



MEMORANDUM

PRIVILEGED AND CONFIDENTIAL—ATTORNEY CLIENT COMMUNICATION AND WORK PRODUCT

TO: Kent Nelson, Acting General Counsel
University of Idaho

FROM: Hawley Troxell Ennis & Hawley LLP

DATE: [July __, 2023]

RE: List of Further Legal Issues

A. Introduction

We previously provided you memoranda addressing several legal issues relevant to the powers of the University (the “University”) and its Board of Regents (the “Regents”) in connection with acquisition of assets of University of Phoenix. On May 18, 2023, the Regents approved entering into an Asset Purchase Agreement between Phoenix and a nonprofit corporation of which the Regents is the sole member (the “Agreement”), which was then signed on May 31, 2023.

The summary of the conclusions of those earlier memoranda was as follows:

“The Regents possess ample powers through the Idaho Constitution and applicable Idaho statutes, and does not violate the Idaho Constitution, to (i) form a nonprofit corporation and act as its sole member, (ii) acquire assets indirectly through the nonprofit corporation, (iii) allow the nonprofit corporation to issue debt and incur liabilities secured principally by the nonprofit corporation’s assets and revenues, and (iv) incur direct University liabilities in support of the nonprofit corporation’s obligations if necessary, subject to the overall limitations that the University serves a public purpose and obligates only funds under its direct control and no state appropriated funds.”

Since the date of approval of the Agreement, the University has received a series of questions from State of Idaho legislators, and the University has formulated replies to these questions. The President of the University presented a number of these responses at a public meeting of the Legislature’s Joint Finance and Appropriations Committee on June 16, 2023 (the “JFAC Hearing”).

Also, since the date of approval the new nonprofit corporation has changed its name to “Four Three Education, Inc.” (“Four Three”).

B. Questions Posed

Several legal questions were posed by JFAC co-chair, Senator Scott Grow, and in the interest of time at the JFAC Hearing the University deferred responding to a later date in written form.

In summary these questions relate to:

- Liquidated damages provisions
- Cross default provisions
- Authority to enter into a Non-Disclosure Agreement (“NDA”).
- Liability of the state of Idaho generally about the transaction.
- Impact on U of I bond rating
- Impact on bond rating of state of Idaho
- Status of Phoenix Employees vis a vis state system, including PERSI.

C. Detailed Q&A

1. Liquidated Damage Provisions

The Agreement has no liquidated damages provisions. Each party is responsible for its own expenses whether the Agreement is consummated or terminated. The Agreement has a number of conditions precedent to closing that must be satisfied before the University is obligated to close. If those conditions are not fulfilled, Four Three may terminate the Agreement without penalty.

2. Cross Default Provisions

The Agreement has no cross-default provisions. For clarity, a “cross default” is a provision in an agreement that a default under that agreement is also a default under one or more other agreements to which the defaulting party is bound. An example would be a provision in a loan agreement that the loan is in default if the borrower defaults on other loans or obligations.

As noted in C1 above, Four Three may walk away from the Agreement without penalty if closing conditions are not fulfilled. There is literally nothing to “cross default” to because Four Three currently has no other agreements. The Agreement also makes no reference at all to any current obligations of the University itself.

The financing documents, which are expected to include principally a loan agreement with lenders between Four Three and a conduit issuer (the “Loan Agreement”), and a limited guaranty

by the University (the “ULG”), have not been prepared yet, but have generally been outlined in a “Term Sheet” that was presented to the Regents and is publicly available.

It is possible the Loan Agreement will have covenants such as an event of default occurs if Four Three is in default of other indebtedness. However, (i) that is not likely or necessary because Four Three is unlikely to have other indebtedness given the substantial cash reserve of \$200 million, and (ii) in any event the cross-default would only affect Four Three. The ULG may or may not be required depending on market conditions for the financing. If it is, the University has been clear that it is limited in amount, and there has been no suggestion in the preliminary negotiation of terms that the University is in default of its obligations under the ULG if the University is in default on its other indebtedness (which is completely unlikely), or conversely that if the University fails to perform on the ULG, that such action constitutes a default on the University’s bonds. The University expects to be able to resist any further commitments beyond a stand-alone backstopping of the Four Three debt reserve fund. As noted in the JFAC hearing, in any event, such obligations are obligations of the University alone and not of the State of Idaho.

3. Authority to Enter into Non-Disclosure Agreement

The University possesses the requisite authority to enter into a non-disclosure agreement much like its ability to enter into a wide range of other agreements – it has the general power to contract an “execute all instrument necessary or convenient.” Idaho Code § 33-3804. Additionally, nothing in Idaho Law prohibits public entities from entering into such non-disclosure agreements – businesses regularly require non-disclosure agreements during negotiations, as the University of Phoenix did here, to better protect their interests and the disclosure of sensitive information that would otherwise not be shared without some sort of assurance from the other party. To be sure, a non-disclosure agreement is not able to completely prevent the disclosure of information under Idaho’s public records laws that is not otherwise exempt from disclosure. However, much of the confidential information protected by a non-disclosure agreement may very well fall under exemptions to disclosure under Idaho’s public records law (e.g., trade secrets or privileged communications).

In fact, Idaho’s public records act specifically contemplates educational institutions, such as the University, entering into confidentiality agreements in the course of academic research. Information collected or utilized in the course of academic research is exempt from public disclosure until the research has been completed, however such information remains exempt from disclosure even after the completion of research if it was “provided to the institution subject to a written agreement of confidentiality.” Idaho Code § 74-107(22).

4. Liabilities Migrating to the State

The earlier Memorandums addressed the constitutional issues relating to the whether the Four Three debt under the Loan Agreement constitutes debt of the State or is subject to legislative appropriation. Those questions are answered in the summary above. In addition, beyond the constitutional, statutory and caselaw analysis, Legislators should note that the State’s

own financial reporting confirms these distinctions and principles. Attached as Exhibit A are excerpts from the State's consolidated financial report ("CAFR"). Page 39 of the CAFR explains that the debt of only the Idaho State Building Authority and the Fish and Wildlife Foundation are considered "component units" of the State. This is the case because the payments for their bonds are traceable to state appropriations. The Note on page 186 of the CAFR states that:

"the debt and liabilities of independent bodies corporate and politic created by law and which have no power to levy taxes or obligate the General Fund of the State are not debts or liabilities of the State of Idaho."

Also, in the State CAFR on page 113 is a reference to the Idaho Housing Agency's bonds issued for the benefit of nonprofit corporations. Although it appears a conduit other than Idaho Housing will issue the bonds secured by the Four Three Loan Agreement, it is instructive that this footnote makes clear, as we have also concluded from a legal matter in Memorandums, that the obligation on such bonds is solely that of the resources of the nonprofit borrower.

5. Rating Impacts on the University and the State

Rating impacts are primarily a financial issue, less so a legal issue. For several years, the University has been advised by the nationally recognized financial advisory firm of PFM. Importantly, in contrast to other financial providers such as Wells Fargo that underwrites the University's bonds, or Citibank, which is retained to market the conduit issuer bonds that will be repaid from payments by Four Three under its Loan Agreement, PFM, as a financial advisor under SEC Regulations, acts with a fiduciary duty to the University. The University expects to rely heavily on PFM's advice concerning the terms of the conduit issuer bonds, the Loan Agreement and the ULG, and the effects on the University's ratings.

A response from PFM would be more authoritative than one from legal counsel, and ultimately a response from the rating agency itself is the only way to have absolute accuracy of the impact on ratings. The summaries of the transaction that the University has provided to date, indicate that the University's bond rating may be downgraded temporarily until the Four Three indebtedness is paid down by some significant degree.

The Regents have a policy on maintaining ratings, but, as it should be, the policy is flexible to allow for incurrence of debt for strategic reasons. Correctly, there is not a philosophy of "managing to the rating;" but rather a recognition that that the University has marketable debt capacity at many rating levels.

I would say with respect to the State that a diminution in the University's rating would not diminish the State's rating, for the exact reason that the University's obligation are not debts of the State, but again PFM and the rating agencies themselves would be the definitive source of information on this point.

6. Employment Issues

One of the University's reasons for forming Four Three was to isolate the employment relationships in a separate entity rather than integrate several thousand employees into the state system right away. As with any corporate entity, Four Three can form valid employment relationships under the direction of its Board of Trustees. The University recognized the importance, confirmed by Co-chair Senator Grow mentioned at the hearing, of keeping Phoenix employees to assure the continued successful operation of the enterprise. In the months ahead before the transaction closes, Four Three will set up employee compensation and benefit plans that are (i) compliant with nonprofit corporate principles, and (ii) designed to retain Phoenix employees going forward. There is no suggestion that they will be State of Idaho Employees or members of PERSI.

Questions have been raised about "piercing the corporate veil," and President Green answered this question at the JFAC Hearing with complete accuracy, which is that a separate, multi-person, independent board, and business operations separately conducted are the keys to avoiding a piercing the veil theory. Accordingly, we do not believe that creditors or employees have Four Three can claim recourse against the University or the State of Idaho.