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Suits against for-profit universities, including Capella, raise question: Do shareholder and student interests coincide?

By Beth Hawkins | Published Thu, Nov 11 2010 9:12 am

On April 28, the price of shares in the corporation that owns Capella University, a for-profit online institution headquartered in Minneapolis, hit an all-time high of $97.58. Small wonder: Quarter after quarter, the publicly traded company had long had nothing but good news to report to shareholders.

At the end of 2009, Capella reported a 23 percent increase in revenues of $334.6 million, thanks in part to an increase in new enrollment of more than 37 percent. The first quarter of 2010 was even brighter: Shares peaked on reports of a 32 percent hikes in both revenues and enrollment.

The current quarter? Not so much. Yesterday, Capella was trading around $55 a share on the Nasdaq.

The university recently joined the long list of publicly traded education companies hit with class-action lawsuits filed on behalf of angry shareholders. The Police Pension Fund of Peoria has filed suit [PDF] in U.S. District Court for Minnesota, claiming that the company misled investors about its business practices in order to inflate the price of its stock.

“The company had been engaging in abusive and fraudulent recruiting and financial aid lending practices, thereby increasing Capella’s student enrollment and revenues,” the suit claims.

Capella enrolls approximately 38,000 students all over the world, with the majority pursuing graduate degrees.

“We have received the complaint,” said Mike Buttry, the company’s vice president for corporate communications. “We believe it has no merit and we are going to fight it vigorously.”

The suits are the latest fallout from the August release of a U.S. General Accounting Office report [PDF] faulting the industry for deceptive recruiting and financial-aid practices. Posing as prospective students, GAO investigators visited 15 colleges in five states. Several were given wildly exaggerated estimates of the salaries they could expect to receive after graduation. Others were coached to lie on entrance or financial-aid applications.

Capella was not among the schools visited, nor does the lawsuit describe any specific fraudulent practices allegedly taking place there. But after the report’s release, Congress asked Capella and other for-profits for information ranging from completion rates to corporate revenues.

At about the same time, the U.S. Department of Education released data showing that loan repayment rates were 54 percent at public colleges and universities, 56 percent at private nonprofit schools, and 36 percent

at for-profits. Capella's repayment rate was 40 percent.

The Obama administration has proposed rules that would encourage transparency and restricting aid at schools with low repayment rates. At some of the schools, 90 percent of revenue comes from student financial aid.

Last year, students attending for-profits received more than $26.5 billion in federal aid. When they don't graduate or can't find work when they do, their loans go unpaid. Shareholders, meanwhile, often fare quite well.

The policy debate whether the for-profits can serve both students and shareholders is as yet unresolved, but publicly traded corporations have a duty to maximize shareholder returns, according to University of Minnesota Professor Brett McDonnell. Protecting investors' interests doesn't necessarily mean neglecting those of other groups, such as students or employees, he said.

"The long-term interests of students, faculty and shareholders are often the same," McDonnell said. "Practices that harm students ultimately harm shareholders."

Shareholders frequently sue when the price of a stock plummets suddenly, but the bar for allowing the suits to go forward is higher than for other suits, added Niels Schaumann, vice dean for faculty at William Mitchell College of Law.

The first goal in such a suit is always to get a judge to order the defendant to provide discovery materials. The evidence may help plaintiffs form specific allegations, but just as often the mere fact that the expensive, laborious process can go forward is enough to prompt a settlement, he said.

"In every case it's about whether they are granted discovery," said Schaumann. "That means they can depose directors, the CEO — it gets expensive and difficult, and most corporations would rather pay to make it go away."

The number of students attending for-profits has mushroomed in recent years. Although most are much more expensive than their public counterparts, they are often quicker and more convenient than community colleges — particularly for working adults.

The plan to tie the universities' eligibility for aid to repayment rates would not go into effect until 2012, but its future is uncertain. The next chairman of the House Committee on Education and Labor, Minnesota Rep. John Kline, a Republican, opposes the rules.

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