Academy of Art financial aid fraud alleged

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Four former recruiters for the Academy of Art University in San Francisco are accusing the private art school of defrauding the government out of millions of dollars in financial aid by using illegal tactics to get students to apply.

Suing in federal court, the ex-employees say the art school used an illegal compensation scheme - adjusting their pay up or down based on how many students they registered and dangling trips to Hawaii as an incentive - then lied to the government about it to collect millions of dollars a year in financial aid.

The school says it did nothing wrong and that its compensation method was allowable under a legal loophole.

The government outlaws "incentive compensation" to discourage schools from enticing unqualified applicants or those who can't afford their student loans.

But the approach is tempting for schools because many students attract federal financial aid, which flows directly from the government to the college. And once a student is enrolled for 60 percent of the term - what schools call the "stick date" - the school can keep the payment even if a student drops out the next day.

"It's just gravy," said Stephen Jaffe, a San Francisco attorney representing the former recruiters. "Schools have a tremendous incentive to enroll as many students as possible."

And the former employees - Scott Rose, Mary Aquino, Mitchell Nelson and Lucy Stearns - have a tremendous incentive to sue the art school.

They're suing under the False Claims Act, which awards triple damages to encourage whistle-blowers who think the government is being defrauded. The law lets individuals sue on behalf of the government, which gets most of any settlement or money recovered. But the haul for whistle-blowers is substantial: an automatic 15 to 30 percent, Jaffe said.

Jaffe filed the suit in 2009. Since then, the Stephens Institute, which does business as the Academy of Art University, has tried unsuccessfully to have the suit tossed out.

Legal loophole

The school argued that its compensation scheme was proper because of a loophole in existence at the time that permitted incentives under some circumstances.

Known as "safe harbor," the loophole let colleges pay recruiters based on the number of students they enrolled as long as the recruiters also were judged on other performance criteria, and if their pay was not adjusted more than twice a year.

Federal law has since been revised, and that loophole is gone. But it was there between 2003 and 2010, most of the period covered by the lawsuit.

"At all times, the Academy of Art complied with the regulations regarding compensation of admissions representatives, said Steve Gombos, a Virginia attorney representing the art school.

In legal papers, Gombos also rejects the accusation that the art school created "sham and superficial qualitative criteria" to make it appear that the Academy of Art University was judging recruiters on anything but the number of students they attracted to the school.

"That didn't happen," Gombos said.

The plaintiffs argue that the school lied to make it appear that it was complying with the loophole criteria.

In June, U.S. District Court Judge Phyllis Hamilton ruled that the case could go forward.

Real estate holdings

Founded as the Academy of Advertising Art in 1929 by artist Richard S. Stephens, the school today is a major San Francisco landlord that has bought apartment buildings, studios and hotels and converted them to student housing. As of 2010, it owned 18 academic buildings and 17 residential buildings. It also operates private shuttles to ferry students throughout the city.

The school would not say how many students are enrolled, but it calls itself the nation's largest private art school. A 2009 transportation management report it commissioned projected an 80 percent enrollment increase between 2008 and 2017. The report said enrollment was 13,335 in 2008 and would be 16,500 in 2012, and 24,000 in 2017.

The school offers courses in classrooms and online in 16 fields, from fine art to fashion, says its website, which puts annual tuition and fees at about $21,000.

To make its case, the lawsuit relies on e-mails, jotted notes and "overpayment adjustment forms" to show how the incentive compensation scheme works.

Single judging criterion

The e-mails show the employees' frustration at getting their bosses to put recruitment goals in writing.

In 2010, for example, Aquino asked her boss what her goal was, how many students she had to register for an $8,000 salary increase, and how many were needed simply for her salary to be restored after she missed a prior goal.

The boss e-mailed back this terse response: "25% over that 65 goal."

A 2009 document shows that Aquino's salary was reduced by $2,100.

The suit also says that in 2011, plaintiff Rose manually copied recruitment goals from a document that his boss refused to give him. He wrote that employees would get an $8,000 salary increase for meeting their goal, $10,000 for exceeding it by 25 percent, and $15,000 for exceeding it by 50 percent.

The suit claims there were no other legitimate criteria on which the recruiters were judged - as the loophole required - and that the art school "attempted to conceal its fraud ... by creating sham and superficial" criteria that were never actually used to judge performance.

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