

# Apollo told feds: Inquiry news would cause harm

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Within weeks of receiving a blistering government report on recruiter pay practices at the University of Phoenix, the school's parent company told regulators that disclosure of the report would cause "great harm" to the company's employees, shareholders and students.

The letter to the U.S. Department of Education and the apparent impact the eventual release of the report had on Apollo's stock raise questions among some experts about whether the company properly disclosed the investigation to shareholders.

The experts say the warning in the March 1 letter, written by Apollo Group Inc. Chief Executive Todd Nelson, indicates the company considered the report to be a material event, meaning under securities laws it must be disclosed in a timely manner.

Nelson and other executives never publicly mentioned the Feb. 5 report until the matter was settled for a record \$9.8 million in September and then only in passing on a conference call. The company did not admit any wrongdoing in the settlement.

"Given the CEO's statement to the Department of Education, investors as well as the SEC should be alarmed as to why this information wasn't made available publicly on a timely basis," said Lynn Turner, former chief accountant for the Securities and Exchange Commission and former director of the Center for Corporate Financial Reporting at Colorado State University.

## **Investors 'wellserved'**

Nelson declined to be interviewed for this story but, in a statement in response to e-mailed questions, said the Phoenix-based company is "confident shareholders have been well-served by the company's handling of this report."

He said the report, details of which were first reported in the media a week after the settlement, contained serious factual and legal flaws and was prepared by department staffers, meaning it was subject to review at the department's higher levels.

"We believed then and still firmly hold that it would have been irresponsible to disclose the Education Department report prior to a full resolution of the issues it raised," Nelson said. "Our shareholders could well have been subjected to an unwarranted share-price drop had we disclosed the report prematurely and with these issues unresolved."

At the worst, inadequate or misleading disclosure opens up a company to potential shareholder

lawsuits and scrutiny by securities regulators. Such scrutiny has intensified in the wake of high-profile corporate-fraud scandals like the one involving Enron. Last week, Apollo was hit with a shareholder lawsuit related to the disclosures in the report. It hasn't formally responded but said in an e-mail to employees that the lawsuit is without merit.

At the least, a lack of disclosure can hurt management credibility if negative details emerge later.

Apollo's stock fell last month after media coverage of the details in the reports. It declined 2.4 percent in a two-day period when stories appeared in *The Arizona Republic*, *Wall Street Journal* and other newspapers.

Wall Street analysts noted the harshness of the report in their notes to investors, although many downplayed it, saying that it didn't matter because Apollo had settled the case and moved on.

Apollo's stock has since fallen further along with the rest of the for-profit education industry, hitting \$68.01 last week, a low it hadn't seen since December, before gaining strongly Monday on a positive research report from Morgan Stanley.

## **Stinging review**

The questions on disclosure by Apollo relate to a "program review" of the University of Phoenix's recruiter compensation that dates to August 2003. As part of that review, Apollo received a 45-page report on the review in early February.

The government didn't mince words in its conclusion, saying the University of Phoenix "systematically engages in actions designed to mislead the Department of Education and to evade detection of its improper incentive compensation for those involved in recruiting activities."

To avoid potential abuses, schools receiving financial aid are not allowed to base enrollment advisers' pay solely on the number of students they sign up.

The department said the University of Phoenix, the nation's largest private university, with more than 200,000 students, had to make substantial changes to recruiters' and supervisors' salary compensation system.

Nelson did disclose the existence of the program review on a March 12 conference call with analysts but spoke of such reviews in general terms and as part of a broad regulatory update, given the high-profile scrutiny of some of its competitors. No mention was made of the report.

## Quick resolution sought

In the March 1 letter to the Department of Education, Nelson urged quick resolution of the matter and said the great harm to employees, shareholders and students, which he called unjustified and unfair, only increases over time. He said the company strenuously disagreed with several of the key findings. The letter noted that he had made the same point in a letter to Education Secretary Rod Paige, though that letter was not made public.

When shown Nelson's letter, obtained along with other correspondence under a public-records request, some experts said it appears that Apollo should have disclosed the report to investors.

They say that Nelson's statement of the potential harm it could have caused indicates the company considered it to be a material event.

There are no hard-and-fast rules on what denotes materiality, but in general it is information that a reasonable investor needs to know in order to make an informed decision about an investment, SEC spokesman John Heine said.

Apollo has pointed out that the amount it paid the government was not material, and Nelson said in his response that it was less than 1 percent of the giant company's cash.

Still, materiality goes well beyond money, experts say.

Russell Piccoli, a securities attorney and litigator with the law firm Marsical, Weeks, McIntyre and Friedlander in Phoenix, said a company can't have it both ways, saying it's not material but essentially telling regulators it is.

"If they had a fear that release of the information would have a significant effect on the market price of their shares, then that in and of itself is evidence of the fact that it needs to be disclosed," he said.

Adds Carolyn Brancato, director of the Conference Board's Global Corporate Governance Research Center in New York, "If the company writes to someone else and says this is going to have a huge effect on it, then the company itself has determined that it is going to be material."

Greg Cappelli, who has followed Apollo for years for Credit Suisse First Boston, said reading such a negative report would "give anybody pause" but added that there are two sides to every story.

He said analysts and investors would always like to have such information as early as possible but noted Nelson's contention that the situation was still evolving. In the end, he said, it's a company's call on whether something is material.

He said the biggest question it heard from investors the day the report was disclosed wasn't about

why it wasn't disclosed. It was: "If it was this bad, why did the DOE settle?"

Nelson has made a similar statement.

## **Gray area**

Brancato said there is some gray area on disclosure requirements when it comes to regulatory investigations and other matters that are still in progress and may be settled. Deana Peck, a securities attorney with Quarles & Brady Streich Lang in Phoenix, said companies can maintain that early release of information in a matter that's still ongoing could unduly harm shareholders because the final outcome could very well look different. Indeed, that is part of Apollo's argument for not disclosing the report.

In today's environment, though, many companies are erring on the side of caution and disclosing as much information as possible even if it's more than necessary, Brancato and others said.

"They're afraid to be caught without disclosing enough in this environment of particularly nasty oversight in the area of securities," she said.

There is also a question of whether Apollo might have misled investors with its comments to analysts in conference calls about the program review.

In response to a question from an analyst in June, Nelson said the program review at the University of Phoenix "continues to go, from our point of view, very smoothly."

Correspondence through May between the two sides seems to indicate some tension.

There was much interest in regulatory updates from Apollo that day because the stock of one of its competitors was falling after a newspaper revealed a negative program report it had received from the department. The company, Corinthian Colleges, disclosed some details after the newspaper report. Two days earlier, another competitor announced a formal SEC probe.

Piccoli said public companies can get into regulatory trouble if they know more than they are revealing about an issue of interest to investors.

"If you're making any sort of public statement that's calculated to reach the investing public, you have to tell the whole truth," he said. "You can't tell half of it and in any way leave a misleading impression."

Apollo says a court will decide the matter in the end.

"We are now in litigation over this matter, and thus we will be addressing these issues formally, in court," Nelson said in the statement.

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