

TAKING THE REINS: THE CASE FOR INVESTOR CONTROL IN INCOME SHARE AGREEMENTS

Note

INTRODUCTION	260
I. PRESENT STATE OF INCOME SHARE AGREEMENTS	262
A. <i>Resurgence of Income Share Agreements in Universities and the Private Sector</i>	262
B. <i>Federally Funded ISAs</i>	263
II. REGULATION OF INCOME SHARE AGREEMENTS	264
III. ANALYSIS OF GIVING INVESTORS CONTROL.....	265
A. <i>Benefits of Giving Investors Control Over Students</i>	266
B. <i>Concerns with Giving Investors Control Over Students</i>	270
IV. PRACTICAL IMPLEMENTATION OF INVESTOR-CONTROL ISAS	273
A. <i>Limitations Needed to Make Implementation Feasible</i>	273
B. <i>Investor-Control ISAs Compared to Federal Student Loans</i>	276
CONCLUSION	278

TAKING THE REINS: THE CASE FOR INVESTOR CONTROL IN INCOME SHARE AGREEMENTS

Note

INTRODUCTION

Increasing tuition prices and the \$1.5 trillion of student loan debt in the United States are discouraging students from pursuing higher education.¹ Further, the recent global pandemic is causing students who would have to fund their higher education using student loans to question whether education after high school is worth the debt.² As such, Income Share Agreements (ISAs) are gaining support as a possible solution to current student loans.³ ISAs are an alternative method for students to finance their pursuit of higher education.⁴ For a standard ISA, an investor, whether that be a private financier or a university, provides a student with the funds needed to finance the student's education.⁵ The student then pays reduced or no tuition while in school, and the investor receives a set percentage of the student's income after graduation over a set time.⁶ Hence, "ISAs represent a notable departure from traditional forms of individual lending (e.g., student loans or venture debt) because they effectively grant the funding provider the upside if earnings are higher than expected and the downside risk if they are lower."⁷

"Unlike a loan, there is no principal balance to repay with an ISA."⁸ Depending on how successful a student becomes after graduation, the student may ultimately pay more or less than the amount the investor funded.⁹ Generally, the percentage of the student's future income is dependent upon the

1. See Alissa Gardenswartz & Nichole Burnett, *How States May Regulate Income Share Agreements*, LAW 360, July 24, 2019, at 1.

2. Michael B. Horn, *COVID-19's Long-Term Impacts on Education in 2020 and Beyond*, EDSURGE (Mar. 23, 2020), <https://www.edsurge.com/news/2020-03-23-covid-19-s-long-term-impacts-on-education-in-2020-and-beyond>.

3. See *id.*

4. Mitch Daniels, *Here is a Powerful Alternative to Student Loans*, WASH. POST (Nov. 28, 2019), https://www.washingtonpost.com/opinions/income-share-agreements-are-a-powerful-alternative-to-student-loans/2019/11/27/5290d0ee-0be3-11ea-97ac-a7ccc8dd1ebc_story.html.

5. Miguel Palacios et al., *Investing in Value, Sharing Risk: Financing Higher Education Through Income Share Agreements*, AM. ENTER. INST. 1–3 (Feb. 26, 2014) (unpublished paper) (on file at <https://www.aei.org/research-products/working-paper/investing-in-value-sharing-risk-financing-higher-education-through-income-share-agreements>).

6. Daniels, *supra* note 4.

7. Shu-Yi Oei & Diane Ring, *Human Equity? Regulating the New Income Share Agreements*, 68 VAND. L. REV. 681, 684 (2015).

8. *Id.* at 707; Palacios et al., *supra* note 5, at 1.

9. Oei & Ring, *supra* note 7, at 754.

student's chosen field of study.¹⁰ The higher the earning prospects a student's chosen field of study has, the lower the percentage of income a student has to pay investors in the future.¹¹ Further, most ISAs have a minimum salary that students must earn before they must begin paying investors, and there is usually a set maximum amount that can be paid back to investors.¹² The stark differences between ISAs and traditional student loans have caused an increase in the number of students who choose ISAs.¹³

Despite an increasing number of students turning toward ISAs to fund their education, ISAs are currently not regulated.¹⁴ However, federal legislators have attempted to enact regulations.¹⁵ Although all attempts to regulate ISAs have been unsuccessful, the proposed regulations have given investors and students insight into how the government may control ISAs.¹⁶ Proposed regulations show that regulators do not believe investors should have any control over the decisions the students they invest in make.¹⁷ Every proposed regulation has called for ISAs to have noninterference clauses.¹⁸ These clauses provide that investors are not allowed to interfere in or control any decision a student makes.¹⁹

This Note asks whether regulators should mandate such blanket noninterference clauses in ISAs or if investors should be able to have control over the students they invest in. Ultimately, I argue that regulators should allow investors to have control over students and not mandate that ISAs have blanket noninterference clauses. This Note does not contend that *every* ISA should give investors control. Instead, it reasons that regulators should not prohibit students from entering into ISAs that give investors control.

I show in three Parts why regulators should permit ISAs that lack noninterference clauses. Part I details the recent rise of ISAs and the current state of regulations placed upon ISAs. Part II provides the benefits of allowing ISAs that give investors control over students ("investor-control ISAs"). It then

10. Derek Tharp, *Can Income Sharing Plans Replace Student Loans?*, FIN. PLAN. (Nov. 8, 2019), <https://www.financial-planning.com/news/income-share-agreements-instead-of-college-student-loans>.

11. Palacios et al., *supra* note 5, at 1 ("[B]ecause ISA investors earn a profit only when a student is successful, they offer students better terms for programs that are expected to be of high value and have strong incentives to support students both during school and after graduation.").

12. Kevin J. Mumford, *Student Selection into an Income Share Agreement 2* (Feb. 2020) (unpublished paper) (on file at <https://krannert.purdue.edu/faculty/kjmumfor/papers/Mumford%20Income%20Share%20Agreement%20Selection.pdf>).

13. Tharp, *supra* note 10.

14. *See infra* Part II.

15. *See infra* Part II.

16. *See infra* Part II.

17. *See* ISA Student Protection Act of 2019, S. 2114, 116th Cong. § 102(c) (2019); Investing in Student Success Act of 2017, S. 268, 115th Cong. § 103 (2017); Investing in Student Success Act of 2014, H.R. 4436, 113th Cong. § 102 (2014).

18. *See* S. 2114.

19. *Id.*

analyzes the possible consequences of allowing investor-control ISAs. In Part III, I present a feasible way for regulators to permit ISAs that lack noninterference clauses. This Part provides five limitations regulators can implement on investor-control ISAs to mitigate concerns. Finally, Part IV displays the practicability of implementing investor-control ISAs by comparing an investor-control ISA with my proposed limitations to current federal student loans.

I. PRESENT STATE OF INCOME SHARE AGREEMENTS

This Part explores modern ISAs and how students have recently begun to utilize ISAs to pay for postsecondary education. It further highlights the broad array of organizations that currently fund ISAs, discusses both current and past proposed federal regulations on ISAs, and provides an overview of noninterference clauses.

A. Resurgence of Income Share Agreements in Universities and the Private Sector

While different than traditional student loans, ISAs are not new.²⁰ Milton Friedman first introduced the idea of an ISA in the mid-twentieth century when analyzing alternative ways for students to finance their pursuit of higher education.²¹ Following Friedman, Yale began the first ISA program in 1971.²² However, Yale abandoned offering ISAs to students in 1978, and the program is widely regarded as a failure.²³ Since then, and until recently, students have not used ISAs to fund higher education.

ISAs have begun to make a resurgence as the fear of a student-loan crisis has increased.²⁴ Schools such as Purdue University have led the way in providing ISAs to students who choose not to opt for traditional student loans.²⁵ Purdue University's ISA program, "Back a Boiler," provides ISAs with an income share between 2.5 and 5.4 percent per \$10,000 of funding for a term of between 80 to 116 months to sophomores, juniors, and seniors.²⁶ Purdue University's ISA offer is a "take it or leave it" funding offer, meaning students

20. See Milton Friedman & Simon Kuznets, *Incomes in the Professions and in Other Pursuits*, in *INCOME FROM INDEPENDENT PROFESSIONAL PRACTICE* 62, 90 n.20 (1945).

21. *Id.*

22. Mumford, *supra* note 12, at 2.

23. See *id.* at 2 n.2 ("Students were placed into cohorts and each agreed to pay 4 percent of their income for every \$1,000 received until their cohorts debt was paid off (or 35 years). At graduation, a student could pay 150 percent of the funding amount and leave the program immediately. Yale bailed out the program in 1999.").

24. See Ritikia Kapadia, Note, *A Solution to the Student Loan Crisis: Human Capital Contracts*, 9 *BROOK. J. CORP., FIN. & COM. L.* 591, 591 (2015).

25. Mumford, *supra* note 12, at 3.

26. *Id.* at 5–6.

have no opportunity to negotiate terms.²⁷ As of 2018, 767 students at Purdue University have chosen to fund their education using ISAs.²⁸ Since Purdue University began to offer ISAs, other schools such as Allan Hancock College, Lackawanna College, Clarkson University, Norwich University, and Messiah College have offered ISAs to students.²⁹

B. Federally Funded ISAs

The United States Department of Education announced in December of 2019 that it plans to create an experimental program that would allow colleges to “take on students’ federal loan debt, with students then repaying the institution for the loan balance, potentially based on their future earnings.”³⁰ Essentially, the Department of Education is creating an experimental ISA program. This experiment, if followed through by the government, would be the first federally funded ISA program.

The Department of Education’s proposed ISA plan will not be permanent. It will serve as a way to gauge the viability of ISAs in higher-education funding. As an experiment, “[t]he goal [of] such projects is to test ideas in a controllable scope and to use what’s learned to inform federal aid policy.”³¹ After the experiment runs its course, the Department of Education will analyze its ability to supplement other federal student loans. However, it is important to note that “such experiments during the last two or three administrations [have] not . . . yield[ed] enough usable data or other evidence to adequately contribute to policy debates.”³² As a result, the fruits that the federal ISA program will yield are uncertain.

The proposed federal ISA program has brought with it supporters and critics. Some experts have criticized the experiment. They claim that “the experiment could be illegal and would pervert the mission of the student loan program while threatening borrower protection.”³³ However, federal officials hope that ISAs will give colleges some “skin in the game” and make colleges more invested in the success of their students post-graduation.³⁴

27. *Id.* at 6.

28. *Id.* at 8.

29. Farran Powell, *Should You Give Your Future Income to a College?*, U.S. NEWS (Sept. 26, 2018), <https://www.usnews.com/education/best-colleges/paying-for-college/articles/2018-09-26/using-an-income-share-agreement-to-pay-for-college>.

30. Paul Fain, *Federal Loans and ISAs*, INSIDE HIGHER ED (Dec. 16, 2019), <https://www.insidehighered.com/news/2019/12/16/experiment-would-allow-federal-loans-be-repaid-through-income-share-agreements>.

31. *Id.*

32. *Id.*

33. *Id.*

34. *Id.*

The future of federally funded ISAs is still uncertain. However, the recent support of ISAs given by the Department of Education likely shows that it is viable for ISAs to be used for funding education. At a minimum, it shows that bureaucrats have an interest in learning what the effects of ISAs in the education sector would be.

II. REGULATION OF INCOME SHARE AGREEMENTS

Despite universities and private financiers beginning to offer ISAs to students, lawmakers have failed to pass federal laws tailored specifically toward regulating ISAs. The lack of regulations has caused both financiers and students to approach ISAs with skepticism.³⁵ In an attempt to instill confidence in ISAs, a bipartisan group of twenty organizations currently offering ISAs submitted a letter to Congress “asking for sensible legislation that provides protections for student consumers and a legal framework to guide the work of institutions and providers.”³⁶

Subsequently, lawmakers have begun to voice their opinions on the subject. In April of 2019, Diane Jones, principal deputy of the Department of Education, said, “[W]e love income share agreements.”³⁷ She further stated that the Trump administration is analyzing ways to support ISAs in the education financing market.³⁸ Senator Elizabeth Warren, among other Congressional Democrats, voiced her opposition to ISAs after the Department of Education’s statement.³⁹ In a letter to Education Secretary Betsy DeVos, Senator Warren stated that it is “deeply disturbing to see a Department official boosting novel forms of student debt instead of trying to stem the tide of indebtedness.”⁴⁰ Although Senator Warren and other Democrats have been vocal about their dislike of ISAs, support for ISA regulation has been bipartisan.⁴¹

In 2014 and 2017, in an attempt to provide a legal structure for ISAs, Senators Marco Rubio, Tom Cotton, and Todd Young and Representative Tom Petri introduced the Investing in Student Success Act.⁴² Both bills gave explicit approval for the use of ISAs in financing postsecondary education and provided

35. See Gardenswartz & Burnett, *supra* note 1.

36. Michael S. Knoll, *Income Share Agreements: A Solution to the Student Debt Crisis?*, WHARTON PUB. POL’Y INST. (July 17, 2019), <https://web.archive.org/web/20200416203023/https://publicpolicy.wharton.upenn.edu/live/news/3057-income-share-agreements-a-solution-to-the-student>.

37. Letter from Elizabeth Warren, U.S. Senator, to Betsy DeVos, U.S. Sec’y of Educ. (June 4, 2019) (on file at <https://www.warren.senate.gov/imo/media/doc/Letter%20to%20DeVos%20re%20ISAs.pdf>).

38. Andrew Kreighbaum, *Education Department May Offer Income-Share Plans*, INSIDE HIGHER ED (Apr. 12, 2019), <https://www.insidehighered.com/quicktakes/2019/04/12/education-department-may-offer-income-share-plans>.

39. Warren, *supra* note 37.

40. *Id.*

41. See ISA Student Protection Act of 2019, S. 2114, 116th Cong. § 102(c) (2019).

42. Knoll, *supra* note 36.

various requirements to qualify as a valid educational ISA.⁴³ Each time the legislators introduced the bill, it failed to pass.⁴⁴ Most recently, in July 2019, Republican Senators Todd Young and Marco Rubio were joined by Democratic Senators Mark Warner and Chris Coons in sponsoring the ISA Student Protection Act of 2019.⁴⁵ The Act provides a potential regulatory structure for ISAs, lists requirements for ISAs to be valid, and prevents states from regulating ISAs other than with their own ISA-specific laws.⁴⁶ Currently, the Senate has not yet taken any action on the bill, and its future remains uncertain.⁴⁷

While no regulations have passed, all three proposed bills mandate blanket noninterference clauses.⁴⁸ A noninterference clause generally states that ISAs should not be construed to give the investor any rights or control over the actions of a student.⁴⁹ Further, most ISAs currently on the market have provisions in the contract prohibiting investors from having any control over the actions of the students they invest in.⁵⁰ If regulators mandate noninterference clauses in all ISAs, investors must pay for students' education while having no say in the students' education or career decisions.

At first glance, it may seem logical that society and regulators do not want investors who enter into ISAs with students to have any rights over students' actions. I challenge this surface-level assumption. The remainder of this Note presents that blanket noninterference clauses should not be mandated. Instead, it suggests that investors and students should be allowed to enter into contracts that give investors control over students' actions.

III. ANALYSIS OF GIVING INVESTORS CONTROL

Part II explores the benefits and concerns that accompany investor-control ISAs. This Part demonstrates how students who enter into ISAs can benefit from an ISA that gives investors control and that investor-control ISAs provide solutions to problems currently inhibiting ISAs from becoming widely utilized by students. It also highlights the two primary concerns with giving investors

43. See Investing in Student Success Act of 2017, S. 268, 115th Cong. (2017); Investing in Student Success Act of 2014, H.R. 4436, 113th Cong. (2014).

44. Knoll, *supra* note 36.

45. S. 2114; see also Andrew Kreighbaum, *Senators Push Alternative to Student Loans*, INSIDE HIGHER ED (July 17, 2019), <https://www.insidehighered.com/news/2019/07/17/senate-lawmakers-introduce-bill-spur-growth-income-share-agreements>.

46. S. 2114.

47. *Id.*

48. *Id.* § 102(c); S. 268 § 103(c); H.R. 4436 § 102(d).

49. See S. 2114 § 102(c).

50. See *ISA Sample Contract*, PURDUE RSCH. FOUND., <https://www.purdue.edu/backboiler/disclosure/contract.html> (last visited Sept. 14, 2020) (“[An ISA] represents your obligation to pay a specific percentage of your future earned income and does not give us any rights regarding your educational, training, or employment pursuits.”).

control over students and shows that these concerns should not prohibit investor-control ISAs from being offered.

A. Benefits of Giving Investors Control Over Students

Students who choose an ISA over other education finance options consistently come from low-income families and are first-generation college students.⁵¹ Students whose parents did not attend college often face significant challenges. In a 2018 report, the U.S. Department of Education released the following statements regarding first-generation students:

A considerable body of research indicates that students whose parents have not attended college often face significant challenges in accessing postsecondary education, succeeding academically once they enroll, and completing a degree. When they do enroll, first-generation students cannot benefit from their parents' college-going experience—a valuable source of cultural capital that helps students navigate college (e.g., understanding the significance of the syllabus, what “office hours” means, or how to cite sources in written assignments). This lack of cultural capital negatively affects even those first-generation students who are academically well prepared for college. Many first-generation students are also at greater risk of not persisting in or not completing credential programs because of such challenges as being less well prepared academically, having children of their own, and working full time while enrolled. In addition, first-generation students often possess other demographic and enrollment characteristics (low socioeconomic status and lower enrollment intensity, among others) that are associated with dropping out. All of these factors and interactions among them increase first-generation students' risk of failing to persist in postsecondary education relative to that of many of their continuing-generation peers.⁵²

As a result, “ISA participants report that their parents are less involved in their college-related . . . decisions.”⁵³ Simply put, ISA students tend to come from families who likely support their children in their educational efforts but do not have the knowledge or ability to help their children seeking higher education. Thus, first-generation college students, the primary user of ISAs, often lack the guidance to make the best decisions for their careers but generally have the same ability to succeed as other students.⁵⁴ Persons who choose to

51. Mumford, *supra* note 12, at 24 (“Fathers of participants [of ISAs] are less likely to have graduated from college and correspondingly, parents of ISA participants have lower income. The nonparticipants believe that their parents are more willing to take on debt incurred by the student, and correspondingly the parents have more influence on the student’s finances.”); *see also* AUDREY PEEK ET AL., AM. INST. FOR RSCH., THE INCOME SHARE AGREEMENT LANDSCAPE: 2017 AND BEYOND 3 (Apr. 2017) (stating that first-generation students who are uncomfortable with debt comprise over half of the students interested in ISAs).

52. EMILY FORREST CATALDI ET AL., U.S. DEP’T. OF EDUC., FIRST-GENERATION STUDENTS: COLLEGE ACCESS, PERSISTENCE, AND POSTBACHELOR’S OUTCOMES 2 (2018) (citations omitted).

53. Mumford, *supra* note 12, at 24.

54. *See* CATALDI ET AL., *supra* note 52.

invest in students through ISAs can help fill the gaps that some parents of students who choose ISAs cannot fill.

ISAs that give investors control have the potential to thrive with first-generation students. In general, ISA investors have a “meaningful stake in the success or failure of the [students they invest in].”⁵⁵ This meaningful stake stems from ISA investors only making a return on their investment if the students they invest in are successful.⁵⁶ If their students do not work or are not reaching their full potential, investors will not earn as much money as they could otherwise. As such, “[s]ince investors and students share common goals—high academic performance, successful completion of a college degree, comfortable earnings, and financial security— . . . investors may feel pressure to provide additional assistance to ensure the students’ realization of these goals.”⁵⁷

Investor-control ISAs increase this pressure on investors. If investors have more control over students, they will likely feel more of a heightened sense of responsibility than traditional ISA investors to help their students succeed because of the power they have over the students they invest in.⁵⁸ Because investors would have a heightened sense of responsibility for the successes or failures of the students they invest in, investors that provide investor-control ISAs are more likely to provide guidance and career opportunities for students than investors that provide traditional ISAs.⁵⁹ Since most ISA students are first-generation students with little higher education experience, investor-control ISAs would provide students with resources they otherwise would not have access to.⁶⁰

Because investors have more interest in student success with an investor-control ISA, investors would likely be incentivized to help students in ways that other, more traditional, lenders are not. This would prove to be beneficial for first-generation students whose parents cannot provide the support that those students need to succeed. Thus, giving investors control over the students would give first-generation students a higher chance of success.

Further, giving investors control over students diminishes adverse selection and moral hazard risks. In general, adverse selection and moral hazard problems are two of the primary reasons that ISAs concern lenders and why ISAs are not

55. Oei & Ring, *supra* note 7, at 740.

56. *Id.*

57. Timothy Machat, Note, *Catalyzing Innovation with Regulation: Income Share Agreements and the Student Debt Crisis*, 70 RUTGERS L. REV. 257, 275 (2017).

58. See Leigh Plunkett Tost, *When, Why, and How Do Powerholders “Feel the Power”? Examining the Links Between Structural and Psychological Power and Reviving the Connection Between Power and Responsibility*, 35 RSCH. ORGANIZATIONAL BEHAV. 29, 45–46 (2015) (describing that with power comes responsibility, and with responsibility comes a social burden for others’ outcomes).

59. Machat, *supra* note 57, at 275 (“In financing their education in this unique, debt-free way, students are also potentially linking themselves with a network of support they otherwise may not have had access to.”).

60. *Id.*

entered into as frequently by students.⁶¹ Scholars have drawn similarities between ISAs and insurance in that both carry with them a risk of adverse selection and moral hazard problems.⁶² These risks pose as barriers to ISAs growing in the education sector.⁶³ Because of adverse selection and moral hazard issues, investors demand a higher percentage of students' future earnings.⁶⁴ Thus, students with relatively safe job prospects may view the price of an ISA as too high and opt out, leaving those students with fewer options to finance education costs and investors with only students who have uncertain future earnings.⁶⁵

Adverse selection exists in education ISAs because of information asymmetry between the investor and student.⁶⁶ The price of an ISA is based on students' future earnings, which students provide to the investors when they form ISAs.⁶⁷ As a result, students who pursue a degree in finance will likely pay a lower percentage of their income than students who pursue a degree in education.⁶⁸ Since it is fairly simple for students to change their major, investors are presented with the risk of contracting with students who, for example, fully plan to become teachers but pretend to seek careers in banking at the time they form the agreement in order to receive an ISA demanding a lower percentage of their future income.⁶⁹

The risk of student dishonesty causes investors to distrust what students indicate as their future career plans and to determine a percentage of future income as if all students plan to seek low-income careers, regardless of what the students say.⁷⁰ As such, "[s]tudents who have information that would lead investors to place a higher estimated value on the student's future earnings would find [ISAs] expensive, and, conversely, students who have information that would lead investors to lower their expectations of the student's future earnings would find [ISAs] cheap."⁷¹ If adverse selection is present in the ISA sector, then only students with low prospects of high-income-grossing careers will pursue ISAs and students with high prospects of high-income careers will opt for traditional student loans. Thus, because investors' profits are contingent

61. Oei & Ring, *supra* note 7, at 726.

62. *Id.* at 725–26.

63. Jeff Schwartz, *The Corporatization of Personhood*, 2015 U. ILL. L. REV. 1119, 1147 (2015).

64. *Id.*

65. *Id.*

66. Miguel Palacios, *Human Capital Contracts: "Equity-Like" Instruments for Financing Higher Education*, 462 POL'Y ANALYSIS 1, 9 (Dec. 16, 2002).

67. David Bornstein, Opinion, *A Way to Pay for College, with Dividends*, N.Y. TIMES (June 2, 2011), <https://opinionator.blogs.nytimes.com/2011/06/02/a-way-to-pay-for-college-with-dividends>.

68. *Id.*

69. *Id.*

70. Oei & Ring, *supra* note 7, at 707.

71. Palacios, *supra* note 66, at 9.

on the salary of students when they graduate, investors will have little or no incentive to create ISAs with students.

To further these concerns, even if a student does enter into an ISA with high motivation and pursuing a high-income career, there is the possibility of a moral hazard. Economic theory suggests that “ISAs create a disincentive by lowering the marginal return to effort for participating individuals.”⁷² That is, because individuals are not receiving the total benefit from their efforts, they may choose to exert less effort and not reach their full potential.⁷³ A moral hazard in the education ISAs context exists if a student who is studious or pursuing a lucrative career becomes less studious or chooses a less lucrative career *because* they enter into an ISA.⁷⁴ If moral hazard issues are present in the education ISA sector, investors will demand a higher percentage of future income from students. As such, the higher percentage of future income will decrease the number of students willing to enter into an ISA.

Concerns of both moral hazards and adverse selection in education ISAs are solidified in a study of current students enrolled in ISA programs.⁷⁵ Researchers found that the percentage of students who earned As is significantly larger among students who did not enroll in an ISA than among students who did enroll in an ISA.⁷⁶ Further, the study found that the portion of students using ISAs who earned Cs is significantly larger than students not using ISAs who earned Cs.⁷⁷ This study indicates that there is evidence of adverse selection and moral hazard problems and that “only individuals who are expected to earn less or perform worse at school select into ISAs.”⁷⁸

Allowing investor-control ISAs will alleviate investor concerns of moral hazard and adverse selection. With control, investors can mandate that students with inadequate grades attend tutoring sessions or log a certain amount of study hours each week at their universities. While this may not guarantee success, an investor is able to guarantee that the student is putting forth effort. Since part of the issue with the moral hazard and adverse selection problem is students taking their grades and school performance less seriously, a mandated amount of study time per week will force students to take their school performance more seriously and incentivize them to work harder.

72. Greg Madonia & Austin C. Smith, *All-In or Checked-Out? Disincentives and Selection in Income Share Agreements*, 161 J. ECON. BEHAV. & ORG. 52, 53 (2019).

73. *Id.*

74. Oei & Ring, *supra* note 7, at 726 (describing moral hazard as “the worry that insureds will behave badly because they feel protected against risk[and a] feature[] of most insurance schemes”).

75. See Maria Claudia Soler, *International Evidence on Income Share Agreements: Perceptions and Characteristics of ISAs Recipients* (Aug. 12, 2020) (unpublished paper) (on file at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3452929).

76. *Id.* at 21.

77. *Id.*

78. *Id.* at 10.

Further, investors can direct that students continue with the career path they chose when they entered into the ISA with the investor. As such, investors and students are given more certainty and predictability because there would be little risk of students being able to change their field of study after they make their agreement with the investor. Investors could also dictate what jobs the students apply for and what jobs the students accept, further increasing certainty and predictability. This increase in certainty and predictability would lead to investors being more willing to enter ISAs that mandate a lower percentage of students' future income. Thus, as the percentage of future income demanded by investors decreases, ISAs will become feasible for more students and provide more students with alternatives to traditional student loans.

Since adverse selection and moral hazard risks will decrease with investor control, the percentage of future income that investors will demand from students' pay will likely decrease. "Accurately pricing [ISAs] is imperative to the instruments' economic success, for [ISAs] 'work best to finance education where there is some predictability about students' future salaries . . .'"⁷⁹ As such, "[t]he salaries [of students] don't have to be high, just reasonably predictable."⁸⁰ Giving investors control over students with ISAs makes the salaries of students reasonably certain and predictable.

Investors having control over investees gives more predictability and certainty than currently offered ISAs. Investor control also ensures that students continue to put effort into their studies and that students continue to seek the type of job agreed upon in the ISA. By giving investors control over students they invest in, the risks associated with adverse selection and moral hazards—an increase in the price of ISAs and a decrease in the number of students willing to opt for an ISA—are diminished. Simultaneously, investors are incentivized to provide students with opportunities and information to succeed during and after college, resources they would otherwise lack. As such, students would have an agreement that accurately reflects the earning prospects of their chosen field of study.

B. *Concerns with Giving Investors Control Over Students*

Giving investors control over students raises concerns of indentured servitude and harmful investor incentives.⁸¹ Critics of ISAs have continued to voice their worries over ISAs being a "modern form of indentured servitude."⁸² Scholars have written on indentured servitude in the ISA context, but most have operated under the presumption that, in an ISA, an investor does not have

79. Kapadia, *supra* note 24, at 611.

80. Bornstein, *supra* note 67.

81. See Archie Hall, *Shares in Students: Nifty Finance or Indentured Servitude?*, FIN. TIMES (Nov. 11, 2019), <https://www.ft.com/content/46827e2a-f990-11e9-a354-36acbbb0d9b6>.

82. Oei & Ring, *supra* note 7, at 714–15.

control over a student's actions.⁸³ Admittedly, giving investors the right to interfere with students' career choices raises Thirteenth Amendment concerns over whether ISAs qualify as indentured servitude.⁸⁴

The Supreme Court of the United States defines indentured servitude as a "situation[] in which labor is compelled by physical coercion or force of law."⁸⁵ Although investor-control ISAs could require labor, it is not "compelled by physical coercion or force of law." While it could be argued that an investor requiring a student to accept a job or to apply to a certain number of jobs a week is compelled by force of law, it is likely not the force of law the Court was referring to. "In the Court's eyes, [the phrase "compelled by force of law"] makes it illegal for the government to force someone to work on threat of criminal sanction."⁸⁶

In *Bailey v. Alabama*, the Supreme Court dealt with a contract similar to an ISA.⁸⁷ In *Bailey*, the plaintiff received fifteen dollars from a company, and in exchange, for one year the plaintiff agreed to work for the company as a farmhand on its farm for a reduced payment of twelve dollars per month.⁸⁸ There, the Court held that it was unconstitutional under the Thirteenth Amendment for criminal sanctions to be imposed upon the plaintiff if he failed to work as a farmhand for a year; however, the Court found no issue with the plaintiff agreeing to work for one year at a decreased pay of twelve dollars in exchange for an initial payment of fifteen dollars.⁸⁹ Similarly, ISAs that allow investors to compel labor are not enforced with the threat of criminal sanctions.⁹⁰ While an ISA is a legally binding contract, it cannot force a student to perform.⁹¹ If students decide to breach their ISAs, specific enforcement of the agreements will likely be denied and damages will be the only available remedy for investors. A breach of an investor-control ISA brings no possibility of criminal sanctions.

Further, even if damages were not the only available remedy, investors cannot force the students they invest in to conduct successful interviews or to perform well at their jobs. For example, if an investor chooses three jobs for the student to interview for and the student does not wish to do any of the jobs, the student could purposely do poorly in the interview to ensure he will not be offered the job. Similarly, if an investor chooses a job for a student to accept

83. See Schwartz, *supra* note 63, at 1135.

84. *U.S. v. Kozminski*, 487 U.S. 931, 943 (1988).

85. *Id.*

86. Schwartz, *supra* note 63, at 1136–37 (citation omitted).

87. 219 U.S. 227, 227–29 (1911).

88. *Id.* at 229.

89. *Id.* at 244–45.

90. Schwartz, *supra* note 63, at 1137.

91. *Id.*

and the student strongly dislikes the job, the student can purposely show a bad work ethic on the job and be dismissed.

The lack of criminal repercussions for students who violate their ISAs and the fact that investors cannot force students to perform well at work or in interviews decreases concerns that an investor-control ISA is a form of modern indentured servitude. However, concerns over the control investors have through investor-control ISAs being a form of indentured servitude are not fully mitigated. Allowing investors control over students still poses a risk of appearing as indentured servitude.

Another possible concern in investor-control ISAs is that investors will only be incentivized to aid students in succeeding in the short-term and will not prioritize a student's long-term quality of life. Investors generally gain a percentage of students' incomes for ten years or fewer. As a result, investors could be incentivized to make students take jobs that bring the highest return in the short-term and not jobs that are in the students' best interests for the duration of their professional lives.

Consider a student who has an investor-control ISA with a term of eight years and two job opportunities when she graduates college. Job one is an entry-level position with a low salary, but the job presents her with the possibility of gaining promotions within the company that would provide much higher salaries as her career progresses. On the other hand, job two is an intermediate-level position with a mid-range salary, but the job has no possibility of any promotion or career progression. The student would likely see job one as her best option for a long-term career and want to accept that position; however, the investor would see job two as the best option because the student only gives the investor a percentage of her income for eight years. In this scenario, the investor is incentivized by the short-term higher salary prospects and not the long-term job prospects.

This risk of harmful investor incentives may be mitigated by investors' interest in the students' happiness. Happiness makes people more productive in the workplace.⁹² Further, higher productivity is often linked to higher salaries.⁹³ Thus, investors who have control over the students they invest in will likely want the students to be happy. The happier the student is, the more likely the student is to have a higher salary. If this is the case, investors will likely choose the career option that will make the student happiest.

Although some investors may want students to be happy in their job, there is a possibility that not all investors will consider students' happiness. Thus, it is still a risk that investors would focus solely on students' short-term interests and not students' long-term career interests. Due to concerns over ISAs being

92. Andrew J. Oswald et al., *Happiness and Productivity*, 33 J. LAB. ECON. 789, 806 (2015).

93. *Id.* at 793.

a form of indentured servitude and misplaced investor incentives, regulators will likely have to place limitations on investor-control ISAs.

IV. PRACTICAL IMPLEMENTATION OF INVESTOR-CONTROL ISAS

Critics of ISAs state that ISAs, especially those that give investors control over students, are impractical.⁹⁴ Undoubtedly, skeptics of investor-control ISAs will argue that regulators will never allow such an agreement to be created. Admittedly, the allowance of unfettered investor control is likely impractical. If left unfettered, investors could treat students as human assets and validate the concerns analyzed in Part II. As such, regulators must limit the rights investors have over students. This Section presents the limits needed for investor-control ISAs to be feasible. It then disproves the theory that investor-control ISAs are too radical for regulators to permit by comparing an investor-control ISA, with my proposed limits, to current federal student loans being offered. This comparison shows that an ISA with my proposed limitations is more practical and has a less drastic effect on students than traditional student loans.

A. Limitations Needed to Make Implementation Feasible

This Note does not advocate that investors should have a Portland “IPO Man” ability of control over students.⁹⁵ Instead, this Section demonstrates that giving investors *limited* control would be beneficial for both the investor and the investee. The following limits on investor-control ISAs create an investor-student relationship that is mutually beneficial: (1) a limited subject matter of a student’s education that an investor can have control over; (2) a maximum number of years the investor has limited control over a student; (3) a limited geographic region an investor can demand a student accept a job in; and (4) investor-control ISAs are nontransferable. All four limits are explained in detail below.

First, regulators should limit the ability of students to delegate control to investors by setting parameters on the subject matter of students’ lives that an investor can dictate. If regulations are not in place, an investor could theoretically control aspects of students’ lives that correspond very little to the ISA students signed. For example, investors could dictate what students eat,

94. See *Income Share Agreements: A Crazy Alternative to Student Loans*, RAMSEY SOLUTIONS, <https://www.daveramsey.com/blog/income-share-agreements> (last visited Sept. 14, 2020).

95. In the case of Portland’s “IPO Man,” Mike Merrill offered “shares” of himself and allowed investors to purchase those shares. Oei & Ring, *supra* note 7, at 699. Each investor who purchases shares gets a potential return on profits earned outside of Merrill’s day job. *Id.* Since he did so, investors have controlled many aspects of his life. For example, shareholders have decided “(1) whom Merrill should date, (2) that he must register as a Republican, (3) that he should become a vegetarian, (4) that he should stop sleeping through the night, and (5) that he should not get a vasectomy.” *Id.*

how they vote, or who they have relationships with. Thus, regulators need to provide boundaries on the interference investors can have.

Investors should only be able to control choices and actions that involve job applications and jobs that are within the student's chosen field of study when the ISA was created. If implemented, investors would not be able to demand that a student apply for and accept a job that is outside of their field of study. Regulators should further limit the interference an investor can have on students while they are in school. The only control an investor should have over students while they are in school is in the form of tutoring or study hours. In this situation, an investor could not demand that students change their major or school but could demand that students spend a certain amount of time studying or in tutoring each week. While there are issues of enforceability with studying and tutoring hours, as discussed earlier, contract law will likely provide remedies to investors.⁹⁶ These boundaries substantially limit the amount of control an investor can have, which will diminish fears of investor-control ISAs being a form of indentured servitude.

Second, regulators must limit the amount of time an investor can interfere in students' careers. There is little predictability for what happens to students throughout their lives. This uncertainty in students' lives can make an investor-control ISA less appealing for students because they could feel as if they are bound to the will of their investors.⁹⁷ Therefore, regulators need to set a maximum amount of time investors can have control over students' actions to give students assurance of the agreements' end and to make the agreements less like indentured servitude.⁹⁸ The less time investors have control over students, the less likely it is to be compared to indentured servitude.

The average ISA extends for ten years; however, an investor's control over a student's career does not have to extend that long. All proposed Congressional regulations on ISAs have set a maximum number of years an investor may receive a percentage of a student's income.⁹⁹ I propose that regulators further provide a maximum number of years investors can have control over the student. A sensible amount of time would be while the student is in school, approximately three years, and three years following the date of their graduation, but not exceeding six years.¹⁰⁰ If regulators impose a time limit

96. Schwartz, *supra* note 63, at 1137 n.140.

97. *Id.* at 1171.

98. *Id.* at 1154 ("The longer the [ISA], the more commodifying it is.").

99. ISA Student Protection Act of 2019, S. 2,114, 116th Cong. § 102(a)(4)(A) (2019); Investing in Student Success Act of 2017, S. 268, 115th Cong. § 103(a)(5) (2017); Investing in Student Success Act of 2014, H.R. 4436, 113th Cong. § 102(a)(4)(A) (2014). Scholars also say that term limits reduce the risks of commodifying the students as human assets. Schwartz, *supra* note 63, at 1171.

100. A maximum of six years is preferred because a second-year student entering into an ISA generally has three more years of undergraduate studies. A maximum of six years accounts for three years in school and three years after graduation. *See also* Schwartz, *supra* note 63, at 1171 (recommending that, if investors are given control, control is limited to five years).

on investor interference, it decreases concern over investors having control and ensures that the control is “relatively short-lived.”¹⁰¹ It also decreases the possibility of harmful short-term investor incentives by limiting the amount of time the investor incentives can affect students.

Third, for investor-control ISAs to be feasible, regulators must limit the geographic area an investor can make a student apply to and accept jobs in. Without a limit on geographic area, investors could force recent graduates to travel thousands of miles away from their families and friends for a career. For example, an investor could force a recent graduate from South Carolina to apply for and, if offered, accept a position in California—an area where the student may have no ambition to live.

To mitigate these concerns, I recommend regulators mandate that students entering into ISAs give investors a specific geographic region that each student would prefer to stay in after graduation. An investor would only be permitted to require that students apply to or accept jobs within that region. This limit would still allow students to pursue other jobs outside of their chosen region. This proposal only limits where an investor can dictate a student must go. As a result, this limit gives students entering into investor-control ISAs comfort that investors will not force students to move to an area they do not wish to live, diminishing the appearance of indentured servitude.

Lastly, if students are going to give control to investors, they should know whom they are giving control to. Therefore, regulators should make investor-control ISAs nontransferable unless the student agrees to the transfer. Under traditional contract law principles, there is little to prevent investors from transferring the rights they possess in an ISA to other investors.¹⁰² Critics of traditional ISAs have indicated that, when investors are allowed to trade and transfer their rights to ISAs, ISAs tend to commodify students and resemble shares in people being traded like stocks.¹⁰³ This critique intensifies when the transfer of an ISA includes the ability to control students’ actions.

Thus, regulators must place limits on the ability of investors to transfer their rights and interests in an ISA to another investor. I propose that regulators bar investors from transferring an investor-control ISA if the student does not agree to the ISA being transferred. Doing so ensures that students know who they contract with when creating an ISA and who will have certain rights in their lives. This regulation also reduces the resemblance of students being traded between investors like stock, decreasing the appearance of ISAs being a form of indentured servitude.

The limits proposed above may not fully diminish all concerns over investor-control ISAs. However, the limits do substantially diminish the risks

101. *Id.* at 1171.

102. Schwartz, *supra* note 63, at 1173.

103. Machat, *supra* note 57, at 268.

of being a form of modern servitude and harmful investor incentives. By diminishing these risks, investor-control ISAs become more feasible and practical to implement.

B. Investor-Control ISAs Compared to Federal Student Loans

Giving investors control over the students they invest in may seem radical; however, there is little difference between an ISA investor being able to demand a student find work and the federal student loan agreements students currently sign. As discussed below, federal student loans likely place more pressure on students to find jobs than investor-control ISAs. And when compared to federal student loans, investor-control ISAs should not be seen as radical and impossible to implement.

Currently, federal student loans such as Direct Subsidized Loans, Direct Unsubsidized Loans, Subsidized Federal Stafford Loans, and Unsubsidized Federal Stafford Loans have a six-month grace period.¹⁰⁴ This means that students have six months after graduation until they must begin paying the fixed amount set by their loan repayment plan. As a result, regardless of whether students can find a job or not, they have to begin making payments after their six-month grace period. Additionally, PLUS loans, the primary student loans that ISAs aim to replace, have no grace period and must be repaid once they are fully disbursed.¹⁰⁵ The fact that payments on federal loans are due within six months after graduation indirectly forces students to take jobs they would not otherwise take.¹⁰⁶

Harsh repercussions of defaulting on their loans force students to take unwanted jobs. When student loans become due, students *must* begin making payments.¹⁰⁷ If students do not make payments, they are faced with the possibility of defaulting on their loans.¹⁰⁸ Defaulting on student loans produces severe consequences for students that can have lasting impacts on their lives.¹⁰⁹ A default on a student loan can ruin a student's credit score, which then harms the student when applying to jobs that check applicants' credit scores. It can also, depending on the state, lead to students losing their professional licenses, driver's licenses, recreational hunting licenses, or any other state-issued

104. *Student Loan Repayment*, FED. STUDENT AID, <https://studentaid.ed.gov/sa/repay-loans/understand#grace-period> (last visited Sept. 14, 2020).

105. *See id.*; Machat, *supra* note 57, at 280 (“[ISAs are] an alternative to private loans and public loans such as Parent PLUS.”).

106. *See* Kevin J. James & Rooney Columbus, *No, Income Share Agreements Are Not Indentured Servitude*, AM. ENTER. INST. (Feb. 6, 2015), <https://www.aei.org/publication/income-share-agreements-indentured-servitude/> (“Compare [ISAs] to traditional loans where students are on the hook no matter how things turn out and how burdensome loan payments may be.”).

107. Machat, *supra* note 57, at 270–71.

108. *Id.*

109. *Id.*

licenses.¹¹⁰ Faced with quickly approaching federal loan payment deadlines and severe consequences of failing to make payments, students often accept jobs that they otherwise would not choose to accept.¹¹¹ While there is no one *directly* controlling students or telling students to accept a job they would not want, the ramifications of defaulting on federal student loans *indirectly* force students to accept a job quickly after graduation.¹¹²

Investor-control ISAs with my limitations give more freedom to students than current federal loans.¹¹³ Unlike traditional student loans, ISAs do not produce any risks or concerns of defaulting for students.¹¹⁴ Students with ISAs who are unable to find a job after graduation do not have any fears of missing upcoming loan payments because a percentage of income repays ISAs.¹¹⁵ If there is no income, there is no payment. As such, students do not have to fear damaging their credit score, losing their professional licenses, losing driver's licenses, or losing any other state licenses. Because there is no possibility of defaulting on an ISA and, in turn, no possibility of the severe consequences that accompany defaulting, students are not forced to accept a job that has no connection with their chosen field of study or a job that they find undesirable. Investor-control ISAs allow students to search for and find a job that falls within their academic discipline.

While investors do have some control over a student's occupation, with the limits introduced above, students will not be forced to take any job that presents itself to begin paying their investor back because an ISA is not debt. Students with investor-control ISAs are not forced to take any job outside of their location preference or chosen occupational field. Investors can only demand students accept jobs that are within their chosen locations and career fields, and although investors can dictate how many jobs students can apply for, they cannot threaten to harm students' credit scores or take away any professional license. As a result, if students who opt for an investor-control ISA can financially support themselves without finding a job in their chosen location and field, there are no consequences for not finding a job within six months.

110. Andrew Wagner, *License Suspension for Student Loan Defaulters*, NAT'L CONF. OF ST. LEGISLATURES LEGISBRIEF, Oct. 2018, at 2. At least fifteen states have some form of law that revokes licenses when a person is in default on student loans. *See id.* Currently eight states have laws requiring all occupational boards to revoke licenses for defaulting on any federal or state education loan. *Id.* Five states revoke the healthcare professionals' licenses for defaulting on education loans, and two states revoke *all* state-issued licenses. *Id.* However, it appears that states are becoming less willing to revoke licenses for default. *Id.*

111. Machat, *supra* note 57, at 271.

112. *Id.*

113. *See* Palacios et al., *supra* note 5, at 10 (“[A] traditional, fixed-payment student loan, particularly one that is extremely difficult to discharge in bankruptcy, more severely restricts a student’s freedom than an ISA.”); Machat, *supra* note 57, at 270-71 (“While some may erroneously argue that ISAs constitute a form of . . . indentured servitude, it is ironically the traditional lending model that currently shackles the nation’s young adults.”).

114. Palacios et al., *supra* note 5, at 3.

115. *Id.*

Both investor-control ISAs and federal student loans control students who opt for either. Federal student loans simply control students in a different manner, by controlling students indirectly with threats of damaging their credit score or losing their professional licenses. However, unlike federal student loans, ISAs that give limited control to investors offer more flexibility and give students the freedom to find a job in their chosen field of study. The consequences imposed upon students who default on federal student loans and the increase in flexibility that investor-control ISAs provide to students show that it is feasible, not radical, for regulators to allow investor-control ISAs.

CONCLUSION

ISAs are becoming a more appealing option for students than traditional student loans. As ISAs become more appealing, the need for regulations increases. Therefore, regulators should analyze the effects of guidelines they propose to put in place to ensure that ISAs remain a viable alternative to student loans. An analysis of blanket noninterference clauses shows that students should be allowed to give control to investors if they wish to do so.

Investor-control ISAs are more beneficial to first-generation students than traditional ISAs. They also decrease issues of moral hazards and adverse selection. While there are risks of harmful investor incentives and appearances of indentured servitude, with the limitations discussed above, these risks can be significantly minimized. Further, limited investor-control ISAs provide students with more flexibility and give students more control of their careers than traditional federal student loans. Although investor-control ISAs give investors the right to interfere in students' decisions, as shown above, they are not as controlling and do not carry as severe of consequences as student loans. Thus, given the benefits of investor-control ISAs for both students and investors, regulators should not mandate blanket noninterference clauses in all ISAs.

John Gillespie