Investment Funds Stir Controversy Over Recruiting by For-Profit Colleges

by Sharona Coutts
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Nancy Panico runs a large center for homeless and at-risk youth in Tucson, Ariz. About a year ago, a woman contacted her with some questions about for-profit schools that have tried to recruit homeless youths -- a problem that Panico's shelter had encountered. The woman, Johnette McConnell Early, visited Panico at the center and, a few months later, asked for her signature on a letter alerting the U.S. Department of Education to the issue.

Panico and 19 other executives from homeless shelters and service agencies around the country eventually signed the letter, addressed to Secretary of Education Arne Duncan, asserting that "for-profit trade schools and career colleges are systematically preying upon our clients." The June 17 letter pledged "unequivocal" support to the department's steps to tighten regulation of the for-profit industry.

Some who signed had personal knowledge of aggressive recruiting tactics, but others told ProPublica they had only heard about them secondhand from colleagues and news reports. Early visited with many of the executives, they said, drafted the letter and coordinated the effort to get them to sign.

What Early did not tell Panico or several others who signed: She was working for a financial firm that pays her to investigate for-profit schools.

"Had I known, I probably wouldn't have signed on," Panico said. "I probably would have contacted one of the other people and said, 'Hey, now that we have all this information, let's do this ourselves.' I think it's sleazy to basically use me and use other executive directors that have a real issue to make a profit for some companies."

For-profit universities have come under increasing scrutiny of regulators and congressional committees who have heard complaints about alleged recruiting abuses. More recently, attention has turned to the behind-the-scenes influence of hedge funds that are also critical of the industry and have sold short, betting that the stock of publicly traded universities will drop in price if, for instance, Congress or the Department of Education cracks down.

To cover tuition costs, the schools rely heavily on federal grant and loan programs controlled by Duncan's agency.

In an interview, Early confirmed to ProPublica that an "investment firm is paying for my time" but would not disclose the identity of that firm. When asked whether her client was betting against the for-profit higher education industry, Early said she did not know.

"Since I'm not part of their firm, I can't say what their position is," Early said. "But clearly an investment firm is not going to look into something unless they're thinking about whether it's a good or bad investment."

Last month, the prominent investment fund manager Steven Eisman testified before a Senate education subcommittee hearing on the "emerging risk" posed by increasing federal subsidies to for-profit schools. Eisman is best known for predicting the crash of the subprime mortgage market. He's become a scathing critic of for-profit colleges and universities, and in his testimony referred to the practice of recruiting at homeless shelters. Eisman predicted that students at these schools will default on $275 billion in government loans over the next 10 years.

Less than a week after Eisman's appearance, Sen. Dick Durbin, D-Ill., called for congressional action to tighten the rules governing for-profits. Referring to Eisman's testimony, Durbin said some schools were enticing "low-income, high-risk students" into "mortgaging their futures -- not on overpriced homes this time, but on worthless diplomas," and said Congress must clamp down on the quality of education the schools deliver, and the way the government administers financial aid.

Eisman's testimony was controversial. Advocates of for-profit schools and a government watchdog group criticized the subcommittee, saying Eisman was allowed to present himself as an expert and make self-serving criticisms of an industry in whose failure they believe he has a vested interest. One group, Citizens for Responsibility and Ethics, wrote to Health, Education, Labor and Pensions Committee Chairman Sen. Tom Harkin, D-Iowa, to complain that Eisman had a conflict of interest in delivering his testimony.

Eisman did not return calls requesting comment. He told the Senate subcommittee he had a stake in the industry, but did not disclose specifics. In an earlier speech, Eisman named five particular companies that he said would suffer if the Education Department adopted regulations tying tuition to the employment their graduates obtain -- Apollo Group, the owner of the University of Phoenix; ITT Educational Services; Corinthian Colleges; Education Management Corporation; and The Washington Post Company, which owns Kaplan University.

Since April, a nonprofit group associated with another high-profile investor, Manuel P. Asensio, has written five letters criticizing the for-profit education industry and calling for tighter regulation to congressmen and regulators with jurisdiction over the sector.

Short sellers have shown a steadily increasing interest in for-profit schools, according to Will Duff Gordon, an analyst at Data Explorers, a company that collects and analyzes data about short-selling. Since April, his company has also seen a spike in short positions in the sector, indicating a strengthening view that the stocks will fall. In general, short sellers place bets that a company's stock or some other financial instrument will decline in value.

"This is not an opportunistic bit of short selling," Gordon said of for-profit schools. "People have worked out that these companies are overvalued. They've put on bigger and bigger short positions as the price keeps going down. And they have been right because the price keeps dropping."

For their part, short sellers claim they are merely bringing to light the fundamental problems of an industry that survives in large part on taxpayer largesse.

More than 1,600 for-profit colleges, universities and trade schools received $3.3 billion in Pell grants in the year ending last June, according to Department of Education data. About 950 schools shared some $2.5 billion in federal loans in the same period. Proprietary schools are slated to pocket significantly more this year, thanks to the Obama administration's increased funding for the need-based Pell grants.

Short sellers say they provide a public service by exposing fraud or mismanagement of publicly traded companies. Most academic studies that have examined the issue confirm that short sellers are most often correct in their assessment that particular companies or industries are overvalued, according to William N. Goetzmann, director of the International Center for Finance at the Yale School of Management.

But some short sellers appear to be moving beyond assessing particular companies and taking a financial position accordingly. Now, says the Career College Association, some are trying to stage-manage the reporting of negative stories to fuel the impression of a groundswell of anger against the schools.

"Certainly there are legitimate critics. I may not agree with them, but they're not in it to fatten their wallets," said Harris Miller, president of the CCA, which represents for-profit schools. "But I think that a lot of the activity going on, and with other media reports, is being driven by the short sellers, who are hiring people who are semi-disguising who they are and not being candid with people about their role in trying to drive down the stock price of certain companies."

Early terminated the interview with ProPublica when asked whether the hedge fund knew she had drafted the letter and coordinated the effort to have it cosigned by representatives for homeless shelters.

But when informed of Early's connection to an investment firm, several people who signed the letter said they found the episode disquieting.

Two who signed told ProPublica they were under the impression that Early was conducting research for a Bloomberg Businessweek reporter working on a story about for-profit schools enrolling homeless people. Early confirmed in the interview that she "connected" the reporter with several people at homeless shelters.

Bloomberg Businessweek in May ran an article under the headline, "Homeless high school dropouts lured by for-profit colleges." In a statement, a Bloomberg spokesperson said: "We did not obtain information from anyone working on our behalf. Our story was the product solely of our own reporting."

The PBS investigative news program Frontline posted the letter on its website after it was provided by another short seller, Frontline producer Marrie Campbell told ProPublica. Campbell said she would "absolutely not" have posted the letter had she known the full circumstances of its provenance.

It is not unusual for reporters to follow up on tips from hedge funds, financial firms or other sources with an interest in how a story might shape events. ProPublica has interviewed hedge fund managers and their researchers about for-profit colleges and universities to learn about their concerns and get leads. They disclosed they were short on the sector; any information or sources they provided were independently verified and vetted by a reporter.

Others who signed the letter said Early told them that she worked for a think tank, or that they believed she was working on a book. Like Panico, they supported the substance of the letter. But one of the signers -- Jennifer Brandon, executive director of Community Voicemail in Seattle, Wash. -- said she had no direct knowledge of for-profits recruiting homeless people.

Early told Neil Donovan, executive director and president of the National Coalition for the Homeless in Washington, D.C., that she worked for a Dallas company that offered advice and private research called J.W. McConnell & Sons, Donovan said. ProPublica contacted state and local officials in Texas who said they could find no record of the firm.

Donovan said he was angered to learn of Early's association with an investment firm.

"My next letter will be to Arne Duncan saying that I didn't know that, and I'm going to ask his inspector general to look into the fact that they received a letter where the source of the letter was misrepresenting themselves," Donovan said. "I think that's completely inappropriate and it's using homeless people as pawns, and that is what our mission is against."

"It makes me feel uncomfortable," added Larry James, president and CEO of Central Dallas Ministries. "I'm quite certain none of us knew that connection, and that would have given me pause."

Not all those who signed were troubled by Early's conduct. Jane Burch, CEO of New Beginnings for Women and Children in Tucson, said Early told a staffer that she had "something to do with an investment firm," and that her organization would never have signed a letter unless they agreed with its contents.

"I have no evidence that there is any wrongdoing here," Burch said. "Why would I not want to see another avenue to have our clients' rights protected?"

Both sides in the debate claim moral ground. The for-profits argue they are performing a social service by making education available to many who have been excluded from traditional four-year colleges; the short sellers claim they are protecting the same groups of people from deceptive marketing techniques and a mountain of debt.

A Department of Education spokesperson said the agency remains focused on regulatory matters. Among other things, the department has announced plans to scrap regulations that watered down a ban on schools paying recruiters according to how many new students they brought in.

ProPublica intern Joe Kokenge *contributed reporting to this story.*