

[Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—S.D.N.Y.: Complaint against school company gets dunce cap for failing to show scienter, \(Jul. 26, 2016\)](#)

Securities Regulation Daily Wrap Up

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By [Rodney F. Tonkovic, J.D.](#)

A securities fraud complaint has been dismissed with leave to amend after a district court found that investors in an education provider failed to plead scienter. The complaint brought fraud claims under the Exchange Act arising from the company's accounting practices, specifically its revenue recognition. While a holistic review of the allegations found no scienter, the court concluded that the allegations concerning partial corrective disclosures could plausibly establish loss causation (*Zamir v. Bridgepoint Education, Inc.*, June 25, 2016, Sammartino, J.).

Bridgepoint is a for-profit higher education provider through two wholly-owned subsidiaries. The company's primary source of revenue is tuition, the majority of which is paid through federal financial aid. In 2012, during an upgrade of its student management system, however, Bridgepoint experienced technical issues that resulted in delays in packaging certain students for financial aid qualification. Consequently, these students were not eligible for financial aid and were required to pay outstanding balances on their own.

In March 2012, Bridgepoint reported an increase over historic levels in its bad debt expense. This increase was blamed on the technical issues, and Bridgepoint indicated that the issues were not expected to repeat in 2013. Unfortunately for Bridgepoint, technical issues again caused a backlog in packaging financial aid in 2013, and the company continued to report higher than normal bad debt expenses as a percentage of revenues.

In November 2013, Bridgepoint purchased over 7 million shares in a tender offer. Soon after, the SEC contacted Bridgepoint's CFO to inquire about the company's declining enrollment, but increased revenue, in 2012; a number of additional communications with the SEC followed.

In May 2014, Bridgepoint announced that it would be restating its financial statements for 2013. As a result, Bridgepoint saw a decrease in revenues and increases in bad debt expense and net income. In June 2014, the Commission told Bridgepoint that it also should restate 2011 and 2012. One month later, the Commission sent Bridgepoint a subpoena requesting information on its accounting practices, including revenue recognition.

Scienter. Viewing the allegations holistically, the court found that the allegations did not give rise to a strong inference of scienter that was at least as compelling as an inference of nonfraudulent conduct. Bridgepoint first argued that the alleged scheme—essentially, that the company committed securities fraud just to report a "paltry" revenue gain—made no economic sense. The investors countered that Bridgepoint violated GAAP by recognizing tuition revenue while knowing that the government would not be paying the tuitions of a significant number of students. The court held that the complaint failed to allege that Bridgepoint's auditors counseled against its revenue recognition practices or that any of the individual defendants knew that they were improper. The inference of scienter was not more compelling than Bridgepoint's contention that it had no reason to believe that its practices were erroneous. The mere publication of a restatement, the court continued, was by itself insufficient to create a strong inference of scienter.

The court then found that trading by Bridgepoint executives during the tender offer failed to show scienter. While the investors claimed that Bridgepoint's executives were the true beneficiaries of the transaction, the court concluded that the allegations concerning the amount and timing of the sales were insufficient to raise a strong inference of scienter. The court noted in particular that none of the individual defendants had any connection to the authorization of the tender offer.

Loss causation. Having dismissed the first cause of action, the court then declined to dismiss the second: loss causation. Here, the court concluded that the allegations pointing to partial corrective disclosures revealing the fraud to the market could plausibly establish loss causation. The court accordingly dismissed the complaint without prejudice, granting leave to file a second amended complaint within 30 days.

The case is [No. 15-CV-408](#).

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Companies: Bridgepoint Education, Inc.; Warburg Pincus LLC; Warburg Pincus Partners LLC; Warburg Pincus Private Equity VIII LP

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