SPECIAL REPORT

Selling Career Colleges Short

By Mark Hyman on 3.31.11 @ 6:08AM

Seemingly, there is no end to what once started as a relatively straight-forward story. The U.S. Department of Education embarked on an effort to impose new regulations that would severely restrict access to various federal loans and grant programs to students attending career colleges. Unlike state-owned public institutions and private, not-for-profit colleges, career colleges operate on a for-profit basis.

Since last autumn, this Dept of Ed effort to malign career colleges (or for-profit colleges) has been detailed in *The American Spectator* on several occasions (October 6, 2010; December 1, 2010; December 14, 2010; and January 18, 2011).

Recently revealed information suggests there may have been a financial motive involved in the Department of Education rulemaking.

Emails and related correspondence obtained from a series of Freedom of Information Act requests suggest stock market short-sellers including at least one who was a major donor to the 2008 Obama campaign had unusually strong involvement in the Ed Dept's process of crafting new regulations impacting career colleges. Advance knowledge of the agency's intention to write harsh regulations would benefit anyone shorting career college stocks with the expectation stock prices would plunge.

In late 2009, stock short-sellers Antal R. Desai and R. Kent McGaughy, Jr. of Dallas-based CPMG Investments met with Deputy Assistant Secretary of Education David Bergeron and senior Ed Dept official Ann Manheimer. Desai and McGaughy presented the two government officials with a 17-page document that severely criticized the career college sector. The document outlined recommended steps to be taken against career colleges to include actions by specific Congressional committees and an investigation to be conducted by the Government Accountability Office.

Neither Desai nor McGaughy were known for having expertise on the subject of post-secondary education. They brought little to the discussion aside from a game plan that, if implemented, could significantly degrade the value of publicly-traded stocks of for-profit colleges.

By the following year the key objectives outlined in the Desai/McGaughy document were met.

The Senate Health, Education, Labor and Pensions Committee chaired by Senator Tom Harkin (D-IA) held hearings that slammed career colleges. Harkin had also become a personal critic of such schools. For its part, the GAO conducted an investigation and issued a blistering report on career college practices.

Beginning in August 2009 and continuing for nearly a year, emails were frequently exchanged between Desai and McGaughy and Bergeron, Manheimer and other senior Ed Dept officials on the topic of career colleges. Even Lee Godwon of Public Strategies, Inc., the lobbyist for CPMG, got into the act by arranging follow-on meetings between the short-sellers and senior Ed Dept officials.

In early 2010 Desai forwarded a nine-page document to Bergeron and Manheimer that addressed specific points Desai would like to see included in new regulations affecting for-profit colleges. Points addressed in the Desai document bear striking similarity to the proposed rule that was eventually released by the Department of Education.

By the spring of 2010, Manheimer had requested Desai provide her with negative "anecdotes or... examples" of practices the Department could use against career colleges. Desai responded with a claim that career college recruiters were frequenting homeless shelters and "systematically and deceptively recruiting the homeless with empty promises [of college degrees]." Desai then emailed ten pages of anecdotes alleging improprieties by career college recruiters.

Adding fuel to the fire was a joint letter signed by directors of several homeless shelters alleging career college recruiters were targeting the homeless. The letter, which was addressed to Education Secretary Arne Duncan, was fodder to further discredit career colleges. After the letter became public, several shelter directors stated they were misled regarding the intention of the letter and expressed regret for having signed it. Some denied having any first-hand knowledge of the alleged recruiting practices. They also did not know that the woman who coordinated the letter was actually working for Desai.

In mid-April, Desai forwarded to Manheimer an investment research report titled "Early Glimpse of Gainful Employment Regulations Ignites Rally" that suggested the rulemaking "will be considerably milder than originally believed." In other words, the value of career college stocks were on the rise as the sector was viewed as having dodged a bullet. Desai asked Manheimer in his email "Is this reporting correct?"

Only days later articles began appearing in publications claiming career colleges were engaging in unethical recruiting practices. This suggests the Ed Dept may have been reacting to and using the material generated by Desai to publicly discredit for-profit colleges.

It turns out that Desai and McGaughy were not the only short-sellers working with the Department of Education on the new rules for career colleges.

Steven Eisman is the portfolio manager for the FrontPoint Financial Services Fund, a hedge fund. Eisman gained celebrity when his success as a stock short-seller was chronicled in the book *The Big Short*. He was also a major donor to the 2008 Obama campaign.

In his prepared text before the 2010 Ira Sohn Conference in New York, Eisman delivered stinging remarks regarding career colleges. Eisman attacked the for-profit college industry

and predicted new regulations under consideration at the Department of Education -- including one titled "Gainful Employment" -- could drive down the stock prices of publicly-traded for-profit colleges by as much as fifty percent.

A precipitous fall in stock prices would occur only two months later.

On July 19, 2010, Eisman sent an email to David Bergeron. The subject line was "I know you cannot respond." The email read, "But just fyi. Education stocks are running [increasing in value] because people are hearing DOE is backing down on gainful employment."

The email trail reveals that only minutes later Bergeron forwarded Eisman's email marked "high" importance to other senior officials in the agency. Moments after that, the email was again forwarded by Deputy Undersecretary James Kvaal to Phil Martin, the confidential assistant to Education Secretary Duncan, with a simple "Let's discuss."

The following day (July 20), Kvaal sketched out a plan in which he and Bergeron would call several individuals and entities apparently to inform them of the soon-to-be released Education Department regulations.

In his reply Bergeron wrote, "Also there's the Eisman/Schluman [sic]/et al but Eisman is a short seller anyway you cut it and anything you tell Schulman gets to Eisman." Diane Schulman is a partner of the Indago Group. The Indago Group is a research firm that serves clients in several fields including the investment community. Schulman had been working for Eisman and accompanied him on several meetings with Dept of Ed officials in the months leading up to the agency's proposed regulations.

Documents suggest the people on this list were notified two days before the new rules were publicly released.

The proposed rules were released to the public on July 23, 2010. On August 4, Harkin's Senate HELP Committee held a hearing that skewered career colleges. The most damning testimony came from Gregory D. Kutz. He was the managing director of the Forensic Audit and Special Investigations team for the Government Accountability Office.

Kutz's testimony included the submission of a 28-page report detailing an undercover sting of career college recruiting practices in which GAO investigators posed as applicants. Kutz testified that recruiters at all 15 colleges tested made deceptive or otherwise questionable statements to the GAO undercover investigators. Further, Kutz claimed four colleges encouraged fraudulent practices.

The triple whammy of the Harkin hearing, Kutz's testimony, and the proposed Department of Education rules occurred within days of one another. The result was calamitous for career colleges. For-profit college stock prices plummeted. Many of the publicly-traded companies saw the value of their stocks decline as much as 35-50%. No doubt this would have been deeply disturbing to most investors. On the other hand, short-sellers anticipating such a drop could have made an absolute killing in the market.

Post Script

Close examination of the GAO report submitted by Kutz to the Harkin hearing and detailed in

The American Spectator (October 6, 2010) resulted in a FOIA request by this columnist. The GAO was less than forthcoming in the answering all questions. However, it did quietly revise the original report and replaced it on the GAO's website without public notice.

The revised report included changes that were so dramatic that it called into question either the competence or the integrity of the GAO. This development was enough to lead to FOIAs filed with the Department of Education. It also led to further examination of the GAO report.

A coalition of for-profit colleges obtained all available electronic recordings of the GAO undercover investigation and had them analyzed by a third party. The results of the analysis were damning: For the GAO. The analysis found numerous instances in which the GAO fabricated entire conversations. Further, the GAO studiously ignored statements in the exchanges between recruiters and GAO investigators that portrayed career college recruiters as acting professionally and responsibly. The GAO report could be viewed as completely fraudulent.

In March 2011, U.S. Comptroller General Gene Dodaro relieved Kutz of his duties as the head of the GAO's Forensic Audit and Special Investigations unit. In a written statement, Dodaro said the change will "ensure greater attention to the issues that led to the need to produce the errata to the for-profit schools report and by the subsequent inspection."

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