Ownership Structures and Changes

A Changing World

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Agenda for Discussion

- Please ask questions!
- Types of transactions
  - For-profit to not for-profit transactions, and more
- The transaction process – the anatomy of a deal
- The complications of the regulatory process
  - The Triad: Department of Education, State Agencies and Acreditors
- Education transaction risks – Not your average deal!
- Parting thoughts – Things to think about when considering transactions
Examples of Basic Transaction Structures

- **Seller**
  - One or more individuals
  - One or more legal entities

- **Buyer**
  - One or more individuals
  - One or more legal entities

- Corporate structure of transaction may involve addition of and/or removal of legal entities in ownership tree, and could occur at a level other than the education institution
Examples of Types of Transactions

• **Mergers and acquisitions**
  – For-profit to for-profit transactions
  – Not-for-profit to not-for-profit transactions
  – For-profit to not-for-profit transactions
  – Not-for-profit to for-profit transactions

• **Investments**
  – Equity
  – Debt

• **Affiliation agreements**
Examples of Basic Transaction Structures

- Sale of substantially all assets of entity that owns and operates one or more institutions
- Sale of substantially all assets that constitute one or more programs or locations
- Merger of legal entities, with one entity surviving
- Sale of stock of a legal entity
  - Preferred Stock, Common Stock, Voting Stock, Non-Voting Stock
- Acquisition of membership interest
- “Conversion in place” transaction, i.e., amendment of articles of organization to transform legal form
Sample Structures

Asset Purchases

For entities with shareholders, does not necessarily require shareholder approval, however shareholder approval may be required for a sale of substantial assets.
Sample Structures

Merger

Merger may be directly with Buyer, or often with a subsidiary formed for the purpose.

Payment of Consideration

Merger Sub → Merger → School

Shareholders

For entities with shareholders, shareholder approval required.
Sample Structures
Stock Purchase

Buyer → Shareholders
Purchase price paid directly to shareholders

Transfer of ownership in School
Buyer acquires the stock of an entity

School

Generally assumes all shareholders participate
Sample Structures

Structures are not always simple

- Shareholders
- Holding Company
- Target

May have multiple entities in the chain of ownership
Sample Structures
And sometimes they are complicated
Different Corporate Forms

- Corporations and limited liability companies (LLCs) are most common
- Corporations are common structure
  - Stock corporations, could be not-for-profit or for-profit
  - Non-stock corporations are not-for-profit
    - Member corporations
  - Board of Directors and Officers for day to day management
  - Charter and bylaws are legal organizational documents
  - Shareholders agreement
Different Corporate Forms

- Limited liability companies can provide easier flexibility
  - May or may not have a board; could be “member managed” or “board managed”
  - Operating agreements provide greater flexibility for governance and decision making
For-Profit to Not-For-Profit Transactions

- Challenges in the industry
- Perception regarding for-profit status
- Regulatory oversight
- Corinthian College collapse
For-Profit to Not-For-Profit Transactions

- Not-for-profit is a state law concept
- 501(c)(3) status is a federal tax classification that exempts a not-for-profit entity from taxation for mission related activities
- An institution must be both not-for-profit and tax-exempt in order for certain U.S. Department of Education (ED) requirements not to apply (90/10 Rule) or to apply in a more limited way (gainful employment)
- Tax-exempt status is what enables institutions to use certain favorable bond financing
For-Profit to Not-For-Profit Transactions

- **Structure can vary;** depends on, for example, tax considerations, financing, and state law
  - Asset Sale
  - Merger
  - Conversion
- Challenging to find a buyer with 501(c)(3) status
- Tax exempt entity can only pay **Fair Market Value**
- Difficult for the tax exempt entity to come up with the financing
- “Private benefit” and “private inurement” issues
- Department of Education or Accreditor Scrutiny
Affiliation Arrangements and Similar Arrangements

- Often the first step of a not-for-profit business combination
- These types of agreements, or other contractual arrangements, can result in parties taking steps that might look like a change of control, even where there is no legal change in structure
- While often dealing with functions other than core academic functions of the education institution, they can be an unregulated precursor to a change in control
Basic Anatomy of an Education Transaction

- Due diligence
- Definitive agreement negotiation
- Corporate structure
- Financing
- Signing
- Pre-closing regulatory considerations
- Closing
- Post-closing regulatory considerations
Regulatory Process

- State education agencies
- State Attorney General
- Institutional accreditors
- Programmatic accreditors
- U.S. Department of Education
- Other state agencies (e.g., board of nursing)
- Other federal agencies (e.g., U.S. Department of Homeland Security, Department of Veterans Affairs)
Regulatory Process

• Does the transaction constitute an event that requires notice to or approval from a regulator? Or both?
  – Is the transaction a change in ownership? A change in control?
  – Is it some other form of substantive change?
• If so, is such notice or approval required to occur before or after consummation? Or both?
• What documentation must be submitted to the regulator in connection with any notice or approval requirements and when is such documentation due to the regulator?
U.S. Department of Education

- An institution that undergoes a change in ownership and control ceases to qualify as an eligible institution for federal student financial aid program purposes upon the change in ownership and control
- Institution must obtain ED approval for change in ownership that results in change in control after the change occurs
U.S. Department of Education

- Examples of transactions that may result in change of ownership and control:
  - Sale of institution
  - Transfer of controlling interest of stock of institution or parent
  - Merger of two or more institutions
  - Division of one institution into two or more institutions
  - Transfer of liabilities of institution to parent
  - Transfer of assets comprising substantial portion of educational business of institution (other than security interest)
  - Change in status as for-profit, nonprofit, or public institution
U.S. Department of Education

• Public company
  – Company files 8-K notifying SEC of change in control
  – Controlling shareholder ceases to be controlling shareholder
    – Controlling shareholder holds or controls through agreement
    – 25 percent or more of total outstanding voting stock of corporation and
    – More shares of voting stock than any other shareholder

• Companies other than public companies and closely held corporations
  – Person who has or acquires an ownership interest acquires both control of at least 25 percent of total outstanding voting stock and control of corporation
  – Person ceases to own or control at least 25 percent of total outstanding voting stock or to control corporation
U.S. Department of Education

- **Parent and subsidiary corporations**
  - If institution is wholly owned subsidiary, change in ownership and control of parent results in change in ownership and control of institution
  - Other education regulators may not view change in ownership or control of parent as change in ownership and control of subsidiary institution
U.S. Department of Education

• ED does not provide advance approval of change in ownership, but will conduct “preacquisition review”
  – Institution must apply at least 45 (preferably 60) days before closing
  – Institution must submit materially complete application
• If preacquisition review is favorable, ED informs institution that it sees no impediment to institution continuing to participate in Title IV programs after change occurs, pending post-closing review
• Based on preacquisition review ED may give notice of conditions on post-closing participation in Title IV programs
U.S. Department of Education

• After closing institution must
  – Notify ED within 10 days
  – Submit by end of month following month in which closing occurs
    – “Same day” balance sheet
    – Remaining approvals from state education licensure agencies and accreditors

• On completion of post-closing review, ED will
  – Issue provisional Program Participation Agreement, usually for three years
  – Notify institution of any conditions on participation
Institutional Accreditors

- **Example: Higher Learning Commission**
  - An accredited or candidate institution must receive Commission approval prior to undergoing a transaction that affects, or may affect, how corporate control, structure or governance occurs at the institution
  - Approval is necessary prior to the transaction consummation to effectuate continued accreditation subsequent to closing
  - Control defined as possession, direct or indirect, of power to direct or cause direction of, the management and policies of an institution, whether through the ownership of voting securities, by contract or otherwise
Institutional Accreditors

Example: Higher Learning Commission

- Process
  - Initial review by Commission staff to determine whether formal approval is required
  - If approval required, deadline for submitting application depends on Board meeting schedule, but at least 6 months prior to Board meeting
  - Fact-finding review, which may include campus visit
  - Staff report
  - Institutional response
  - Board decision (approve, with or without conditions; defer consideration pending more information; additional review; deny)
  - If approved, transaction closing
  - Subsequent evaluation/focused visit within 6 months
Institutional Accreditors

Example: Higher Learning Commission

- **Institution must:**
  - Apply for approval
  - Demonstrate to satisfaction of Commission’s Board that (1) the transaction and the institution that will result from the transaction meet the requirements of the Commission’s policy and (2) that approval of the change is in the best interest of the Commission
  - Board will not consider for approval any proposed change involving an institution under sanction, show-cause, or loss of status or authorization from any other recognized accrediting agency or state entity
Institutional Accreditors

- **Example: Higher Learning Commission**
  - Board reviews change of control against several approval factors:
    - Extension of the mission, educational programs, student body and faculty that were in place when institution last reviewed
    - Ongoing continuation and maintenance of institution historically affiliated with Commission with regard to mission, objectives, outreach, scope, structure, and related factors
    - Substantial likelihood that institution will continue to meet Commission’s Eligibility Requirements, Assumed Practices, and Criteria for Accreditation
    - Sufficiency of financial support for transaction
    - Previous experience in higher education, qualifications, and resources of individuals who play a key role in institution
Programmatic/Specialized Accreditors

- **Example: Commission on Collegiate Nursing Education**
  - Change in legal status, control, or ownership of the institution or program is a substantive change
  - Substantive change notification must be submitted no earlier than 90 days prior to the change but no later than 90 days after the change
  - Notification must document nature and scope of substantive change, how the change affects the program’s compliance with accreditation standards
  - Notification reviewed by CCNE Substantive Change Review Committee, then CCNE Executive Committee
  - Executive Committee acts to approve the change or request more information, refers to Board for review and action
State Agencies

- **Primary education licensure agency**
  - Example: Florida Commission for Independent Education
  - Licensed institution must notify Commission in writing no less than 30 days prior to a change of ownership or control
  - Commission reviews each case and, if standards for licensure are met, takes affirmative action to issue new license after receipt and evaluation of documentation and payment of required fee
  - Currently licensed institution is responsible for arranging and conducting change in a manner and at a time so there is no adverse impact on opportunity of currently enrolled students to complete training and receive student services

- **Agencies that regulate particular programs, e.g., nursing**
Education Transaction Risk

• **How do parties address risk that education regulatory agencies may disapprove transaction?**
  – Thorough diligence
  – Advance communication with education regulatory agencies
  – Closing conditions for material pre-closing approvals
  – Risk of post-closing disapproval is low
  – Risk of unexpected post-closing conditions is somewhat higher, but can be minimized through advance disclosure and consultation with education regulatory agencies
  – If agreement provides for rescission, ED will not review change in ownership
  – Escrow arrangements and post-closing price adjustments
Things to Think About

- Who are the stakeholders that have an interest in the transaction?
- Are there endowment or other gift restrictions to consider?
- Who is the new owner?
- Are there contractual arrangements that result in different economics than basic ownership structure indicates?
- Does the new owner have experience operating education institutions?
- What will be the new ownership tree?
- Where is the debt?
- How will the transaction affect the institution’s financial condition?
- How will the transaction affect the institution’s mission and strategic plan?
- How will the transaction affect students and instructors?
Any Questions?
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