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July 26, 2011

The Honorable Arne Duncan
Secretary
U.S. Department of Education
400 Maryland Avenue SW
Washington, DC 20202

Dear Secretary Duncan,

I am writing to express concern after reading a June 13, 2011, article from the Project on Government Oversight (POGO) regarding the Department of Education's interaction with short sellers during the negotiated rulemaking process to regulate for-profit education institutions.¹ My concerns center on the possibility that senior Department of Education staffers may have provided information to short sellers during the time leading up to the public release of the Notice of Proposed Rule Making (NPRM) on the recently finalized "gainful employment" rule.²

Adding to these concerns are the documents obtained through the Freedom of Information Act (FOIA). These documents include e-mails that suggest that Department of Education officials knew the financial impact the "gainful employment" rule would have on for-profit education corporations and despite this, continued to communicate with hedge fund managers who have taken a position against for-profit education corporations. For example, the documents show contact between Mr. Steve Eisman and several participants in the negotiated rulemaking prior to its public release.

On July 19, 2010, at 9:45 a.m., Mr. Eisman sent an e-mail to Department of Education employee Mr. David Bergeron titled: "i (sic) know you cannot respond."³ The text of Mr. Eisman's e-mail was as follows, "But just fyi. Education stocks are running because people are hearing DOE is backing down on gainful employment."⁴ 21 minutes later, at 10:06 a.m., Mr.

¹ Project on Government Oversight, Adam Zagorin, Did Education Department Officials Leak Market-Sensitive Info to Stock Traders? June 13, 2011.

² *Id.*

³ Email from Steve Eisman to David Bergeron, July 19, 2010.

⁴ *Id.*

Bergeron forwarded this e-mail to Department of Education employees Mr. James Kvaal and Ms. Georgia Yuan with a high importance level added to the e-mail.⁵ Three minutes later, at 10:09 a.m., Mr. Kvaal forwarded this e-mail to Department of Education employee Mr. Phil Martin with the message, “Let’s discuss.”⁶

To place these e-mails in perspective, less than two months prior, on May 26, 2010, Mr. Eisman gave a presentation at the Ira Sohn Conference where he attacked the for-profit education industry sector and stated that he expected for-profit education stocks to be the next sub-prime mortgage sector.⁷ Mr. Bergeron also appears to have known Mr. Eisman’s position on the sector, writing to Mr. Kvaal on July 21, 2010, “...Eisman is a short seller any way you cut it...”⁸

Mr. Eisman justified his position against the sector at the Sohn Conference by pointing to the fact that the gainful employment rule would be changed in such a way as to reduce for-profit companies’ profit margins. In his words, “I cannot emphasize enough that gainful employment changes the business model...(d)ownside risk could be as high as 50%.”⁹ Mr. Eisman also dismissed concerns about a recent rally in for-profit stocks in similar language to the words he used in his e-mail to Mr. Bergeron. “There was a news report out that Bob Shireman, the Undersecretary of Education in charge of this process was leaving. This caused a massive rally in the stocks under the thesis that this signaled that the DOE was backing down from gainful employment. This conclusion is absurd.”¹⁰

Then, only weeks later, Mr. Eisman appears to have been confronted with the fact that his position against the for-profit industry, which was premised on the idea that the Department of Education would not be “backing down” on the gainful employment rule, may have been wrong.¹¹ In fact, on July 19, 2010, at 2:47 p.m., the Associated Press posted a story titled: “For-profit school shares soar,” noting that some for-profit education stocks had increased in value by as much as 11 percent in less than one day.¹²

While Department of Education employees cannot prevent investors such as Mr. Eisman from contacting them, it is extremely concerning that Mr. Eisman’s e-mail to Mr. Bergeron that education stocks are “running” within 15 minutes of the stock market’s open at 9:30 a.m. would be forwarded to high-level Department of Education employees within 24 minutes. Given Mr. Eisman’s position against the for-profit education sector, any financial investment was strongly contingent on a Department of Education regulatory decision. Therefore, it seems surprising that Mr. Eisman was on such familiar terms with Mr. Bergeron.

If it is indeed the case that Department of Education employees were on familiar terms with hedge fund short sellers, this raises serious questions regarding the internal controls the Department of Education utilizes to ensure that the Department promulgates regulations without

⁵ Email from David Bergeron to James Kvaal and Georgia Yuan, July 19, 2010.

⁶ Email from James Kvaal to Phil Martin, July 19, 2010.

⁷ Steve Eisman, *Subprime Goes to College*, delivered May 26, 2010 at the Ira Sohn Conference.

⁸ Email from David Bergeron to James Kvaal, July 21, 2010.

⁹ Steve Eisman, *Subprime Goes to College*, delivered May 26, 2010 at the Ira Sohn Conference.

¹⁰ *Id.*

¹¹ Email from Steve Eisman to David Bergeron, July 19, 2010.

¹² Associated Press, *Sector Snap: For-profit school shares soar*. July 19, 2010.

improper interference or influence. In light of these concerns, it is essential for Congress to investigate the circumstances surrounding the NPRM for the “gainful employment” rule. Accordingly, please provide written responses to the following questions:

1. Did the Department of Education have a policy regarding communication with investors in for-profit education institutions prior to the release of NPRMs aimed at the oversight of these institutions?
 - a. If so, what is the policy?
 - b. If not, why not?
2. If the Department of Education employees do communicate with these types of investors, what internal controls does the Department have to ensure that non-public information is not leaked to these investors and that these investors do not influence the Department’s policies?
3. Is it the Department’s policy to provide non-public information to any organizations involved in negotiated rulemaking for stricter regulation of for-profit education institutions that, if released, would significantly impact the fiduciary interest of short sellers?
4. In addition to the email on July 19, 2010, what other communications (including phone calls) did Mr. David Bergeron and other Department of Education staffers have with Mr. Steve Eisman?
5. Has the Department of Education conducted any investigations (not including the Inspector General’s Office investigation) regarding the process surrounding the promulgation of the gainful employment rule?
6. One of the most important sources of information regarding the possible cooperation between short sellers and Department of Education staffers has been the FOIA process. Is the Department of Education providing documents to FOIA requesters on a rolling basis? If not, why not?
7. How many FOIA requests does the Department of Education have outstanding on this issue?
8. When does the Department of Education expect to fulfill those requests?

When responding to this letter, please number your answers in accordance with my questions. I would appreciate receiving your responses to this matter by August 9, 2011. Should you have any questions regarding this matter, please do not hesitate to contact Chris Lucas of my staff at (202) 224-5225.

Sincerely,

A handwritten signature in blue ink that reads "Chuck Grassley". The signature is written in a cursive, flowing style.

Charles E. Grassley
Ranking Member
Committee on the Judiciary