenue rulings are distinguishable on other grounds. In 76-91, there is no mention of owner financing, and in 76-441 two situations are presented. In Situation 1, the IRS determined that the school qualified for tax exemption, based on the fact that "personal property" of the former for-profit school was purchased at fair market value, lease payments were at "fair market" and salaries paid to the former owners were "reasonable." In Situation 2, the IRS determined that the school did not qualify for tax exemption, based on the fact that the notes to the former owner exceeded the "fair market value of [the transferred] assets."

<sup>7</sup> As described in the Decision Letter, Redacted  
Redacted

<sup>8</sup> CEHE attempts to draw a comparison between the debt in its acquisition of the Colleges and the debt of nonprofit institutions (naming Columbia and Stanford), suggesting that the analysis set forth in the Decision would render those institutions as "for profit." Reconsideration Request at 9, and Exhibit 14 (excerpt from Columbia 990) and Exhibit 15 (excerpt for Stanford 990). This comparison is so lacking in legitimacy that it can be dispatched with little ink: unlike Mr. Barney, the Columbia and Stanford bondholders do not control those institutions, nor is there any suggestion (let alone evidence) that the tax-exempt bonds were issued in anything other than a transaction at fair market value.

### **C. Other Financial Benefits also Flowed to Mr. Barney**

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. In October 2012, Mr. Mercer was allowed to review documents in CollegeAmerica's data room. CEHE September 2016 Response at Exhibit 3 (Memorandum to CEHE Board). He noted certain issues "of concern," including the potential of private inurement and excess benefit to Mr. Barney as a result of the leases. He stated his understanding that the real estate properties the Colleges leased would be donated by Mr. Barney, and if they were not donated, an excess benefit, conflict of interest, and private benefit analysis would have to be performed, to determine whether the leases from Mr. Barney's real estate company were "in the best interest of the Colleges: location, cost, size, [etc.]." *Id.* at 2, 5. The documents submitted by CEHE provide no evidence that any such analysis was ever performed, whether by Mr. Mercer, or a real estate expert, or the Board itself, despite a bare recitation in the December 27, 2012 Board Minutes that the Board has "reviewed the leases" and other "Related Party Agreements" and the terms are "equal to fair market value or better." December 27, 2012 Minutes at 6. As set forth in the Colleges' and CEHE's audited financial statements, from the date of the Transaction through 2015, those leases resulted in nearly \$15 million in payments to Mr. Barney's real estate companies. The Decision Letter correctly concluded that this benefit to Mr. Barney was an additional factor supporting denial of the conversion of the Colleges to nonprofit status.

In addition, CEHE also provided a revised schedule of compensation and expense reimbursement when it submitted the CEHE September 2016 Response (at Exhibit 6).<sup>9</sup> That schedule reveals that Mr. Barney received compensation as "Chief Marketing Officer" up until early January 2015. He was paid \$95,833 in 2013, and \$100,000 in 2014. Yet, there does not appear to be any determination by the CEHE board that this was appropriate compensation for the position -- the only compensation related information pertained to Mr. Juhlin (compensation analysis contained in Exhibit 4 of the CEHE September 2016 Response). The compensation to Mr. Barney as marketing director thus provides further evidence of personal benefit to him from the Colleges.

### **III. The Denial of Nonprofit Status was Warranted**

The Decision represents the reasoned determination of the Department that the Transaction, because of the continued benefit to Mr. Barney and the Trust coupled with his significant control, deprives the Colleges from converting to nonprofit status as a result of their ownership by CEHE. I have reviewed the record supporting the Decision, as well as the additional information and documents submitted with, and subsequent to, CEHE's

---

<sup>9</sup> In its response to the Department's June 13, 2016 request for information and documents, CEHE identified the amounts of "Annual Compensation & Expense Reimbursement Paid for Services as CEHE Member or Director." (Emphasis Added). See Exhibit 3 to CEHE June 29, 2016 response to the Department's June 2016 request. When the Department requested additional information to evaluate the Reconsideration Request, it advised CEHE that its June 2016 request for information about "compensation or reimbursements" paid to members and directors was not limited to compensation relating to services as member or director.

Reconsideration Request, and conclude that there is no basis to reverse or modify the Decision. CEHE's request to convert the Colleges to nonprofit status is denied. The status of the Colleges can be re-examined when the institutions apply for recertification at the end of the provisional participation agreements, and changes in the relationship and agreements between Mr. Barney and CEHE during the intervening period may lead to a different determination in the future.

This is a final decision of the Department.

Sincerely,

Redacted

Ron Bennett  
Director, School Eligibility Service Group

cc:

Stevens Henager College  
1890 South 1350 West  
West Haven, UT 84401  
Lana Moon, Lana.Moon@stevenshenager.edu

CollegeAmerica Denver  
CollegeAmerica Arizona  
California College of San Diego  
1385 South Colorado Blvd, 5th Floor  
Denver, CO 80222  
Sonia Martinez, Sonia.Martinez@collegeamerica.edu