

# INVESTORS AND STUDENTS FALL VICTIM TO FRAUD

By Louis Gottlieb

The post-secondary education sector has been a booming industry for several years, and new schools continue to pop up in cities all over the United States. High school graduates seeking careers in photography, fashion, cooking, and secretarial work, among other vocations, are enticed to enroll by the schools' promises of financial aid and their high job placement rates. But what happens when a school operates like a corporation, that is more concerned with increasing revenues than providing adequate training for its students? What happens when recruiters promise students a 95% chance of getting good-paying jobs in their chosen field of study when they graduate and accept virtually every applicant who can pay the application fee and has a pulse?

In the case of Career Education Corp., three things happened: first, tens of thousands of students (most of whom receive government loans or grants) signed up for the programs, allowing the Company to post record revenues quarter after quarter. Second, the price of the stock rose, and Company insiders sold hundreds of thousands of shares for tens of millions of dollars. Third, the vast majority of those students found out that the promised jobs are not available, leading to bitter disappointment, huge (largely uncollectible) debts owed by the former students, government investigations of the Company, television exposés, Congressional criticism, and private lawsuits.

Labaton Sucharow is at the forefront of this battle. After being appointed lead counsel in June 2004, the First Amended Complaint was filed alleging violations of Section 10(b) of the Securities Exchange Act. The Amended Complaint included statements by more than a

dozen confidential witnesses who had worked at various Career Education schools. The details set forth in the Amended Complaint were reported in the business press. Within weeks, investigations of the Company were started by the SEC, the Department of Justice and various state agencies. Major newspapers, including the *New York Times* and the *Chicago Tribune*, and television news programs like *60 Minutes*, published exposés.

On the legal front, the Court dismissed the First Amended Complaint, finding that its allegations of wrongdoing were too anecdotal and did not sufficiently allege fraud on a company-wide basis. However, a Second Amended Complaint was filed, which addresses the Court's concerns in at least four ways. It includes, among other things: (i) allegations related to a recent restatement by Career Education, in which the Company admitted that it overstated income and did not properly reserve for bad debt; (ii) internal Company documents provided by confidential witnesses that show how the Company manipulated its reported bad debt reserves; (iii) findings by a government agency, the California Bureau of Private Post-Secondary Education, that Brooks Institute of Photography, a Career Education School located in California, accepted unqualified students (who did not have proof of high school graduation or a GED) and lied to applicants about the school's job placement success rate for graduates; and (iv) statements by ten new confidential witnesses about the Company's fraudulent practices related to student recruitment, reported student enrollment, and reported bad debt.

Briefing on defendants' motion to dismiss the Second Amended Complaint was recently completed. Meanwhile, the Company remains in the news. In July 2005, the California Bureau

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of Private Post-Secondary Education issued a second scathing report on fraudulent practices at Brooks Institute of Photography. As a result, it may require the school to provide restitution to current and former students as a condition of allowing it to continue in business. Some analysts believe that other Career Education schools may soon face similar problems.

Jonathan Plasse, one of the Labaton Sucharow attorneys leading this case, noted, "This is good news for defrauded Career Education students, but it is more bad news for Career Education investors."