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Webinar

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M&A or Closure?

Complex Considerations, Critical Choices

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Agenda

- Introduction
- Pre-Planning – Informing & Engaging Stakeholders
- Due Diligence & the Anatomy of a Deal
- The New Two-Step Change in Ownership Process
- The Closure & Teach-Out Option
- Accreditation Substantive Change Review
- Additional State Authorization & Accreditation Requirements & Post Transaction Considerations
- Audience Q&A and Closing Remarks

Trends

- Small, private colleges have experienced the most change
- Institutions with specialized focus have also experienced significant change
  - E.g., religious, healthcare, graduate-only
- Notable increase in strategic transactions since 2023
- Enrollment and financial issues were present for many years preceding the transaction/closure
- Few transactions are truly strategic - most have been out of necessity
- Closure is the typical result when transactions fail
- Clear patterns in certain states (e.g., NY, CA)
- State regulatory requirements can have a significant impact on the trajectory of a transaction and the options available to institutions

Pre-Planning & Stakeholder Engagement

- Timing: strategic vs. of necessity
- Stakeholders for conversations
- When to engage accrediting agencies
- The role of the GC

The Anatomy of a Deal

- Stages of an M&A Transaction
- Corporate & Regulatory Due Diligence
- Stakeholders
- Nondisclosure Considerations

The New Two-Step Process

- What changed and why?
- What is the new process?
- What are the challenges and alternatives?

Dept. of Education: Regs and Guidance

- Final Regulations, Change in Ownership and Change in Control
  87 Fed. Reg. 65487 (Oct. 28, 2022), Effective July 1, 2023
- Updated Guidance and Procedures for Changes in Ownership
  FSA General-22-70 (Sept. 15, 2022)
- Accreditation Group, Office of Post-Secondary Education, Memorandum to Executive Directors and Presidents (Feb. 2, 2023)

What has changed?

- Previously, the Department had allowed mergers of two institutions to occur without first treating them as a change of ownership ("CIO"), resulting in a one-step process where an institution simultaneously changed ownership and became an additional location of the surviving institution.
- The Department has revised its approach and determined that these transactions are CIOs requiring (1) a review of the CIO and (2) only after such review and approval, a consolidation of the two OPEIDs.

Change of Ownership - § 600.31

- "A change of ownership that results in a change of control includes any change by which a person who has or thereby acquires an ownership interest in the entity that owns the institution or the parent of that entity, **acquires or loses the ability to control the institution.**"
- 34 CFR § 600.31(c) contains examples of transactions representing CIOs
- Institutions may seek an **Abbreviated Pre-Acquisition Review**
    - The Department will determine if the new owner of the institution will be required to provide financial protection in the form of an irrevocable letter of credit or cash escrow equal to 10-25% of the acquired institution's Title IV distribution.

The New Reality: Step #1

Step #1: The **<u>target</u>** institution must first receive approval under the Department's change of ownership procedures.

- To maintain program eligibility during the transaction process, provide 90-day notice to the Department of the intended CIO (notice also must be provided to enrolled and prospective students).
- Within 10 business days of the CIO, submit a materially complete application to the Department for approval of the CIO.
  - Audited financial statements of both acquirer and institution for past 2 years
  - State authorizing agency approval of CIO
  - Institutional accrediting body approval of CIO
  - Audited Same day balance (due end of the month after the month in which transaction closes)
- Target institution's Title IV participation terminates, and Department issues TPPPA, which, subject to providing certain information to Department, is extended until Department approves the CIO.
- Department approves the CIO and issues a PPPA to the target institution.
  - **Acquiring institution must guarantee the Title IV obligations** of the target (or put up a letter of credit)

The New Reality: Step #2

Step #2: If approved, the <u>**acquiring**</u> institution must then apply to add the targeting institution as an additional location or merge if co-located.

- Submit an application to the Department for approval of the acquisition.
- Once approved, the acquiring institution will continue as an approved institution and the target institution will cease to exist in the eyes of the Department.

The New Reality: A Two-Step Process

“Until both steps are complete, Title IV funds continue to be processed separately for each institution. Separate state and accrediting agency approvals must be maintained during this period, and additional state and accrediting agency approvals are required for the second step.”

- The Department has also suggested that a closure is an option, but requires teach-outs and risks borrower defense claims and paying loan defaults from non-continuing students.

Transaction Timeline

Exploration to Deal Closing	(continue contingency planning)	
• Exploration (1-2 months) • Negotiation & Due Diligence (3-4 months) • Sign Definitive Agreement • Consultation with Accreditor & State Licensing Agency (Review may take 6-12 months)	**Step #1 (Target Institution)** • Notice of CIO to ED (90 days) • "Materially Complete Application" to ED (10 days!) • ED issues TPPPA; Acquiring Institution guarantees Title IV obligations • Accreditor must approve "entire" transaction • ED begins review (Sometimes takes 12-18 months) • ED issues PPPA	(if approved…) **Step #2 (Acquiring Institution)** • May now apply for Target to become an additional location • Once approved: Acquiring Institution continues, Target ceases to exist
(10-18 months)	(12-18 months)	(6-12 months)

The Closure & Teach-Out Option

- When does a transaction involve a closure?
- When are teach-outs encouraged or required?
- How do teach-outs work?

Teach-Outs

- **Definitions - 34 C.F.R. § 602.3 (referencing 34 C.F.R. § 600.2 - Definitions)**
  - *Teach-out*: A process during which a program, institution, or institutional location that provides 100 percent of at least one program engages in an orderly closure or when, following the closure of an institution or campus, another institution provides an opportunity for the students of the closed school to complete their program, regardless of their academic progress at the time of closure.
  - *Teach-out agreement*: A written agreement between institutions that provides for the equitable treatment of students and a reasonable opportunity for students to complete their program of study.
  - *Teach-out plan*: A written plan developed by an institution that provides for the equitable treatment of students.
- **When is a teach-out required? 34 C.F.R. § 602.24(c)**
  - Heightened Cash Monitoring
  - Withdrawal of accreditation
  - Closure
  - Revocation of state licensure
  - Other discretionary reasons

Accreditation Substantive Change Review

- Governed by Federal Regulations
- Each accreditor has its own process
- Might involve multiple accrediting agencies

Additional Requirements

- State Authorization
- Timing of Accreditation & Department of Education Review
- Post-transaction Accreditation Review?
- Other Regulatory or Accreditation Processes?
- Final Recommendations?

Questions?