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October 1, 2018

Donna Mangold, Esq.
Office of General Counsel
U.S. Department of Education
400 Maryland Avenue, SW
Washington, DC 20202

Re: Pending Application of Grand Canyon University

Dear Ms. Mangold:

I am writing in response to your letter of September 10, 2018, with respect to the ongoing review by the U.S. Department of Education (the "Department") of the transaction by which the ownership of Grand Canyon University was transferred to a 501(c)(3) nonprofit organization so that it is now owned and operated by a nonprofit corporation.

I. Relevant Parties.

For purposes of this letter and to avoid confusion:

- Grand Canyon University ("GCU") is the accredited institution that was previously owned and operated by Grand Canyon Education, Inc., a Delaware corporation ("GCE"), and that was sold by GCE to a nonprofit entity originally incorporated as Gazelle University ("New GCU") in the transaction under review.

- New GCU—the 501(c)(3) nonprofit corporation that acquired GCU—was originally incorporated as Gazelle University, an Arizona nonprofit corporation. Upon the closing of the transaction, it changed its legal name to Grand Canyon University and is referred to in this letter as "New GCU."

- GCE is the publicly traded, for-profit entity that previously owned and operated GCU and that sold GCU to New GCU. GCE remains in existence as a for-profit entity operating as an educational services provider.

- The transaction by which New GCU acquired GCU from GCE, including the entry by the parties into an asset purchase agreement (the "APA"), a credit agreement (the "Credit Agreement") and a master services agreement (the "MSA"), is referred to as the "Transaction."

II. GCU's Pre-Acquisition Review Application and Correspondence with the Department.

As you are aware, GCU filed its pre-acquisition review application with the Department on January 18, 2018. From that filing to the present, including up to and throughout the closing of the Transaction, GCU made substantial efforts to keep the Department well-informed regarding the details of, and the proposed timetable for, the Transaction, including promptly responding to multiple additional requests for information and offering to make its representatives available for meetings and consultations. During that period, GCU obtained approval for the Transaction from its institutional accreditor, the Higher Learning Commission ("HLC"), in early March 2018, and from its state regulator, the Arizona State Board for Private Postsecondary Education (the "Arizona Board"), in April 2018, each of which were promptly provided to the Department. HLC typically requires transactions to close within 30 days of its grant of approval, but GCU obtained HLC's authorization to extend the time for closing until the end of June 2018 in hopes that it would receive a response from the Department to its pre-acquisition review application by that date. On several occasions, the Department informally indicated to GCU's representatives that GCU could receive a response to its application in May 2018, but the only official communication that GCU received was a supplemental document request on May 17, 2018, to which GCU promptly and thoroughly responded.

With no further contact from the Department and no indication as to when its review would be completed (and understanding that Department personnel are operating under a substantial workload), New GCU and GCE, and their respective boards, were forced to decide whether to continue to delay closing the Transaction without any information as to how long that delay could last (and potentially placing in jeopardy previously received approvals from HLC and other agencies), or to proceed with the closing and commence the Department's post-closing review process without a response to GCU's pre-acquisition review application. In this regard, the parties understand that, under Department regulations, the decision to obtain a pre-acquisition review letter is optional and at the discretion of the institution. New GCU and GCE considered the significant costs already incurred and the additional costs that would be incurred if the Transaction was further delayed, as well the monumental efforts undertaken to effect the Transaction. These efforts included, among other things, the transfer from GCE to New GCU of nearly 7,500 employees, real estate improvements, and other assets valued at over $1.0 billion; the establishment of insurance, benefits programs, and policies to govern and support New GCU and its employees; and the establishment of separate email and communication systems for the 2,500 employees remaining with GCE. In light of these considerations, the boards determined that certainty was in the best interests of New GCU and GCE and that the benefits of closing the Transaction on July 1 outweighed the potential risks of doing so prior to receiving the Department's response. Closing on July 1, 2018, had the added benefits of enabling New GCU to begin its ownership of GCU on the first day of its fiscal year, giving its auditors the maximum time to prepare its audited opening day balance sheet, and allowing the two organizations to transition into the new operating structure before the start of GCU's fall semester when its student population is at its highest.

New GCU and GCE therefore closed the Transaction on July 1, 2018, without receiving a response from the Department to the pre-acquisition review application. Since closing, the parties have received an additional document request from the Department dated July 3, 2018, to which New GCU and GCE promptly responded on July 10, 2018. The parties also timely filed substantial supporting documentation with the Department as required on August 31, 2018, including all final agreements between the parties, an audited same-day balance sheet, and multiple independent valuation reports of the school assets.

III. <u>Extensive Review of the Transaction to Date</u>.

The Transaction and the plans for New GCU to own and operate GCU as a nonprofit institution have been thoroughly reviewed by other regulatory bodies. We understand that the Department makes an independent decision regarding an institution's status as a nonprofit institution for Title IV purposes, but we offer this as evidence of the fact that other government bodies and regulators, having scrutinized the Transaction for their own purposes, have concluded that it is appropriate to treat GCU as a nonprofit institution.

(a) ***HLC***. As you are likely aware, New GCU and GCE made an initial effort to effect a transaction during the 2014-2016 time period. The HLC staff, after a detailed review of the proposed transaction that included a multi-day site visit, recommended that the transaction be approved by the HLC board. In March 2016, however, the HLC board denied GCU's application for approval of a substantive change for several reasons, but most notably HLC's view that its accrediting standards in effect at the time did not countenance the type of service relationship between institutions and third-party entities that was proposed by New GCU and GCE.

In the spring of 2017, HLC began to study new standards to govern its review and approval of service relationships between accredited institutions and third-party providers and, in May 2017, proactively invited GCU, if interested, to resubmit its application for a substantive change. GCU determined to move forward, and GCE and New GCU reengaged in the transaction process during the summer and fall of 2017, pending HLC's final adoption of the new standards. HLC adopted its new standards in November 2017, and after advance consultations with HLC on the proposed transaction structure (including a lengthy response to written questions from outside legal counsel engaged by HLC to determine whether the proposed structure complied with the new standards and addressed all concerns noted in the 2016 denial letter), GCU filed its updated application seeking approval of a substantive change with HLC on December 18, 2017. HLC staff once again reviewed GCU's application, the financial and other terms of the transaction documents (including the terms of the APA, Credit Agreement and MSA), the governance structure of New GCU, and GCU's post-closing plans in great detail. It is important to note that while the new HLC standards necessitated certain changes to the terms of the MSA (such as the inclusion of specific rights in favor of New GCU to audit GCE's performance of its services) that generally favored New GCU, these changes did not alter in any material respect the structure of the Transaction and the terms of the MSA from those initially proposed in GCU's 2014 application.

HLC's review of GCU's application focused on several issues relevant to the Department's review, including New GCU's governance structure and the terms of the MSA as they relate to New GCU's independent governance. On this subject, HLC scrutinized the identity of the members of the New GCU board of trustees, their relationships with one another and with GCE, the complete independence of the New GCU board and the GCE board from one another (there being no overlapping members), the proposed role of Mr. Brian Mueller as both president of GCU and chief executive officer of GCE (a dual role that he had held for more than six years), and the provisions of the MSA that ensure that GCU retains absolute control over all of its academic functions and decision making processes. On each point, HLC was satisfied and gave its approval, adopting the conclusions of the HLC staff in its Summary Report that formed the basis for the HLC board's decision. A copy of the Summary Report is attached hereto as Exhibit A and we list below several quotations included therein:

- With regard to GCU's mission (p. 6): "[T]here continues to appear to be good continuity in mission, academic programs, student enrollment, and faculty that will exist after the transaction takes place."

- With regard to governance (p. 8): "[A]ll evidence submitted indicates that [New GCU] will otherwise have an independent governing board (i.e., the Board of Trustees) that possesses and exercises the necessary legal power to establish and review the basic policies that govern the institution."

- With regard to New GCU's projected finances (p. 12): "The updated application and financial model shows that New GCU net revenue in FY18 will be approximately $1.1B with total operating expenses of approximately $900M. Net income will be approximately $22M. The financial model shows net income increasing significantly over the next 5 years. . . . New GCU's revenues would be more than sufficient to fund its projected expenses including the fees due under the MSA, as well as interest payments that would be required to be made on the note (in connection with the purchase agreement). The institution also maintains that New GCU should have sufficient cash flow to fund the capital expenditures it continues to make to its ground campus to accommodate up to 28,500 (as projected in FY2024) and any other improvements it plans to continually make to its online infrastructure after the first two years post transaction."

- With regard to Mr. Mueller's dual role (pp. 13-14): "At the time of the 2016 HLC notification to the institution regarding its application, the HLC Board of Trustees had not yet addressed in its rules and policies any standards, applicable to its institutions with respect to the entering into and performing of shared serves arrangements, similar to Draft Master Services Agreement. GCU was informed, in a letter dated November 17, 2017, that at its meeting on November 2-3, 2017, the HLC Board of Trustees adopted new guidelines related to the determination and evaluation of shared services arrangements. The new guidelines apply to the examination and approval of the GCU's 2017 application for Change of Control, Structure, or Organization. In that regard, the new guidelines address a dual appointment by stating that "the institution may have overlapping senior executive leadership [with the service provider] who may have voting or non-voting positions on the institution's board. This arrangement is appropriate provided that a majority of the board of each organization is independent and decisions with respect to the appointment, hiring and retention of any overlapping executives are made by a majority of the independent directors of each institution.

  "GCE's Board of Directors is comprised of five members, four of which are independent members. Mr. Mueller, the Chief Executive Officer of GCE, is not independent. GCU currently has a separate institutional board of trustees comprised of five members and Brian Mueller, the President of GCU, is not independent.[1] New GCU will be comprised of the same board members that currently exist at GCU. Therefore, it appears that this arrangement would comply with the HLC's new guidelines.

  "Moreover, to avoid any conflict of interest, or apparent conflict of interest, the draft Master Services Agreement provides that Mr. Mueller is specifically excluded from any direct role in overseeing the relationship between GCE and GCU in connection with any services provided by GCE. Likewise, New GCU's amended and restated bylaws will provide for the establishment of an "MSA Committee," comprised of members of New GCU's Board of Trustees who are also free of any conflicts of interest with respect to GCE, to oversee the relationship. As referenced above, the dispute resolution process set forth in Section 18.11 of the draft MSA places responsibility for New GCU in the hands of the MSA Committee.

  "Finally, as noted, other than Mr. Mueller, there is no overlap or other relationship between the boards of New GCU and GCE. As stated in their respective organizational documents, each board possesses the customary fiduciary duties to oversee and manage its respective entity."

- With regard to New GCU's post-closing structure (p. 36): "Once the transaction has closed, the GCE stockholders will continue to retain ownership in the remaining publicly traded company, but any such ownership interests in GCU will be null and void. Grand Canyon University will continue to be operated by its existing Board of Trustees following the

[1] Subsequent to the HLC approval, Mr. Mueller and New GCU determined that, while acceptable to HLC, Mr. Mueller should not serve as a member of its board of trustees. Mr. Mueller resigned from that position in June 2018, prior to the final decision of the trustees to approve the Transaction.

> transaction; likewise, the current management staff will continue to serve in their roles thus bring a solid background in higher education as well as a thorough understanding of GCU and its goals."

We hope the above highlights indicate to the Department the seriousness with which parties focused on governance and structure, and the extent to which the New GCU and GCE relationship differs from other "nonprofit conversions" that have come under Department scrutiny in the past.

The independent governance of New GCU has been demonstrated in its conduct since the closing of the Transaction on July 1, 2018. Since that date, the New GCU board has added three new and independent board members, who were vetted by the members of the board of trustees, again, all of whom are independent. Accordingly, the New GCU board now consists of seven members, and each of them is independent. GCE, as the former owner and ongoing service-provider, had no role whatsoever in these decisions.

(b) ***Arizona Board***. The Arizona Board conducted its own review and also approved the Transaction. In its approval letter, dated April 26, 2018, the Arizona Board specifically acknowledged that, upon the closing of the Transaction, it would recognize GCU as a nonprofit institution. A copy of the Arizona Board approval letter is attached as Exhibit B.

(c) ***Internal Revenue Service***. During 2015, New GCU filed a Form 1023 with the IRS and sought a determination that it was qualified under Section 501(c)(3) of the Internal Revenue Code to operate as a nonprofit university. The Form 1023 was filed specifically in contemplation of the proposed transaction with GCE and contained extensive details regarding the terms of the proposed transaction between New GCU and GCE, including the terms of the proposed MSA and *the fact that Mr. Mueller would serve both as President of GCU and Chief Executive Officer of GCE*.[2]

In November 2015, the IRS issued its determination letter designating New GCU as a tax-exempt educational organization pursuant to Section 501(c)(3) of the Internal Revenue Code. While New GCU obtained this approval nearly three years ago during the pendency of the prior iteration of the transaction, the basic structure of the transaction as described in the Form 1023 is not different from the terms of the Transaction as consummated on July 1, 2018, and the terms of New GCU's governance structure, including Mr. Mueller's dual role, as well as the terms of the MSA, were described in detail.[3] On August 31, 2018, at GCU's request, the IRS issued an affirmation letter confirming GCU's status as a tax-exempt entity under Section 501(c)(3) of the Internal Revenue Code. A copy of the Form 1023, as filed with the IRS, the IRS determination letter, and the IRS affirmation letter are attached to this letter as Exhibits C, D, and E.

(d) ***Status of GCU with Other Governmental Authorities and Accrediting Bodies***. In addition to the IRS, HLC and the Arizona Board, we would also like to make the Department aware of

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[2] As with the HLC approval, the Form 1023 upon which the IRS based its 501(c)(3) determination noted that Mr. Mueller was, and would continue to serve as, a board member of New GCU. As noted in Note 1 above, Mr. Mueller resigned from that position in June 2018, prior to the final decision of the trustees to approve the Transaction. At that time, New GCU changed its governance documents to prohibit any individual who has a financial interest in GCE from serving on its board.

[3] The financial terms of the transaction have changed since the 2015 application. At that time, the third party valuation and transfer pricing studies that New GCU had initiated for purposes of informing the pricing of the acquisition of GCU and the terms of the MSA had not yet been completed. As further discussed below, we believe that the terms of the Transaction as closed on July 1, 2018, based on very recent valuation and transfer pricing studies, are more favorable to New GCU than the terms that were anticipated in 2015.

actions taken by other governmental authorities and accrediting bodies in response to the closing of the Transaction and GCU's operation as a nonprofit institution.

(i) Maricopa County, the county where GCU's campus is located, has granted GCU's claim for property tax exemption as a nonprofit educational organization under A.R.S. 42-11104 (see Exhibit F attached hereto).

(ii) GCU is now registered and approved as a "foreign ("domestic" in the case of Arizona) nonprofit corporation" in 45 states and the District of Columbia, with applications currently pending in 5 states that are expected to be approved in the coming weeks.

(iii) The NCAA now recognizes GCU as a nonprofit member institution with full authority to participate in the NCAA governance structure. Earlier this month, for example, GCU's Deputy Athletics Director and Senior Woman Administrator, Jamie Boggs, was appointed to serve on the NCAA Division I Council.

IV. The Department's September 10, 2018 Letter.

The Department's September 10, 2018 letter requests that we "provide the Department with a narrative explaining how this new structure and servicing arrangement warrants recognizing the institution's conversion to nonprofit status for purposes of the Title IV programs, with the identification of supporting documentation" and to "address the impact of the Master Services Agreement (and any ancillary agreements) on GCU's requested nonprofit status." The above recitation of the history of the transaction, the extensive review done by accrediting bodies and regulatory agencies, and the recognition of GCU's nonprofit status by HLC, the Arizona Board, the IRS, the NCAA, and other accreditors and state and local authorities, provides part of this explanation, and the documents attached as Exhibits A-F provide some of the supporting documentation. Nevertheless, we recognize the Department's position that it must make an independent determination as to whether to recognize GCU as a nonprofit institution for purposes of Title IV programs. For the reasons discussed below, we believe that GCU qualifies under the Department's regulations as a "nonprofit institution" and we request that the Department recognize it as such for purposes of Title IV programs.

(a) ***The Department's Definition of a "Nonprofit Institution."*** The Department's definition of a nonprofit institution is codified at 34 C.F.R. § 600.2, which defines a nonprofit institution as an institution that:

> *(1) 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;*
>
> *(2) Is legally authorized to operate as a nonprofit organization by each State in which it is physically located; and*
>
> *(3) Is determined by the U.S. Internal Revenue Service to be an organization to which contributions are tax-deductible in accordance with section 501(c)(3) of the Internal Revenue Code (26 U.S.C. 501(c)(3)).*

On the surface, GCU meets each of these requirements: (i) it is owned and operated by a nonprofit corporation and none of its net earnings benefits any private shareholder or individual; (ii) GCU's physical campus, comprised of more than 270-acres in the heart of Phoenix, is located in Arizona and, as noted above, pursuant to its letter dated April 26, 2018, the Arizona Board has authorized GCU to operate as a nonprofit institution in that state, and Maricopa County has granted GCU's claim for property tax exemption as a nonprofit educational organization under A.R.S. § 42-11104, and (iii) pursuant to the IRS determination letter dated November 9, 2015, which was affirmed by the IRS on August 31, 2018, the IRS determined that New GCU is an organization to which contributions are tax-deductible in accordance with section 501(c)(3) of the Internal Revenue Code (26 U.S.C. § 501(c)(3)).

To our knowledge, the Department has never published any Dear Colleague Letter or other generally applicable and publicly available guidance on any other factors that the Department would consider in assessing whether an institution qualifies as nonprofit entity for Title IV purposes beyond the three factors above. However, written decisions of the Department concerning other institutions that have sought status as a nonprofit institution for Title IV purposes do shed some light on factors that the Department may consider below the surface when ruling on an institution's request to be treated as a nonprofit institution. We understand that the factors most carefully scrutinized by the Department are:

- With respect to clause (i) of the definition above, whether the terms of the financial and contractual arrangements between the requesting institution and third parties effectively grant operational control of the institution to a third party or provide benefit or inurement to (e.g., by causing the net earnings of the nonprofit owner to benefit) private shareholders or individuals; and

- With respect to clause (iii) of the definition above, whether the IRS' determination that the requesting institution entity qualifies as a 501(c)(3) organization was made based on a full understanding of the facts and circumstances relevant to the Department's review, or whether the institution is being operated by a nonprofit entity that was formed for a different purpose and achieved its 501(c)(3) designation based on a different purpose and set of facts.

We submit below that both of those factors weigh heavily in favor of GCU's request to be recognized as a nonprofit institution for Title IV purposes.

(b) ***New GCU's governance structure and the terms of the Transaction and the ongoing agreements between New GCU and GCE make clear that GCU is both owned <u>and</u> operated by New GCU***. The governance structure of New GCU and its relationship to GCE are critical aspects of the Transaction, which we believe fully support the conclusion that New GCU, through its board of trustees, has appropriate authority over GCU and its operations that is not limited in any fashion by its governance documents, the financial terms of the Transaction, or the terms of the MSA.

(1) *Governance structure*. The board of trustees of New GCU and the board of directors of GCE are fully independent of one another and have no overlapping members. New GCU is a member nonprofit corporation. The sole member of New GCU is Grand Canyon University Foundation ("GCUF"). The members of the board of directors of GCUF are identical to the seven independent members of New GCU's board of trustees. GCE and its board have no involvement with or authority over New GCU's board and its decisions and as noted above, since the closing of the Transaction, the New GCU board, consisting entirely of independent members, has expanded its roster of independent members from four to seven. Further, New GCU's governing documents reflect that its board possesses and exercises the necessary legal power to establish and review the basic policies that govern the institution. In the exercise of their respective fiduciary duties, the boards of each of New GCU and GCE made independent decisions to retain Mr. Mueller in his positions as President of GCU and Chief Executive Officer of GCE, respectively, but each retains the full, independent authority to retain or terminate his services in the future (i.e., New GCU could choose to terminate Mr. Mueller as President of GCU without regard to his status at GCE, and vice versa). Further, as highlighted in the HLC Staff Summary quoted above, the terms of New GCU's bylaws and of the MSA limit Mr. Mueller's direct involvement in the day to day oversight of the relationship

with GCE: first, direct oversight is vested in a "Designee" appointed by each party (a position in which Mr. Mueller is ineligible to serve) and, second, from New GCU's side, management oversight of the MSA relationship is vested in a standing committee of the independent board of trustees designated as the MSA Committee (on which Mr. Mueller is ineligible to serve) which answers directly to the board of trustees (as to which Mr. Mueller is not a member).

(2) *Contractual terms*. In connection with the closing of the Transaction, the parties entered into the APA, the Credit Agreement and the MSA.

(A) APA and Credit Agreement. Under the APA, New GCU purchased the land and buildings comprising the GCU campus. In consideration for the purchase, it issued to GCE a secured promissory note governed by the terms of the Credit Agreement. Several aspects of the Credit Agreement are important to note as they relate to New GCU's control over the operations of GCU and the issue of whether any private shareholder or individual is receiving any portion of the net earnings of GCU.

- First, GCE has long been a party to a credit agreement with a syndicate of banks led by Bank of America. To ensure that their agreement reflected standard commercial terms for third party credit arrangements, New GCU and GCE agreed to use the Bank of America form of credit agreement in place with GCE as the foundation for the Credit Agreement between the parties. Subject to changes made to reflect the underlying deal between New GCU and GCE, the Credit Agreement tracks the Bank of America form, including as its relates to negative covenants and events of default. The rights granted to GCE as a secured lender under the Credit Agreement are well in line with customary terms of commercial credit agreements.

- Second, the purchase price New GCU paid for GCU reflects no goodwill. Rather, the purchase price was established as the lesser of the fair value of the tangible assets (as determined by third party appraisals commissioned by New GCU) or the book value of the tangible assets (land, improvements and personal property) sold plus $1 for all intangible assets sold.[4] In reality, the principal balance of the secured note payable by New GCU is significantly less than the fair value of the hard assets it acquired and substantially less (on the order of several hundred million dollars) than the combined value of the tangible and intangible assets it acquired. This element of the Transaction is entirely to the benefit of New GCU.

- Third, the secured note has a fixed interest rate that does not fluctuate with the profitability of New GCU. In establishing the applicable rate, the parties agreed that New GCU would commission a third party (in this case, Wells Fargo) to analyze the Transaction and recommend an interest rate range that it believed reflected fair market terms. The parties then negotiated the mid-point of this range as the rate to apply to the secured note. That rate is fixed at six percent (6%) for the life of the secured note.

[4] The referenced appraisals have been previously provided to the Department. The fact that New GCU owns and controls this immensely valuable real estate is further confirmed in the audited same-day balance sheet submitted to the Department on August 31, 2018.

(2) MSA. The structural terms of the MSA reflect that New GCU retains full control over all policy and academic decisions and substantial and significant rights to audit GCE's performance, seek modifications to the MSA, enforce its rights, and otherwise act as a fully independent counterparty on the contract. These terms are discussed in detail in the HLC Staff Report attached as Exhibit A. In addition, the financial terms of the MSA provide that New GCU will pay GCE 60% of its "University Adjusted Gross Revenue" (as that term is defined in the MSA). This percentage was agreed by the parties after consideration of the terms of publicly available services agreements between institutions and third parties, the level and scope of the services to be provided by GCE, and the results of a transfer pricing study commissioned by New GCU.[5] To protect New GCU against future changes in the services market that may impact the market price for third party services, the MSA allows New GCU to request that a new third party analysis be conducted and that the pricing be re-set after year ten of the initial term. In addition, the MSA includes terms, such as Section 18.2, that specifically provide that the parties will engage in additional negotiations to amend the MSA if the Board of Trustees of New GCU determines in good faith that the MSA may jeopardize the institution's accreditation, impair the institution's tax status, impair the institution's eligibility to participation in Title IV Programs or if an amendment is otherwise required to comply with applicable law. The process by which the MSA services were priced, and the terms of the MSA, were specifically established to ensure that New GCU pays a market rate for the services provided to GCE.

(c) ***No portion of the net earnings of New GCU inures to the benefit of any private shareholder or individual***. We are aware that, in other cases, the Department has determined that, notwithstanding an institution's nonprofit status, the terms of the institution's relationship with its former for-profit owner suggest that the former owner still benefits from the net earnings of the institution. This has been found where, for example, the former owner continues to own and lease to the institution the facilities at which the institution operates; where the terms of the note payable to the former owner require payments based on the net earnings of the institution; where the purchase price payable to the former owner reflects substantial goodwill and is not supported by an independent valuation or backed by real assets; or where the transaction documents contain negative covenants or other consent rights in favor of the former owner that effectively vest in the former owner the power to control the financial destiny of the institution. None of these factors exist here. In fact:

- Except for the three principal transaction documents – the APA, the Credit Agreement, and the MSA – and a Facilities Services Agreement, copies of which have all been provided to the Department, there are no other agreements between New GCU and GCE.

- New GCU acquired all of the land, buildings and personal property that comprise the GCU campus and has complete control over those assets. The GCU campus today consists of more than 270 acres in the heart of Phoenix, with classroom facilities, a library, administration buildings, dormitories, parking structures, a performing arts center, recreational and NCAA athletic facilities, and other improvements, nearly all of which have been built in the last eight years at a cost of more than $1.0 billion.

- The financing terms negotiated and agreed to under the Credit Agreement reflect a straight debt obligation with a fixed interest rate within a range recommended by an independent third party and other customary commercial terms modeled on GCE's existing market-based credit agreement. Neither the interest rate, nor the principal balance of the note, change based on the profitability of New GCU.

[5] The referenced transfer pricing study authored by Deloitte LLP has been previously provided to the Department. We emphasize that Deloitte was engaged by and owed its duties to New GCU.

- The revenue share rate under the MSA was negotiated and agreed to in large part based on a third party transfer pricing study and does not change based on the profitability of New GCU.

- The projected revenue net of expenses and revenue net of expenses after interest of New GCU in its first fiscal year of operations as a stand-alone nonprofit institution are projected to be $79.2 million and $20.2 million, respectively, increasing to $123.1 million and $60.8 million, respectively, by its fifth year of operations. This reflects a compound annual growth rate of New GCU's revenue net of expenses of 9.2% and of its revenue net of expenses after interest of 25.3%. All of those earnings are for the benefit of New GCU, and New GCU's board of trustees alone has the authority to determine how New GCU's earnings are utilized.

- GCE is a publicly traded company whose common stock is principally held by funds managed by institutional investors such as Vanguard, Fidelity and BlackRock. No individual holds or controls more than 2.0% of its outstanding shares. Accordingly, control of GCE resides in its board of directors, which is made up of a majority of members who qualify as "independent" under the applicable rules and regulations of the Securities and Exchange Commission and the Nasdaq listing standards, none of whom serve on the board of trustees of New GCU and none of whom (other than Mr. Mueller) have any relationship – employment, economic or otherwise – with New GCU. In addition, Article I, Section 3(a) of New GCU's Bylaws precludes an individual who has a financial interest in GCE from serving as a member of the board of trustees of New GCU.

We believe the foregoing amply demonstrates that New GCU, both on paper and in fact, satisfy the first element of the Department's definition of a nonprofit institution.

(d) ***New GCU's Section 501(c)(3) determination should carry weight since it was issued on the specific basis of the transaction with GCU***. In its definition of a nonprofit entity under Section 501(c)(3) of the Internal Revenue Code, the IRS applies the same net earnings standard, couched in terms of "inurement." The critical definition at 26 U.S.C. § 501(c)(3) refers to:

> *A Corporation, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.*

Because the standard applied by the IRS is substantively the same as the Department's, and because the IRS is the agency tasked with determining an entity's 501(c)(3) status, we believe that, under ordinary circumstances, the IRS's determination that an institution qualifies as a 501(c)(3) entity should be given appropriate deference by the Department in making its decision. We do understand, however, that the Department has chosen in certain cases to discount the value it places on a 501(c)(3) determination, and substitute its own independent judgment, if it concludes that the IRS issued the determination letter to a nonprofit entity at a time when the nonprofit entity's stated purpose and its historical operations involved matters other than operating a university and delivering educational services. Again, this is not the case with New GCU.

New GCU filed its Form 1023 application in 2015 and it specifically focused the application around its then-pending transaction with GCE. As part of its Form 1023, New GCU submitted substantially complete drafts of the transaction documents, including the APA and MSA, and highlighted Mr. Mueller's proposed dual role. While the Transaction that closed on July 1, 2018 differs in some respects from the transaction described in the Form 1023 – for example, Mr. Mueller no longer serves on both boards, and the purchase consideration was paid in the form of a note rather than the cash proceeds of a bond offering – the stated purpose of New GCU and the substance of its application as reviewed by the IRS do not differ from the New GCU in operation today. Because New GCU's Form 1023 squarely addressed the transaction and the IRS granted the 501(c)(3) determination letter following its review of that application, we believe that its determination should be given great weight and that there is no reasonable basis upon which to discount this determination or take a contrary view. Again, the 2015 IRS documents, plus the 2018 IRS affirmation, are at Exhibits C, D and E.

(e) Impact of Other Transactions. The Department's September 10, 2018 letter requests that we discuss other service provider transactions upon which we are relying in making our request for recognition of GCU as a nonprofit institution. We believe that here it is valuable to provide a brief history of GCU. While much of what we say here may be familiar to you, we think it is important in setting the context and understanding the distinctive reasons why New GCU and GCE consummated the Transaction and why we believe that recognition of GCU as a nonprofit institution is warranted.

GCU was founded in Prescott, Arizona in 1949 as a traditional, private, nonprofit college under the name Grand Canyon College and moved to its existing campus in Phoenix, Arizona in 1951. Established as a Baptist-affiliated institution with a strong emphasis on religious studies, the school initially focused on offering bachelor's degree programs in education. Over the years, the school expanded its curricula to include programs in the sciences, nursing, business, music, and arts. The college obtained regional accreditation in 1968 from the Commission on Institutions of Higher Education, North Central Association of Colleges and Schools, the predecessor to HLC, and began offering nursing programs and master's degree programs in education and business in the 1980s. In 1989, it achieved university status and became Grand Canyon University. In early 2000, it discontinued its Baptist affiliation and became an interdenominational Christian university.

GCU's student enrollment during most of the period after it became a university was less than 2,000 students with the vast majority of these students studying to be teachers or nurses. Even with what was considered a reasonable tuition rate for a private university, GCU struggled to compete with the heavily tax-subsidized state universities in Arizona and other well-established private universities in California and Texas. In early 2000, GCU's Board of Trustees decided to invest in a student union, a new dormitory and additional classrooms with the hopes that this would help increase student enrollment. Unfortunately, it did not. Fundraising efforts were initially successful in keeping GCU operating but, by late 2003, GCU was over $20 million in debt and teetering on the verge of insolvency. Without a significant donor base, GCU's only alternative to bankruptcy was to sell the school to a group of investors who quickly implemented a new business plan that included selling and leasing back the campus and instituting online programs designed for working adults. During the period between 2004 and mid-2008, GCU continued to focus on its financial stability and growth primarily through online education while the ground campus continued to lose money and ground campus enrollment remained stagnant. In June 2008, during the process leading to GCE's initial public offering in November 2008, the school hired a new management team led by President Brian Mueller and Executive Vice President Dr. Stan Meyer.

Beginning in 2009, the management team implemented a strategy focused on reinvigorating GCU's ground campus and creating a university that, in many respects, would be indistinguishable from the traditional, private, nonprofit universities with which it competed. Since repurchasing the campus in 2009, GCU has nearly tripled the campus footprint to over 270 acres and has invested over $1.0 billion in educational infrastructure including new classrooms, dormitories, technology, and athletic and parking facilities. For the fall of 2018, GCU has over 20,000 students enrolled on its ground campus and over 70,000 non-traditional students attending online. The growth has been accomplished with tuition rates that are comparable to tuition rates for in-state students at state universities and that are often 1/3 the rates charged by private nonprofit universities.

While other universities raise tuition every year as a matter of course, GCU has accomplished its astounding growth *without raising on-campus tuition in the last decade*. The painstaking re-engineering of GCU has made a private, Christian education affordable for many who previously could only dream of such an opportunity. Maintaining affordability is critical to New GCU's mission and one of the primary objectives of the Transaction is ensuring that New GCU can maintain this exceptional record and commitment which benefits the public by ensuring that higher education is accessible and affordable to all socioeconomic classes of Americans.

Today, nearly half of GCU's campus students are enrolled in STEM programs, primarily in health sciences and the majority of its working adult students are pursuing graduate degrees or degree completion programs such as the Registered Nurse to Bachelors in Nursing. Moreover, in keeping with its mission of preparing students with the skills and knowledge needed in the contemporary job market, and in light of Bureau of Labor Statistics and Burning Glass Technologies reports on the growing need for STEM-field employees, GCU commenced programs in engineering and technology in the last four years with a stated goal of having over 70% of campus students studying in the STEM areas within the next five years. The public derives great benefit from the growth of these programs as these are critical areas of need for the community at large. One of the primary benefits of the Transaction is that the decreased tax burden on GCU, along with new access to charitable giving and grant opportunities, will aid GCU in its continued efforts to reinvest in these critical programs for the public's benefit.

Along with the significant improvements in the academic experience at GCU, GCU re-ignited its performing arts programs in theatre, music, and dance in 2010 and these programs are winning local awards for their quality. GCU's athletic program sponsors 21 intercollegiate sports. In 2013, GCU made the leap to NCAA Division I athletics when it was invited to join the Western Athletic Conference. This move has elevated the profile of GCU and its student-athletes to even greater levels – in the 2017-2018 season, for example, the University's men's basketball team played games at Louisville and Illinois, played in front of sold out crowds of greater than 7,000 at almost all of its home games, and was one win away from receiving an automatic bid to the NCAA Division I basketball tournament before losing in the WAC conference finals. In addition, campus life is rich with concerts, intramural sports and over 100 student clubs and organizations that are directly supported and managed by GCU.

In the surrounding community, GCU lives out its mission through its community involvement and efforts to perform public good. GCU is involved in hundreds of community events and projects throughout the year. Two of GCU's most prominent public outreach programs involve Habitat for Humanity and the GCU Learning Lounge:

- *Habitat for Humanity*: GCU has a long-standing partnership over several years with Habitat for Humanity to renovate and rebuild over 700 homes in the surrounding neighborhood. GCU's students, faculty and staff provide the volunteer labor to complete the repairs, which are funded by contributions from faculty and staff. In the past three years, GCU has raised over $1.0 million and its students, faculty and staff have helped renovate over 200 homes to date.

- *GCU Learning Lounge*: In 2013, GCU launched an ambitious partnership with nearby Alhambra High School through which GCU students provide after-school tutoring and mentoring to Alhambra High School students. The program's goal is to dramatically raise Alhambra's graduation rates and test scores and to better prepare its students, many of whom come from disadvantaged minority households, for the rigors of college study. In a short period of time, this partnership has achieved results with Alhambra improving its state rating from a "D" to just ten points shy of a "B". In 2016 Alhambra High School was awarded the Beat the Odds Gold award from the Arizona Department of Education by demonstrating improved AIMS scores over three years, in addition to other criteria. The program has now been expanded to include over 1,000 GCU students volunteering to provide tutoring and mentoring in 90 neighboring schools.

In addition to the above-described projects, GCU holds popular annual gift drives at Christmas and Easter to help brighten those seasons for many underprivileged families. GCU further supports its surrounding neighborhoods via its long-standing Serve the City and Canyon Kids programs. Another initiative, 12 Months of Service, identifies specific needs in the community (such as graffiti abatement) and focuses volunteer support from students, faculty and staff to meet those needs on a monthly basis.

In short, GCU is a comprehensive liberal-arts institution that offers over 220 degree and certification programs across nine colleges, along with established fine arts programs, NCAA Division I athletics, and a thriving campus. GCU is virtually indistinguishable from other leading faith-based institutions, such as Baylor University, DePaul University, St. John's University and Marquette University. The average incoming grade point average of GCU's first year traditional ground students is over 3.5. Over 70% of GCU's online students are studying in graduate or degree completer bachelor programs. GCU's graduation rates, cohort default rates, and other university metrics are now in many cases equal to or better than rates found at public universities and faith-based private universities. GCU's most recent official three-year cohort default rate, for example, is 6.1%. Based on current admissions trends and under the ownership of New GCU, GCU plans to continue its investment in its ground campus in order to grow traditional enrollment to 25,000 students over the next five years and achieve growth in its online student body of approximately 7 percent per year over that period. Improved academics, partnerships with the City of Phoenix and surrounding neighborhoods, and extensive community outreach efforts and servant leadership will continue to be hallmarks of GCU.

Despite GCU's indisputable success, and its strong belief that such success was poised to continue, GCU's board of trustees believed that it was in the best interest of GCU's students, faculty, staff, and community to return the university to its historical status as a nonprofit institution. The reality was that operating as a for-profit university put GCU at a significant disadvantage relative to the universities it competes against. Prior to the Transaction, as a for-profit entity, GCE paid substantial amounts in income and property taxes – nearly $100.0 million in 2017 – while its competitors paid none and, with respect to its state university peers, some of its competitors received additional benefits in the form of state subsidies. In addition, among other factors, GCU was ineligible to receive government research grants or charitable donations, was prohibited from recruiting in school districts in various states, and was treated by the NCAA as a non-voting member.

Perhaps most importantly, however, any perceived disadvantages to GCU in operating as a for-profit entity do not extend to regulatory disadvantages. To be clear, the Transaction was in no way done to avoid regulations applicable to for-profit universities as GCU's regulatory performance on factors such as its composite score and cohort default rate, as well on regulations applicable only to for-profits such as the

90/10 ratio and gainful employment metrics, have far exceeded the standards applicable to schools generally or for-profits in particular. In addition, GCU has been subjected to regular government oversight and hefty regulatory compliance efforts for more than ten (10) years and its track record, especially in recent years, has been exemplary. In the last two years alone, GCU has been subjected to reviews by six major institutional and specialized accrediting bodies. GCU completed those comprehensive reviews with 100 percent compliance, including a visit from HLC in which GCU's accreditation was reaffirmed for an additional 10 years, which is the maximum extension of accreditation the HLC offers. In addition, GCU recently received the maximum 10-year accreditation from the Commission on Collegiate Nursing Education; completed the four-year transition to NCAA Division I athletics; completed a Veterans Administration audit with no findings; received a 10-year reaccreditation from the Accreditation Council for Business Schools and Programs; and has been granted associate membership of the Association of Theological Schools as it completes the process for full accreditation. Simply put, *regulatory considerations were not a factor and played no role in the decision by New GCU to consummate the Transaction*.

In reality, GCU first developed the proposed structure for this transaction *in the fall of 2010* and before any "nonprofit conversion" of which we are aware had occurred. GCU management traveled to Washington, D.C. and presented the structure in person to Department representatives *in June 2011*. It made application to the HLC for a transaction based on this structure in *2015-2016* and then again in *2017-2018*.

We cite this brief history to demonstrate that GCU has pursued this transaction, in this structure, for a long time and for reasons having nothing to do with salvaging a failing business model, a desire to avoid regulatory compliance, or imitating another "conversion" transaction. Returning GCU to its nonprofit roots has long been a goal of GCU's board of trustees and management because they have long believed that such an outcome would be in the best long-term interests of the institution, its students, faculty, staff and the public.

In developing the financial terms of the MSA, New GCU and GCE and their respective advisors of course conducted market research, reviewing the terms of as many publicly available higher education servicing agreements as could be obtained. And while those agreements, to the extent available, informed this financial analysis, New GCU did not rely on them per se but on the transfer pricing study conducted by Deloitte on behalf of New GCU (referred to above), which concluded that the pricing terms of the MSA were fair to New GCU. Furthermore, New GCU relied upon personal property, real property, and intangible asset valuations performed by independent, third party experts, along with the advice and counsel of sophisticated outside corporate, regulatory and tax counsel, and independent, third party financial experts, such as Wells Fargo, to ensure that all terms of the Transaction were fair and reasonable from an independent commercial standpoint. New GCU did not rely, at all, on any other agreements with respect to the governance structure of its board and management or as it relates to the MSA. Rather, those structures were developed based on careful analysis of IRS regulations and HLC accrediting standards and with advice of outside counsel with expertise in nonprofit matters (including outside counsel hired by HLC to review these structures), as well as a laser-like focus on ensuring that the resulting structure and financial terms placed GCU in the best possible position to succeed on its own and continue to pursue its mission for the benefit of its students, faculty, staff and the public. As such, GCU believes that comparisons to the Kaplan transaction or any other example are not relevant. Rather, it believes that the Transaction, and the completely transparent and aboveboard approach that both New GCU and GCE took in engaging with one another, their respective regulators and other stakeholders, stands on its own.

V. <u>Conclusion</u>.

We sincerely hope that the Department finds this letter to be responsive to its request, and that the Department concludes that GCU warrants recognition as a nonprofit institution for Title IV purposes.

Thank you for your attention, and please let us know if you have additional questions.

Sincerely,

Jonathon C. Glass

Counsel to Grand Canyon University

Enclosures