IN THE COURT OF COMMON PLEAS OF ALLEGHENY COUNTY, PENNSYLVANIA

OKLAHOMA LAW ENFORCEMENT RETIREMENT SYSTEM,

Plaintiff,

v.

TODD S. NELSON, JOHN R. McKERNAN, MICK J. BEEKHUIZEN, SAMUEL C. COWLEY, ADRIAN M. JONES, JEFFREY T. LEEDS, LEO F. MULLIN, PAUL J. SALEM, PETER O. WILDE, and JOSEPH R. WRIGHT

Defendants,

and

EDUCATION MANAGEMENT CORP.,

Nominal Defendant.

CIVIL DIVISION

No.: GD-12-008785

Code: 020 Equity

COMPLAINT IN CIVIL ACTION

Filed on behalf of Plaintiff:
Oklahoma Law Enforcement Retirement System

Counsel of Record for this Party:

CAROSELLI BEACHLER MCTIERNAN & CONBOY, LLC

William R. Caroselli, Esquire
PA I.D. #00452
E-Mail: wcaroselli@cbmclaw.com

20 Stanwix Street, 7th Floor
Pittsburgh, PA 15222

Telephone: (412) 391-9860
Fax: (412) 391-7453

Firm ID: 589

JURY TRIAL DEMANDED

IN THE COURT OF COMMON PLEAS OF ALLEGHENY COUNTY, PENNSYLVANIA

OKLAHOMA LAW ENFORCEMENT RETIREMENT SYSTEM, *Plaintiff*, v. TODD S. NELSON, JOHN R. McKERNAN, MICK J. BEEKHUIZEN, SAMUEL C. COWLEY, ADRIAN M. JONES, JEFFREY T. LEEDS, LEO F. MULLIN, PAUL J. SALEM, PETER O. WILDE, and JOSEPH R. WRIGHT *Defendants*, and EDUCATION MANAGEMENT CORP., *Nominal Defendant*.	CIVIL DIVISION No.: GD-12-008785 Code: 020 Equity

COMPLAINT IN CIVIL ACTION

Plaintiff Oklahoma Law Enforcement Retirement System ("OLERS" or "Plaintiff"), by and through its undersigned counsel, asserts this action on behalf of Education Management Corp. ("EDMC" or the "Company") against the EDMC Board of Directors. OLERS makes the following allegations upon knowledge as to itself and upon information and belief (including the investigation of counsel and review of publicly available information) as to all other matters, and alleges as follows.

SUMMARY OF THE ACTION

1. This is a shareholder derivative action that seeks to recover damages incurred by the Company caused by breaches of fiduciary duty by its Board of Directors ("Board").

2. EDMC was taken private in 2006 in a leveraged buy-out ("LBO") led by Goldman Sachs, and then taken public again with an initial public offering in 2009. Since the

LBO, there has been a radical shift in the Company's priorities. The $2 billion debt Goldman Sachs and its fellow investors took on in the LBO has driven the Company to value short-term return over long-term, sustainable growth. This focus has led to aggressive and illegal recruiting techniques to drive up student enrollment.

3. As a result, EDMC has become one of the largest for-profit educational providers in the country. EDMC's primary revenue stream comes from the tuition that students pay to enroll in the Company's various academic programs. The majority of tuition paid at EDMC is funded by federal student financial aid programs authorized by Title IV ("Title IV") of the Higher Education Act of 1965, as amended (the "HEA").

4. In order to continue receiving Title IV funds, EDMC must be compliant with the regulations of both the federal and state governments. Specifically, EDMC must comply with the rules and regulations established by the Department of Education ("DOE"), as well as those established by state agencies and accrediting agencies. These regulations prohibit, *inter alia*, compensating employees based solely on the number of new students they recruit and various aggressive recruitment tactics.

5. Educational institutions receiving Title IV funding must maintain state authorization and accreditation by a recognized accrediting agency. The requirements for agency accreditation include showing that graduates of EDMC schools are "gainfully employed" in a profession that utilizes the degree earned. Most of the agencies accrediting EDMC schools that have specific percentage standards require placement of approximately 65% to 70% of each graduating class in jobs in their chosen field of study to receive accreditation.

6. EDMC maintains that it is fully compliant with all governing rules and regulations, but the reality is that the advent of the LBO and the extraordinary focus on servicing

the debt-load has led it to violate several key requirements. EDMC's practices that are in violation of these rules and regulations include: improperly compensating its employees based solely on the number of new student enrollments; aggressive and misleading recruitment practices; and misrepresentations concerning EDMC graduates' job placement data.

7. As a result of EDMC's misconduct and violations of Title IV and state regulations, EDMC faces the possibility of losing its eligibility to accept Title IV funding, which would threaten close to 90% of its revenue stream and its very existence.

8. EDMC is already facing some of the consequences of these violations. Two *qui tam* actions were filed by relators under the federal and state False Claims Acts, alleging that EDMC has violated governmental regulations while receiving Title IV funding. The federal government and various state governments intervened in the action, which is pending against EDMC in the United States District Court for the Western District of Pennsylvania under the caption *United States of America v. Education Management Corp.*, 2:07-cv-461 (W.D. Pa., filed August 8, 2011) ("Government Action"). EDMC faces substantial liability in the Government Action, including the possibility of treble damages that could total more than $33 billion.

9. Plaintiff learned of the misconduct at EDMC on or about August 8, 2011, when the federal government intervened in the Government Action and the seal that had previously kept the action from public disclosure was lifted. By letter dated August 19, 2011, Plaintiff made a demand on the EDMC Board to bring suit asserting the claims set forth herein ("Demand Letter"). On December 8, 2011, counsel for Plaintiff received a reply letter from R. Todd Cronan, Esquire ("Cronan") at Goodwin Procter LLP ("Goodwin"), which referenced a committee of unidentified "disinterested directors" (the "Committee") which was purportedly

investigating the conduct described in the Demand Letter, and which invited Plaintiff to participate in the investigation by providing information.

10. Counsel for Plaintiff responded to Goodwin's letter by letter dated December 15, 2011, expressing a strong interest in providing the Committee with information and otherwise participating in the Committee's investigation. Plaintiff's counsel also requested that Goodwin identify the Committee members and provide a copy of the resolution of the EDMC Board that created the Committee and defined its authority.

11. Notwithstanding the invitation for Plaintiff to participate in the investigation, and Plaintiff's acceptance of such invitation, Plaintiff did not receive a response from Goodwin or any representative of Board, the Committee or the Company concerning the Committee's investigation. On January 19, 2012, Plaintiff wrote to Cronan again, reiterating Plaintiff's willingness to work with the Committee on the investigation, and supplementing the initial Demand Letter with additional allegations of wrongdoing, including allegations that EDMC's financial health was questionable in light of certain actions of the DOE and that EDMC falsified its job placement data. Given the lengthy amount of time since the Plaintiff's demand was first made, with no substantive response from the Committee, Plaintiff requested a response from the Committee on or before February 20, 2012.

12. On February 17, 2012, Stuart M. Glass ("Glass") of Goodwin wrote to Plaintiff's counsel stating that the Committee expected to have a "response" to "some of the issues addressed in your letters" by the end of the week of February 20, 2012. That response finally materialized on March 6, 2012. In the March 6 response, the Committee refused Plaintiff's demand with regard to the issue of why EDMC was required to post a greater letter of credit and with regard to the issue of false job placement data. The Committee purported to still be

investigating the issue of improper recruitment and other practices that threatened EDMC's receipt of Title IV funds.

13. The Committee has not acted reasonably or in good faith in addressing Plaintiff's demands. First, the Committee members – whose identities were finally revealed in the March 6 response – are conflicted because they are closely connected with two of the investors in the LBO. It is the heavy debt load incurred in the LBO that caused the sea change at EDMC so strongly toward the wrongful recruitment practices. The Committee members were also conflicted as of the time of their decisions reflected in the March 6 response because they are defendants in a securities action ("Securities Action"),[1] and ultimately could have faced significant potential liability in that case. In other words, they had a vested interest in seeing the issues that underlie the Securities Action swept under the rug through a demand refusal.

14. Second, the Committee, despite paying lip service to a desire to meet with the Plaintiff, never responded to Plaintiff's multiple offers to meet and work with the Committee.

15. Third, the refusal of the Demand on the issue of EDMC's failing financial reliability in the eyes of the DOE and the need to post increasingly higher letters of credit with the DOE was wrongful. The Committee's "explanation" for the fact that the EDMC has failed to meet the DOE's ratios indicating financial health was that EDMC is carrying a great deal of goodwill on its financial statements since the LBO. The Committee further stated that EDMC believes that the DOE raised the letter of credit requirement from 10% to 15% because it expects EDMC's receipt of Title IV funds to increase by 5% each year. That makes no sense, however,

[1] The Securities Action, *Gaer v. Education Management Corp., et. al.*, 2:10-cv-1061RCM (W.D. Pa., filed Jan. 1, 2011) was initially filed on August 11, 2010. The case was dismissed for failure to meet the scienter requirement of securities fraud, but was on appeal to the United States Court of Appeals for the Third Circuit at the time of the March 6 Response. On April 18, 2012, EDMC announced that the plaintiffs in the securities case had withdrawn their appeal.

because as Title IV funds increased, so too would the amount of the required 10% letter of credit because 10% of a bigger number yields a higher number itself. Moreover, the DOE was concerned enough about the financial situation at EDMC to give its schools only provisional certification – a determination that is based upon the Secretary of the DOE's belief that the institution is not sufficiently financially stable.

16. Fourth, the refusal of the Demand on the false job placement data reporting was also wrongful. The Committee admits that it did not even conduct its own investigation of the issue, but rather relied on an internal investigation that was biased toward a finding of no falsifications. Moreover, the internal investigation was limited to one division of EDMC, whereas Plaintiff's demand was not so limited.

17. Finally, the Committee, despite its claim to the contrary, has essentially refused demand on the issue of the practices which endanger EDMC's receipt of Title IV funding. The March 6 response states that the Committee has determined that EDMC's internal controls with regard to the issue are "robust" and that the directors and executive officers therefore bear no liability for any wrongs that may have been committed. The Committee's stated reasons for finding "robust" internal controls do not truly address the practices Plaintiff outlined in its demand, and are, in any event, belied by the facts that have been revealed in the Government Action and through other means.

18. For these reasons, Plaintiff asserts that its demands have been wrongfully refused by the Committee, which has not acted reasonably or in good faith. Plaintiff therefore brings this derivative action to address the wrongdoing at the Company that the Board and its Committee have refused to address in a timely fashion.

JURISDICTION

19. This Court has jurisdiction over this action because the Company is headquartered in Pittsburgh, Pennsylvania.

20. As directors of a Pennsylvania Corporation, the Individual Defendants have consented to the jurisdiction of this Court pursuant to Section 5322(a)(7)(iv) of the Judicial Code, 42 Pa.C.S.A. §5322(a)(7)(iv).

THE PARTIES

21. Plaintiff Oklahoma Law Enforcement Retirement System is a public pension retirement fund with an address of 421 NW 13th St # 100 Oklahoma City, OK 73103. Plaintiff has owned EDMC common stock continuously during the time of the wrongful course of conduct by the Defendants alleged herein and continues to hold EDMC stock.

22. Nominal Defendant EDMC is a Pennsylvania corporation with its principal place of business located in Allegheny County at 210 Sixth Avenue, 33rd Floor, Pittsburgh, Pennsylvania 15222. It is one of the largest for-profit education providers in the United States, offering campus-based and online instruction to students through its Art Institute, Argosy University, Brown Mackie College and South University schools. In total, EDMC operates schools in 108 locations across the United States and Canada, and through those schools awards undergraduate and graduate degrees and certain specialized non-degree diplomas in a broad range of disciplines. On October 1, 2009, EDMC offered 20 million shares of its common stock pursuant to a Registration Statement on Form S-1/A ("Registration Statement") and an Initial Public Offering ("IPO") for proceeds of $330 million.

23. Defendant Todd S. Nelson has served as the Company's Chief Executive Officer ("CEO") and a Director since February 2007. Defendant Nelson's address is 3250 East Tere

Street, Phoenix, AZ 85044. Defendant Nelson was formerly the CEO of Apollo Group, Inc., which was the parent company of the University of Phoenix, the nation's largest for-profit post-secondary school educational provider. During Nelson's tenure there, the University of Phoenix was accused by the DOE of misconduct that is very similar to that described herein, and ended up paying a record settlement of the DOE's allegations.

24. Defendant John R. McKernan, Jr. ("McKernan") has served as a director of the Company since June 1999, and is currently the Chairman of the Board of Directors ("Board"). McKernan also served as EDMC's CEO from September 2003 until February 2007. Defendant McKernan's address is 337 Foreside Road, Falmouth, ME 04105.

25. Mick J. Beekhuizen ("Beekhuizen") has served as a director of the Company since October 2009. Beekhuizen has been a Managing Director in the Merchant Banking Division of Goldman Sachs & Co. since 2010. Beekhuizen is a designee on the EDMC Board by Goldman Sachs Capital Partners, one of the entities that participated in the 2006 LBO. Defendant Beekhuizen's address is 92 Laight Street, Apartment 9B, New York, NY 10013.

26. Samuel C. Cowley ("Cowley") has served as a director of the Company since October 2009. Defendant Cowley's address is 14629 South 1st Street, Phoenix, AZ 85048.

27. Defendant Adrian M. Jones ("Jones") has served as a director of the Company since June 2006. Jones also serves as a managing director of Goldman, Sachs & Co.'s Principal Investment Area of its Merchant Banking Division. Jones was appointed to the EDMC Board by Goldman Sachs Capital Partners. Defendant Jones' address is 122 Phelps Road, Ridgewood, NJ, 07450.

28. Defendant Jeffrey T. Leeds ("Leeds") has served as a director of the Company since March 2007. Leeds is also the President and a co-founder of Leeds Capital Partners, one of

the entities that participated in the LBO, and was appointed to the EDMC board by Leeds Capital Partners. Defendant Leeds' address is 435 East 52nd Street, Apartment 11G, New York NY 10022.

29. Defendant Leo F. Mullin ("Mullin") has served as a director of the Company since June 2006. Mullin serves as a consultant to Goldman Sachs Capital Partners. Defendant Mullin's address is 710 Fairfield Road, NW, Atlanta, GA 30327.

30. Defendant Paul J. Salem ("Salem") has served as a director of the Company since June 2006. Salem is also a Senior Managing Director and Co-Founder of Providence Equity Partners, one of the participants in the 2006 LBO, and was appointed to the EDMC board by Providence Equity Partners. Defendant Salem's address is 41 Nayatt Road, Barrington, RI 02806.

31. Defendant Peter O. Wilde ("Wilde") has served as a director of the Company since June 2006. Wilde also serves as a Managing Director of Providence Equity Partners and was appointed to the EDMC board by Providence Equity Partners. Defendant Wilde's address is 280 Warren Street, Brookline, MA 02445.

32. Defendant Joseph R. Wright ("Wright") has served as a director of the Company since August 2011. Defendant Wright's address is 10 Gracie Square, #7G, New York, NY 10028.

33. Defendants Nelson, McKernan, Beekhuizen, Cowley, Jones, Leeds, Mullin, Salem, Wilde and Wright are referred to herein collectively as the "Individual Defendants."

34. By virtue of their positions as directors of Education Management and/or their exercise of control and ownership over the business and corporate affairs of the Company, the Individual Defendants at all relevant times had the power to control and influence, and did

control and influence and cause the Company to engage in the practices complained of herein. Each Individual Defendant owed the Company's shareholders fiduciary obligations of candor, due care, good faith, and loyalty and were required to: (1) use their ability to control and manage EDMC in a fair, just, and equitable manner; (2) act in furtherance of the best interests of EDMC's shareholders; (3) govern EDMC in such a manner as to heed the expressed views of its public shareholders; (4) refrain from abusing their positions of control; and (5) not favor their own interests at the expense of the Company and its public shareholders.

SUBSTANTIVE ALLEGATIONS

I. THE GROWTH AND PROBLEMS OF THE FOR-PROFIT EDUCATION SECTOR

A. The Relationship of For-Profit Institutions, Title IV Funding and the Incentive Compensation Ban

35. For-profit universities and colleges are known primarily for training students for "passion" fields, such as art, cooking, fashion design and the like. EDMC is of that mold, having acquired the Art Institute of Pittsburgh in 1970 and having grown to more than 70 campuses nationwide by 2006 with its brand names of the Art Institutes, Brown Mackie College, Argosy University and South University.

36. For-profit universities rely heavily on funding from the federal government in the form of financial aid for their students. For example, from July 1, 2003 through June 30, 2011, EDMC received over $11.1 billion in Title IV funding for students enrolled in EDMC institutions. On a yearly basis, those amounts ranged from $656 million in "Award Year" 2003-2004 (an Award Year runs from July 1 through June 30 of the following calendar year) to over $2.5 billion in Award Year 2010-2011.

37. Title IV of the HEA, 20 U.S.C. §§ 1070, *et seq.*, governs the provision of various student loan and grant programs, including, *inter alia*, the Federal Pell Grant Program ("Pell"),

the Federal Family Education Loan Program ("FFELP") and the Federal Direct Loan Program ("FDLP") (collectively, "Title IV Funding"). The purpose of Title IV Funding is to assist students in paying for a post-secondary school education who would otherwise not be able to afford the tuition and other associated costs.

38. The regulations surrounding the grant of Title IV Funding are meant to protect these resources from abuse. For example, if a student defaults in repaying a loan under FFELP, a state or private guaranty agency reimburses the lender or the subsequent holder of the loan for the outstanding balance and takes assignment of the loan. 34 C.F.R. § 682.401(b)(14). If the guaranty agency is unable to collect from the borrower, the DOE reimburses the guaranty agency for any loss, 20 U.S.C. § 1078(c)(1)(A), and the DOE may, in its discretion, take assignment of the loan. 20 U.S.C. § 1078(c)(8). In this way, the government – not the for-profit institution – ultimately bears the losses for any unpaid loans.

39. Each of the programs under Title IV requires that certain conditions be met before students, and ultimately the institutions they attend, are eligible to receive federal funds. Specifically, in order to receive Title IV Funding, a student must attend a school that had first entered into a program participation agreement ("PPA") with the DOE. 20 U.S.C. § 1094(a); 34 C.F.R. §668.14. Pursuant to the PPA, the university must certify that its educational institutions are compliant with various regulations.

40. Any act which violates the HEA, including falsely certifying that an institution's schools are entirely compliant with HEA regulations or submitting false PPAs, threatens an institution's ability to receive Title IV funding. In addition, violations of the HEA laws can subject the institution to substantial fines, including in some cases, treble damages.

41. One key provision that educational institutions must comply with in order to receive Title IV funding is the "Incentive Compensation Ban." Section 487(a)(20) of Title IV of the HEA, 20 U.S.C. § 1094(a)(20) requires that schools "will not provide any commission, bonus, or other incentive payment based directly or indirectly on success in securing enrollments or financial aid to any persons or entities engaged in any student recruiting or admission activities or in making decisions regarding the award of student financial assistance. . . ."

42. This means that in order to receive Title IV Funding, an institution may not pay its employees based on the number of new students those employees recruit. The Incentive Compensation Ban was enacted because there was a correlation between high loan default rates and the payment of commissions, bonuses, or other incentive payments based upon the success in recruiting new students to an institution. Not surprisingly, where an employee's compensation is based upon the number of students he or she is responsible for enrolling – and in turn the tuition and fees that student pays to the institution – there is an incentive for that employee to relax the admissions standards and/or to aggressively target students who are not actually qualified to either attend the institution or to repay the loans. The high loan default rates occurring before the Incentive Compensation Ban were causing a significant drain on funds where the government was acting as loan guarantor. The impetus for the Ban was Congressional findings of significant abuses in federal student aid programs, including, e.g., "contests" that "were held whereby sales representatives earned incentive awards for enrolling the highest number of students for a given period." S. Rep. No. 58, 102nd Cong., 1st Sess., at 8 (1991).

43. The Incentive Compensation Ban was amended in 2002 to clarify that schools may pay "fixed compensation, such as a fixed annual salary or a fixed hourly wage, as long as that compensation is not adjusted up or down more than twice during any twelve month period,

and any adjustment is not based solely on the number of students recruited, admitted, enrolled, or awarded financial aid." 34 C.F.R. §668.14(b)(22)(ii)(A) ("Regulatory Safe Harbor").

B. Apollo Group, Under Defendant Nelson's Leadership, Tests The Bounds Of The Incentive Compensation Ban And Pays A Record Settlement

44. The leader of the for-profit educational sector is the Apollo Group ("Apollo"), which runs the University of Phoenix. About a decade ago, Apollo's enrollment and revenues took off – with Defendant Nelson at the helm, first as President, then as CEO and Chairman.

45. Under Nelson's guidance, Apollo tripled its revenues between 2001 and 2006. Between 1998 and 2003, Apollo tripled its enrollment. All told, it was the success story of the industry.

46. The growth and success were not without a price, however. In early 2004, the DOE issued a report that alleged Apollo was garnering these remarkable results through predatory admissions practices at its University of Phoenix – practices which violated the Incentive Compensation Ban.

47. The DOE report stated that admissions officers at the University of Phoenix were little more than salespeople who were constantly pressured to increase the number of students they admitted.

48. Successful admissions officers, *i.e.*, those who met their student enrollment quotas, were rewarded with lavish trips and other perquisites. Admissions officers who did not meet their quotas were subjected to ridicule, humiliation and threats of firing. Underperformers were forced to do their jobs from the "red room," which was constantly monitored by supervisors, and were denied vacation time and breaks. Admissions officers' "performance" –

the number of students they recruited – was tracked daily on dry erase boards for the entire department to see.

49. Admissions officers' compensation was determined according to a system called the "Matrix." Under the Matrix, there was a direct correlation between an officer's compensation and the number of students they recruited. Other "quality of performance" factors were also supposedly considered in determining compensation, but in reality what really drove compensation was the number of students an officer enrolled.

50. In September 2004, the University of Phoenix settled the charges leveled by the DOE for a record amount at the time – $9.8 million. Defendant Nelson left Apollo in January 2006, having been pushed out by Apollo's founder for his ruthless pursuit of short term profits to temporarily bolster the stock price.

II. THE PERFECT STORM – DEREGULATION, MORE FEDERAL DOLLARS AND EDMC'S 2006 GOLDMAN SACHS-LED LBO

51. 2006 was an eventful year for the for-profit institutions. The federal government was making more Title IV funding available for students who wanted to go to college, and it also lifted certain regulations that constrained for-profit institutions in their growth models. Specifically, the government lifted the requirement that at least 50% of students be enrolled in brick and mortar institutions. Until that change, the for-profit institutions could never have their online students account for more than 50% of their student body.

52. This deregulation and increased financial aid created a potential for growth that the sector had not seen before. The for-profit institutions wasted no time expanding their recruiting efforts for online students.

53. Goldman Sachs recognized the unique opportunity that the confluence of these factors created. Thus, in 2006, it and a small consortium of investors (Providence Equity

Partners and Leeds Capital Partners) bought EDMC in a leveraged buy-out for $3.4 billion. In total, EDMC took on $2 billion in debt to finance the purchase.

54. Not surprisingly, once Goldman Sachs, Providence and Leeds took over, the composition of the board of directors changed as well. By the time of the IPO in 2009, 50% of the EDMC Board was appointed by the LBO investors. Goldman Sachs appointed Defendants Beekhuizen and Jones, both Goldman Sachs employees. Leeds appointed Defendant Leeds, who is a co-founder of Leeds. Providence appointed Defendants Salem and Wilde, both of whom are Managing Directors of Providence.

III. THE NEW CULTURE OF EDMC – ENROLLMENT ABOVE ALL ELSE

55. According to the CFO who retired shortly after the LBO, Robert T. McDowell, the debt from the LBO changed EDMC's focus. As McDowell observed, when "you take on that amount of private-equity debt, you need to earn high rates of return for these investors." Indeed, a former EDMC vice president for marketing and admissions operations noted that once the LBO investors took over in 2006, the "new group managed [EDMC] short term."

56. In pursuit of those short term, high rates of return, the consortium turned to Defendant Nelson. In February 2007 – virtually as soon as his non-competition agreement with Apollo had expired – EDMC brought on Defendant Nelson as its new CEO.

57. Soon thereafter, other former Apollo executives were brought on board – Robert Carroll (Apollo's former CIO), Craig Swenson (a former Senior Vice President of the University of Phoenix), Ken Boutelle, Sam Yaghoubi, David Preece, Phil Clark, Sean St. Clair, Jamie Wellnitz, Mary Dyer-St. Clair, Anthony F. Digiovanni (Senior Vice President of Marketing and Admissions) and John Kline (President of EDMC Online Higher Education).

58. With the change in management came a change in culture at EDMC. Admissions, which had always been important, became the paramount focus of the administration. According to Kathleen Bittel, who started her career at EDMC as a recruiter at its Argosy University in the first year after the LBO, "it was an absolute feeding frenzy. They were on us every minute of the day. We had managers who were just literally circling the pods, listening to every word that was spoken. I swear I thought they were going to wear out the carpeting."

59. Admissions staff grew exponentially, from 950 to 2,600. The "sales" focus of the admissions process was bolstered by hiring career salespeople rather than people experienced in the academic arena. For example, in late July or early August of 2006, Michael Mahoney interviewed with the Vice President of Admissions for EDMC's Online Higher Education division, Ken Boutelle (a former Apollo employee under Nelson), for the position of Director of Training for EDMC's online division. Mr. Mahoney's background was in sales and sales training in the automotive industry. During that meeting and in a subsequent interview, Mr. Boutelle informed Mr. Mahoney of EDMC's enrollment goals, including: (a) increasing the total number of enrollees ten-fold within five years; (b) increasing the average number of new enrollees for each Assistant Director of Admissions ("ADA") from 1.6 to 3.0 students per week; (c) increasing the turnover rate for ADAs from 17% to 25%, by firing ADAs who did not meet their enrollment quotas; (d) increasing the number of ADAs from 530 to 1,000 within two years; and (e) hiring an individual to oversee training of new ADAs, referenced sometimes as EDMC's "sales force."

60. During the Mahoney interviews, Mr. Boutelle was extremely interested in Mr. Mahoney's sales experience and indicated that Mr. Mahoney would be hired, in part, to write a training manual on how to "close the sale" and get a student to enroll. Mr. Mahoney was then

hired to fill EDMC's newly-created "Director of Training" position, effective October 2, 2006, with the understanding that he would use his sales experience in the automotive industry to help achieve EDMC's new student enrollment targets through a new training program.

61. Mr. Mahoney's core function was to train EDMC employees who would then train the ADAs. The pre-existing training materials did not mention Title IV's ban on incentive based compensation, and Mr. Mahoney was never instructed to add any description of the Incentive Compensation Ban to the materials. New marketing scripts and internal teaching brochures were handed down that listed typical reasons potential students gave for not enrolling and forbade the staff to accept those reasons. Scripts of ways to get around the potential recruits' reasons were distributed.

62. None of the sales training materials referred to or acknowledged the prohibition regarding incentive-based compensation. Moreover, during his employment at EDMC, Mr. Mahoney never gave any instruction – nor was he told that he should – regarding the "quality factors" that EDMC purports to use in determining an ADA's salary, *i.e.*, those factors that supposedly keep the compensation from being based solely on new student enrollment. In fact, he never heard anyone even discuss the "quality factors."

63. In order to meet the aggressive quotas that were set, ADAs began enrolling "anyone and everyone," according to a former HR Manager for EDMC's Online Division, including people who "barely passed high school," and who would "never pass in this college environment."

64. The "find the pain" technique was taught to admissions personnel. They were taught to determine what a prospective student's emotional weakness was and to press that issue as a reason to enroll at an EDMC school. For example, a current admissions officer for the

online program at EDMC's South University recalled a single mother who was worried about taking out student loans because she could barely pay her utility bills. The admissions officer thought the woman was not an appropriate candidate, but his manager told him to use her dire financial straits to their advantage by implying that a college degree would change her circumstances. Brian Buchanan, an admissions representative at South University from December 2005 to May 2007, stated that his managers told him that if the candidate was a single mother, he should say to her "How are you going to explain to your children that you cannot buy them the things they need because you couldn't be bothered to finish your education?" or "Do you honestly think that your children are ever going to go to college and graduate after watching their mother never even try to finish hers?"

65. Brian Klein, a former admissions employee for three years at the online division of Argosy University, said "you'd probe to find a weakness. You basically take all that failure and all those bad decisions, and you spin it around and put it right back in their face as guilt…."

66. Admissions staff even lied to potential recruits. For example, people with felony criminal records were told that pursuing a criminal justice degree at EDMC could lead to working for the FBI. That is patently untrue, as the FBI is barred from hiring anyone with a felony criminal record.

67. Patrick Flynn, a recruiter at EDMC's South University from 2006 to 2009, stated that "it just got to the point where I felt like I was lying to these people on a regular basis. Honestly, I just felt dirty doing the things I was doing."

IV. THE VIOLATIONS OF FEDERAL AND STATE REGULATIONS THAT ARE DAMAGING THE COMPANY

A. EDMC Violates The Incentive Compensation Ban

68. The new system that was instituted at EDMC after the LBO has made recruiting and enrolling new students the sole focus of its compensation system for its admissions personnel. This violates the Incentive Compensation Ban. Through its compensation system and practices, the representations and certifications it makes to the federal government in its PPAs, in connection with annual compliance audits, and in other documents, EDMC knowingly violates Title IV of the HEA's Incentive Compensation Ban and Regulatory Safe Harbor, and its accompanying regulations.

69. EDMC's compensation system for admissions personnel is called the Admissions Performance Plan. EDMC provides its ADAs with a copy of a document explaining the Admissions Performance Plan. During the relevant time period, this document has had various titles including "Your Guide to the Admissions Performance Plan for Assistant Directors of Admission" (the "Performance Guide") and "Admissions Performance Plan, Information for Assistant and Associate Directors of Admission." What it truly is, however, is the Matrix that led Apollo afoul of the DOE regulations and resulted in a record settlement.

70. EDMC explains to ADAs that their compensation is based on an evaluation of their performance against quality factors combined with the number and types of new students recruited in the previous 12 months. The Performance Guide informs ADAs that "[t]he number of new students you recruited over the previous 12 months is converted into points, and the point total ["New Student Points"] determines the salary range. Your salary within the range is determined by your manager's evaluation of performance against quality factors."

71. The Matrix, more formally titled the "ADA/Associate Annualized Salary Chart," sets forth the number of "New Student Points" that an ADA must attain in order to achieve a particular compensation level. New Student Points are calculated based on the number of

students the ADA recruits. The Matrix lists compensation schedules, with a compensation level corresponding to the "New Student Point Range" an ADA achieves, i.e., based on the number of students recruited. Pursuant to the Matrix, "quality factors" purport to adjust the employee's compensation within the level set by the number of new students recruited.

72. Per EDMC's Performance Guide, newly hired ADAs are subject to a six-month introductory period, at the end of which they are supposed to be evaluated solely on qualitative factors, and not on the number of New Student Points. After that six-month period, however, ADAs are evaluated on the number of New Student Points, again, supposedly taking into account qualitative factors as well. The employee's compensation is then based upon the greater of "quality points only" or on the New Student Points and qualitative factors. Once an employee has attained a sufficient number of New Student Points to result in a higher compensation based on the combination of New Student Points and quality factors rather than quality factors alone, the employee has "gone on the Matrix." An employee's third review, which occurs after 18 months of employment, must take into account the New Student Points.

73. In addition to appearing in the Performance Guide, the Matrix is presented to employees during their interviews and as part of their initial training and orientation sessions. Employees have been informed that "the number of points based on new students recruited for the prior twelve months determines a person's salary range and 'quality factors' determine the person's position within the salary range."

74. Despite the "quality factors" in the Matrix, EDMC's admissions personnel are compensated based solely on the number of new students they are responsible for enrolling. Members of EDMC's Admissions Department have openly admitted to their admissions employees that compensation is tied to enrollment numbers. Some employees have been told

that their compensation would increase after six months if they achieved certain enrollment goals. For example, Jan Anton, a Vice President at the Art Institute of Chicago, advised an ADA in 2007 at her evaluation that "quality factors" were insignificant in ADA compensation. In fact, Anton openly admitted that the "quality factors" were merely a ruse, created for the purpose of getting around the Incentive Compensation Ban.

75. A former ADA for South University's online division was told when he was hired by the Director of Online Admissions, "I can't pay you on commission but we have something called a matrix." The former ADA was then told that the Matrix is used to get around the restriction on incentive based compensation for Title IV Funding. The former ADA also noted that his enrollment quotas increased from 6 up to 30 new students every three months, and said if he failed to meet those quotas, there was a risk that his salary would be reduced by 15%.

76. An ADA at Brown Mackie College stated that he was shown "a chart, and depending on how much money you wanted to make was your quota that you had to get." Several former ADAs described how admission representatives would receive substantial increases in compensation after short periods of time due to having met or exceeded enrollment quotas. The former Director of Admissions for EDMC's online division from March 2006 through December 2009 stated outright that ADAs received points for each student they enrolled, and that "these points were tallied up and this determined your salary."

77. Directors of Admissions are also provided with documents that provide an overview of the compensation system ("Manager Guidelines"), including the Matrix. The Director of Admissions for each EDMC school is the primary recruiting and marketing manager for that school. He manages or oversees the managers of all recruiting functions, including

ADAs and Assistant Directors of Admissions. The Manager Guidelines reinforce the Matrix system and specify that

> [t]he fundamentals of the Admissions Performance Plan work the same way for all participants, to ensure that ***Associate and ADA compensation is standardized*** and rewards performance against specific and quantitative objectives."

(Emphasis added).

78. At the Illinois Institutes of Art, for example, there is ample evidence that ADAs are compensated solely based on new student enrollments. In the Government Action, Illinois alleged that one ADA had, during one evaluation period, recruited 65 new students, which resulted in an increase of her compensation to $46,440. At the next evaluation, she had only recruited 57 new students, and her compensation declined to $42,120. At each of those reviews, however, her "qualitative factors" evaluations were the same. Therefore, the adjustments in her salary were due solely to changes in the number of new student enrollments.

79. Illinois alleges that another ADA at the Illinois Institutes of Art had received compensation of $37,908 in a January 2006 evaluation for enrolling 54 students. Six months later, she had recruited 62 new students and her compensation increased to $42,120. And six months after that, when her enrollment figures increased again to 71 new students, her compensation increased again, to $46,440. Throughout these three review periods, her marks on the qualitative factors remained constant.

80. Jason Sobek, a former admissions officer for South University, alleged in a qui tam suit he filed against EDMC in January 2010 that compensation for admissions officers was entirely driven by new student enrollments, and quoted part of the 2008-2009 EDMC Admission Compensation Plan as follows:

Hire date: August 1, 2008; Review date: February 1, 2009 (1st Review)

18 new students, 8/1/2008-1/30/2009 (3 points each)----------54

Quality Points (Meets Expectations) -----------------------------14

Annualized baseline salary ---------------------------------$39,000

Hire date: August 1, 2008; Review date: August 1, 2009 (2nd Review)

30 new students 2/1/2009-7/30/2009 (3 points each)-----------90

Quality Points (Meets Expectations)-----------------------------15

Annualized baseline salary----------------------------------$44,000

81. The portion of the Compensation Plan that Sobek quoted demonstrates that new student enrollment is what drives an admissions officer's compensation. To achieve a $5000 annualized increase, the officer need only raise their "quality points" by 1 point, or 7%, but they must raise their new student enrollment by 12 students, or 67%.

82. In fact, Sobek's own compensation demonstrates that salary for admissions personnel was determined solely on the number of new students they enroll. For all four of his biannual reviews, he received 20 quality points and was rated in the Highly Effective range. Yet his salary over the same time period fluctuated from roughly $15.38 per hour (annualized to roughly $33,000) to $29.56 (annualized to roughly $61,500) and was clearly tied to the number of new students he enrolled.

83. An ADA is given a "Student Start Plan," which are quotas of students that the ADAs are expected to enroll. If an ADA achieves the number of enrollments set forth in the Student Start Plan, he goes "on the Matrix," meaning that his compensation is governed by new student enrollments (and is typically higher than if qualitative factors are taken into account). Based on the Student Start Plan, an ADA's supervisor formulates a "Plan to Make Plan," which

is essentially a roadmap for what the ADA must do in order to achieve the new student enrollment quotas for the upcoming quarter.

84. ADAs do not receive credit for a new student enrollment until the new student confirms enrollment in a class so that the student becomes liable to EDMC. Therefore, during the week before the start of "start date," i.e., when classes begin (which occurs, in most EDMC schools, twice per quarter, or eight times a year), ADAs are expected to call any student who has not confirmed enrollment in a class to ensure that the student enrolls.

85. To motivate ADAs to meet their enrollment quotas, their supervisors often ask them to think of a financial goal, such as a "dream car" or vacation that they can attain by reaching the enrollment quotas. EDMC uses financial planning documents to show the ADAs exactly how many New Student Points are required to make a particular amount of compensation, and that is broken down by number of applications, interviews, and appointments per week.

86. EDMC closely tracks and maintains data regarding the actual number of student enrollments that the ADA obtained versus the number of enrollments the ADA was expected to obtain according to the Student Start Plan. For example, EDMC circulates reports that track each ADA's enrollment activities on a daily, weekly, monthly, quarterly and annual basis. Some of these reports include, "Operations Dashboard," "Plan Status Report," "Call Summary Report," "Underachiever Report," "Stacked Rankings-Applications," "ADA Trend Analysis," "Stacked Rankings-Starts," and "Conversion Report." These reports are widely disseminated within EDMC, and are used to manage, evaluate and compensate EDMC ADAs. At the office level, the dry erase boards that were used to track each ADAs admissions at Apollo under Nelson's

leadership were implemented at EDMC as a daily reminder that the number of students enrolled was the paramount concern of the admissions department.

87. Notably, quality factors are not discussed in an ADA's Student Start Plan, Plan to Make Plan or any other documents that EDMC uses to track the ADAs' performance. To the contrary, these documents focus solely on the number of new student enrollments each ADA is responsible for, and only measure quantitative factors.

88. ADAs are reviewed by their supervisors, but such reviews focus solely on the number of enrollments the ADAs are expected to obtain in order to reach their identified financial goals. ADAs are not given any similar prodding or incentivizing with regard to quality factors.

89. The number of students that an ADA enrolls governs whether the ADA is promoted, gets an increase in salary, or is fired. Lynntoya Washington, an EDMC ADA from June 1, 2004 through May 25, 2007, was warned on October 11, 2006 that failure to hit her enrollment numbers could result in her termination by Gregg Schneider, an Art Institute Online Director of Admissions. He reprimanded ADAs, including Ms. Washington, for failing to meet goals for the October 2006 start date. In an email, he wrote, "Each of you knows your plan for November. This number is not a casual level that I want you to be at but rather a number that you must hit to have a good review, get promoted or keep your position here. This number is set by the VP of Admissions and the Director of Admissions."

90. One ADA stated that she received a $15,000 raise after just six months on the job due simply to exceeding enrollment quotas. She also stated that ADA salaries would be cut if they did not meet their quotas, a practice which also directly ties compensation to new student enrollments and violates the Incentive Compensation Ban.

91. The former Manager for Human Resources for EDMC's Online Division stated that there was one ADA who started with an annual salary of $30,000-$40,000, and whose salary was increased to $90,000 after just six months based on new student enrollments.

92. Further evidence that EDMC used only enrollment numbers to compensate its employees occurred during a meeting between Ms. Washington and EDMC's then-president of Online Higher Education, Stephen Weiss, on August 24, 2005. During that meeting, Ms. Washington expressed concern about a dip in her "quality" ratings, and Mr. Weiss assured her that the quality factor rating would have no effect on her compensation.

93. EDMC also provides incentive-based awards to its ADAs in the form of commissions, bonuses and other incentive awards. These are based solely on success in obtaining new student enrollments. For example, the top 10% of EDMC admissions personnel, as measured by new student enrollments, are given an all-expenses paid "President's Club" trip to a location such as Cancun, Mexico, or Las Vegas. In addition, the top ADAs, as measured by new student enrollments during brief periods of time, are awarded gifts such as Godiva chocolates, movie tickets, baseball tickets, and various restaurant and Starbucks gift cards, as well as free lunches with EDMC management. Other ADAs have been rewarded with early departures/time off from work.

94. In addition, the walls of EDMC's offices display posters and charts graphing each ADA's progress toward his sales goals and noting prizes for which the ADAs may be competing. However, if an auditor or accreditor is expected to conduct an on-site visit, these graphs and posters are taken down until such auditor or accreditor leaves.

95. "Underachieving" ADAs are also closely monitored and are routinely fired for failing to meet an acceptable number of student enrollments, without regard to the ADA's ratings

in the "quality factors" area. Written warnings sent to underachieving ADAs focus entirely on the number of new student enrollments. If an ADA fails to meet a new student enrollment goal, EDMC administers a Performance Improvement Plan ("PIP") which advises the ADA of a minimum amount of activity, such as meetings with potential students, the ADA must achieve in a given time frame. PIPs are based entirely on student enrollment figures.

96. The intense sales environment designed to enroll as many new students as possible was corroborated by Kathleen Bittel, who started her EDMC career as an admissions officer and ended it as a career service advisor in the online division of EDMC's Art Institute of Pittsburgh. Ms. Bittel gave testimony before a Senate Committee in September 2010. She described a "high pressure" environment where ADAs were constantly pressured "to deliver a minimum of two applications per week" and were instructed to pressure prospective students to enroll. She stated that "new leads" could be called three times a day for at least a week, and noted that "high-pressure sales tactics are being used to recruit individuals from the lower-income sector of our population as they are eligible for the most amount of [federal student] aid."

B. EDMC's Improper Recruitment Tactics Violate Title IV and Accrediting Agencies' Guidelines

97. State authorization and accreditation by a DOE-approved accrediting agency are also required for an institution to become and remain eligible to receive Title IV Funding. As such, EDMC is subject to extensive state regulations and accrediting agency requirements including the Accrediting Council for Independent Colleges and Schools; Accrediting Commission of Career Schools and Colleges, Commission on Colleges of the Southern Association of Colleges and Schools, Higher Learning Commission of the North Central Association, Middle States Association of Colleges & Schools of the Commission on Higher

Education, Northwest Commission on Colleges and Universities, and the Commission on Colleges of the Western Association of Schools and Colleges.

98. The accrediting agencies monitor the performance of each individual educational institution that falls under the EDMC umbrella according to a variety of criteria. Monitoring occurs through self-reporting and through periodic site visits by employees of the accrediting agency.

99. The accrediting agencies require periodic reporting and conduct regular site visits to ensure that, *inter alia*:

- Advertising, recruiting and admissions information adequately and accurately represent the programs, requirements and services available to students;

- An institution is not delegating unsupervised recruiting activities to anyone whose economic incentives are to recruit prospects through means that are unethical or subject to public criticism or to admit ill-prepared students;

- Institutions' recruitment methods are ethical and compatible with the educational objectives of the institution, including ensuring that any person engaged in admissions or recruitment activities is communicating current and accurate information regarding courses and programs, services, tuition, terms and operating policies;

- Institutions describe themselves to prospective students fully and accurately and to follow practices that permit prospective students to make informed and considered enrollment decisions without undue pressure.

- Institutions make efforts to attract only those students who are qualified and likely to complete and benefit from the training provided by the school and not simply obtain enrollments; and

- Institutions are not making misrepresentations to prospective students, including . . . misrepresenting job placement and employment opportunities for graduates; misrepresenting program costs; misrepresenting abilities required to complete intended program.

100. Likewise, Title IV requires that institutions make no "false, erroneous or misleading statement," "regarding the nature of its educational program, its financial charges, or the employability of its graduates" to "a student enrolled at the institution, to any prospective

student, to the family of an enrolled or prospective student, or to the Secretary" of the DOE. 34 C.F.R. § 668.71.

101. In order to achieve the aggressive recruiting goals, management of EDMC encourages its ADAs to utilize several improper recruiting tactics in violation of the accrediting agencies' guidelines and Title IV's prohibition on false statements to prospective students. Indeed, the unrealistically high enrollment goals could not be achieved unless such improper and aggressive recruiting methods were used.

102. EDMC's ADAs used a wide variety of tactics to improperly pressure students to enroll in EDMC institutions. For example, management urges EDMC's ADAs to enroll students before thoroughly examining their academic qualifications, such as transcripts or essays written. For example, a governmental audit in the 2008-2009 academic year of EDMC's Brown Mackie-South Bend campus found that of 5 student files tested, 3 were found to not be eligible at the time federal funds were disbursed due to inability to meet the high school requirements for the program or not being enrolled full-time. Although EDMC schools require a 150-word essay with the student's application, the quality of the essay is not evaluated, and all EDMC applicants are admitted.

103. ADAs are also pressured into tactics that overestimate an EDMC student's likelihood of attaining employment upon graduation. ADAs often tell potential EDMC students that EDMC schools have a very high career placement rate and that the Career Services Office will contact students prior to graduation to set up interviews with prospective employers. However, the Career Services Office has minimal involvement and students must find employment on their own, something which is frequently not possible. One former employee recalled that prospective students were told that, upon graduation, the career service department

would offer them "umpteen amount of places they can refer you to," when in actuality, "career services was [for] people who basically go on monster.com and indeed.com, they have no connections." Another former employee said that in response to questions about potential salaries post-graduation, ADAs were instructed to tell students, "go onto the web and punch it in, and see what numbers you come up with," rather than tell them the reality which might mean spending $40,000 on tuition and ending up with an $8 per hour medical assistant position.

104. A former student confirmed that admissions personnel frequently promise that the career placement division will essentially find a job for graduating students. This student was told by an admissions officer that career placement would arrange interviews with top companies and all the student would have to do was show up for the interview. Approaching graduation, the student looked to career placement for assistance, only to be given a list of websites where the student could post a resume. When the student complained about difficulty in finding a job, the student was encouraged to take yet more courses at EDMC schools.

105. Kathleen Bittel recently recounted at a seminar on for-profit universities that a graduating student came to her during her tenure as a career placement counselor and said, "I'm ready for my job now." She stated that the student told her he had been told by admissions personnel that when he was nearing graduation, the career placement office would find him a job.

106. Carrianne Howard, who graduated from EDMC's game art and design program, stated in an interview that she was led to believe by EDMC personnel that such a degree would lead to a very lucrative job. What she found, however, was that the best she could do was a $12 an hour job recruiting for a gaming company. When she lost that job due to a shut down of her division, she applied for any position, including minimum wage positions such as a retail clerk

position. The only way she could make a living and begin to pay her parents back the $70,000 they gave her for tuition was to turn to dancing in a strip club.

107. Furthermore, ADAs are instructed to use various pressure tactics to encourage prospective students to enroll, including "finding the pain," which means locating a prospective student's particular vulnerability. For example, a student may be motivated to attend school so that she may eventually move out of a dangerous neighborhood, and the ADAs are instructed to assure the prospective student that such goal will be attainable if she attends an EDMC school.

108. Several former employees provided statements that ADAs were instructed to misrepresent such matters as post-graduation employment prospects, the full cost of EDMC's programs, and a student's financial aid repayment obligations. For example, a former ADA recalled that EDMC trained the ADAs not to tell prospective students that the majority of tuition costs would need to be paid using loans, which would need to be repaid, as opposed to outright grants of funds, and that federal student loans were not dischargeable in bankruptcy, or that defaulting on a student loan could prevent an individual from obtaining a mortgage. A former ADA at EDMC for three years stated that it was the job of an ADA to talk a student into enrolling, even people who "would never be able to pay for their education."

109. Another former employee recalled that a prospective student, who had a child and was herself suffering from AIDS, was encouraged to enroll by being told, "now more than ever you need an education, for what time you have left here, get a job where they might have life insurance, get a job where you can get health insurance."

110. A former Senior Admissions Representative for South University's online division recalled a company-wide meeting held sometime before Thanksgiving 2009. The Online Higher Education CEO Stephen J. Weiss and President John R. Kline attended the

meeting. The purpose of the meeting was to inform ADAs of changes in EDMC's recruitment practices, which would increase the amount of time ADAs spent interacting with prospective students, forcing them to make up to 200 calls per day and spend at least 4 hours per day talking to prospective students. In addition, ADAs were told that they would have to become more closely involved with helping new students obtain financial aid.

111. An ADA at Brown Mackie College in Arizona stated that ADAs were encouraged to speak to people working at fast-food restaurants and other "dead end jobs," and to tell them that they could "get into a career" if they enrolled in an EDMC institution.

112. Furthermore, ADAs were instructed to give evasive answers if the truth would discourage a prospective student from enrolling. For example, a former employee stated that if a student asked whether credits from Brown Mackie would be transferrable to another school, rather than tell the truth – that no school would accept EDMC credits – ADAs were instructed to tell the prospective student to call the school to which he or she was considering transferring.

113. EDMC was sued in Texas state court by 18 of its students who alleged that they were misled about the accreditation status of their program. They alleged that Argosy University falsely told applicants to the clinical psychology doctoral program that the institution would be accredited by the American Psychological Association. They claimed that their degrees were far less valuable than they would have been had the program been accredited, and that the high tuition left them with debts that they could not pay. One of the plaintiffs, Stephanie Capalbo, got her doctorate from that program in 2008. Capalbo was turned down by many employers because she lacks a degree from an institution accredited by the American Psychological Association. She was able to find a job in New York paying $60,000 a year, but she graduated with student

loans totaling $280,000. She stated in an interview that "I'll be working the rest of my life to pay off these student loans. It's an unbearable debt."

114. The Director of Staffing at EDMC's online division from December 2007 through May 2008 stated that a lot of people "were asked to do things [that were] unethical," describing that ADAs were asked to provide incorrect information to students regarding financial aid so they could meet their quotas. Some ADAs complained to the former Director of Staffing, stating, "I can't do this to people. [Students] don't know what they're getting into. It's too expensive." The former Director of Staffing described EDMC as a "diploma mill," stating that it issued "valueless degree[s]."

115. In connection with the GAO investigation, Ms. Bittel stated that certain of her ADA co-workers attempted to enroll gentlemen in homeless shelters and programs for the underprivileged in EDMC programs, and she stated that she was encouraged to enroll a woman hiding out in a battered women's shelter.

116. Individuals with no access to a computer or the internet were told by admissions staff that they could use local public library computers, but this was not true as the online program requires files to be saved and software to be downloaded – something that cannot be done on public access computers.

117. Pressure tactics are employed by ADAs in encouraging prospective students to accept financial aid packages. ADAs are in constant contact with EDMC Financial Aid Officers. ADAs are responsible for ensuring that students complete all of their loan applications and submit those applications to EDMC schools and the federal government. The ADA ensures that his name is on the financial aid forms so that he receives credit for that student. Once all the student's applications are complete, the ADA forwards them to an assigned EDMC Financial

Aid Officer, who calculates the student's financial aid plan and informs the student. The student may accept or reject the financial aid plan. But if a student rejects the plan, usually because he does not qualify for enough financial aid to cover the entire tuition due, the ADA then seeks to convince the student to accept the financial aid package anyway.

118. ADAs use a number of tactics to encourage the students to enroll despite a deficient financial aid package. For example, a student may change his status from full-time to part-time, so that the financial aid package will cover the tuition. Students are refunded the difference in the amount of financial aid they received and the amount they paid in tuition, but are typically not informed that they must re-pay the full amount to the lender.

119. In addition, former employees reported that they were instructed to tell students what to do when filling out their financial aid forms, including falsifying information, such as changing the ages of their dependents, the amounts of money earned by students or dependents, and/or whether the student was living with the parent so that he could be considered a dependent. A former employee recounted an instance where a student was instructed that she could claim three undocumented, non-citizen children as dependents on a financial aid form in order to qualify for more federal student aid, even though that student had not claimed those children as dependents on her tax return.

120. Evidence that EDMC's institutions violated the accrediting agencies' guidelines is even found in its public filings. In its Form 10-K for the fiscal year ended June 30, 2011, EDMC reported that seven of its schools were required to provide supplemental reports to their accrediting agencies due either to student retention or employment placement issues. EDMC further reported that it expected twelve additional schools to be required to provide supplemental reports during fiscal 2011 due to student retention issues.

121. If an institution is found to be noncompliant with the accrediting agency's standards, it can be ordered to show cause as to why its accreditation should not be revoked or withdrawn, or it may be placed on probation for stricter scrutiny. In its Form 10-K for the fiscal year ended June 30, 2011, EDMC reported that two of its programs were placed on probation: The Doctor of Psychology program at Argosy University's San Francisco campus and the physical therapy assistant program at Brown Mackie College in Fort Wayne, Indiana.

C. Management Causes EDMC To Falsify Job Placement Data

122. The HEA requires that programs at for-profit institutions, other than those that are clearly designated as "liberal arts," and other vocational programs, must prepare students for "gainful employment in a recognized occupation" to be eligible for Title IV funding. A graduate is considered to be gainfully employed only if he is engaged in work for which the degree he earned is designed. Accrediting agencies also require institutions to achieve certain levels of placement of graduates in their chosen fields in order to maintain accreditation. The agencies that accredit EDMC institutions – to the extent that they have specific numeric requirements for job placement – require on average that 65% to 70% of graduates be employed in their chosen fields to maintain accreditation. For example, the Accrediting Council for Independent Colleges, which accredits 19 of EDMC's schools, requires that at least 65% of graduates must have jobs in their chosen field of study in order to receive accreditation. The Accrediting Commission of Career Schools and Colleges, which accredits 2 of EDMC's schools, requires 70% placement for accreditation.

123. Despite these regulations, EDMC's schools misrepresented EDMC's employment placement rates both to prospective students and to the accrediting agencies.

124. Ms. Bittel testified extensively to the Senate HELP Committee regarding falsification of EDMC's graduate career placement statistics. It was made clear to her that career

placement was far less of a concern than student recruitment, considering there were "only nine career service advisors to accommodate the graduates of all their online programs" compared to 1,600 admissions personnel at the time of her employment. Career placement advisors were stretched so thin, they were each responsible for assisting the placement of 150 to 180 students at any given time, and generally only had six months to help get this large number of students placed in their fields. With that level of discrepancy in resources, EDMC had to resort to manipulation of job placement statistics in order to meet accrediting agencies' requirements.

125. The examples Ms. Bittel provided regarding these tactics used to meet "gainfully employed" statistics are shocking. EDMC schools routinely used estimated, rather than actual, reported salaries. For example, a graduate earning $8000 a year was documented as earning $25,000 per year because $25,000 was the average salary in the area for that type of position.

126. EDMC schools also stretched graduates' job descriptions to have them included within the definition of "field related employment," and counted students as "employed" even if they worked at a relevant job for only one day. According to the Sobek qui tam complaint, internal reporting procedures explained that "[t]he graduate must work at least one day. No additional days on the job are required as long as the grad went to a job that fit their skill level."

127. Ms. Bittel was repeatedly pressured to call graduates and ask them about the courses they had taken to see if there was not some "skill" from those courses that could be used to shoehorn their current employment into field-related employment. A graphic design graduate working at a Starbucks was deemed to be gainfully employed in graphic design because she was "using her skills" by making signs for the daily specials. A graduate of the residential planning program was deemed to have been placed in her chosen field because her arrangement of candy bars for sale supposedly utilized her program skills. Ms. Bittel was pressured to count a graduate

of the game arts program as working in his field even though he worked at Toys R Us selling video games and earned $8.30 an hour.

128. Another way EDMC inflated its job placement numbers was to get as many non-complying students as possible out of the pool that counted toward the statistics. Career advisors were routinely pressured to obtain waivers from graduates on the grounds that they had a medical condition or cared for someone with such a condition, were stay at home parents, or were continuing their education.

129. These abuses are clearly systemic at EDMC institutions. Ms. Bittel testified that management at EDMC had weekly brainstorming meetings for its career services personnel where they could come up with "angles" to address how to deal with graduates who were not gainfully employed in order to maximize the institutions' gainful employment statistics. Job placement counselors are clearly told that they have placement quotas to meet, but are encouraged to meet those quotas through the types of manipulation detailed above.

130. In his qui tam complaint, Sobek confirmed that EDMC schools routinely manipulated the data to be able to report high job placement rates. The complaint alleges such examples as the following that were counted as working in their field of study; (i) a bank teller with a business degree earning roughly $23,000 a year; (ii) a fashion marketing program graduate working in a sneaker outlet for approximately $14,000 a year; (iii) an interior design graduate working at Target for $19,273 a year; (iv) an accounting graduate working as a cashier at a McDonald's for $15,700 a year; and (v) a business management graduate working as a customer service representative at Walmart for $16,549 a year.

131. The percentage of graduates employed in their field as reported by EDMC defies credulity in the current job market. For example, South University Online reported that of "all

2009 South University Online graduates available for employment, 92.1% were working in a field related to their program of study within six months of graduation and earning an average salary of $51,005." According to a national survey of 50,000 new college graduates across disciplines conducted by the National Association of Colleges and Employers, only 24% of graduates had a job offer at the time of graduation in 2010. Even well-recognized universities reported much lower employment rates than EDMC. For example, Fordham University reported that only 68% of its 2009 graduates were employed.

132. South University Online also reported that of 234 graduates of the nursing bachelor's degree program, 98.3% of them were employed with six months of graduation at an average salary of $61,467. In contrast, the American Association of Colleges of Nursing released the results of a survey that only 88% of nursing school graduates with bachelor's degrees were employed in their field four to six months after graduation.

133. EDMC's most recent Form 10-K – for fiscal 2011 – reveals that EDMC is already suffering some consequences of these wrongful acts. As of June 30, 2011, seven EDMC schools had to make supplemental submissions to accrediting agencies due to those agencies concerns over "either student retention or placement issues." Form 10-K at 21. Argosy University's San Francisco campus was placed on probation by the American Psychological Association in August 2010. That probationary status gives the program two years to improve before accreditation is revoked. Brown Mackie College in Ft. Wayne, Indiana had its physical therapy program's accreditation placed on probation by the Commission on Accreditation in Physical Therapy in April 2011, and can have that accreditation revoked at any time during the following two year period if the program does not improve.

134. In December 2011, the Company received a letter from the City Attorney of the City of San Francisco, California requesting information about, among other things, job placement reporting by The Art Institute of San Francisco and seven other Art Institutes located in California.

135. There will undoubtedly be further consequences for EDMC schools in light of new federal regulations. The federal government recently passed new regulations regarding the definition of "gainful employment." The new measure of gainful employment is that: (i) 35% or more of former students are repaying their loans; (ii) annual loan payments do not exceed 30% of a typical graduate's discretionary income; or (iii) annual loan payments do not exceed 12% of a typical graduate's total income. Data collection on these statistics starts in July 2012, and enforcement begins in 2015.

136. Based upon the deceptive practices regarding placement described above, EDMC is going to have difficulty withstanding the federal government's scrutiny under the new regulations. Moreover, EDMC has had growing loan default rates among its students, *i.e.*, the number of students who default on loans within two years of leaving school. For example, loan default rates at the Art Institute of Pittsburgh more than doubled between 2008 (7.9%) and 2009 (15.4%), and grew substantially at South University from 2008 (7.9%) to 2009 (13.5%).

D. EDMC Fails To Meet Financial Responsibility Guidelines

137. The DOE also requires educational institutions to meet certain "financial responsibility" standards. The financial responsibility standards measure: (1) an institution's capital resources and ability to borrow and finance its operations; (2) an institution's ability to support current operations from expendable resources; and (3) an institution's profitability.

138. Following the LBO, the DOE adjudged EDMC's financial responsibility at the consolidated level. In fiscal years 2009 and 2010, respectively, the DOE required EDMC to post

a letter of credit in an amount equal to 10% of Title IV funds received in fiscal 2008 and fiscal 2009.

139. As of June 30, 2011, EDMC once again did not meet the required quantitative measures of financial responsibility. Unlike previous years, however, the DOE raised the letter of credit requirement for EDMC from 10% to 15% of the Title IV program funds received by students at its schools during fiscal year 2010, which amounted to $361.5 million. In order to cover this new requirement, EDMC had to enter into a new $150 million Letter of Credit Facility with Bank of America.

140. The letter of credit requirement could go up in the future. The DOE is entitled to assess a letter of credit up to 100% of the Title IV funds that EDMC receives. Based upon the amount of Title IV funds EDMC received in 2011, that requirement could go as high as $2.4 billion.

141. As a further result of its failure to demonstrate financial responsibility, all of EDMC's schools have been provisionally certified. The letter of credit and provisional certification result in heightened financial and cash monitoring by the DOE, which is costly to the Company and could require the Company to assume additional letters of credit.

V. DAMAGES TO EDMC FROM THE MISCONDUCT

A. EDMC Is At Significant Risk Of Losing Its Eligibility For Title IV Funds and Its Accreditation

142. EDMC's violations of HEA regulations, including its improper recruiting practices, its incentive-based compensation plans and its misrepresentation of job placement data, threaten its ability to continue to receive Title IV funding. If EDMC's institutions cannot accept Title IV funding, there is little doubt that EDMC would go under because nearly 90% of its revenues come from Title IV funding.

143. EDMC faces potential damages if its financial health does not improve and the DOE raises its required letter of credit. The DOE can force EDMC to post a letter of credit equal to 100% of the Title IV funding it receives – or in excess of $2.5 billion.

B. Pending Litigation Threatens EDMC With Billions of Dollars in Potential Liability

144. The pervasiveness of the misconduct at EDMC described above has led to a number of actions that threaten EDMC with substantial liability and the loss of its ability to receive Title IV funds.

145. There are two *qui tam* actions pending against EDMC in which the federal government and several states intervened. The first of these actions was filed on April 5, 2007 by relator Lynntoya Washington, who was employed by EDMC from June 1, 2004 through May 25, 2007 and served as an Assistant Director of Admissions at EDMC's Art Institute of Pittsburgh Online Division.

146. The second of the two *qui tam* cases was filed by relator Michael T. Mahoney on behalf of the United States and the States, pursuant to the *qui tam* provisions of the False Claims Act, 31 U.S.C. § 3730(b)(1). Mr. Mahoney was employed by EDMC as its Director of Training for EDMC's Online Higher Education Division from October 2, 2006 through June 22, 2007. The relators described improper recruiting and compensation practices in violation of Title IV occurring at EDMC schools, as detailed above.

147. Upon intervening in these actions, the United States brought claims against EDMC under the Federal False Claims Act, 31 U.S.C. § 3729(a)(1) (1986), 31 U.S.C. § 3729(a)(1)(A) (2009), 31 U.S.C. § 3729(a)(1)(B)(2009) and for unjust enrichment. The United States seeks treble damages plus interest and civil penalties and fines. Because EDMC received

over $11 billion in federally funded tuition during the time period addressed by the suit, it has potential liability for over $33 billion.

148. The states of California, Florida, Illinois and Indiana have joined the Government Action and seek fines and penalties for fraudulent claims by EDMC to obtain state funded tuition.

149. In the Government Action, California brings claims under the California False Claims Act, Government Code Section 12650, *et.* seq. California does not specify how much in damages and penalties it seeks from EDMC, but does specify that it is seeking treble damages and penalties.

150. Florida brings claims in the Government Action against EDMC under the Florida False Claims Act, §68.082(2)(a), Fla. Stat. Florida, which alleges that EDMC schools received approximately $5.2 million in Florida state funds for student grants and scholarships, seeks treble damages, as well as civil penalties, attorneys' fees, expenses and costs.

151. Illinois brings claims against EDMC in the Government Action under the Illinois False Claims Act, 740 ILCS 175/1 *et. seq.* Illinois alleges that EDMC schools received "millions of dollars in grant funds annually from the State of Illinois through its Monetary Award Program ("MAP") in violation of the Illinois False Claims Act, ranging from $1,476,677 in MAP grant funds to $3,139,511 in MAP grant funds, totaling $27,471,111 for the academic years 2004-2005 to 2010-2011. Illinois seeks treble damages, fines and penalties.

152. Indiana brings claims in the Government Action against EDMC under the Indiana False Claims and Whistleblower Protection Act, Ind. Code § 5-11-5.5-2(b)(1), (2) and (8). Indiana does not specify how much in damages and penalties it seeks from EDMC, but does specify that it is seeking treble damages and penalties.

C. Other Government Investigations Threaten EDMC's Ability To Receive Title IV Funds

153. The Government Accountability Office ("GAO"), in connection with the Senate Health Education Labor & Pension Committee ("HELP Committee"), has been conducting an investigation into improper recruitment and compensation practices, *inter alia*, at for-profit institutions. On August 4, 2010, the GAO released a report entitled, "For-Profit Colleges: Undercover Testing Finds Colleges Encouraged Fraud and Engaged in Questionable Marketing Practices" (the "GAO Report"). The *New York Times* reported on August 4, 2010 that undercover investigations in connection with the GAO inquiry at 15 for-profit institutions discovered that recruiters were encouraging students to falsify their financial aid applications and were misleading prospective students about the duration and quality of the programs offered. The GAO Report concluded that the abusive and deceptive recruiting practices did exist at, among other places, Argosy University, an EDMC school.

154. At an August 4, 2010 hearing in connection with the HELP investigation, it was revealed that EDMC regularly and systemically engaged in improper practices related to student enrollment, admissions and financial aid. As part of the Senate investigation, EDMC employee Kathleen Bittel, who worked at EDMC for more than three years in career services and admissions, including as an Assistant Director of Admissions at Argosy University and as a career services advisor at the Art Institute of Pittsburgh, wrote a letter dated September 15, 2010 to the HELP Committee and provided testimony before the HELP Committee on September 30, 2010, describing the improper practices in recruitment and compensation at EDMC, as well as EDMC's falsification of graduates' job placement data.

155. On August 13, 2010, the DOE published loan repayment rates for for-profit educational providers, including EDMC. The data showed an overall repayment rate of 38%.

EDMC's low repayment rates confirmed that it was systematically employing improper recruiting and enrollment practices.

DERIVATIVE ACTION ALLEGATIONS

156. Plaintiff brings this action derivatively to redress injuries suffered by the Company as a direct result of the breaches of fiduciary duties by the Individual Defendants.

157. Plaintiff has owned EDMC stock continuously during the time of the wrongful course of conduct by the Individual Defendants alleged herein and continues to hold EDMC stock.

158. Plaintiff will adequately and fairly represent the interests of EDMC and its shareholders in enforcing and prosecuting its rights and has retained counsel competent and experienced in shareholder derivative litigation.

DEMAND REFUSAL WAS IMPROPER

159. On August 19, 2011, Plaintiff made a demand on the EDMC Board ("Demand Letter") to bring suit asserting the claims relating to the wrongful recruiting and other practices that jeopardized EDMC's receipt of Title IV funding (the "Title IV Issues"). In the Demand Letter, Plaintiff informed the EDMC Board that if the Board had not instituted an action addressing the wrongdoing set forth in the Demand Letter within 120 days of receipt of the Demand Letter, Plaintiff would exercise its right to bring a shareholder derivative suit against the Board of Directors. The Demand Letter was delivered to EDMC on August 22, 2011.

160. On December 8, 2011, just a few weeks before the 120 day investigation period was set to expire, counsel for Plaintiff received a letter from R. Todd Cronan, Esquire ("Cronan") at Goodwin Procter LLP. The letter stated that Goodwin represented a committee of "disinterested directors" ("Committee") formed to investigate the matters set forth in the Demand Letter. The letter purported to invite Plaintiff to participate in the investigation.

161. Counsel for Plaintiff responded to Cronan's December 8, 2011 letter by letter dated December 15, 2011. Plaintiff's counsel expressed a strong interest in participating in the Committee's investigation, and requested certain information, including identity of the Committee members and a copy of the Board resolution creating and empowering the Committee.

162. Notwithstanding the invitation for Plaintiff to participate in the investigation, and Plaintiff's acceptance of such invitation, the Committee did not respond. On January 19, 2012, Plaintiff wrote to Cronan again, reiterating Plaintiff's willingness to work with the Committee on the investigation and supplementing the initial Demand Letter (the "Supplemental Demand") with additional allegations of wrongdoing, including allegations that EDMC's financial health was failing (the "Letter of Credit Issues") and that EDMC falsified its job placement data (the "Placement Falsification Issues"). Plaintiff further stated that if it did not hear back from the Company by February 20, 2012, Plaintiff would pursue its claims outside of the Company.

163. After promising Plaintiff a response to its Demand Letter and its Supplemental Demand by communications on February 17 and 24, 2012, the Committee finally gave a partial response by letter dated March 6, 2012 (the "March 6 Response").

164. The March 6 Response purported to give the Committee's findings on the Letter of Credit Issues and the Placement Falsification Issues. The Committee concluded that it would not be in the Company's best interests to pursue claims relating to the Letter of Credit Issues and the Placement Falsification Issues. The Committee purported to be still investigating the Title IV Issues.

A. The Committee Members Are Conflicted

165. In the March 6 Letter, the identity of the Committee members was revealed for the first time. Defendants Mullin and Salem were appointed to the Committee by the Board. Plaintiff does not know what their precise charge and authority were, as the Committee never did give Plaintiff the requested copy of the resolution creating and charging the Committee. In the March 6 Letter, the Committee's counsel professed Mullin's and Salem's disinterestedness with a cursory and conclusory statement that they meet the ALI Principles' definition of disinterestedness.

166. Mullins and Salem are anything but disinterested. Salem is a designee to the Board of a member of the consortium of investors that led the LBO and to whom EDMC's exorbitant debt is owed. Specifically, Salem is a Senior Managing Director and Co-Founder of Providence Equity Partners. Mullins is a consultant to Goldman Sachs. They each owe their livelihoods to entities that have a vested interest in seeing the continuation of the practices complained of herein. Without the artificial boost to enrollment and Title IV funds that results from the incentive compensation program and the other deceptive practices detailed herein, EDMC would have difficulty servicing the debt that was incurred in the LBO.

167. Mullins and Salem were also interested at the time the March 6 Response was issued because they signed the Registration Statement that was at issue in the Securities Action, and were defendants in that action. Thus, at the time of the March 6 Response, they each stood to face substantial liability for the conduct detailed in that action.

168. Salem is not independent for the additional reason that EDMC does business with Providence Partners affiliates. In 2011 alone, EDMC paid $3.8 million to Providence Partners affiliates.

B. The Committee Did Not Conduct a Good Faith and Reasonable Investigation of the Letter Of Credit Issues, the Placement Falsification Issues and the Title IV Issues

169. The Committee, vested with the Board's authority to investigate Plaintiff's demands and to determine the Company's response thereto, did not conduct a good faith and reasonable investigation of the issues raised in the Demand Letter and the Supplemental Demand. It has therefore wrongfully refused Plaintiff's demands.

170. With regard to the Letter of Credit Issues, the Committee claimed that there was no merit to Plaintiff's claim because the additional $150 million letter of credit with Bank of America was supposedly taken out merely because a portion of EDMC's existing line of credit was going to mature in June 2012. The Committee contended that the increase the DOE required in the letter of credit was due in some inexplicable way to the fact that EDMC's receipt of Title IV funds is expected to go up by 5% each year.

171. The Committee's "explanation" of its findings with regard to the Letter of Credit Issues makes no logical sense. It admits that EDMC has failed to meet the required DOE ratios demonstrating financial health, and that the DOE increased the requirement for EDMC's letter of credit from 10% to 15% of Title IV funds received. It tries to explain this increase away by contending that an increase in Title IV funds by an approximate 5% each year is the reason for the increased letter of credit requirement. It states that "[a]ccordingly, the amount of the letter of credit has increased each year primarily because of the increase in Title IV revenues."

172. This explanation does not hold water. First, the required letter of credit did not change in fiscal 2009 and fiscal 2010, even though Title IV revenues went up in those years. Second, the DOE does not have to raise the percentage requirement of the letter of credit in order to have a larger letter of credit to account for an increase in Title IV funds. As the total amount of Title IV funds increases, so does the number represented by 10% of those funds. In other

words, if Title IV funds received were $1 billion, the necessary 10% letter of credit would be $100 million. If Title IV funds increased by 5% to $1.05 billion, then the necessary 10% letter of credit would increase to $105 million. There is something going on at EDMC that caused the DOE to raise this requirement, but it does not appear to be the fact that EDMC is receiving more Title IV funds. Regardless, it is the Committee's responsibility to determine precisely why this requirement has changed, and their failure to do so shows the unreasonableness of their investigation and their lack of good faith.

173. The Committee also never addresses the issue of the provisional certification of EDMC's schools as a result of the need for a higher line of credit. Under 20 U.S.C. §1099c(h), an institutional can be provisionally certified if the Secretary of the DOE finds it to be "in an administrative or financial condition that may jeopardize its ability to perform its financial responsibilities under a program participant agreement." Far from being a routine matter as portrayed by the Committee, the requirement that EDMC post a larger letter of credit – and its resulting provisional certification – demonstrate that the DOE found EDMC to be in a financial condition that might "jeopardize its ability to perform its financial responsibilities" under its PPA. The Committee's finding otherwise demonstrates the unreasonableness of its investigation of this issue.

174. The Committee also concluded that there was "no support for your claim that EDMC 'systematically falsified job placement data'" and that the claim "is simply not true." March 6 Letter at 4. The Committee contends that Plaintiff's allegations regarding the False Placement Issues were taken "directly from Kathleen Bittel" and her testimony before the Senate HELP Committee. The Committee stated in the March 6 Letter that rather than conduct its own investigation into the allegations of false job placement statistics, it relied instead on an internal

investigation conducted by EDMC employees that purportedly found "no support for [Ms. Bittel's] claims of undue pressure placed on Career Services Advisors at EDMC Online Higher Education to meet placement goals or falsely verify graduates' employment was related to their field of study." March 6 at 20. The Committee also relied on a subsequent investigation conducted by EDMC's outside counsel of employees in the Online Higher Education division that similarly found no support for Ms. Bittel's allegations. Finally, the Committee claimed that EDMC has "robust" internal controls in place to train its employees not to falsify job placement data.

175. The Committee's reliance on the internal investigation and the investigation of EDMC's outside counsel was not reasonable. First, the Committee, had it been acting in good faith, would have conducted its own investigation rather than relying on prior investigations that may have been tainted by internal participation. Moreover, those investigations appear to have been for the express purpose of negating Ms. Bittel's testimony. It was also unreasonable for the Committee to rely on those investigations because they related only to the Online Higher Education department. The Committee should have conducted its own investigation of career placement services throughout EDMC, and not just focused on negating Ms. Bittel's testimony. Plaintiff's Supplemental Demand was not limited to the Online Higher Education department or Ms. Bittel's assertions, but rather was directed to the entire Company. The Committee, due to its bad faith approach to Plaintiff's demands, simply presumed that the Supplemental Demand was limited to Ms. Bittel's allegations and conveniently used the internal investigations as a reason to reject the demand.

176. The Committee claims not to have made a determination yet as to Plaintiff's demand on the Title IV Issues. However, the Committee devoted 8 pages of the March 6 Letter

to contentions that EDMC maintains "robust" internal controls that are meant to prevent and detect wrongdoing at the Company. The Committee also concluded that "there is no evidence that any director or officer breached his or her fiduciary duties to EDMC in connection with the oversight of the Company's internal controls." March 6 Letter at 14.

177. The Committee's claim not to have reached a determination on the Title IV issues is not made in good faith. It is clear from its contentions in the March 6 Letter that it has already reached a conclusion – baselessly – that the Board and the officers of the Company bear no responsibility for the Title IV Issues. This constitutes a refusal of Plaintiff's demand thereon.

178. The Committee's refusal as to the Title IV Issues is based upon an incomplete and unreasonable investigation. The Committee admits that it has not reached the end of its investigation of the Title IV Issues, yet its March 6 Letter makes clear that the Committee has already concluded that the Board and Company officers bear no responsibility for those matters that it has not yet fully investigated. This is the definition of bad faith.

179. Even if the Committee's prejudgment could be overlooked, its failure to conclude its investigation of the Title IV Issues constitutes a wrongful refusal of Plaintiff's demand. Not only has the Committee been "investigating" the Title IV issues since Plaintiff sent its Demand Letter in August 2011 – almost eight months ago – it has, by its own admission, been investigating these issues since the GAO Report issued in August 2010. In other words, the Committee was formed not to respond to Plaintiff's demand, but to investigate the issues raised by the GAO Report more than 20 months ago.

180. The passage of this amount of time without a conclusion from the Committee – other than the unsupported conclusion that the Board and officers bear no responsibility – is tantamount to a refusal of Plaintiff's demand. This refusal is wrongful because the Committee

has not acted reasonably or in good faith, ostensibly keeping its investigation open while prejudging the role of the Board and the officers.

181. The Committee's investigation was not and has not been reasonable or in good faith for the additional reason that it has failed to include Plaintiff in the investigation, despite having invited Plaintiff to participate and Plaintiff's having accepted that invitation.

C. The Committee's Apparent Conclusion That The Board of Directors and the Company Officers Cannot Be Liable Due To The Company's Internal Controls Is Not Reasonable

182. The Committee devotes more than 8 pages of its March 6 Letter to a description of the alleged internal controls that the Company has in place. Much of this discussion consists of unsupported statements of corporate training policies that have nothing to do with the Board's ability to detect and correct wrongdoing. For example, the March 6 Letter states that the Company's "internal controls operate to educate and train the Company's employees on significant policies and practices, to monitor the performance of departments and individuals, and to take remedial efforts as appropriate." The March 6 Letter does not describe what these internal controls are, how they operate or how they address the wrongdoing alleged in the Demands.

183. The March 6 Letter purports to describe the "high ethical standards" on which EDMC purportedly trains its ADAs. The Letter does not describe how this training takes place, who conducts it or even how frequently it supposedly occurs. The Letter refers to "unethical behavior" but never describes what is viewed as unethical behavior. With the record EDMC has, as reflected in the numerous incidents of illegal behavior detailed in this Complaint, very little, if anything, is viewed as "unethical."

184. To the extent the March 6 Letter does describe audit and monitoring functions, it does so in the most generic sense. It does not describe how many employees staff these

functions, how frequently they conduct audits or monitor the practices complained of herein, or how they conduct their audits or monitoring functions. The Letter refers to the Internal Audit Department ("IAD"), which purportedly "identifies and remediates risks facing EDMC by auditing corporate processes, ground schools and the Online Higher Education Division ("OHE")." The Letter states that "[a]ll business activities of EDMC are subject to auditing, and IAD identifies the frequency of such audits using a risk-based approach. At the conclusion of its audits, IAD issues a comprehensive and objective assessment of its findings and recommendations." The Letter does not describe what reports have been issued or even what action has been taken as a result.

185. The March 6 Letter states that "OHE Internal Audit and Compliance Department, which performs a similar function as IAD within OHE, is designed to prevent, mitigate and remediate, among other things, student-facing risks by monitoring interactions between students and ADAs or Student Financial Services representatives in OHE. Poor performing employees receive remediation – ranging from verbal coaching and re-training to termination." This passage does not say that EDMC employees are disciplined for improper or illegal recruiting techniques. Rather, it states that "poor performing employees" receive retraining – "poor performing" can just as easily mean employees who are not generating sufficient enrollment to meet the demands of management. Moreover, there is absolutely no discussion of how often or even if there have been incidents of employee discipline and what the disciplining action was.

186. The Committee's lack of explanation may well stem from the fact that the actual application of discipline in the Company is toothless. As Jason Sobek, a former admissions officer, stated in his qui tam complaint against EDMC, admissions officers are encouraged to take risks and to not worry about compliance issues because they have "three 'Get Out of Jail

Free Cards,'" meaning nothing would happen to them if they were caught violating the rules and regulations. Employees who are disciplined, according to Sobek, are told of the infraction but then sent directly back to work without consequence. According to Sobek, employees regard these notices of violations as "a joke," as there are no counseling programs to rely upon in these circumstances. Sobek also claimed that compliance auditing was spotty at best, given that the use of personal and Company cellphones for calls with prospective students is not monitored.

187. In fact, the only "discipline" that seems to be meted out at EDMC is for an admissions officer's failure to make his or her quota of production of new students. Sobek describes in his qui tam complaint that admissions personnel not meeting their quotas first received a "discussion memo" for "deficient performance." The discussion memorandum would set forth the recruiter's tenure (upon which the recruiter's quota was based), four week application/enrollment averages and start rates. Discipline and subsequent training for these individuals consists of listening in on calls more successful recruiters make.

188. According to Sobek, the next step in the disciplinary process for an underperforming recruiter is the issuance of a Performance Management Plan ("PMP"). The PMP would set forth in chart form the recruiter's quota and the recruiter's actual, deficient numbers. The PMP would often also state that if performance, *i.e.* new enrollments, did not improve, the recruiter was at risk of termination.

189. The March 6 Letter claims that ADAs must take annual exams on the Company's "policies and procedures" relating to how to interact with prospective students. The Letter contends that successive failures on the exam will lead to termination. What the Letter does not reveal is what the exam actually tests for – the "policies and procedures" are never identified or described – or what an ADA has to score to have "failed" the exam. Nor does the Letter say how

frequently a failing ADA is retested – the implication of the Letter's description is that it could be another full year before they are retested.

190. The March 6 Letter also contends that a Corporate Compliance Hotline is accessible twenty four hours a day to receive anonymous employee reports regarding suspected misconduct, and that reports made through the hotline are investigated. The Letter does not state whether any reports have actually been made through the hotline or what was the disposition of such reports.

191. The absence in the March 6 Letter of any description of disciplinary action taken as a result of the hotline or even other forms of reporting misconduct is not surprising, as several former and current employees have stated that they complained to their superiors about illegal and unethical practices at EDMC and nothing whatsoever was done about it. For example, Kathleen Bittel reported such conduct to her manager and to the Human Resources department, only to find no discipline was ever issued nor did the wrongful behavior cease. In one instance, she reported a colleague of hers who falsified the salary a graduate was earning in order to count that graduate as gainfully employed. That employee was not only not disciplined, the employee was given EDMC's "North Star Award," which signifies exemplary performance.

192. According to the March 6 Letter, EDMC's compliance "policies and programs" are designed by its Vice President of Compliance "to emphasize EDMC's values and promote a culture of integrity." Once again, the Letter fails to describe what these "policies and programs" are, and the generic language about promoting values and integrity is mere lip service in the absence of any detail.

193. It is clear that the reason for the Committee's vagaries about these functions is that they are wholly inadequate – apparently by design.

194. The allegations contained in this Complaint – all from publicly available sources that the Committee could easily access – demonstrate that EDMC's engrained culture since the LBO revolves around driving up student enrollment, no matter what it takes to do so. This initiative has been led by Defendant Nelson, the current CEO of EDMC and a member of the Board. Nelson's history of creating the same culture and the same illegal compensation system at Apollo is well-known in the for-profit industry. The consequences to Apollo are also well-known, as this conduct resulted in a record settlement.

195. That Nelson is trying to do at EDMC what he was caught doing at Apollo cannot be doubted. First, he has brought over many of the high ranking management personnel from his Apollo/University of Phoenix days and ensconced them at EDMC, including the following: Ken Boutelle, Sam Yaghoubi, David Preece, Phil Clark, Sean St. Clair, Jamie Wellnitz, Mary Dyer-St. Clair, Robert Carroll (Exeutive Vice President and Chief Information Officer), Anthony F. Digiovanni (Senior Vice President of Marketing and Admissions) and John Kline (President of EDMC Online Higher Education).

196. Second, he has instituted a policy of oversight of the admissions functions. A former Vice President of Human Resources at EDMC's online division stated that "all pay raises for admissions reps were approved by corporate headquarters."

197. A former Vice President of Human Resources stated that the compensation system for admissions staff was developed at the corporate level and approved by EDMC Corporate. A former Vice President of Admissions reported that the compensation scheme was developed by seven to ten high level executives and was reviewed and approved by Defendant Nelson.

198. A Vice President for Marketing and Admissions at EDMC's corporate headquarters from 1988 until April 2010 stated that Defendant Nelson criticized EDMC's historical business practices, including that EDMC had not "grown fast enough" and was "too cautious" and "not aggressive enough." This former Vice President had historically been responsible for planning and forecasting for the Company, but Nelson took over this process and made plans that "did not make sense" and were "overly aggressive."

199. Other former employees have described the central role that senior management played in attempting to make new student enrollment quotas. One former employee described an environment whereby Defendant Nelson would meet directly with directors of admission, the ADAs' supervisors, to increase enrollments, resulting in an environment that was "very frightening, very intimidating" for ADAs, who were concerned that they would be fired for missing their quotas. Another former employee described a company-wide meeting in or about November 2009 attended by EDMC's Online Higher Education CEO, Weiss, and President Kline, where new requirements for ADAs were instituted, adding to the pre-existing enrollment quota system. The changes included increasing the number and duration of phone calls with prospective students.

200. The conduct at EDMC schools described herein was so widespread that it rose to the level in many employees' views as "company policy." For example, the Bittel Letter states that Ms. Bittel could "attest" that the improper conduct "testified to in the [HELP Committee] hearings [on August 4, 2010] was not only very true, but a companywide policy and not just" conduct that occurred at Argosy University where she was employed. She stated that the improper recruiting "tactics were part of our daily sales meetings and were being utilized by my most 'successful' colleagues."

201. Because the "overly aggressive" growth strategy along with the approval of the improper, incentive-laden compensation scheme came from the CEO, who is also a member of the Board of Directors, and flowed systemically throughout EDMC's many schools, it is unreasonable for the Committee to conclude that the internal controls at the Company are sufficient and that the "directors and officers of EDMC have satisfied [their] fiduciary duties to the Company by establishing and maintaining, appropriate governance structures…."

202. Indeed, for the remaining members of the Board not to have known about the improper practices strains credulity. Notably, the sheer number of abusive and deceptive recruiting and enrollment practices detailed by many current and former employees, located in various geographic locations and business units, supports the fact that the Board of Directors knew or should have known of the abuses described herein. These were not isolated instances, but rather were a widespread pattern of company-sanctioned activity. For the foregoing reasons, the members of EDMC's Board of Directors were incapable of exercising objective judgment in determining whether to enforce the Company's claims for the misconduct described herein, and their decision to refuse demand is not entitled to the protections of the business judgment rule.

CAUSE OF ACTION

COUNT I
(Breach of Fiduciary Duty)
(Derivatively Against the Director Defendants)

203. Plaintiff realleges the preceding paragraphs as set forth above and incorporates them herein by reference.

204. The Individual Defendants, as Directors of EDMC, are fiduciaries of the Company and its shareholders. As such, they owe the Company the highest duties of good faith, fair dealing, due care, candor and loyalty.

205. In contemplating, planning, and/or effecting the foregoing conduct, the Individual Defendants were not acting in good faith toward the Company and breached their fiduciary duties. The Individual Defendants further breached their fiduciary duties by failing to implement appropriate internal controls to detect and correct the harmful recruiting and other practices.

206. As a result of these actions of the Individual Defendants, the Company has been and will be damaged.

207. Plaintiff has no adequate remedy at law.

WHEREFORE, Plaintiff prays for judgment as follows:

(a) for an order declaring that the Defendants breached their fiduciary duties to the Company;

(b) for an order requiring Defendants to immediately overhaul the Company's admissions and recruiting personnel compensation structure such that no portion of compensation earned by ADAs – including any bonuses or other awards – is based on the number of new student enrollments that ADA achieves;

(c) for an order requiring Defendants to immediately adopt and establish policies and procedures that eliminate improper new student recruitment tactics, including, but not limited to, aggressive techniques designed to encourage unqualified students to enroll in EDMC programs and to seek and obtain government funding to pay for such education;

(d) for an order requiring Defendants to immediately establish internal controls sufficient to ensure that if such wrongful compensation and recruiting practices occur at the Company in the future, those practices will be brought promptly to the attention of the Board of Directors so that they can be eliminated before they cause the Company any legal liabilities;

(e) for an order requiring the Defendants to compensate EDMC for the damage it has suffered and continues to suffer as a result of the wrongdoing set forth herein, including, but not limited to, the harm that EDMC will suffer as a result of the Government Action;

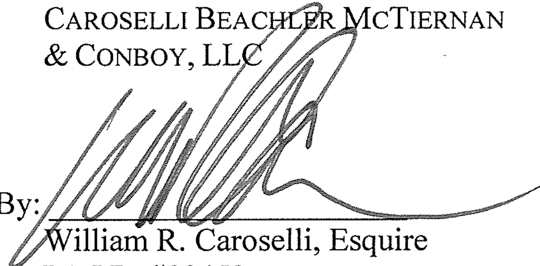
(f) for Plaintiff's costs and expenses incurred in this action, including, but not limited to, experts' and attorneys' fees; and

(f) for such other and further relief as may be just and proper.

JURY TRIAL DEMANDED.

Respectfully Submitted,

CAROSELLI BEACHLER MCTIERNAN
& CONBOY, LLC



By: ____________________
William R. Caroselli, Esquire
PA I.D. #00452
E-Mail: wcaroselli@cbmclaw.com

20 Stanwix Street, 7th Floor
Pittsburgh, PA 15222

Telephone: (412) 391-9860
Fax: (412) 391-7453
Counsel for Plaintiff

- And -

GRANT & EISENHOFER
Jay W. Eisenhofer, Esquire
PA I.D. #46584
Michael J. Barry, Esquire
PA I.D. #69122
Cynthia A. Calder, Esquire
PA I.D. #64711

123 Justison Street
Wilmington, DE 19801
Telephone: (302) 622-7000
Co-Counsel for Plaintiff

VERIFICATION

I, Gigner Poplin, Executive Director of the Oklahoma Law Enforcement Retirement System, herein aver that the statements of fact contained in the foregoing COMPLAINT IN CIVIL ACTION are true and correct to the best of my information, knowledge and belief and are made subject to the penalties of 18 Pa. C.S.A. §4904 relating to unsworn falsification to authorities.

DATE: March 16, 2012

Ginger Poplin, Executive Director