

March 1, 2011

**By Facsimile (202) 401-2854 and First-Class Mail**

Arne Duncan  
Secretary of Education  
U.S. Department of Education  
400 Maryland Avenue, S.W.  
Washington, D.C. 20202

Dear Secretary Duncan:

Citizens for Responsibility and Ethics in Washington (“CREW”) writes to follow-up to our letter to you of January 19, 2011, requesting that you examine the role hedge fund managers and outside interest groups have played in the Department of Education’s (Education) formulation of regulations governing the for-profit education industry. Additional agency records CREW obtained recently in response to our Freedom of Information Act (FOIA) request provide further evidence that high-level Education officials involved in the agency rulemaking process not only knew of the efforts of certain hedge fund managers to influence the regulatory outcome, but may themselves have colluded with those individuals to protect the short-sellers’ financial interests. They also document a plan by high-level Education officials to leak the contents of the gainful employment regulations in advance of their public issuance.

The newly discovered documents show, among other things, that both Deputy Undersecretary James Kvaal and Budget Development Staff Director David Bergeron carried out a planned leak of the proposed gainful employment regulations to a number of outside individuals and groups in advance of the regulations’ public release. This effort started with an email from hedge fund short-seller Steven Eisman to Mr. Bergeron on July 19, 2010, just days before Education released the regulations. The subject line of Mr. Eisman’s email reads “I know you cannot respond” with the following text:

But just fyi. Education stocks are running because people are hearing DOE is backing down on gainful employment.<sup>1</sup>

The email thread of which this is a part shows this email was forwarded to a number of Education officials, landing eventually in the email box of your confidential assistant, Phil Martin, with the statement “Let’s discuss.”<sup>2</sup>

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<sup>1</sup> A copy of this email is attached as Exhibit A.

<sup>2</sup> *See id.*

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The following day Mr. Kvaal initiated a plan to call various outside groups and individuals with the apparent purpose of giving them a heads up on the upcoming regulations. The email thread shows that Mr. Kvaal and Mr. Bergeron divided the calls between them, with some key individuals and groups scheduled for contact as early as July 21, two days in advance of when Education issued the proposed gainful employment regulations.<sup>3</sup> None of the listed groups and individuals included anyone representing or acting on behalf of the for-profit education industry.

The email chain references both Mr. Eisman and Diane Schulman of The Indago Group as individuals who should receive advance notice.<sup>4</sup> The Indago Group is a small research company used by Mr. Eisman and his hedge fund, FrontPoint Services Fund to obtain information and entree to Washington lawmakers for Mr. Eisman.<sup>5</sup> Notice to either Mr. Eisman or Ms. Schulman, either directly from Education officials or indirectly from others in contact with Education officials, would have provided Mr. Eisman with reassurance about the likely market impact of the upcoming regulations. While neither is listed on the final call list for Mr. Kvaal or Mr. Bergeron, other documents reveal that Mr. Eisman likely received that notice from at least one non-profit group in receipt of an advance copy of the regulations.<sup>6</sup>

The newly acquired documents also show that on the same day Mr. Eisman initially contacted Mr. Bergeron with an update on how education stocks were faring, Mr. Kvaal quickly located the analysis prepared by the investment banking firm Signal Hill that apparently was fueling market speculation that Education had made the proposed gainful employment regulations “more accommodating” to the for-profit education industry.<sup>7</sup> Signal Hill questioned Mr. Eisman’s analysis, suggesting a need to “discredit the widely-circulated Eisman negative-earnings scenario,” and disputing “the assumption used by most shorts, including apparently Mr.

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<sup>3</sup> This email chain is attached as Exhibit B.

<sup>4</sup> Specifically, a follow-up email from Mr. Bergeron on July 21 (enclosed with Exhibit B) discussing who both he and Mr. Kvaal would call states: “Also, there’s the Eisman/Schluman/etal [sic] but Eisman is a short seller anyway you cut it and anything you tell Schulman gets to Eisman.”

<sup>5</sup> Their professional relationship is spelled out in our January 19, 2011 letter to you.

<sup>6</sup> See Letter to Arne Duncan from Anne L. Weismann, January 19, 2011, at pp. 6-7.

<sup>7</sup> See Email from Barmak Nassirian to James Kvaal, Re Write-up, July 19, 2010 and enclosed Regulatory Update from Signal Hill, attached as Exhibit C.

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Eisman, that ‘active repayment’ means current within 30 days.”<sup>8</sup> Mr. Kvall, with no explanation, promptly characterized this assessment as “not all accurate information.”<sup>9</sup>

These documents also bear directly on issues that have been referred to Education Inspector General Kathleen Tighe. Last November Senators Richard Burr (R-NC) and Tom A. Coburn (R-OK), who at that time were both on the Senate Committee on Health, Education, Labor and Pensions, requested that Ms. Tighe investigate the failure of key Education negotiators for the gainful employment regulations to comply with the organizational protocols governing Education’s rulemaking process. Among their concerns was evidence that “the Department may have leaked the proposed regulations to parties supporting the Administration’s position and investors who stand to benefit from the failure of the proprietary school sector.”<sup>10</sup> As this latest batch of documents reveals, Education officials at least had a coordinated plan to leak information about the gainful employment regulations to outside organizations in advance of the regulations’ issuance.<sup>11</sup>

Together with the previously released documents discussed in our letter of January 19, 2011, this new batch of documents raises extremely troubling questions about the actions of Education officials at the highest levels of this regulatory process. Those officials knowingly allowed short-sellers to manipulate agency processes for personal gain and ignored their own

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<sup>8</sup> See Signal Hill Regulatory Update at p. 1.

<sup>9</sup> See Email from James Kvaal to Gomez Gabriella (Education’s Assistant Secretary for Legislative and Congressional Affairs), Re Write-up, July 19, 2010 (attached as Exhibit D).

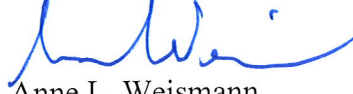
<sup>10</sup> See letter from Senators Burr and Coburn to Kathleen Tighe, November 17, 2010 (attached as Exhibit E).

<sup>11</sup> One of the newly released documents shows that at least some in the non-profit community understood the restrictions imposed on Education officials. In a June 17, 2010 email to Education Press Secretary Justin Hamilton, Edie Irons, Communications Director for TICAS, notes: “I know that you all haven’t been allowed to talk publicly about these rules yet.” This email is enclosed as Exhibit F.

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responsibilities to the agency they serve. Unless these questions are answered, the public can have no faith in any aspect of Education's rulemaking process.

Very truly yours,



Anne L. Weismann  
Chief Counsel

cc: Chairman Tom Harkin  
Ranking Member Michael B. Enzi  
Senator Richard Burr  
Senate Committee on Health, Education, Labor, and Pensions  
Chairman John Kline  
Ranking Member George Miller  
House Committee on Education and the Workforce  
Inspector General Kathleen Tighe

Enclosures

# **EXHIBIT A**

**Kvaal, James**

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**From:** Kvaal, James  
**Sent:** Monday, July 19, 2010 10:09 AM  
**To:** Martin, Phil  
**Subject:** FW: i know you cannot respond

**Importance:** High

Let's discuss

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**From:** Bergeron, David  
**Sent:** Monday, July 19, 2010 10:06 AM  
**To:** Kvaal, James; Yuan, Georgia  
**Subject:** FW: i know you cannot respond  
**Importance:** High

fyi

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**From:** Eisman, Steven [<mailto:seisman@fppartners.com>]  
**Sent:** Monday, July 19, 2010 9:45 AM  
**To:** Bergeron, David  
**Subject:** i know you cannot respond

But just fyi. Education stocks are running because people are hearing DOE is backing down on gainful employment.

Steven Eisman  
FrontPoint Financial Services Fund  
[seisman@fppartners.com](mailto:seisman@fppartners.com)  
917-934-1770

## **EXHIBIT B**

**Kvaal, James**

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**From:** Bergeron, David  
**Sent:** Wednesday, July 21, 2010 2:47 PM  
**To:** Kvaal, James  
**Subject:** RE: group calls

Looks good. Hartle called me today from the road and asked what was going on. I said to expect a call from one of us tomorrow or Friday. He said he'll be in the office and that we should ask to have him interrupted to take the call.

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**From:** Kvaal, James  
**Sent:** Wednesday, July 21, 2010 2:45 PM  
**To:** Bergeron, David  
**Subject:** RE: group calls

How's this for a division of labor?

**Today/Tomorrow morning:**

David:  
Baime  
AASCU

James:  
TICAS  
Barmak  
Terry  
Kantrowitz

**Friday:**

David:  
Angela Peoples, USSA  
Jason DeLisle and Steve Burd, New America  
Deanne Loonin, NCLC

James:  
Chris Lindstrom, PIRG  
David Halperin, Campus Progress  
Jamie Studley, Public Allies

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**From:** Bergeron, David  
**Sent:** Wednesday, July 21, 2010 8:02 AM  
**To:** Kvaal, James  
**Subject:** RE: group calls



I'd suggest we add David Baime, ACCU & Pat Smith or Robert Moran at AASCU. Also, should probably call NASFAA on Day 2 or 3. I can make any calls you'd like. I'd prefer not to call Mark but Danny could do that one. He gets the guy. When I talk Mark, the conversation goes more like Bob & Tony.

Also, there's the Eisman/Schluman/et al but Eisman is a short seller anyway you cut it and anything you tell Schulman gets to Eisman.

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**From:** Kvaal, James  
**Sent:** Tuesday, July 20, 2010 11:13 PM  
**To:** Bergeron, David  
**Subject:** group calls

While I'm on a roll ... here is my list of people who need calls. What am I missing? Do you want to sign up for a few or how should we split up?

Day 1 (most likely to be called by reporters)

- Pauline Abernathy and Lauren Asher, TICAS
- Barmak Nassarian, AACRAO
- Terry Hartle, ACE
- Mark Kantowitz, Finaid

Day 2:

- Deanne Loonin, NCLC
- Jason DeLisle and Steve Burd, New America
- Chris Lindstrom, PIRG
- Angela Peoples, USSA
- Jamie Studley, Public Allies
- David Halperin, Campus Progress

## **EXHIBIT C**

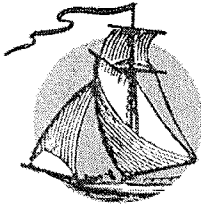
**Kvaal, James**

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**From:** Kvaal, James  
**Sent:** Monday, July 19, 2010 10:52 AM  
**To:** Martin, Phil  
**Subject:** FW: Write-up  
**Attachments:** Download.aspx.pdf

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**From:** Nassirian, Barmak [<mailto:barmak@aacrao.org>]  
**Sent:** Monday, July 19, 2010 10:47 AM  
**To:** Kvaal, James  
**Subject:** Write-up



Signal Hill

## Business Services - Education Services Industry Update

July 16, 2010

### Regulatory Update -- What's Next

Trace Urdan

turdan@signalhill.com  
415.364.0365

#### Our Call:

#### On Gainful Employment:

Multiple reliable sources say that the Department of Education (ED) sent a revised, metric-based Gainful Employment draft to the OMB for review around July 4, suggesting that next week could see the proposal released for public comment. We believe this new draft could include terms more accommodating than the infamous 8% language first floated by ED in January's neg-reg sessions.

We further expect, based on reports of conversations between industry and ED officials over the last few months, that the revised proposal will effectively relieve most of the BA and MA programs from the debt/income measure through an alternative measure of graduate loan repayments. We believe the intent of the rules is to target AA and non-degree programs, where students are seen as less sophisticated and less able to make informed decisions about borrowing for their education. We also think there could be a completion/placement standard as part of the final proposal.

Near-term, we see the publication of the Gainful Employment draft rule as most likely to relieve pressure on BA and MA programs and to better clarify the exposure for non-degree and AA degree providers. (We note that COCO management has publicly stated that it will offer an indication of the the likely impact of the rule on its future earnings, even before a final rule is published.) Because we believe that clarity in both cases will begin to discredit the widely-circulated Eisman negative-earnings scenario, we see the GE rule as a potentially positive catalyst.

Specifically, we believe the terms of an alternative default measure will be such that company's with two-year graduate default rates of <3.5% should meet the 90% "active repayment" criterion. We do not believe the assumption used by most shorts, including apparently Mr. Eisman, that "active repayment" means current within 30 days.

- Near-term beneficiaries: APOL, BPI, DV, EDMC, LOPE, STRA.

But near-term evidence that negative earnings are unlikely will not by itself relieve the short pressure on the sector or persuade disenchanted longs to reinvest. The more meaningful catalyst for the sector will not come, in our opinion, until we see a) an LBO; b) a balanced assessment of the industry's contribution to higher education by the GAO; or c) some positive commentary/testimony from USDOE following the rules being finalized.

We believe that private equity remains highly engaged in the sector, and possible Senate bills notwithstanding, inclined to act as soon as rules become clearer. Though some may be cowed by Harkin's rhetoric, we think others will be able to read the political environment as one in which a liberal Democrat will be hard-pressed to pass heavy new regulations that will discourage college access, industry jobs and tax receipts.

- Most likely LBO candidates: ESI, COCO, CECO, and (if John Sperling is prepared to cede control,) APOL.

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Please see important disclosure information on pages 2 - 3 of this report.

July 16, 2010



## Investment Analysis:

### Senate HELP Hearings

We're told that the next Senate HELP committee hearing on for-profit education will be devoted to the issue of "misrepresentation" and will take place during the first week of August.

We believe the politics of rule-making, which encourages USDOE to generate support for the rules during this public comment period, as well as the politics of the mid-term elections, in which the Democrats appear to be appealing to the left in order to rally their political base, has caused the current firestorm of populist outrage in Congress as expressed by Senators Harkin, Franken, Sanders, and Durbin.

Our read is that having been placed on the defensive early with respect to the need and appropriateness of new Gainful Employment rules that effectively cap student debt levels by program, USDOE has coordinated an impressive and highly successful public relations and lobbying effort to shift the terms of the debate such that these rules now appear to the public to be a badly-needed and even moderate response to a crisis.

We read the Senate HELP hearings, as well as Senator Durbin's speech to the National Press Club, in this context as well. There is a strong professional association between Senator Harkin's top education staffer Luke Swarthout and Bob Shireman's advocacy organization, the Institute for College Access & Success. And Senator Durbin's speech likewise seems to have benefited from a host of talking points supplied directly by USDOE.

In our analysis, the mid-term elections, the publication of a GAO report and most importantly, the finalization of new rules on Nov. 1, 2010 governing the sector should result in a much more moderate tone among lawmakers. While we cannot dismiss the possibility of new legislation being introduced in the Senate to alter rules governing for-profit schools, we rate the likelihood of *passage* of any such law as very low given the source of the agitation and the tough line being taken by Republicans on new regulatory initiatives.

## Important Disclosures

### Analyst Certification

I, Trace Urdan, hereby certify that all of the views expressed in this research report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report. Signal Hill does not compensate its equity research analysts based on specific investment banking transactions. Signal Hill Equity research analysts receive compensation based on several factors, including overall profitability and revenues of the firm, which include investment banking revenues.

Applicable current disclosures for all companies covered in this report are available in written or electronic format upon request. To request copies of applicable current disclosures please write to the Signal Hill Capital Group Research Department at the following address: Signal Hill Capital Group Research Department, 300 East Lombard Street, Suite 1700, Baltimore MD 21202.

### Meaning of Ratings

Signal Hill uses a three-tiered rating system defined as follows:

BUY: We expect this stock to outperform its peers over the next 12 months:

HOLD: We expect this stock to perform in line with its peers over the next 12 months:

SELL: We expect this stock to underperform its peers over the next 12 months:

July 16, 2010



Distribution of Ratings/IB Services  
Signal Hill

| Rating | Count | Percent | IB Serv./Past 12 Mos. |         |
|--------|-------|---------|-----------------------|---------|
|        |       |         | Count                 | Percent |
| BUY    | 79    | 61.7    | 74                    | 93.7    |
| HOLD   | 48    | 37.5    | 39                    | 81.2    |
| SELL   | 1     | 0.8     | 1                     | 100.0   |

**Disclaimer**

This report has been prepared using sources we deem to be reliable but we do not guarantee its accuracy and it does not purport to be complete. This report is published solely for information purposes and is not intended to be used as the primary basis for making investment decisions, which should reflect the investment objectives and financial situation of the investor. The opinions expressed herein are subject to change without notice. This report is not an offer or the solicitation of an offer to buy or sell securities. Additional information is available upon request.

## **EXHIBIT D**

**Kvaal, James**

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**From:** Kvaal, James  
**Sent:** Monday, July 19, 2010 11:12 AM  
**To:** Gomez, Gabriella  
**Subject:** Fw: Write-up  
**Attachments:** Download.aspx.pdf

This is not all accurate information

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Sent using BlackBerry

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**From:** Nassirian, Barmak <[barmak@aacrao.org](mailto:barmak@aacrao.org)>  
**To:** Kvaal, James  
**Sent:** Mon Jul 19 09:47:29 2010  
**Subject:** Write-up



## **EXHIBIT E**

# United States Senate

WASHINGTON, DC 20510

November 17, 2010

Ms. Kathleen Tighe  
Inspector General  
U.S. Department of Education  
Office of Inspector General  
400 Maryland Avenue, SW  
Washington, DC 20202-1500

Dear Ms. Tighe:

The work of your office is essential to protecting the efficiency and effectiveness of programs administered by the U.S. Department of Education. Independent analysis helps ensure the integrity of the Department's mission and operations. To that end, we request an investigation by your office of the events leading up to the issuance of the Department's proposed regulations regarding "gainful employment."

As you know, Section 492 of the Higher Education Act requires the Department to convene negotiated rulemaking any time it promulgates regulations affecting the federal student aid programs. Negotiated rulemaking ensures the Department works with individuals who are experienced in implementing the federal student aid programs and who understand the consequences of the proposed regulations.

Information has become available that raises serious concerns about whether some negotiators failed to comply with the organizational protocols governing the rulemaking process and other laws governing these proceedings. In addition, publicly available documents indicate the Department may have leaked the proposed regulations to parties supporting the Administration's position and investors who stand to benefit from the failure of the proprietary school sector. We believe an independent investigation will provide additional transparency surrounding the actions taken by Department officials and those who stand to benefit financially from the regulations.

Since November 2009, the Department of Education has been engaged in negotiations to promulgate regulations designed to improve the integrity of the federal student aid programs. At the beginning of the rulemaking sessions, the negotiators adopted "Organizational Protocols" that governed the proceedings. One of the agreed upon principles states: "All members and the organizations they represent shall act in good faith in all aspects of these negotiations" ("Organizational Protocols," U.S. Department of Education, Section VI.B). Another states: "Contact with the media, the investment community, and other organizations outside the community of interest represented by the member will generally be limited to discussion of the overall objectives and progress of the negotiations" ("Organizational Protocols," U.S. Department of Education, Section VI.C.).

The panel met three times between November 2009 and January 2010 and did not reach consensus on the regulations package. On June 16, 2010, the Department released the first package of proposed regulations on "program integrity." A month later, on July 23, 2010, the Department released the second package of proposed regulations on "gainful employment."

In a July 23 Freedom of Information Act (FOIA) request, Citizens for Responsibility and Ethics in Washington (CREW) sought information pertaining to the communications occurring between Department officials and several individuals and organizations outside of the Department. In its request, CREW stated:

Specifically the requested records will inform the public about the role of Education in the controversy over the for-profit education industry and the extent to which Education has knowingly relied on, or has been manipulated by, the views of individuals who seek to advance their financial interests in the for-profit industry by publicly criticizing certain for-profit education entities and companies.

It is our understanding that as of today, the Department has not responded to this FOIA request.

Based on information that has come to light from records released under a Florida public records request, it appears Department officials may have leaked information to outside organizations, some of whom may stand to financially benefit from the failure of the proprietary school sector. For example, an email attached to this letter demonstrates that Edie Irons, Communications Director for TICAS, emailed an embargoed copy of the program integrity regulations to the "GainfulEmploymentGroup" on June 15 at 5:38 p.m. As previously noted, the regulations were not made public until June 16. If one group received an embargoed copy of these proposed regulations, other groups, including those who stand to benefit financially from the failure of the proprietary sector, may have as well.

To resolve these questions, we request an investigation by your office into the events leading up to and surrounding the issuance of the Department's proposed program integrity regulations for the period of April 2009 to the present. In this investigation we respectfully request your review of whether the organizational protocols adopted for negotiated rulemaking were followed by both non-federal negotiators and Department staff. In addition, we ask that you review the propriety of all communications between Department employees and outside individuals and organizations to determine if the proposed regulations packages were inappropriately provided to any individuals or organizations prior to their public release.

Members of the public, including students and the institutions they attend, have a right to expect the Department of Education to promulgate regulations through a negotiated rulemaking process that is undertaken in good faith and without bias.

Thank you for your attention to this request. If you have any questions, please do not hesitate to contact our offices.

Sincerely,



Richard Burr  
United States Senator



Tom A. Coburn, M.D.  
United States Senator

Enclosures

## **EXHIBIT F**

**Kvaal, James**

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**From:** Pauline Abernathy [pabernathy@ticas.org]  
**Sent:** Thursday, June 17, 2010 6:53 PM  
**To:** Kvaal, James  
**Subject:** FW: Error in your NPRM release

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**From:** Hamilton, Justin [mailto:Justin.Hamilton@ed.gov]  
**Sent:** Thursday, June 17, 2010 3:45 PM  
**To:** Edie Irons  
**Cc:** Lauren Asher; Pauline Abernathy  
**Subject:** Re: Error in your NPRM release

Thanks. We'll take a look.

---

Justin Hamilton  
Press Secretary  
U.S. Department of Education  
c: 202-591-6734

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**From:** Edie Irons <EIrons@ticas.org>  
**To:** Hamilton, Justin  
**Cc:** Lauren Asher <LAsher@ticas.org>; Pauline Abernathy <pabernathy@ticas.org>  
**Sent:** Thu Jun 17 17:43:13 2010  
**Subject:** Error in your NPRM release

Hi Justin,

I left you a voicemail yesterday. Your press release on the proposed rules says, "Though current laws prohibit schools from compensating admissions recruiters based solely on success in securing student enrollment," however, the current law actually says "directly or indirectly." "Solely" is the language that was in the safe harbors, and what the for-profits want to keep! This definitely needs to be fixed online ASAP, not sure it is worth issuing a correction.

I wanted to flag another issue – not one that needs immediate correction, but something to be aware of. None of the stories from yesterday characterize the likely GE rule correctly. They say the metric will be based on an average of the student's debt-to-income ratio, or they make it sound like any student with a high debt-to-income ratio could cause a school to lose federal aid eligibility. Here are the three points we have found it is very important to make super clear (and sometimes reporters still get it wrong!):

1. More than half of a program's students would need to be beyond 8% (or whatever the metric will be).
2. 8% is just a "red flag," and there are other metrics that the school could then use to prove gainful employment. In other words, it's not the be-all-end-all, but the first of a series of tests, so schools are getting ample and flexible opportunities to show they lead to gainful employment.
3. That the rules apply to *programs*, not schools. So even if a program is negatively affected, it wouldn't necessarily put an entire school out of business.

I know that you all haven't been allowed to talk publicly about these rules yet, so I just thought it might be helpful to share what we've learned since we've been talking about this for a while!

Edie

Edie Irons  
Communications Director

The Institute for College Access & Success

405 14th St. 11th floor

Oakland, CA 94612

(510) 318-7902

[eirons@ticas.org](mailto:eirons@ticas.org)

*Please note the new address and phone number, we moved in April.*

[www.ticas.org](http://www.ticas.org)

<http://projectonstudentdebt.org>