

EXHIBIT A

EXHIBIT D

SULLIVAN & CROMWELL LLP

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June 5, 2013

Via FedEx

Lois C. Greisman, Esq.,
Associate Director, Division of Marketing Practices,
Federal Trade Commission – Bureau of Consumer Protection,
600 Pennsylvania Avenue, N.W.,
Washington, D.C. 20580.

Re: Herbalife

Dear Lois:

I write on behalf of our client Pershing Square Capital Management, L.P. (“Pershing Square”) to bring to your attention an interesting development in the class action filed against Herbalife recently in federal district court in Los Angeles on behalf of lower-level Herbalife distributors. The complaint in that case, captioned *Bostick v. Herbalife International of America*, Case No. 13-cv-02488 BRO (RZx) (attached as Exhibit A), is worth reading because it contains a detailed explanation of why Herbalife is an inherently fraudulent pyramid scheme. The central claim asserted against Herbalife in the *Bostick* case is for violations of California’s Endless Chain Scheme Law, Cal. Penal Code § 327, but the analysis in the complaint is broadly applicable to other laws—federal and state—proscribing pyramid schemes and deceptive practices.

Late last week, Herbalife filed a motion to dismiss the complaint in the *Bostick* case. (A copy of the motion to dismiss (“MTD”) is attached as Exhibit B.) The motion to dismiss is notable in a number of respects.

First, Herbalife’s principal line of defense is that it should have been apparent to the plaintiff that the majority of Herbalife distributors fail, and that even those who do not fail make very little money. Herbalife makes this point repeatedly in the motion to dismiss. *See, e.g.*, MTD at 3 (“Bostick claims he was the victim of a business that . . . made it clear to him that only a small percentage of individuals similarly situated could expect to—as is true—generate significant income as a result of their relationship

with Herbalife.”); *id.* at 10 (“Bostick was well-informed . . . that most Distributors do not achieve Sales Leader status, and even of those that do, most make only modest, if any, income from commissions.”); *id.* (“Bostick knew that . . . most of even Herbalife’s most successful leaders made only modest amounts of commission income.”); *id.* at 11 (“Bostick knew that even the top Herbalife Distributors, on average, earn only a modest amount of income.”); *id.* at 15 (“The Complaint’s own documents show that Herbalife makes clear that even active Distributors are likely to earn, at most, only modest commissions income.”). Indeed, Herbalife contends that “no reasonable consumer could have believed that success was guaranteed, or (as with most business ventures) even likely.” MTD at 21.

The concession that the vast majority of Herbalife distributors are unable to generate “significant income” underscores the deceptive nature of Herbalife’s recruiting materials. As we have shown you in the past, those recruiting materials convey the impression that anyone can make significant income as an Herbalife distributor if he or she is willing to devote sufficient time and effort to the business. Such recruiting materials prominently feature testimonials from people who claim to be making very substantial amounts of money as Herbalife distributors, and those distributors are shown enjoying lavish lifestyles and all the trappings of wealth. *See* Compl. ¶¶ 138-50. The reality is very different. As Herbalife now admits, the chances of earning “quit your job type money” as an Herbalife distributor are remote, and the chances of a new Herbalife distributor making enough money to drive around in a Bentley or a Ferrari are zero.

By emphasizing in the motion to dismiss the low probability that a new Herbalife distributor will ever make significant amounts of money, Herbalife confirms that it is a pyramid scheme. This conclusion flows directly from Herbalife’s acceptance of the principle that “pyramid schemes are inherently fraudulent in nature because the futility of the plan is not apparent to the participant,” and that “an endless chain perpetuates itself because the participants do not realize that most are doomed to failure.” MTD at 5 (quotations omitted). Having acknowledged that most of its distributors are likewise “doomed to failure,” Herbalife places itself squarely within its own definition of a pyramid scheme.

Herbalife seeks to avoid responsibility for its misleading recruiting materials by relying on boilerplate disclaimers in small print and on its Statement of Average Gross Compensation, *see, e.g.*, MTD at 10-11, 21, but Herbalife’s position is unpersuasive. As an initial matter, Herbalife ignores established law that boilerplate disclaimers do not immunize a defendant from liability for making deceptive income claims. For example, in *FTC v. Equinox International*, No. CV-S-990979HBR (RLH), 1999 WL 1425373, at *6 (D. Nev. Sept. 14, 1999), the court noted that “Equinox, in its recruitment and training seminars, emphasizes the promise of lucrative rewards for recruiting others. Distributors are given unrealistic hypothetical examples that their profits will increase geometrically if distributors focus on recruitment rather than retail

sales. Equinox's video presentations and certain materials provided by Equinox contain disclaimers as to the amount of profits obtainable. These disclaimers, however, are difficult to read, do not accurately indicate the actual amount of earnings that can be expected and do not immunize Equinox's exaggerated claims of income."¹ The same could be said of Herbalife's recruiting materials, which convey the impression that it is easy to get rich being an Herbalife distributor. For example, in the issue of the *Herbalife Today* magazine distributed in late 2012, Chairman's Club member Paulina Riveros is described as "earning amazing income" and having "a lifestyle that she couldn't have imagined in her wildest dreams." Compl. ¶ 144.

Herbalife's argument that its Statement of Average Gross Compensation neutralizes its misleading recruiting materials is equally misplaced. As we explained in the presentation entitled "Herbalife's Disclosure of Distributor Earnings is Inadequate" (attached as Exhibit C), Herbalife's latest Statement of Average Gross Compensation, published in February 2013, is not only an implicit concession that prior versions of the document in use for many years were misleading, but is itself misleading in numerous respects. *See also* Compl. ¶¶ 158-71.

Second, Herbalife seeks to distance itself from actions of its senior distributors, including members of the Founder's Circle and Chairman's Club, by referring to them as "third part[ies]" and asserting that they are "not associated" with the company. MTD at 10. As a factual matter, Herbalife's position is baseless because these senior distributors are very closely affiliated with the company, and they are prominently featured in Herbalife's recruiting materials. *See, e.g.*, Compl. ¶¶ 151-57. As a legal matter, Herbalife's position is baseless because Herbalife bears responsibility for the actions of senior distributors whom it cloaks with apparent authority to speak on its behalf. As the court held in *FTC v. Five-Star Auto Club*, 97 F. Supp. 2d 502, 527 (S.D.N.Y. 2000), "[f]or purposes of liability under the FTC Act, it does not matter whether Mr. Cole and Mr. Bewley would be considered at law as employees of the company or independent contractors. The law is clear that under the FTC Act, a principal is liable for misrepresentations made by his/her agents (i.e., those with the actual or apparent authority to make such representations) regardless of the unsuccessful efforts of

¹ *See also* *FTC v. Medicor LLC*, 217 F. Supp. 2d 1048 (C.D. Cal. 2002) (holding, with respect to a "results may vary" disclaimer, that "assuming that their advertisements did include such language, the advertisements are still misleading because consumers could reasonably believe that the statements of earnings potential represent typical or average earnings"); *FTC v. Davidson Associates*, 431 F. Supp. 2d 548, 556 (W.D. Pa. 2006) ("The disclaimers used by defendants, both in written and oral form, to the effect that there are no guarantees of financial success or of a license are not sufficiently prominent and unambiguous and do not clearly, conspicuously, and directly address the misrepresentations made regarding defendants' track record, and are, therefore, ineffective."); Guides Concerning the Use of Endorsements and Testimonials in Advertising, 73 Fed. Reg. 72374, 72379 (proposed Nov. 28, 2008) (discussing results of two FTC studies confirming the ineffectiveness of even prominent disclaimers).

the principal to prevent such misrepresentations. Indeed, it would be inappropriate for Defendants to hold out Mr. Cole and Mr. Bewley as Five Star representatives and to reap the fruits from their acts and doings without incurring such liabilities as attach thereto.” See also *FTC v. Medical Billers Network, Inc.*, 543 F. Supp. 2d 283, 319 (S.D.N.Y. 2008); *FTC v. Stefanchik*, No. C04-1852RSM, 2007 WL 1058579, at *8 (W.D. Wash. Apr. 3, 2007) (“It is well-settled that a principal is liable under the FTC Act for misrepresentations made by its agents, even if those agents do not fall within the traditional definition of agency.”).

Third, Herbalife argues that purchases of products by distributors purportedly for their own personal use should be viewed as retail sales in deciding whether Herbalife is a pyramid scheme. See MTD at 14-16. That argument is wrong because it permits Herbalife to reclassify purchases made by failed distributors as retail sales, even if the products end up stored in attics and garages or are dumped at steep discounts on eBay. The argument is also inconsistent with the holding in *Webster v. Omnitrition*, 79 F.3d 776 (9th Cir. 1996), in which the court held that “[i]f *Koscot* is to have any teeth, such a sale cannot satisfy the requirement that sales be to ‘ultimate users’ of a product.” *Id.* at 783 (citing *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106 (1975)). Herbalife tries to sidestep this holding by arguing that it was “fundamentally tied to the facts of Omnitrition and its plan’s ‘recruitment focus’” (MTD at 15), but that argument is unavailing given the “recruitment focus” of Herbalife’s own marketing plan.

Recent statements by the FTC have reemphasized the critical role of retail sales to customers outside the distribution network in determining whether a multi-level marketing company constitutes an illegal pyramid scheme. For example, on January 24, 2013, the FTC and three state attorneys general filed a complaint alleging that Fortune Hi-Tech Marketing (“FHTM”) was an illegal pyramid scheme. See Complaint in *FTC v. Fortune Hi-Tech Marketing, Inc.*, No. 13cv578 (N.D. Ill.) (“FHTM Compl.”), attached as Exhibit D. That Complaint alleges as follows:

36. FHTM induces new recruits to join FHTM by representing that such recruits will be able to resell FHTM products and services to people not affiliated with FHTM for a profit and simultaneously earn large commissions. FHTM claims that its representatives will be able to easily sell its products and services to consumers not affiliated with FHTM. In fact, few of FHTM’s products and services are ever sold to anyone other than the Reps themselves. Furthermore, Reps receive minimal financial rewards from FHTM for selling the products and services to outside consumers.

FHTM Compl. ¶ 36.

On April 1, 2013, the FTC filed its opposition brief in an appeal from a decision embracing the FTC's position that BurnLounge, Inc. was an illegal pyramid scheme. *See* 2d Cross-Appeal and Answering Br. of Pl.-Appellee FTC, *FTC v. BurnLounge, Inc.*, Nos. 12-55926, 12-56197, 12-56288 (9th Cir.) ("BurnLounge Br."), attached as Exhibit E. In that brief, the FTC confirms that sales to distributors do not constitute retail sales: "If *Koscot* is to have any teeth, such a sale *cannot satisfy the requirement that sales be to 'ultimate users' of a product.*" BurnLounge Br. at 42 (emphasis in original) (quoting *Omnitrition*, 79 F.3d at 783). In its motion to dismiss, Herbalife ignores the FTC's interpretation of *Omnitrition* and the need to establish that Herbalife has actual retail sales. Despite Herbalife's denials, it plainly matters that relatively few Herbalife products are sold to people other than aspiring Herbalife distributors.

Fourth, Herbalife ignores the allegations in the complaint that Herbalife artificially inflates the Suggested Retail Price ("SRP") of its products, which has the dual effect of masking the recruiting focus of Herbalife's marketing plan and misleading potential distributors into believing they can make money selling the products at retail. *See, e.g.*, Compl. ¶¶ 26-27, 41, 172-74. Rather than answering these allegations, which are true, Herbalife pretends they do not exist: "[t]here is no allegation, other than a few conclusory assertions, that Herbalife inflates the prices at which its Distributors sell products." MTD at 3. As the plaintiff in *Bostick* will be able to demonstrate, Herbalife inflates the SRP of its products—upon which Herbalife calculates various distributor discounts, fees and rewards—but that SRP bears no relationship to the prices at which distributors actually sell Herbalife products.

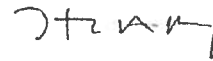
Fifth, Herbalife's argument that it is not a pyramid scheme because it merely "encourages" but does not "require[]" large inventory purchases by distributors in order to qualify for Supervisor, *see* MTD at 12-13, is at odds with the maxim that "[w]hether a multi-level marketing plan operates as illegal pyramid scheme is determined by how it functions in practice." *Whole Living, Inc. v. Tolman*, 344 F. Supp. 2d 739, 744 (D. Utah 2004) (citations omitted). In practice, Herbalife distributors are strongly encouraged to make large inventory purchases in order to qualify as a Supervisor quickly and thereby become eligible to receive recruiting rewards. *See, e.g.*, Compl. ¶¶ 190-93.

Sixth, Herbalife argues that the plaintiff in *Bostick* cannot rely on *Omnitrition* because "a Distributor can become a supervisor (which is required to earn certain types of commissions) 'without purchasing or reselling any Herbalife products.'" MTD at 12. Of course, the fact that a distributor, theoretically, can become a Supervisor based solely on purchases made by lower-level distributors who were recruited by the relevant distributor into Herbalife merely confirms that Herbalife pays compensation which is facially unrelated to the sale of product to ultimate consumers, *i.e.*, precisely the sort of "recruitment focus" that led the court to conclude that *Omnitrition's* marketing plan "appears to be a pyramid scheme." *See Omnitrition*, 79 F.3d at 782.

Seventh, in an effort to avoid the RICO claim asserted in the *Bostick* case, Herbalife concedes that “investments in a pyramid scheme constitute an ‘investment contract,’” both under California law and under federal securities laws. MTD at 23-24. Because Herbalife is a pyramid scheme—as Herbalife effectively concedes by acknowledging that the vast majority of its distributors fail to earn significant income—the operation of Herbalife’s marketing plan is subject to attack under securities laws as well as consumer protection laws. *See* MTD at 23-24 (quoting *Omnitrition*, 79 F.3d at 784 (“We hold that operation of the pyramid scheme violates 10b-5’s prohibition against engaging in an ‘act, practice or course of business which operates as a fraud or deceit upon any person.’”))).

In short, rather than establishing that the attacks on its marketing plan are without merit, Herbalife’s motion to dismiss confirms that Herbalife is an inherently fraudulent pyramid scheme.

Yours sincerely,

A handwritten signature in black ink, appearing to read "St. L. Holley", written in a cursive style.

Steven L. Holley

(Attachments)

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October 1, 2013

Via FedEx

Lois C. Greisman, Esq.,
Associate Director, Division of Marketing Practices,
Federal Trade Commission – Bureau of Consumer Protection,
600 Pennsylvania Avenue, N.W.,
Washington, D.C. 20580.

Re: Herbalife

Dear Lois:

I write on behalf of our client Pershing Square Capital Management, L.P. (“Pershing Square”) to bring to your attention the enclosed bankruptcy petition filed by senior Herbalife distributor Michael Burton and his wife Michelle in the Eastern District of Texas, Case No. 13-41669.

By way of background, Michael Burton is a member of Herbalife’s Senior Executive President’s Team and part of the downline of Chairman’s Club member Dan Waldron. I enclose a disc containing slides that detail some of the deceptive practices engaged in by Burton and Herbalife’s complicity in those practices.¹

Burton’s bankruptcy petition is interesting in several respects, including the following:

- Burton, who tells potential recruits that he has made millions of dollars with Herbalife and enjoys a lavish lifestyle, has assets of \$74,135.92 and liabilities in excess of \$7.1 million.

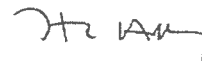
¹ Sources for the materials featured in those slides are provided in the Comments field.

- Burton owes the Internal Revenue Service an enormous amount of money, including \$938,097 for the years 2004-2008, \$63,410 for 2009, and an undetermined amount for the years 2010-2012.
- Burton owes exactly \$500,000 to a total of ten individuals or entities. These debts, which are all in the amounts of \$25,000, \$50,000 or \$100,000, are either not described at all in the bankruptcy petition or are vaguely described as "Debt of Corporate Affiliate." Two of the creditors on these debts are based in the Bahamas.
- Burton owes money not only to his own online recruiting businesses (which are described in the enclosed slides), but also owes money to other companies that we believe are involved in selling leads and other business tools to Herbalife distributors, including eHome Business Network (associated with Anthony Powell) and On-Line Marketing Solutions/Centurion Media (associated with Shawn Dahl).
- Burton owes a very large amount of money to courier services, including \$196,110 to FedEx, \$405,311 to UPS and \$288,000 to Worldwide Express.
- Burton owes \$1,472,203 to something called LG Technology and \$746,374 to something called Revshare, both of which are based at the same address in Temecula, California.

Similar to John Beall, who recently went through personal bankruptcy despite being a senior lieutenant under Anthony Powell, Burton professes in his videos to be making millions of dollars through Herbalife while in fact incurring millions of dollars of debt (much of which appears to be related to operating his Herbalife business.)

In short, Burton's bankruptcy petition provides a number of interesting angles for investigating the activities of senior Herbalife distributors, many of whom are connected with one another in various ways and are likely to have the same issues as Burton with the Internal Revenue Service and other creditors.

Yours sincerely,



Steven L. Holley

(Enclosures)

EXHIBIT E

Witherington, James

From: Todaro, Christine
Sent: Monday, July 15, 2013 11:47 AM
To: Greisman, Lois C.; Ammerman, Janet; Vaca, Monica E.; Anguizola, Roberto
Subject: RE: FYI: NY Post story re Herbalife

I find it interesting that the story says Jessica may attend because I didn't tell Sally that until this morning.

From: Greisman, Lois C.
Sent: Monday, July 15, 2013 10:54 AM
To: Todaro, Christine; Ammerman, Janet; Vaca, Monica E.; Anguizola, Roberto
Subject: FW: FYI: NY Post story re Herbalife

From: Dorman, Frank
Sent: Monday, July 15, 2013 10:22 AM
To: Greisman, Lois C.
Subject: FYI: NY Post story re Herbalife

http://www.nypost.com/p/news/business/groups_ftc_to_talk_herbalife_probe_keVtZm0e8x3EPhOZHgT4aJ

EXHIBIT F

NEW YORK POST

Groups, FTC to talk Herbalife Probe

By Michelle Celarier

July 12, 2013

Consumer advocates are planning to ask regulators on Monday for their commitment to investigate allegations that Herbalife is a pyramid scheme, The Post has learned.

The National Consumers League — the first group to call for an investigation in a March 12 letter — asked for the meeting with the Federal Trade Commission, according to sources. The Hispanic Federation, the League of United Latin American Citizens (LULAC) and Consumer Action are also expected to attend.

The activists are set to meet with Lois Greisman, the FTC's head of consumer fraud. Jessica Rich, the new director of the Bureau of Consumer Protection, may also be there.

The debate about Herbalife has been raging since hedge-fund activist Bill Ackman called the company a pyramid scheme in December and placed a \$1 billion short bet against the stock.

Herbalife has consistently denied his charges.

Still, at least six different letters have been sent to the FTC asking it to probe Herbalife's practices.

Most of the concern has come from the Hispanic community, including local, state and federal lawmakers as well as consumer groups concerned that Herbalife is targeting minorities.

"I'm mad," said LULAC's National Executive Director Brent Wilkes. "I've seen Latinos ripped off by banks and others, but this scheme really takes the cake."

After talking with Herbalife "and not getting the answers I wanted to hear, I concluded they are defrauding upwards of 300,000 Latinos a year," he said.

Another consumer activist planning to attend the meeting said, "We think the problem is getting worse, and we think that the FTC is really important."

Several sources told The Post that they believe the FTC is reluctant to launch an investigation of Herbalife because of the company's financial resources and legal firepower.

Some FTC officials have even suggested to consumer activists that a plaintiff lawsuit against Herbalife would be a preferable way to address their concerns, according to sources.

The FTC declined to comment.

Herbalife has been sued over allegations that it is a pyramid scheme five times. It was found guilty in a Belgian court, a ruling that is on appeal. Other cases have been settled out of court while one is pending.

Critics say that litigation has not addressed their issues.

“Our plaintiffs have been injured because the FTC is not actively involved in regulating this industry,” said Phil Dracht, the lawyer for a failed California distributor who sued Herbalife in April.

EXHIBIT G

03

ORIGINAL 1

1 UNITED STATES SECURITIES AND EXCHANGE COMMISSION

2

3

4 In the Matter of:)

5) File No. HO-9523

6 GOTHAM PARTNERS MANAGEMENT)

7 COMPANY, LLC)

8

9 WITNESS: William Ackman

10

11 PAGES: 1 through 189

12

13 PLACE: 450 5th Street, N.W., Room 1403

14 Washington, DC

15

16 DATE: Thursday, June 5, 2003

17

18

19 The above-entitled matter came on for hearing, pursuant

20 to notice, at 8:55 a.m.

21 Diversified Reporting Services, Inc.

22 (202) 467-9200

23

24

25

1 APPEARANCES:

2 On behalf of the Securities and Exchange Commission:

3 (b)(7)(C)

4 (b)(7)(C)

5 (b)(7)(C)

6 Securities and Exchange Commission

7 Division of Enforcement

8 450 Fifth Street, N.W.

9 Washington, D.C. 20549

10 (202) 942-7189

11

12 On behalf of the Witness:

13 (b)(7)(C)

14 (b)(7)(C)

15 Fried, Frank, Harris, Shriver and Jacobson

16 One New York Plaza

17 New York, NY 10004

18 (212) 859-8000

19

20

21

22

23

24

25

C O N T E N T S

1			
2	WITNESSES:		EXAMINATION
3	William Ackman		194
4			
5	EXHIBITS:	DESCRIPTION	IDENTIFIED
6	43	Research report of MBIA, prepared	
7		by Gotham, "Is MBIA Triple-A"	278
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1 Q And what happened after she wrote that story?

2 A I started writing my report.

3 Q Did you talk to any other reporters, other than
4 Henny Sender?

5 A During this period of time?

6 MR. STEIN: Prior to the report?

7 BY MR. KINSEY:

8 Q Yes. Prior to the release of the research report.

9 A I think a couple of days before the Journal
10 published the story, I told Allison Cowan, at the New York
11 Times, on what I would call an embargoed basis, that I had
12 given the story to the Journal sort of as a courtesy because
13 I had a relationship with her. I explained to her why I had
14 given it to the Journal. And I think I mentioned it to a
15 Reuters person, although I didn't identify the company, about
16 a week before the story came out.

17 Q But your primary motivation for giving the story to
18 Henny Sender was to help your position at Gotham with respect
19 to your investment in MBIA.

20 A To expose the facts in MBIA. And we thought that
21 would lead to -- we would profit by virtue of the investment
22 we had taken.

23 Q All right. What happened after -- did you talk to
24 anybody else, other than Henny Sender, about MBIA before you
25 published your report?

1 Q And Mr. Steinberg is one of your investors?

2 A Yes. They also own a New York State regulated
3 insurance company. And I had spent time talking to Joe about
4 the legal -- insurance related legal issues at MBIA. And he
5 arranged a meeting through their principal regulatory person.
6 They called the superintendent of insurance and set up a
7 meeting for me to meet with the person responsible for
8 overseeing MBIA.

9 Q Okay. Let's go back. Mr. Steinberg. What is his
10 position?

11 A He is a CEO of Leucadia National Corp.

12 Q And what is the name of the insurance company?

13 A They have a company called Empire Insurance. They
14 may own other insurance companies, but that is the New York
15 one that I am aware of.

16 Q So when you were doing -- during the course of your
17 research for this report, you talked to Mr. Steinberg --

18 A Yes.

19 Q -- about MBIA.

20 A I spoke -- he is one of the investors in Gotham
21 Credit Partners.

22 Q And so he suggested that you talk to the New York
23 Insurance Department.

24 A That is correct.

25 Q And what was -- why did he suggest that, do you

1 know?

2 A I mean, it is really the same. You know, as I
3 spoke about in my last interview, it was, I call, shining
4 sunlight on the problem. If the New York State Insurance
5 Department came to the same conclusion we did about various
6 insurance related issues at the company, it might shut down
7 MBIA and that would certainly help our investment.

8 Q What did Mr. Steinberg tell you about -- when you
9 talked to him about this insurance issue that you have at
10 MBIA, what did he tell you?

11 A He was incredulous.

12 Q Well, let's talk about the issue for a minute.
13 What is the insurance issue that you found in the course of
14 research that you thought was a problem?

15 A Well, there are a couple of issues, but the one I
16 was focused on from a pure legal -- there is a disclosure
17 issue I would say with respect to the SPVs and the SPV debts
18 and there is a legal issue that is relevant both to MBIA as a
19 monoline insurance company and MBIA as an insurance -- New
20 York State insurance company generally. And the issue is --

21 Q Well, focus on the legal issue first.

22 A Okay.

23 Q Okay?

24 A Fine.

25 Q All right.

1 Q Did you tell Whitney Tilson about your meeting at
2 the insurance?

3 A I may have. He is one of the Gotham Credit
4 Partners.

5 Q Oh, that is right. What about Mr. Einhorn?

6 A It is possible. I don't remember if I specifically
7 did.

8 Q What about Mr. Spier?

9 A Yes.

10 Q Okay. How do you know Alice Schroeder?

11 A How do I know her now or how did I know her then?

12 Q How did you first meet her?

13 A I sent her an e-mail.

14 Q Was it your -- you sent her an e-mail with respect
15 to MBIA?

16 A Yes.

17 Q When did that -- when did you do that?

18 A November.

19 Q And why did you do -- why did you send her an
20 e-mail?

21 A I thought it would be valuable to have. She is the
22 number one ranked or was the number one ranked insurance
23 analyst. She is the only analyst that Buffett sort of
24 allowed to write a research report on Berkshire Hathaway.
25 And that means something to me. And I had read a lot of the

1 stuff that she had written on the insurance industry and some
2 of the stuff they had written -- that one of her analysts had
3 written on MBIA. And I liked the quality of her work. And I
4 thought if I could convince her that I was right, it would be
5 very valuable to have the number one ranked analyst agree
6 with me.

7 Q And what was the substance of your e-mail to her?

8 A I wrote her an e-mail sort of introducing myself
9 saying, "I am writing about MBIA and, you know, there is some
10 very significant issues at MBIA."

11 Q All right. So your primary motivation in
12 contacting Ms. Schroeder was essentially to tell her what you
13 had found in your research and basically help your investment
14 position in MBIA.

15 A Yes. It would help me a lot if someone -- some
16 third party, particularly someone perceived as more objective
17 than I am, adopted our views.

18 Q After you sent her the e-mail in November, did she
19 respond?

20 A She did.

21 Q How did she respond?

22 A She left me a voice mail.

23 Q Okay. And what happened?

24 A Well, she left me a voice mail saying that she was
25 very adverse to being part of some market manipulation scheme

1 by a short seller, but she was going to check out my
2 references and get back to me as to whether she would meet.

3 Q And what happened after that?

4 A I called Byron Wien, who is, I guess, their market
5 strategist. He is a guy who has been there for 35 years and
6 I have known 10. Not incredibly well, but he knew of me in
7 the investment business. And I asked Byron if he would call
8 Alice and just vouch for me as an honorable, you know, person
9 and also someone who is a good analyst.

10 And, you know, and then Alice did call me back
11 later. She had spoken to a number of people that -- I put
12 Joe Steinberg and Ian Cumming on that list as well as Jack
13 Byrne at White Mountain and a couple of other well known
14 people in the insurance business. She called back and said
15 she checked out the references, they checked out and that she
16 would be willing to meet and she was interested to hear what
17 I had to say. And we set up a meeting.

18 Q And when did you meet with her?

19 A I am not sure. Yes, that was a telephone call. I
20 am pretty sure about that. Shortly thereafter.

21 Q And --

22 A It was in mid November.

23 Q Where was the meeting held?

24 A At her office at Morgan Stanley in a conference
25 room.

EXHIBIT H

THE WALL STREET JOURNAL.

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<http://www.wsj.com/articles/prosecutors-interview-people-tied-to-ackman-in-probe-of-potential-herbalife-manipulation-1426196822>

DEALS & DEAL MAKERS

Prosecutors Interview People Tied to Ackman in Probe of Potential Herbalife Manipulation

U.S. attorney's office and FBI are probing remarks about Herbalife

By **CHRISTOPHER M. MATTHEWS**

Updated March 12, 2015 6:18 p.m. ET

Federal prosecutors and the Federal Bureau of Investigation are probing potential manipulation of Herbalife Ltd. stock and have interviewed people hired by hedge-fund billionaire William Ackman, who has led a long-running campaign against the nutritional-products company, people familiar with the matter said.

Prosecutors in the Manhattan U.S. attorney's office and New York field office of the FBI have conducted interviews and sent document requests in recent months in connection with the investigation, which is looking into whether people, including some hired by Mr. Ackman, made false statements about Herbalife's business model to regulators and others in order to spur investigations into the company and lower its stock price, the people said. Mr. Ackman's firm, Pershing Square Capital Management LP, has made a huge bet on Herbalife shares declining.

One of the people familiar with the matter said investigators are scrutinizing public statements and allegations relayed to regulators by the array of consultants and activists who have lobbied against Herbalife, as well as any connections or potential collaboration between those people and Pershing Square.

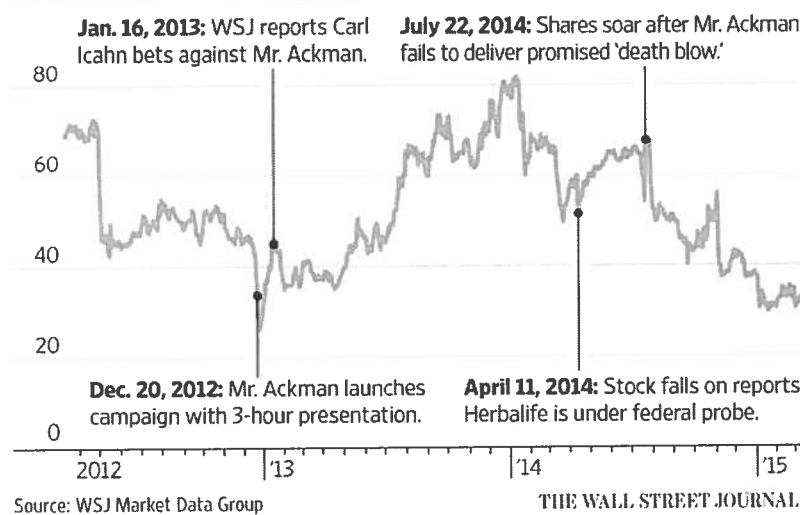
Neither Mr. Ackman nor Pershing Square has been served with a subpoena or

been visited by FBI agents in connection with the probe, another person familiar with the matter said. The investigation could end with no charges being filed.

Eye of the Storm

Herbalife stock has zigged and zagged since investor William Ackman targeted the firm.

\$100



Market manipulation can be a fraught area of the law, legal experts say. Attempting to discredit a company, even through false statements, isn't illegal, nor is paying others to make such statements on your behalf. Market manipulation cases rise and fall on the "intentionality and deliberateness" of making false

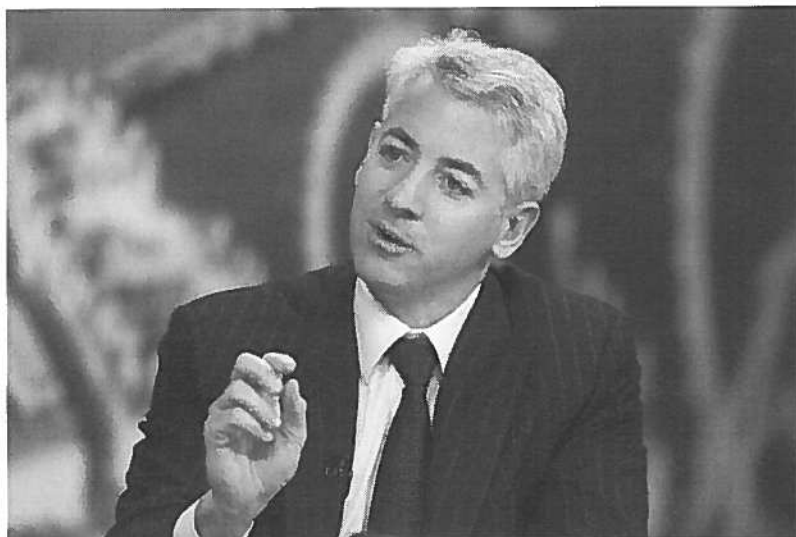
statements to affect a stock price, said Columbia Law School Prof. Daniel Richman.

In a statement, a Pershing Square spokesman said the firm was proud of "exposing the pervasive victimization by Herbalife of millions of people and would welcome any scrutiny of those efforts."

"We have been completely transparent about our position and our research, and we have acted lawfully in every respect," he said.

Herbalife Executive Vice President Alan Hoffman said in a statement that Mr. Ackman and Pershing Square had spent tens of millions "orchestrating a false and fabricated attack against Herbalife."

"Mr. Ackman has a \$1 billion bet against Herbalife and a direct financial interest in hurting our company," Mr. Hoffman said.



William Ackman, founder and chief executive of Pershing Square Capital Management LP, during a Bloomberg Television interview in January. *PHOTO: BLOOMBERG NEWS*

MORE READING

- Ackman Says Buying Salix at \$170 Is a Mistake (<http://blogs.wsj.com/moneybeat/2015/03/13/ackman-says-buying-salix-at-170-is-a-mistake/>)

-

The investigation is a significant turn in the long-running battle over Herbalife. The Federal Trade Commission has been investigating for at least a year allegations made by Mr. Ackman and others that Herbalife is a pyramid scheme. That probe is continuing, as is a related investigation by the Securities and Exchange Commission that is focused on whether the company's business practices have violated any securities laws.

Spokesmen for the SEC and the trade commission declined to comment.

The New York-based investigation is the first known criminal probe into potential market manipulation of Herbalife's stock. Spokesmen for the FBI and the Manhattan U.S. attorney's office declined to comment.

Mr. Ackman has led a high-profile campaign to prove Herbalife is a pyramid scheme, backing it up with a \$1 billion bet that the company's stock will fall. Herbalife has denied the accusations and accused the investor of manipulating its stock.

Both sides have been vociferous in their attacks on each other and have pushed

regulators to look at the other's actions.

After publicly coming out against Herbalife in 2012, Mr. Ackman says he has spent more than \$50 million to research and publicize his fund's negative view of Herbalife. He has hired a team of lobbyists and consultants to contact a host of politicians and regulators and encourage investigations into the company. Herbalife, in turn, has said it has spent more than \$54 million defending itself and pushing for investigations into Pershing Square's actions.

In a series of public presentations, Mr. Ackman has made his case that the company is a pyramid scheme in which millions of salespeople have failed to make money selling its products, while top recruiters have taken home fortunes for signing up sellers.

"Under any real examination, Herbalife's business cannot survive," a Pershing Square spokesman said Wednesday. "More than 1,000 U.S. victims have come forward."

"We are confident in the strong fundamentals of our business model and have remained committed to helping people and communities improve their nutrition," Herbalife's Mr. Hoffman said.

The battle has captivated Wall Street for more than two years. Mr. Ackman first made a presentation, titled "Who wants to be a Millionaire" and disclosing his so-called short bet against the stock, in December 2012, sending shares plunging. In a short bet, investors typically borrow stock and then sell it, hoping the share price falls and they will be able to buy stock more cheaply to return to the lender, pocketing the difference.

Herbalife's stock soared in the year after Mr. Ackman established his big short position, as investors like Carl Icahn, George Soros and Daniel Loeb established bullish positions, leaving Mr. Ackman with big losses on paper.

The stock fell after the company said in late February that its sales were flat in the last three months of 2014 and that its 2015 profit would be hurt by changing foreign-exchange rates, particularly in Venezuela. Underwhelming earnings reports in July and November also sent the company's shares lower. The stock, which was trading around \$65 a share in mid-July, priced Thursday at \$33.30.

At recent prices, Mr. Ackman's bet would be profitable, though his expenses on

the investment have driven up his initial cost, he said earlier this year. He has pledged to continue his campaign against Herbalife until the stock is wiped out.

Prosecutors and the FBI began looking at the allegations from both camps in early 2014, according to people familiar with the matter. The investigation's focus shifted to potential market manipulation by Herbalife's accusers around the beginning of this year, one of the people said.

With about \$20 billion in assets under management, Mr. Ackman manages one of the largest activist funds, which buy stakes in companies and urge changes like stock buybacks, management shake-ups or outright sales.

Activists, consultants and others have submitted letters to regulators and politicians around the country accusing Herbalife of wrongdoing and asking for investigations.

In Connecticut, for example, the office of Attorney General George Jepsen received about 26 letters accusing Herbalife of being a pyramid scheme and asking for an investigation, Mr. Jepsen said in an interview. Pershing Square paid a government-relations firm in that state to lobby Mr. Jepsen and other offices, according to state lobbying disclosures. Many of the letters were submitted by that firm, Mr. Jepsen said.

Mr. Jepsen described the majority of the letters as nearly identical "form letters." He said his office investigated the allegations in every letter and was unable to substantiate any of them. His office has no active investigation into Herbalife, Mr. Jepsen said.

There isn't anything illegal about directing a letter-writing campaign or submitting form letters, a common lobbying tactic that is protected by the First Amendment.

Mr. Jepsen, who said he met with Mr. Ackman in October 2013 to discuss Herbalife, said his office didn't form any conclusions about Herbalife's business model and could re-open an investigation if it received "organic complaints" not solicited by a letter-writing campaign. He also said he had met with representatives of Herbalife.

—David Benoit contributed to this article.

Write to Christopher M. Matthews at christopher.matthews@wsj.com

Corrections & Amplifications:

Investor William Ackman has pledged to continue his campaign against Herbalife until the stock is wiped out. An earlier version of this article incorrectly stated Mr. Ackman had pledged to hold his personal part of the Herbalife investment until the stock is wiped out.

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EXHIBIT I



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
STATION PLACE
100 F STREET, NE
WASHINGTON, DC 20549-2736

Office of FOIA Services

March 18, 2013

Jeffrey Gardner

Re: Freedom of Information Act (FOIA), 5 U.S.C. § 552
Request No. 13-04533-FOIA

Dear Mr. Gardner:

This letter partially responds to your request, dated and received in this office on February 19, 2013, for records of certain investment/trading activity regarding Pershing Square Capital Management, L.P., Herbalife, and/or William Ackman, from December 1, 2012 through February 15, 2013.

We are withholding records responsive to your request under 5 U.S.C. § 552(b)(7)(A), 17 C.F.R. § 200.80(b)(7)(i). This exemption protects from disclosure records compiled for law enforcement purposes, the release of which could reasonably be expected to interfere with enforcement activities. Since Exemption 7(A) protects the records from disclosure, we have not determined if other exemptions apply. Therefore, we reserve the right to assert other exemptions when Exemption 7(A) no longer applies.

Because the underlying circumstances may change, we may later disclose some of the exempt records. If you wish, you may request them again six months from the date of this letter.

I am the deciding official regarding this adverse determination. You have the right to appeal our decision to our General Counsel under 5 U.S.C. § 552(a)(6), 17 C.F.R. § 200.80(d)(5) and (6). Your appeal must be in writing, clearly marked "Freedom of Information Act Appeal," and should identify the requested records. The appeal may include facts and authorities you consider appropriate.

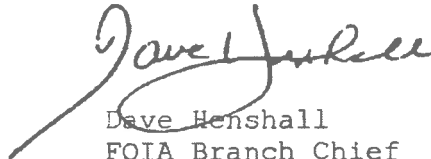
Jeffrey Gardner
March 18, 2013
Page Two

13-04533-FOIA

Send your appeal to the Office of FOIA Services of the Securities and Exchange Commission located at Station Place, 100 F Street NE, Mail Stop 2736, Washington, D.C. 20549, or deliver it to Room 1120 at that address. Also, send a copy to the SEC Office of the General Counsel, Mail Stop 9612, or deliver it to Room 1120 at the Station Place address.

We are still consulting with other Commission staff regarding information that may be responsive to your request. In the interim, if you have any questions, please contact Clarissa Anderson of my staff at andersonc@sec.gov or (202) 551-8315. You may also contact me at foiapa@sec.gov or (202) 551-7900.

Sincerely,



Dave Henshall
FOIA Branch Chief

EXHIBIT J

CREW | citizens for responsibility and ethics in washington

February 9, 2011

By Facsimile (without exhibits) (202-772-9279) and hand-delivery

Robert Khuzami
Director
Division of Enforcement
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Dear Mr. Khuzami:

Citizens for Responsibility and Ethics in Washington (CREW) requests that the Securities and Exchange Commission (SEC) open an investigation into the short-selling activities of hedge fund managers to determine if they have been illegally manipulating the market price of stock in the for-profit education industry. Publicly available data as well as documents CREW obtained through a Freedom of Information Act (FOIA) request to the U.S. Department of Education suggest substantial and highly suspicious market activity in the for-profit industry and behind-the-scenes efforts by short-sellers to manipulate that market.

CREW was first alerted to this problem by the congressional testimony of Steven Eisman, a hedge fund manager for FrontPoint Financial Services Fund and known short-seller of stocks in for-profit education companies, before the Senate Committee on Health, Education, Labor and Pensions on June 24, 2010. Despite a complete lack of expertise in education policy, Mr. Eisman sought to be included as a committee hearing witness, during which he offered a scathing attack on the for-profit education industry. Describing that industry as “fundamentally unsound,” Mr. Eisman predicted that over the next 10 years, defaults of Title IV loans would total \$275 billion.¹ Of note, although Mr. Eisman acknowledged during the Senate hearing that his hedge fund has shorted stocks of certain for-profit colleges, he did not identify any specific companies he was shorting or the dollar amount of short positions he held, nor did anyone ask him to do so.² After

¹ Testimony of Steven Eisman before the U.S. Senate Committee on Health, Education, Labor and Pensions, June 24, 2010, available at <http://help.senate.gov/hearings>.

² See David A. Kaplan, [Short-Sellers Get Snagged in Education Litigation](#), *Fortune.com*, October 16, 2010, available at http://money.cnn.com/2010/10/15/news/eisman_education_lawsuit.fortune/index.htm.

Mr. Eisman's congressional testimony, stocks of for-profit companies fell significantly.³ This market reaction was predictable given that shares in for-profit education institutions also fell several weeks earlier, when Mr. Eisman offered a similar characterization of for-profit education institutions as resting on shaky financial footing in a May 26, 2010 speech at the Ira Sohn Investor Conference, "Subprime Goes to College."⁴

Documents CREW obtained from a lawsuit brought to compel the Department of Education to comply with its FOIA obligations reveal that beyond his congressional testimony, Mr. Eisman worked actively behind the scenes to affect the outcome of Education's regulatory process. Not only did Mr. Eisman meet with top Education Department officials leading the regulatory charge (by telephone and in-person) in early April 2010, including then Deputy Undersecretary Robert Shireman, he also circulated widely within the Education Department analyses he and his firm prepared of the for-profit education industry.⁵ This was all part of his lobbying effort for specific and more stringent gainful employment regulations that, if adopted, are likely to have a substantial negative effect on the market price of shares in for-profit education companies.⁶ As someone who is neither regulated by nor affected directly by the for-profit regulations, Mr. Eisman appears to have injected himself into the agency's process for the sole purpose of causing a specific outcome to advance his own financial interests.

³ For example, shares of the Apollo Group, the parent company of the University of Phoenix, were trading at \$46.33 per share at the close of June 23, 2010 – the day before Mr. Eisman's congressional testimony – and had dropped to \$43.75 per share by the close of June 25, a drop in value of over 9.4%. See <http://www.bloomberg.com/apps/quote?ticker=APOL:US>. The overall decline in the stocks of for-profit education companies in the 24 hours following Mr. Eisman's congressional testimony has been placed at between 6% and 8%. Kaplan, *Fortune.com*, Oct. 16, 2010.

⁴ See Kaplan, *Fortune.com*, Oct. 16, 2010.

⁵ At a speech Mr. Shireman gave to state regulators several weeks after this meeting, which Mr. Shireman attended by telephone, he borrowed a page directly from Mr. Eisman's "Subprime Goes to College" theme by comparing the for-profit education industry to Wall Street firms responsible for the financial meltdown. See Comparing Higher Ed to Wall Street, *Inside Higher Ed*, April 29, 2010 (attached as Exhibit A).

⁶ The specific steps taken by Mr. Eisman and others acting on his behalf are set forth in CREW's letter of January 19, 2011, to Secretary of Education Arne Duncan requesting an investigation into the role hedge fund managers and outside interest groups have played in the agency's formulation of regulations governing the for-profit education industry (Duncan Letter). A copy of the Duncan letter is attached as Exhibit B.

Additional documents suggest other hedge funds also shorting stocks in the for-profit education industry pursued similar strategies. For example, emails show a lobbyist and analysts for CPMG, a Dallas-based hedge fund, also met with Education officials on these issues and worked with them to gather student testimonials designed to illustrate the problems with for-profit education institutions.⁷ CPMG's criticism of the for-profit education industry was aided by research put together by Alternative Research Services, a firm that has openly acknowledged its underlying financial motivation in seeking stock prices decrease.⁸ Another hedge fund short-selling stock in the for-profit education industry, QuilCap Corp., wrote to the Education Department with concerns over the business models used by certain publicly traded for-profit schools.⁹ Like FrontPoint, neither CPMG nor QuilCap is directly affected by the regulations in question, and both appear to be attempting to enhance their financial interests through actions likely to negatively affect the market price of for-profit education institutions.

The for-profit education industry, although a discrete segment of the financial market, generates substantial revenue. Correspondingly, stocks in for-profit education companies have suffered substantial losses dating back to Mr. Eisman's June 24, 2010 congressional testimony. One financial services firm that invests in the for-profit industry has calculated that stocks fell by \$7.9 billion from June 21 through December 17, 2010, a loss of 27 percent.¹⁰ Some in the for-profit industry were particularly hard hit: Corinthian College, for example, experienced a 60% drop in its stock price during that period.¹¹ At the same time, investors like Mr. Eisman have substantial short holdings in for-profit institutions, as illustrated by the attached charts, drawn from publicly available NASDAQ information, showing short positions in specified for-profits

⁷ See Duncan Letter at p. 7. See also Mary Pilon, Jonathan Weisman, and Brody Mullins, A 'Short' Plays Washington, *The Wall Street Journal*, January 25, 2011 (copy attached as Exhibit C).

⁸ See Pilon, Weisman and Mullins, *The Wall Street Journal*, Jan. 25, 2011.

⁹ Duncan Letter at pp. 7-8.

¹⁰ See Richard Vedder, An \$8 Billion Misunderstanding, *Forbes.com*, available at <http://blogs/forbes.com/ccap/2010/12/22/an-8-billion-misunderstanding/>. Mr. Vedder's blogpost was based on data and analysis prepared by Arcady Bay Partners (Arcady Bay Report), a copy of which is available at www.arcadybay.com and attached as Exhibit D. According to the Arcady Bay Report, "it seems that the Senate hearings have had their intended impact and slowed down the growth of the for-profit colleges. The overhang of the Gainful Employment rules should continue to pressure stock prices and in all probability increase operating costs for the for-profit sector, if increase reporting is required." *Id.*

¹¹ Arcady Bay Report at p. 3.

Robert Khuzami
February 9, 2011
Page Four

for the period November 2009 through December 2010.¹² Simply stated, there are significant sums of money to be made by shorting stocks in the for-profit education industry, as evidenced by the short-selling activities of such notables as Mr. Eisman, who reaped similar financial gains by shorting the mortgage industry before its collapse.

The limited nature of publicly available information about short sales in the for-profit education industry makes it impossible for groups like CREW, unversed in the intricacies of the financial markets, to prove improper financial manipulation by short-sellers. At least one analyst has suggested to us a careful examination of this market will reveal wild swings in trading activity that, when coupled with the actions to date of certain short-sellers such as FrontPoint and CPMG and the substantial profits to be made from short-selling, raise the possibility of illegal market manipulation. Accordingly, we respectfully ask the SEC to conduct this analysis as part of an investigation into possible market manipulation in the stock of for-profit education institutions.

The SEC should ask FrontPoint and other hedge funds associated with the for-profit education industry to disclose their holdings and how they changed as the fund managers were attempting to influence the outcome of the Department of Education's regulatory process. A comparison of the buying patterns of stock options or short positions of these funds may reveal evidence of collusion relevant to a determination of market manipulation.

As Linda Chatman Thomsen, one of your predecessors, stated in 2008 when announcing the expansion of a probe into market manipulation in financial institutions, "Abusive short selling market manipulation and false rumor mongering for profit by any entity cuts to the heart of investor confidence in our markets."¹³ These words are even more true today, with public confidence in Wall Street at an all-time low. During these difficult economic times, brought on at least in part by the overly aggressive and unscrupulous behavior of some Wall Street investors, it is imperative that the SEC thoroughly and fairly investigate any possible market manipulation. Americans need to have faith that our government will never again turn a blind eye to the suspicious conduct of finance professionals.

¹² These charts are attached as Exhibit E. The data does not identify who has these short holdings, just the total short interest.

¹³ Press Release, SEC Expands Sweeping Investigation of Market Manipulation, September 19, 2008 (statement of Linda Chatman Thomsen, Director of the SEC's Division of Enforcement), available at <http://www.sec.gov/news/press/2008/2008-214.htm>.

Robert Khuzami
February 9, 2011
Page Five

Thank you for your prompt attention to this important matter.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Anne L. Weismann', with a long, sweeping horizontal stroke at the end.

Anne L. Weismann
Chief Counsel

Enclosures

EXHIBIT K

CREW | citizens for responsibility and ethics in washington

January 19, 2011

By Fax (202) 401-2854 (without exhibits) and Hand Delivery

Arne Duncan
Secretary of Education
U.S. Department of Education
400 Maryland Avenue, S.W.
Washington, D.C. 20202

Dear Secretary Duncan:

Citizens for Responsibility and Ethics in Washington ("CREW") respectfully requests that you examine the role hedge fund managers and outside interest groups have played in the Department of Education's (Education) formulation of regulations governing the for-profit education industry. Agency records CREW obtained recently from Education in response to a Freedom of Information Act (FOIA) request and records made public as a result of a private Florida lawsuit¹ reveal certain hedge fund managers had direct and sustained input into the regulatory process in furtherance of their own financial interests. More troubling, Education officials knew of this involvement and the financial motivations of the short sellers, yet continued to solicit and receive their input. The FOIA documents also reveal the extraordinary degree to which Education has been captivated by outside groups in the development of its regulations. These groups essentially functioned as agency decision-makers with unprecedented access to high-level Education officials. This backdrop raises a serious question about the propriety of Education's regulatory process and the regulations that process produced.

Role of Steven Eisman and His Hedge Fund at Education

CREW was first alerted to this problem by the testimony of Steven Eisman before the Senate Committee on Health, Education, Labor and Pensions (HELP Committee). Mr. Eisman is a portfolio manager of a hedge fund, FrontPoint Financial Services Fund, known to short-sell stocks in for-profit education companies. Despite his lack of expertise in education policy, Mr. Eisman, after contacting Chairman Tom Harkin, was invited to testify at a June 24, 2010 hearing on federal spending on for-profit education. Mr. Eisman offered a scathing attack on an industry he described as "fundamentally unsound" and predicted that over the next ten years, defaults of Title IV loans would total \$275 billion.² Previously, when Mr. Eisman offered similar

¹ Those documents are posted at <http://www.careercollegecentral.com/keiser-university-lawsuit-repository/document-index>.

² Testimony of Steven Eisman before the U.S. Senate Committee on Health, Education, Labor and Pensions, June 24, 2010, available at <http://help.senate.gov/hearings>.

Honorable Arne Duncan
January 19, 2011
Page Two

characterizations of the for-profit education institutions as resting on shaky financial footing at a May 26, 2010 speech at the Ira Sohn Investor Conference (“Sohn Speech”), share values of the named companies plummeted and Mr. Eisman reaped huge profits from short-sales in those companies.³ Mr. Eisman’s June 24th congressional testimony had a similar affect on the stocks of for-profit companies.⁴

Documents CREW obtained through a Freedom of Information Act lawsuit filed against Education reveal that beyond his congressional testimony, Mr. Eisman worked actively behind the scenes to affect the outcome of Education’s regulatory process. In early April 2010, Mr. Eisman sought a meeting with then-Education Deputy Undersecretary Robert Shireman, who was leading the regulatory effort at Education, and Policy and Budget Development Staff Director David Bergeron to provide the results of his firm’s research on the for-profit education industry.⁵ During the meeting that followed on April 16, at which Mr. Bergeron was present in person and Mr. Shireman participated by telephone, Mr. Eisman provided his “Subprime Goes to College” slide deck and data on the for-profit industry.⁶ Of note, at a speech Mr. Shireman gave to state

³ David A. Kaplan, Short-Sellers Get Snagged in Education Litigation, *Fortune.com*, October 16, 2010, available at http://money.cnn.com/2010/10/15/news/eisman_education_lawsuit.fortune/index.htm.

⁴ For example, shares of the Apollo Group, the parent company of the University of Phoenix, were trading at \$46.33 per share at the close of June 23, 2010 – the day before Mr. Eisman’s congressional testimony – and had dropped to \$43.75 per share by the close of June 25, a drop in value of over 9.4%. See <http://www.bloomberg.com/apps/quote?ticker=APOL:US>. The overall decline in the stocks of for-profit education companies in the 24 hours following Mr. Eisman’s congressional testimony has been placed at between 6% and 8%. Kaplan, *Fortune.com*, Oct. 16, 2010. The share value of for-profit education stocks experienced a similar decline after Mr. Eisman’s Sohn Speech. *Id.*

⁵ See email from David Bergeron to Kathleen Smith and Robert Shireman, April 7, 2010 (suggesting to Mr. Shireman that “we take this meeting”); email from David Bergeron to Diane Schulman, April 7, 2010 (confirming Mr. Bergeron’s ability to attend the meeting) (both attached as Exhibit A).

⁶ See email from Chris Susanin (of FrontPoint) to Bob Shireman, April 19, 2010 (thanking him for reviewing the slides, financial analysis and data, and describing Steve Eisman as “a character”); email from Andrew Black (of FrontPoint) to Bob Shireman, April 16, 2010 (forwarding FrontPoint’s slide presentation). FrontPoint updated the slides a week later. Email from Matthew Leahy (of FrontPoint) to David Bergeron and Bob Shireman, April 22, 2010 (providing “new analyses” as an update from the prior week). See also David A. Kaplan, Did Steve Eisman Unduly Influence the Education Dept.?, *Fortune*, November 2, 2010 (all attached

Honorable Arne Duncan
January 19, 2011
Page Three

regulators several weeks later, he reportedly compared the for-profit education industry to Wall Street firms responsible for the financial meltdown, apparently borrowing a page directly from Mr. Eisman's book and foreshadowing Mr. Eisman's May 26 Sohn Speech.⁷ Mr. Eisman's "Subprime Goes to College" theme would be echoed repeatedly during the regulatory process, particularly by non-profit groups seeking the most restrictive gainful employment regulations.

This was the beginning of a months-long correspondence between Mr. Eisman, others at FrontPoint and key Education officials at a critical point in the debate over Education's treatment of gainful employment at for-profit schools. At times, Mr. Eisman merely forwarded articles and news of interest.⁸ At other times FrontPoint and Mr. Eisman provided Education officials with substantive analysis of the for-profit industry to justify their views on the percentage Education should adopt for the gainful employment regulations. For example, on May 26, 2010, Mr. Eisman sent an email to numerous Education officials, including you and David Bergeron, advising that his Sohn Speech of that afternoon had been "very negative on the industry." Mr. Eisman included his speech and power point presentation as an attachment.⁹

Two days later, Mr. Eisman sent another email to numerous Education officials, including Dan Madzelan, then-Acting Assistant Secretary for the Office of Postsecondary Education, and David Bergeron, calling attention to his views on the for-profit education industry. He also included an analysis completed by FrontPoint of the gainful employment regulations then under review at Education, focusing on what he termed "key metrics (specifically the debt service percentage and the repayment period)."¹⁰ As you know, the gainful employment regulations have been the most controversial in the regulatory package with the potential to have the greatest economic impact on the for-profit education industry, as the percentage Education chooses could cause for-profit institutions to lose access to the bulk of their revenue, which comes from federal

as Exhibit B).

⁷ See Comparing Higher Ed to Wall Street, *Inside Higher Ed*, April 29, 2010 (attachment to email from Susan Lehr to Mark Bailey, April 29, 2010 (attached as Exhibit C)).

⁸ See, e.g., email from Steven Eisman to David Bergeron, April 20, 2010 (forwarding write-up by Height Analytics of lawsuit involving for-profit education institute) (attached as Exhibit D).

⁹ A copy of this email and the attached speech, *Subprime Goes to College*, are attached as Exhibit E.

¹⁰ A copy of this email, which begins "My name is Steven Eisman," and goes on to discuss highlights of his enclosed analysis of the gainful employment proposal, is attached as Exhibit F.

financial aid.¹¹

The documents CREW obtained also reveal that Education officials were well aware of the economic interests Mr. Eisman was attempting to further as he contacted Education officials, although he himself never revealed those interests. For example, Mr. Bergeron was sent a copy of a *Bloomberg Businessweek* article entitled “FrontPoint’s Eisman Bets Education Stocks to Fall on Loan Rules” that outlines how Mr. Eisman is pursuing the same investment strategy he did with the housing market – shorting shares of for-profit education companies.¹² Similarly, a June 14, 2010 email from Mark Kantrowitz, the publisher of FinAid.org and FastWeb.com, to Mr. Shireman, among others, states: “I mentioned previously that Steve Eisman, an analyst with some fame for shorting subprime mortgages, is now shorting for-profit higher education . . . Keep in mind that this guy is a short-seller . . .”¹³

Contacts Between Steven Eisman, His Hedge Fund , and Non-Profit Groups

Other documents show the role of The Indago Group, a small research company used by FrontPoint that worked behind the scenes to obtain information and entree to Washington lawmakers to help FrontPoint gain a further economic advantage.¹⁴ Beyond contacting Education

¹¹ See, e.g., Goldie Blumenstyk, Education Dept. to Delay Issuing ‘Gainful Employment’ Rules Opposed by For-Profit Colleges, *Chronicle of Higher Education*, September 24, 2010, available at <http://chronicle.com/article/Education-Dept-to-Delay/124617/>.

¹² This document was an attachment to an email from Peter Warren to David Bergeron and is attached as Exhibit G.

¹³ See email from Mark Kantrowitz to Bob Shireman and James Kvaal (Deputy Undersecretary of Education) entitled “Talk at Ira Sohn Conference,” June 14, 2010 (attached as Exhibit H). Mr. Kantrowitz and Mr. Shireman talked so frequently that Mr. Shireman was on Mr. Kantrowitz’s “speed dial.” See email from Bob Shireman to Mark Kantrowitz entitled “Morgan Stanley on NPRM publication data and contents,” June 14, 2010 (also attached as Exhibit H).

¹⁴ FrontPoint also appears to have used the services of another research firm, Alternative Research Services, headed by Rob MacArthur. In a February 23, 2010 letter to a number of non-profits and Education officials, including Zakiya Smith, Policy Advisory to the Assistant Secretary, Mr. MacArthur commented on a GAO letter issued that day regarding schools participating in federal student aid programs that had violated the ban on making incentive compensation payments. Mr. MacArthur noted distribution of this letter “may affect the stock prices in the industry if the market believes there will be increased scrutiny from various parts of the federal government.” See email from Rob MacArthur to Barmak Nassirian (Associate

officials directly, Diane Schulman of The Indago Group and Mr. Eisman formed alliances with a small group of non-profits and community colleges (collectively “non-profits group”) seeking to ensure that Education adopted the most stringent regulations of the for-profit education industry, particularly the gainful employment rules. As outlined below, this group had an enormous impact on the scope and direction of the regulations and Education officials essentially allowed the group to function as agency officials, completely eviscerating the line between the agency and outside groups pursuing their own agenda.

As part of The Indago Group’s efforts, Ms. Schulman shared with the non-profits group FrontPoint’s analysis of the issue, which was in sync with the view of the non-profits group that the gainful employment level should be eight percent.¹⁵ Ms. Schulman also shared Mr. Eisman’s Sohn Speech with the group, which provoked the following enthusiastic reaction from Susan Lehr, Vice President of Government Relations at Florida State College, as to its likely affect on the market:

This is a speech given to Wall Street today that will rock the market. Eisman was one of the first ones to see the mortgage crisis coming – he is a Wall Street big time guy profiled in the book The Big Short. Thought you would like to see this. It is very WOW! . . .¹⁶

The group also obtained an advance copy of Mr. Eisman’s June 24, 2010 congressional testimony that Ms. Lehr circulated internally two days ahead of the hearing with the gushing

Executive Director, American Association of Collegiate Registrars and Admissions Officers), et al. entitled “GAO report,” February 23, 2010 (attached as Exhibit I). Of course, this is the market effect FrontPoint, as a short seller, was hoping for.

¹⁵ See email from Diane Schulman to Deanne Loonin (staff attorney at the National Consumer Law Center), James Simpson (Vice President of Florida State College), Susan Lehr entitled “Gainful Employment Analysis,” May 21, 2010 (email and attachment attached as Exhibit J). A regulation dictating an eight percent gainful employment level would mean that students at for-profit institutions would be eligible for federal student loans only if Education determined their career programs prepare them for gainful employment in an occupation with expected pay scales that would establish a debt-to-earnings ration of eight percent or less.

¹⁶ See email from Susan Lehr to Joe Jangro of Water Street Capital entitled “Wall Street Speech today on For Profit Education Industry,” May 26, 2010; email from Diane Schulman to Susan Lehr and James Simpson (forwarding Sohn Speech), May 26, 2010 (both attached as Exhibit K).

description of Mr. Eisman as “my hero.”¹⁷ Days before Education released the proposed regulations on gainful employment, Ms. Schulman forwarded to some group members what she described as “some of the speculation” on the effect of the gainful employment regulations on education stocks, laying out the effects of the two proposals Education was considering.¹⁸

Like the Education officials, the non-profits group was well aware of Mr. Eisman’s underlying financial motives. The group’s head, Pauline Abernathy, Vice President of The Institute for College Access and Success (TICAS), an organization she co-founded with Robert Shireman, sent a cautionary email to Ms. Lehr advising that while Mr. Eisman “and his folks sometimes have useful info . . . I try to be careful what I share since he has a financial interest we do not, and he may make money based on what happens in the market each day while we only care about the final outcome.”¹⁹ Nevertheless, Mr. Eisman remained tuned in to the group’s efforts, giving him an inside track on the progress of the regulations, most particularly the gainful employment regulations of greatest interest to both.

While it is not known whether Mr. Eisman received an advance copy of the gainful employment regulations from Education officials prior to their issuance on July 23, 2010, at least some in the non-profits group received an advance copy and spoke with Mr. Eisman around this time. A July 21, 2010 email from Ms. Lehr to Ms. Abernathy conveys Ms. Lehr’s understanding that the gainful employment regulation was coming out at midnight the following evening with the subsequent request “don’t pass on beyond our group.” A later email that day from Ms. Lehr conveys her expectation she would receive an embargoed copy before its official release and notes “Jim met by phone with Eisman yesterday for a very interesting conversation.” Another email sent the following morning states “We expect lots of market churn” from the issuance of the gainful employment regulations. That same morning, Ms. Lehr told Ms. Abernathy “Eisman had questions for Jim on Wednesday . . . they spoke for about an hour . . .”²⁰ This email chain

¹⁷ See email from Susan Lehr to Doug Cooley and Doug Axteil, June 22, 2010 (attached as Exhibit L).

¹⁸ See email from Diane Schulman to James Simpson and Susan Lehr entitled “Here’s some of the speculation,” July 20, 2010 (attached as Exhibit M).

¹⁹ Email from Pauline Abernathy, to Susan Lehr, July 22, 2010 (attached as Exhibit N).

²⁰ Email from Susan Lehr to Pauline Abernathy entitled “GE out Tomorrow,” July 21, 2010; email from Susan Lehr to CEO entitled “Gainful Employment,” July 21, 2010; email from CEO to Gilchrist Berg entitled “Gainful Employment,” July 22, 2010; email from Susan Lehr to Pauline Abernathy entitled “GE-ED briefing hill staff at 6pm tonight!,” July 22, 2010 (all attached as Exhibit O).

suggests, at a minimum, Mr. Eisman likely knew Education was about to issue the long-awaited regulations.

Role of Other Hedge Funds

FrontPoint is by no means the only hedge fund to both actively short-sell stock in the for-profit education industry and attempt to influence Education's regulation of that industry. Partners of a Dallas-based hedge fund, CPMG, also met with Education officials and traded information and data extensively with non-profit group members on the negotiated regulations committee ("NegReg Committee") Education established to make recommendations on the regulatory package. A March 31, 2010 email from Pauline Abernathy to NegReg Committee members describes efforts to coordinate with Education to gather gainful employment examples, such as individuals who took on debt to pursue education at a for-profit institution and then could not find jobs in their promised fields. Ann Manheimer, Director of Education's Management Systems Improvement Group, was coordinating the effort and the email noted Education officials already had met with a lobbyist and analysts for short-seller CPMG, including Antal Desai, as part of this effort.²¹ Mr. Desai had been working on gathering student testimonials for the past year, as reflected in a July 8, 2009 email from James Simpson to Susan Lehr and Elizabeth Baldwin.²² That email describes CPMG as "a mid size investment company" with "some investments (stocks) of publically [sic] traded education companies," and explains "they [CPMG] are trying to determine the amount of risk that may be associated with these investments."²³ By actively injecting itself into the regulatory process, it appears CPMG was doing more than assessing the risk of its investments – it apparently was trying to cause a specific regulatory outcome.²⁴

Another hedge fund that claimed to have followed the education and student loan companies for over a decade, QuilCap Corp., also voiced its growing concern "over the viability

²¹ See email from Pauline Abernathy to Susan Lehr, et al. regarding Neg reg follow up info and docs for review by Friday COB, March 31, 2010 (enclosed as Exhibit P).

²² See email from James Simpson to Susan Lehr and Elizabeth Baldwin entitled "Student Testimonials," July 8, 2009 (attached as Exhibit Q).

²³ *Id.*

²⁴ Moreover, at least some in the non-profits group were willing to overlook the fact that CPMG was acting in pursuit of its own financial interests. A July 28, 2009 email from Barmak Nassirian to Susan Lehr (attached as Exhibit R) states: "I know Antal [Desai] and have been impressed with him and his firm. I don't care – or fully understand – what their financial interests in these matters might be . . ."

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of certain publicly traded for-profit schools' business models" in a June 9, 2009 letter to Education.²⁵ QuilCap's annual report outlines its strategy and rationale for pursuing short sales of the for-profit education industry.²⁶

Role of Non-Profits Group at Education

At the same time, the non-profits group and others in the non-profit education community enjoyed an inordinate amount of influence over Education's internal deliberations and decision-making. Their influence began with Robert Shireman serving as Senior Advisor to the Secretary, starting at the beginning of the Obama administration. While in his capacity as a consultant to Education, Mr. Shireman remained on the board of TICAS, a group leading the charge in advocating for more stringent gainful employment regulations. A few months later in April, 2009, Mr. Shireman was appointed Deputy Undersecretary. A day before his appointment was announced, he sent an email to TICAS officials advising them of his appointment to the position where he would have "responsibility for financial aid policy and operations as well as higher education and related initiatives."²⁷ While Mr. Shireman noted he would "have no further official connection to TICAS," he also expressed his intent "to make myself available as a volunteer in my personal time. Let me know how I can be helpful."²⁸

In fact, however, Mr. Shireman did not limit his assistance to his "personal time." Instead, as reflected in numerous documents Education released to CREW under the FOIA, Mr. Shireman had ongoing contacts with TICAS and others working with TICAS to push a specific regulatory agenda, even during sensitive internal agency deliberations over the regulations. Among the many examples, on November 10, 2009, just after the first negotiating committee meeting, TICAS Vice President Pauline Abernathy sent Mr. Shireman and others an article on for-profits with the notation, "Apollo Group and other for-profit colleges will find it harder to make the grade – especially as they come under scrutiny for aggressive enrollment practices."²⁹

²⁵ Letter to Wendy Macias, U.S. Department of Education, from QuilCap (name of signator has been redacted), June 9 2009 (attached as Exhibit S).

²⁶ QuilCap's annual Report of January 2009 is enclosed as Exhibit T.

²⁷ Email from Robert Shireman to Roger Nozaki, et al., April 19, 2009 (attached as Exhibit U).

²⁸ *Id.*

²⁹ Email from Pauline Abernathy to Luke Swarthout (HELP Committee), James Kvaal, Bob Shireman, Dan Madzellan entitled "Baron's cover article on for-profits," November 10, 2009 (attached as Exhibit V).

In February 2010, once the NegReg Committee completed its work by making recommendations to Education, Ms. Abernathy reconvened many in the group telephonically along with Education officials such as Mr. Shireman – who asked specifically to be included in the call,³⁰ – then-White House official James Kvaal, and HELP Committee staffer Luke Swarthout, to develop a strategy for dealing with the for-profit industry, which was expected to fight back hard against the rule.³¹ The following month, Ms. Abernathy solicited help from Mr. Shireman, Mr. Bergeron, and other Education officials to respond to the “firestorm” she feared would result from a newly released paper by Mr. Kantrowitz critiquing Education proposals on gainful employment as “a little bit too harsh.”³² Two months later, on April 13, 2010, Ms. Abernathy complained to Education officials Shireman, Madzelan, and Manheimer about Education’s failure to provide “consumer, student and workforce stakeholders” with the same information Education had provided to industry groups.³³ In response, Ms. Manheimer – who serves on Mr. Shireman’s staff – quickly provided Ms. Abernathy with answers to her questions about how the gainful employment regulation would affect bachelor of arts programs at for-profit schools.³⁴

Most troubling, in April 2010, Mr. Shireman accepted an invitation from TICAS to travel to California for a two-day small “brainstorming session” to discuss “consumer and taxpayer issues related to distressed borrows and identify our own research and/or policy priorities.”³⁵

³⁰ See email from Bob Shireman to Pauline Abernathy, et al. entitled “Height Analytics – For-Profit Ed. Gainful Employment Means,” February 3, 2009 (Mr. Shireman stated “If I’m available when you have your call I’d like to listen in.”) (attached as Exhibit W).

³¹ See email from Bob Shireman to David Bergeron entitled “Height Analytics – ForProfit Ed. Gainful Employment Means,” February 5, 2010 (entire email chain together with analysis by Height Analytics attached with Exhibit W).

³² See email from Pauline Abernathy to Bob Shireman, et al. entitled “What is Gainful Employment? What is Affordable Debt?,” March 2, 2010 (included with Mr. Kantrowitz’s analysis as Exhibit X).

³³ See email from Pauline Abernathy to Dan Madzelan, et al. entitled “Industry take on what was submitted to OMB on Friday on GE,” April 13, 2010 (attached as Exhibit Y).

³⁴ See email from Ann Manheimer to Pauline Abernathy entitled “Application of GE,” April 14, 2010 (attached as Exhibit Z).

³⁵ See email from Lauren Asher (TICAS) to Bob Shireman, et al., May 11, 2010 (describing the April 29-30 session) (attached as Exhibit AA).

Other attendees included Margaret Reiter, a negotiator for the NegReg Committee and former Deputy Attorney General for the California Attorney General's Office; Deanne Loonin, staff attorney at the National Consumer Law Center, alternate negotiator for the NegReg Committee, and frequent email correspondent with Ms. Schulman; Tim Ranzetta, founder and president of Student Lending Analytics; Jamiene Studley, President of Public Advocates, Inc.; and Michelle Rodriguez, a staff attorney at Public Advocates, Inc. No one from the for-profit industry was included. Mr. Shireman's participation in this two-day session belies his claim that he would limit his assistance to TICAS to his "personal time," and demonstrates that by that time, the interests of the outside non-profit groups and Education were so aligned there no longer was any distinction between the two.

The non-profits group had extensive contacts with other Education officials throughout the regulatory process, as documented in the records Education provided in response to CREW's FOIA request.³⁶ Those contacts paid off handsomely for the non-profits. For example, on the eve of Education's June 16, 2010 publication of its notice of proposed rulemaking Ms. Lehr and others had managed to obtain an embargoed copy of the rulemaking.³⁷ And when TICAS was preparing its public comments on the gainful employment regulations in September 2010, David Bergeron responded readily to Ms. Abernathy's inquiry about "what share of the more than 26,000 public comments received so far support the reg and/or making it stronger."³⁸ These are just some of the many examples illustrating the inside track TICAS and other non-profits had with Mr. Shireman and other Education officials in their combined effort to tighten the gainful employment regulations.

Conclusion

In sum, Education employed a deeply flawed process to formulate these regulations, regardless of their underlying merit. Education officials knowingly allowed that process to be tainted by the undisclosed role of short-sellers, seeking to use the regulatory arena to manipulate the financial markets and drive down the share value of for-profit education companies, all for their own personal gain. Further, Education officials at the highest levels of this process put

³⁶ Those documents are posted at http://www.scribd.com/document_collections/2742136.

³⁷ See email from Susan Lehr to Michele Bowles and Mary Cauley entitled "Here are the regs!," June 15, 2010 (attached as Exhibit BB).

³⁸ See email from Pauline Abernathy to David Bergeron entitled "Today's NYT article," September 4, 2010, and email from David Bergeron to Pauline Abernathy entitled "Today's NYT article," September 7, 2010 (attached as Exhibit CC).

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aside their responsibilities to the agency to examine these issues impartially, and instead formed a collaboration with and ceded authority to outside groups advancing their own specific agenda. Americans' confidence in the regulatory system is severely undermined when Wall Street investors with no policy expertise are allowed to insinuate themselves into the regulatory process. We therefore ask that you immediately launch an investigation not only into this matter, but also into whether other Education regulations similarly are being manipulated by outsiders. It is imperative that you act quickly to restore integrity to Education's rulemaking process.

Thank you for your attention to this very important matter.

Very truly yours,

A handwritten signature in dark ink, appearing to read 'Anne L. Weismann', with a long, sweeping horizontal stroke at the end.

Anne L. Weismann
Chief Counsel

cc: Chairman Tom Harkin
Ranking Member Michael B. Enzi
Senate Committee on Health, Education, Labor, and Pensions
Chairman John Kline
Ranking Member George Miller
House Committee on Education and the Workforce

Enclosures

EXHIBIT L

CREW | citizens for responsibility and ethics in washington

July 9, 2012

By Facsimile (without exhibits) (212) 637-2932 and First-Class Mail

Preet Bharara
United States Attorney
U.S. Attorney's Office for the
Southern District of New York
One St. Andrew's Plaza
New York, New York 10007

Dear Mr. Bharara:

Citizens for Responsibility and Ethics in Washington (CREW) respectfully requests that your office initiate an investigation into the short-selling activities of hedge fund manager Martin Shkreli and possibly others to determine if there has been illegal manipulation of the market price of stock in the biotechnology and pharmaceutical industries. Publicly available data, documents CREW obtained through a Freedom of Information Act (FOIA) request to the U.S. Food and Drug Administration (FDA), and information provided by an individual whose company has been affected by Mr. Shkreli's actions suggest he has engaged in behind-the-scenes efforts to manipulate the biotech industry market for financial gain.

Mr. Shkreli is the chief investment officer for the New York-based hedge fund MSMB Capital Management LLC.¹ MSMB Capital Management has been described as "a leading investment firm focused on global healthcare and biotechnology opportunities and long-term investments."² As its chief investment officer, Mr. Shkreli has taken a number of steps aimed at influencing the stock value of biotech companies in which he held a financial interest. These include his contributions to a blog on a well-known investing website sharply criticizing stocks in which he held short positions and efforts to insert himself into the FDA approval process for at least four pending drugs in which he held short positions.

Specifically, on June 2, 2011, Mr. Shkreli took the unusual action of submitting a citizen petition to the FDA asking the agency not to approve the New Drug Application (NDA) for

¹ Mr. Shkreli's website indicates his firm is based at 330 Madison Avenue, New York, New York. <http://www.msmbhealthcare.com/>.

² MSMB Capital Proposed Acquisition of Amag Pharmaceuticals for \$18 Per Share, *Business Wire*, August 3, 2011 (available at <http://www.businesswire.com>).

Lymphoseek, a lymph-node mapping agent developed by the Ohio-based biotech firm Neoprobe (now known as Navidea Biopharmaceuticals, Inc.). Mr. Shkreli claimed Lymphoseek was not properly and scientifically tested against the current standard “blue dye” method of finding lymph nodes.³ In his filing, Mr. Shkreli did not claim – as, indeed, he could not – to be an expert in medicine or biological sciences.⁴ Further, he acknowledged his hedge fund, MSMB Capital, would gain financially from a decline in the company’s stock price.⁵

In addition to contacting the FDA directly, Mr. Shkreli used a well known investing website, SeekingAlpha.com, to influence the stock price of Neoprobe. SeekingAlpha.com offers stock tips and trading advice, and receives nearly four million visitors in the U.S. each month.⁶ Mr. Shkreli’s opinions were published frequently on SeekingAlpha.com during the summer of 2011. In his June 2, 2011 blog post Mr. Shkreli argued the value of Neoprobe stock was highly inflated, and predicted its price would drop dramatically because Lymphoseek would not win FDA approval as a result of numerous shortfalls Mr. Shkreli identified in the testing process. His controversial blog post sparked a sharp backlash from other investors, who argued his so-called scientific claims were biased and possibly fraudulent. In addition, several of his critics noted he was a short seller and therefore not a reliable source.⁷

Nevertheless, Mr. Shkreli’s tactics worked; after he posted his blog on SeekingAlpha.com and filed his citizen petition with the FDA the following day, shares of Neoprobe began to fall significantly. According to Google Finance, after trading at \$5.48 on May 31 – an all-time high – Neoprobe dropped to \$4.93 the next day. By August 8, after a steady drop, Neoprobe stock was trading at a low of \$1.95.⁸

³ MSMB Capital Management LLC, Citizens Petition to the Division of Dockets Management, Food and Drug Administration, filed by Martin Shkreli on June 2, 2011 (attached as Exhibit A).

⁴ *Id.*

⁵ *Id.*

⁶ <http://www.quantcast.com/seekingalpha.com>.

⁷ <http://seekingalpha.com/article/272708-the-short-case-for-neoprobe-skeptical-of-its-primary-assets-s-success>; <http://www.massdevice.com/blogs/medcity-news/neoprobe-does-stocks-40-percent-drop-validate-its-biggest-critic>.

⁸ See <http://finance.yahoo.com/q/bc?s=NEOP&t=1y>. Mr. Shkreli called off his short sale recommendation of Neoprobe on August 5, 2011, indicating the share price had fallen far enough. See <http://seekingalpha.com/article/272708-the-short-case-for-neoprobe-skeptical-of-its>

Mr. Shkreli made similar use of his blog post to drive down the stock price of other biotech firms he was shorting, including Avanir, Zalicus, and Mesoblast. On May 31, 2011, Mr. Shkreli posted an article on SeekingAlpha.com describing the biopharmaceutical firm Avanir (symbol: AVNR) as a “compelling short sale opportunity.”⁹ He calculated the fair value of the stock at \$1.00, despite its then market value of \$4.62.¹⁰ As he did with Neoprobe, Mr. Shkreli outlined his reasons for labeling the stock overvalued, including his claim the firm’s drug Nuedexta was only mildly effective and would experience weak sales in a brief intellectual property life.¹¹ As with Neoprobe, critics of Mr. Shkreli argued his claims were intentionally false and purposely ignored important data.¹²

Just as they did with Neoprobe, Mr. Shkreli’s efforts resulted in a stark decline in stock prices. On May 27, 2011, four days prior to Mr. Shkreli’s blog post, Avanir was trading at \$4.67, its highest price since early November 2010. During trading the day following Mr. Shkreli’s post, the stock price dropped to \$4.39. On June 3, the stock price rose slightly on heavy trading to \$4.46 a share, but then began a precipitous slide. By November 25, shares of Avanir were selling for \$2.00, having never fully recovered to May levels.¹³ From May 31 to November 28, Avanir lost 45% of its value.¹⁴

primary-assets-s-success.

⁹ <http://seekingalpha.com/article/272463-avanir-pharmaceuticals-compelling-short-sale-opportunity>.

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ <http://www.google.com/finance?q=NASDAQ%3AAVNR>.

¹⁴ *Id.* Other factors also may have affected the stock price of Avanir. For example, on May 25, 2011, Senator Herb Kohl (D-WI) sent a letter to Avanir concerning allegations of unfair pricing of Nuedexta that had begun to surface. *See* <http://www.thestreet.com/story/11132797/1/avanir-congress-gripes-about-drug-price.html>. Avanir’s stock price, however, reached its all-time high on May 27, two days after the letter was reported. <http://www.google.com/finance?q=NASDAQ%AAVNR>. By contrast, the price began to decline the day after Mr. Shkreli’s blog post appeared. *Id.* On November 27, 2011, Mr. Shkreli published an article on Seeking Alpha in which he called off his short on Avanir. *See* <http://seekingalpha.com/article/310348-avanir-closing-short-position>.

Documents CREW obtained from Mr. Shkreli himself reveal that beyond his citizen petition against Neoprobe, he also worked actively behind the scenes to affect the outcome of the FDA's regulatory process with other drugs where he had substantial financial conflicts of interest.¹⁵ In September 2010, Mr. Shkreli asked to be included on a panel discussion on Arena Pharmaceuticals' weight-loss drug Lorcaserin.¹⁶ He also submitted a slide show presentation to the FDA that claimed Lorcaserin had not been tested properly, and requested his findings be considered by the advisory committee.¹⁷ Part of his presentation included a conflict of interest statement in which he stated: "I am a fund manager who would likely benefit financially if the FDA requested Arena conduct an outcomes-based study."¹⁸

Similarly, on December 25, 2010, Mr. Shkreli sent a presentation via email to 12 FDA officials, including Commissioner Margaret Hamburg, asking the FDA to deny approval of the inhaled insulin drug Afrezza based on his claim trials conducted by the company's manufacturer, MannKind, failed "to meet required efficacy primary endpoints."¹⁹ An FDA denial of a new drug presumably would cause the company's stock price to decline, resulting in a direct profit for Mr. Shkreli. Again, Mr. Shkreli acknowledged his "substantial financial conflicts of interest" as he would "benefit substantially if the FDA adopts [his] viewpoint."²⁰ Apparently, Mr. Shkreli was short selling the stock of both Arena Pharmaceuticals and MannKind. However, acknowledging these conflicts did not make them disappear.

More recently, CREW was advised about another company targeted by Mr. Shkreli through a blog post on SeekingAlpha.com, Nektar Therapeutics. In a June 18, 2012 blog post, Mr. Shkreli stated boldly, "[s]horting Nektar is a good investment," based on his claim of

¹⁵ Email from Martin Shkreli to FDA Commissioner Margaret Hamburg, et al., Afrezza Review for DMEP/CDER/FDA - Personal Letter and pending Citizen's Petition request for Complete Response Letter pending further Afrezza studies, sent December 25, 2010 (attached as Exhibit B).

¹⁶ Email from Martin Shkreli to Paul Tran and Cicely Reese, Re: Lorcaserin AdCom Presentation Request, September 9, 2010 (attached as Exhibit C).

¹⁷ See Exhibit B.

¹⁸ *Id.* at slide 16.

¹⁹ See Exhibit A.

²⁰ Martin Shkreli, Afrezza Review for FDA DMEP Consideration by Martin Shkreli, sent to FDA officials on December 25, 2010 (attached as Exhibit D).

“material deficiencies” with its NKTR-118 drug.²¹ According to Mr. Shkreli, the drug will fail “to achieve Phase III clinical trial primary endpoints.” Therefore, he argued, Nektar’s stock was worth roughly \$1 per share, not the \$8 per share at which it was then trading.²² Further, Mr. Shkreli hyped the success of Nektar’s competitors and dismissed any positive attributes of NKTR-118 as not “clinically meaningful.”²³ In essence, despite his lack of expertise, Mr. Shkreli contested the results of clinical trials conducted by Nektar in language intended to convey scientific certainty.

According to a Nektar Therapeutics representative, Mr. Shkreli’s post was based on mischaracterizations of NKTR-118’s Phase III drug trials and erroneous conclusions about the nature and extent of Nektar’s competitors. Thus, it appears that once again, Mr. Shkreli is using SeekingAlpha.com to spread unfounded or inaccurate rumors designed to depress the price of a stock in which he holds short positions.

Beyond NKTR-118 drug, Mr. Shkreli also attacked some of Nektar’s other products, specifically NKTR-102 and NKTR-061, claiming they are in difficult markets and have low sales potential.²⁴ More broadly, Mr. Shkreli criticized Nektar’s structure and cash flow, claiming the company’s stock rarely moves.²⁵

Once again Mr. Shkreli hit his target. On June 15th, the Friday before his blog post, Nektar’s stock closed at \$8.01. On Monday, June 18th, when he posted his blog, it opened at \$7.93, shot up to \$8.11 by 1:00 p.m., but then took a dive and by the close of trading Nektar’s stock had dropped a total of \$.33, losing 4.12% of its value.

While biotech and pharmaceutical industries generate a substantial amount of revenue, they also face the possibility of substantial losses, which can result in wildly fluctuating stock prices. The FDA must approve all new drugs through a process that takes place after the company has invested a considerable amount of money in the research and development necessary to bring a new drug to market. This creates significant opportunities for short sellers. Adam Feuerstein, a senior columnist for *The Street*, wrote in an October 4, 2011 article that short sellers were “piling into biotech stocks” because of a weak economy and the “challenge of selling

²¹ <http://seekingalpha.com/article/666541-nektar-phase-iii-trials-at-risk>.

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ <http://seekingalpha.com/article/666541-nektar-phase-iii-trials-at-risk>.

new drugs in an uncertain environment of health care reform and high drug prices.”²⁶ His list of the ten most heavily shorted stocks in the biotech industry included Avanir and Oncothyreon,²⁷ both profiled by Mr. Shkreli on SeekingAlpha.com as promising short opportunities.

Taken as a whole, this evidence suggests a pattern of suspicious behavior in the trading of biotech stocks that warrants a thorough investigation. Given the lack of transparency in the holdings of hedge funds, it is impossible for CREW to shed further light on this issue. Accordingly, in January of this year, CREW requested that the U.S. Securities and Exchange Commission investigate possible market manipulation in the stocks of biotechnology firms.²⁸ To our knowledge, however, the SEC has yet to act on our request, but a comparison of the buying patterns of stock options or short positions by MSMB Capital Management and other hedge funds associated with the biotech industry may reveal further evidence of collusion relevant to determining whether Mr. Shkreli engaged in market manipulation. The U.S. Attorney’s Office for the Southern District of New York, which has aggressively pursued those involved in insider trading, is perfectly positioned to investigate the potentially illegal conduct of short sellers as well.

²⁶ Adam Feuerstein, 10 Most Shorted Stocks in Biotech, *The Street*, October 4, 2011 (attached as Exhibit E).

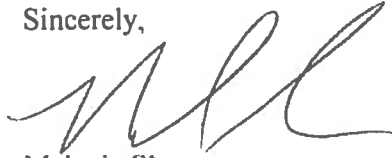
²⁷ Mr. Shkreli went after Oncothyreon (ONTY) in a blog post of July 25, 2011, criticizing the Merck cancer drug Stimuvax in which Oncothyreon has an 8-12% royalty. According to Mr. Shkreli, Stimuvax was not “well-designed,” does not generate a sufficient immune system response to cancer in humans, and does not seem to have a mechanism to prevent metastasis. See <http://seekingalpha.com/article/281421-oncothyreon-phase-iii-unlikely-to-show-survival-benefit>. Once again, Mr. Shkreli hid behind a hodgepodge of scientific jargon to justify his conclusion that Oncothyreon’s market cap was too high. *Id.* And once again the market reacted. On the day of Mr. Shkreli’s post, Oncothyreon’s stock experienced a 14.14% drop, from \$9.69 to \$8.32, and steadily declined over the next several months. <http://www.google.com/finance?q-Oncothyreon>.

²⁸ A copy of CREW’s letter is attached as Exhibit F.

Preet Bharara, Esq.
July 9, 2012
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Thank you for your prompt attention to this important matter.

Sincerely,

A handwritten signature in black ink, appearing to read 'MS', is written over the word 'Sincerely,'.

Melanie Sloan
Executive Director

Enclosures

The New York Times <http://nyti.ms/1ImCIDs>



BUSINESS DAY

After Big Bet, Hedge Fund Pulls the Levers of Power

Staking \$1 Billion That Herbalife Will Fail, Then Lobbying to Bring It Down

By MICHAEL S. SCHMIDT, ERIC LIPTON and ALEXANDRA STEVENSON MARCH 9, 2014

WASHINGTON — At a Midtown Manhattan steakhouse last June, William A. Ackman, the activist hedge fund manager who had bet a billion dollars on the collapse of the nutritional supplement company Herbalife, offered his latest evidence to a handful of other hedge fund managers about why the company's stock could soon plummet.

Mr. Ackman told his dinner companions that Representative Linda T. Sánchez, Democrat of California, had sent a letter to the Federal Trade Commission the previous day calling for an investigation of the company.

The commission had not yet stamped the letter as received, nor had it been made public. But Mr. Ackman, who had personally lobbied Ms. Sánchez and stood to profit if the company's stock dropped as a result of the call for an inquiry, already knew what it said, and read from a copy of it that he had on his cellphone.

When Ms. Sánchez's office ultimately issued a news release a month later, it was backdated as though it had been made public the day before Mr. Ackman's dinner talk.

The letter was a small hint of Mr. Ackman's extraordinary attempt to leverage the corridors of power — in Washington, state capitols and city halls — for his hedge fund's profit after taking a \$1 billion financial position called a short, a bet that will pay off only if Herbalife's stock drops.

Corporate money is forever finding new ways to influence government.

But Mr. Ackman's campaign to take this fight "to the end of the earth," using every weapon in the arsenal that Washington offers in an attempt to bring ruin to one company, is a novel one, fusing the financial markets with the political system.

Others have criticized the business practices of Herbalife, a company that sells vitamins and other health supplements through independent distributors, many of whom are lower-income Latinos or African-Americans. But Mr. Ackman's attack is unprecedented in its scale, and Herbalife officials strongly deny his accusations that the company is a pyramid scheme that stays afloat by constantly recruiting new distributors.

To pressure state and federal regulators to investigate Herbalife, an act that alone could cause its stock to dive, his team has helped organize protests, news conferences and letter-writing campaigns in California, Nevada, Connecticut, New York and Illinois, although several of the people who signed the letters to state and federal officials say they do not remember sending them, an investigation by The New York Times has found.

His team has also paid civil rights organizations at least \$130,000 to join his effort by helping him collect the names of people who claimed they were victimized by Herbalife in order to send the leads to regulators, the investigation found. Mr. Ackman's team also provided the money used by some of these individuals to travel to Washington to participate in a rally against Herbalife last month.

Herbalife has mobilized its own army of lobbyists to defend itself against Mr. Ackman's charges. "These accusations are provably false," said Herbalife's chief financial officer, John G. DeSimone. "And they can all be traced back to the same source: hedge fund billionaire Bill Ackman, who is motivated by one thing — getting even richer by winning a billion-dollar bet he made against our company, by any means possible, no matter how unscrupulous."

The feud has touched off a bidding war of sorts, emails obtained by The Times show, as the advocacy groups have in some cases pressed Mr. Ackman's team and Herbalife to contribute more money in exchange for their allegiance.

Mr. Ackman is not new to playing chess on a billionaire's scale. The brash 47-year-old, a graduate of Harvard Business School, built his \$12 billion, New

York City-based hedge fund, Pershing Square Capital Management, on enormous, risky bets on companies like Jim Beam and Canadian Pacific Rail that earned billions for him and his clients. He has had some big losses too, including an estimated \$473 million last August on an investment in J. C. Penney, the struggling retailer.

Regulators frequently get entreaties from financiers urging action for their own financial gain, like the hedge fund executives who in 2010 tried to secretly push Obama administration officials to investigate for-profit colleges, again citing fraudulent industry practices, after betting that their stocks would decline.

But Mr. Ackman's efforts illustrate how Washington is increasingly becoming a battleground of Wall Street's financial titans, whose interest in influencing public policy is driven primarily by a desire for profit — part of an expanding practice in the nation's capital, with corporations, law firms and lobbying practices establishing political intelligence units to gather news they can trade on.

So far, Mr. Ackman has persuaded four members of Congress, a New York State senator, a City Council member in Boston, the majority leader of the Nevada Senate and other elected officials in California to join the cause. Prominent consumer advocates in Washington, as well as leaders of well-respected Hispanic and African-American community groups who have been lobbied by Mr. Ackman's team, have also written regulators demanding action.

Mr. Ackman has trumpeted the news conferences and protests to create the image that the walls were closing in on Herbalife, a company no stranger to controversy, whose sales reached a record \$4.8 billion last year.

He has argued that he is trying to protect Hispanics, who he says are most frequently recruited by Herbalife as distributors, only to find out that there is little money to be made.

Yet Mr. Ackman's staff acknowledges that this crusade is really rooted in one goal: finding a way to undermine public confidence in Herbalife so that his \$1 billion bet will produce an equally enormous return. Mr. Ackman has said he will donate any profits he personally earns to charity, calling it "blood

money.” The clients who invest in his hedge fund, however, would still benefit enormously.

Brent A. Wilkes, the national executive director of the Washington-based League of United Latin American Citizens, or Lulac, rejected any suggestion that he had become Mr. Ackman’s tool — even though his organization accepted a \$10,000 contribution early last year, and since then has taken a position at the forefront of the anti-Herbalife campaign.

Instead, Mr. Ackman’s bet is just helping draw attention to longstanding abusive practices by Herbalife, said Mr. Wilkes, who acknowledged that he had never previously focused on the issue.

“It’s not the Latino groups that are helping Bill Ackman,” Mr. Wilkes said. “Bill Ackman is helping the Latino groups. He has elevated this battle.” On Sunday evening, after questions from The Times, Mr. Wilkes said he had decided to return the donation, so there was no chance anyone could suspect he had undertaken the effort “for a mere \$10,000 table purchase” at one of his fund-raising events.

Harvey L. Pitt, a former chairman of the Securities and Exchange Commission, said that Mr. Ackman’s campaign was starting “to look like an effort to move the price rather than spread the truth.”

“If you are trying to spread the truth, that is O.K.,” Mr. Pitt said. “If you are trying to move the price of a stock to vindicate your investment philosophy, that’s not O.K.”

Mr. Ackman rejected the assertions that he had done anything wrong.

“Our goal here is to shine a spotlight on Herbalife and let the government know all the facts and motivate them to do something,” Mr. Ackman said in an interview on Sunday.

So far, Mr. Ackman has little to show for his efforts. Herbalife’s stock has climbed higher, in part because the billionaire investor Carl C. Icahn decided to buy a large stake in the company, and the regulators lobbied by Mr. Ackman have not taken any formal action against the company.

That has not deterred Mr. Ackman, who is not known to retreat from a risky investment without a fight, even if it takes years.

In February, 14 months after he announced he had wagered big money on

the collapse of Herbalife, and with around \$500 million in paper losses so far, he announced that instead of backing down, he had made his bet even bigger.

If Herbalife “were to disappear tomorrow, we’d make a lot more than had it just blown up the day after I gave my last presentation — although life would be a little easier,” he told an audience of Wall Street investors and media attending an investor conference last month.

Pitches to Regulators

One of Mr. Ackman’s first stops in his crusade to bring Herbalife down was a meeting at the regional field headquarters of the S.E.C. in Lower Manhattan, where more than 400 enforcement lawyers, accountants, investigators and other staff members work to police some of the nation’s biggest corporate players.

He presented investigators in New York with a year’s worth of financial research that he said showed that Herbalife was misleading investors by failing to properly disclose that most of its sales were generated by simply recruiting more distributors, rather than by selling large amounts of its product to consumers.

Mr. Ackman, according to people who were present at the briefing, pointed to internal company records that showed a large share of these distributors, recruited to join the sales teams based on extravagant predictions, quickly gave up.

He made other presentations, to investigators from the F.T.C. and state authorities, because he knew regulatory action would be among the quickest ways to make good on his prediction that the company’s stock was going to crash.

“So the risk we took in making this investment was could we get the world to focus on a company, could it get enough of a spotlight so that the S.E.C., the F.T.C., the 50 attorney generals around the country, the equivalent regulators in 87 countries, if any one of them, or at least any powerful member of that group, could we get them interested?” Mr. Ackman explained at the investors conference in February, 14 months after he made his bet on Herbalife public. “And I think that was the biggest risk we took in going short” on Herbalife.

Mr. Ackman once made a similar bet against the bond insurer MBIA, one

that reaped him and his investors a \$1.1 billion return. In a book about his MBIA wager called “Confidence Game,” the reporter-turned-financial analyst Christine S. Richard chronicled how he fought with regulators for seven years before his prediction that MBIA stock would “spiral downward” came true. In a twist, it was Ms. Richard, who left Bloomberg News to work at the Wall Street research shop Indago Group, who gave Mr. Ackman the idea to short Herbalife.

After listening to Mr. Ackman’s pitch, S.E.C. investigators moved almost immediately last January to begin an inquiry into Herbalife — which newspapers reported, creating the coverage that Mr. Ackman needed to fuel his strategy.

From there, his team worked to create outside pressure, assigning lobbying, public relations and so-called grass-roots advocacy teams to attempt to build support across the country.

The team includes lobbying firms run by two former members of Congress: Toby Moffett, a Democrat who once represented Connecticut, and Robert S. Walker, a Republican from Pennsylvania. Mr. Ackman also hired firms run by former top White House aides for President Obama and President Clinton. Jim Papa, who handled legislative affairs for the Obama White House, also joined the effort, with his firm, Global Strategy Group, a longtime consultant to Mr. Ackman.

In some cases, the hiring was even more strategic. In Massachusetts, Mr. Ackman’s firm hired the lobbyist Larry Rasky, who was an aide to Senator Edward J. Markey, Democrat of Massachusetts, when Mr. Markey was a member of the House. Another lobbyist, Malcolm Grace, is a former aide to Ms. Sánchez. Both Mr. Markey and Ms. Sánchez would ultimately play critical roles in the effort.

Mr. Ackman also retained the Dewey Square Group, a Washington-based firm that specializes in “grass-roots advocacy,” to influence officials by recruiting surrogates to speak out against Herbalife in emails, tweets, letters or rallies.

He employed Dewey Square to focus on Hispanic and black community leaders and politicians based on a belief that because many of the individuals

who are recruited as distributors by Herbalife are minorities, taking on the company might in some way help the Latino community. Separately, the lobbyists and grass-roots organizers set up meetings with major consumer groups.

Enlisting Allies

A wave of additional letters started to be sent to federal regulators by groups like the Hispanic Federation and the National Consumers League. Each person contacted by The Times acknowledged in interviews that they wrote the letters after being lobbied by representatives from Pershing Square, or said they did not remember writing the letters at all. Mr. Ackman's team also then started to make payments totaling about \$130,000 to some of these groups, including the Hispanic Federation — money he said was being used to help find victims of Herbalife. The pitch by Mr. Ackman peaked in early February, when nearly 30 people affiliated with Latino advocacy and church groups, several of whom had joined the cause after being briefed by consultants hired by Mr. Ackman, flew to Washington to meet with members of Congress and the head of the F.T.C., again pressing for investigators to take action against the company.

Three of the nonprofit group leaders who participated in the event, from Massachusetts, Illinois and Washington, said they took part because they also believed that Herbalife was taking advantage of the working class and poor.

“At the end of the day, these people are becoming millionaires off the back of the people in the shadows,” said Julie Contreras, the president of the Lulac chapter in Waukegan, Ill., who traveled to Washington for the event, adding that she had not taken any money from Mr. Ackman or anyone on his team.

Mr. Ackman did not publicize his role in helping generate these letters or rallies, or the fact that his consultants in many cases wrote the language that is used in these letters, but his team still issued news releases noting that yet another group had called for an investigation.

In Washington, Mr. Ackman's efforts bore fruit on Jan. 23, when Mr. Markey's office, which Mr. Ackman had lobbied himself and which had been provided with detailed information about Herbalife by Mr. Ackman's team,

sent letters to the S.E.C. and F.T.C., calling for investigations of the company. A little more than a half-hour after the stock began trading that day its value fell by 14 percent.

The letter sent by Ms. Sánchez in June, which Mr. Ackman discussed at the dinner, did not move the stock. Ms. Sánchez's office acknowledges that it sent a copy of this letter to Mr. Ackman's team a month before it issued its news release on the matter, and says that it backdated the letter when making it public because The New York Post reported its existence a week after the dinner. The dinner itself was reported in August by The Wall Street Journal. A spokeswoman for Ms. Sánchez said backdating the news release was not inappropriate, as the office considered the document public when it was sent to the F.T.C.

Despite his efforts, Herbalife's stock over the last 14 months has actually gone up. But Mr. Ackman, at least publicly, has tried to maintain the confidence of his investors, telling them last summer that he was confident he had made "material progress" in his attempts to persuade regulators to crack down on the company — an act that would be certain to hurt its stock price.

"We believe that the probability of timely, aggressive regulatory intervention has increased materially," he said in the letter.

A Lack of Victims

The Nevada attorney general, Catherine Cortez Masto, was among the many officials who found herself enmeshed in the debate. But as the fight unfolded, with Latino groups holding a news conference in East Las Vegas demanding that she investigate Herbalife, she had some questions.

She says she was struck by the appeals for an investigation of Herbalife, at first directly from representatives for Mr. Ackman's firm and then from others: All three of the letters from nonprofit groups demanding an investigation were identical — except they were signed by three different Hispanic community leaders, each on a different letterhead.

When Ms. Masto invited the Hispanic leaders to meet with her individually, none of them could identify a victim of abusive practices.

"We are not going to move forward unless we have victims," she told the community leaders.

In Nevada, the Ramirez Group, a political consulting firm run by a former aide to the Senate majority leader, Harry Reid of Nevada, helped line up Hispanic groups and then contacted local reporters to attend a news conference, emails obtained by The New York Times show.

The attorney general in Connecticut, George Jepsen, said he had a similar experience. He received five letters with almost identical text. “Herbalife is a complex and abusive pyramid scheme,” the letters each said. “Herbalife unfairly targets minority groups and falsely markets itself as an easy business opportunity.”

One came from the mayor of the city of Waterbury, another from a former state legislator that Mr. Ackman had hired as a lobbyist, and a third from Israel Alvarez, a Puerto Rican-born hairstylist in Hartford.

In a telephone interview, Mr. Alvarez said he did not recall writing the letter. Asked if he had ever heard of the company named Herbalife, he said it was “a vitamin thing, and food thing.”

None of the letters cited any specific victims of Herbalife’s business practices. In fact, only one person had filled out a formal complaint form with the Connecticut attorney general’s office. State investigators were ultimately unable to substantiate the person’s claim that he lost \$1,500 through the company five years ago.

The effort reached the West Coast as well. In California, Mr. Ackman’s team sent Minyon Moore, a former senior Clinton White House aide, to host a meeting in October at the landmark West Angeles Church of God in Christ in the city’s predominantly black South Central neighborhood. Ms. Moore detailed what she said were Herbalife’s deceptive sales techniques, participants in the meeting said.

Within a matter of weeks, Mr. Ackman’s consultants had helped organize a demonstration outside an Herbalife conference in Los Angeles and helped persuade nearly two dozen prominent Latin American and black community leaders to send letters to state and federal officials demanding action — letters that are now posted on an anti-Herbalife website that Mr. Ackman’s consultants control.

Najee Ali, a longtime activist in Los Angeles who attended the meeting at

the church and then wrote one of the letters to California's attorney general, said he was moved by Ms. Moore's appeal.

"Her remarks were very touching and compelling, and her credibility across black America — it is unquestioned, so I really took to heart her argument," Mr. Ali said.

But he had no idea that Ms. Moore was working on behalf of a hedge fund manager who had made a bet on Herbalife's stock — and that his letter had become part of a lobbying strategy.

"Have I become an instrument in some billionaire's investment campaign?" he said, adding that he now regrets sending the letter. "I don't want to be an unwitting pawn, and that is how I am feeling right now."

Pershing Square and its lobbyists argue that many of Herbalife's victims are afraid to come forward because they are undocumented. "It's a problem that we haven't been able to find victims to come out," said Maria Cardona at Dewey Square, who specializes in appeals to Hispanic Americans.

But Mr. Ackman once again had a solution: Pay nonprofit groups across the United States to find the victims Mr. Ackman knew he needed to compel the regulators to act.

So Global Strategy Group, a consulting firm helping Mr. Ackman conduct the campaign, began to make such payments, including about \$120,000 to the Hispanic Federation and another \$10,000 to Make the Road New York.

Other leaders of prominent Hispanic nonprofit groups said that a New York-based lobbyist hired by Mr. Ackman, Luis A. Miranda Jr., had also been holding a series of meetings offering payments at the same time that he was asking for their help in the anti-Herbalife campaign. Mr. Miranda denied these allegations, but emails obtained by The Times include discussions of possible support for programs run by groups whose leaders he had just approached for help on the Herbalife campaign.

The effort to find Herbalife victims now also includes toll-free numbers set up in at least four states, with recordings in English and Spanish urging people to report wrongdoing by the company.

"If you, a loved one or a friend have fallen for Herbalife's deceptive marketing practices, we need you to share your story," the recording says.

“Every story can make a difference.”

A Global Powerhouse

Herbalife, according to the company’s official history, was born out of the trunk of a car in 1980, when a 24-year-old California man, Mark R. Hughes, began selling a protein shake that he had concocted, he said, after his mother had died of an accidental overdose of diet pills.

The company has grown into a global powerhouse, with a worldwide team of more than three million so-called members and distributors who operate as independent contractors through a system that rewards many of them not only based on actual sales, but also on their ability to recruit more distributors.

The sales tactic, popular with many nutritional supplement companies, has frequently been the target of criticism. In 1986, California authorities issued an order prohibiting Herbalife from making false claims about the weight-loss powers of its nutritional drinks.

But never before has the company met an opponent quite like Mr. Ackman. In fact, company executives acknowledge that they underestimated just how far-reaching his effort would be.

Herbalife’s opinion changed on Jan. 23, when Mr. Ackman’s campaign scored its biggest hit yet: a United States senator, Mr. Markey, sent letters to the S.E.C. and the F.T.C., and Herbalife’s stock fell.

Mr. Ackman’s anti-Herbalife website originally posted copies of the letters dated Jan. 22, while Mr. Markey’s office sent them out to the public dated Jan. 23. Mr. Markey’s office attributed this to a clerical mistake and added that Mr. Ackman’s office had merely obtained early versions of their letters from Mr. Markey’s website.

Herbalife, after Mr. Ackman announced his bet, had already expanded its own lobbying team, hiring, among others, the Glover Park Group, founded by former top Clinton administration aides, and the Podesta Group, run by Tony Podesta, who is known for his close ties to the Obama White House. With help from this team, last month the company held a private briefing for more than 30 Capitol Hill aides, defending itself against Mr. Ackman’s charges — and the echo chamber they argue he has manufactured.

They also retained the law firm Dickstein Shapiro, which has a large practice that specializes in lobbying attorneys general around the United States. Herbalife was so determined to force Mr. Ackman to back down it asked an investment adviser it retains, Moelis & Company, to approach some of the investors in Mr. Ackman's fund, suggesting that his bet was dangerous and could cost them dearly.

To counteract the appeals Mr. Ackman had made to Latino groups, it also decided to significantly boost its spending on donations to such nonprofits, such as a \$25,000 payment to the National Puerto Rican Coalition. Its president, Rafael A. Fantauzzi, was among the signers of a letter sent in February from a group that called itself Friends of Herbalife, which defended the company's business practices.

Dueling Donations

In recent weeks, the back-and-forth donations by the two sides have generated something of a bidding war.

For example, a top executive at the United States Hispanic Leadership Institute informed a member of Mr. Ackman's consulting team in late February that he had already received a \$30,000 donation from Herbalife. He then solicited payment of the same amount from Pershing Square in exchange for the group remaining "neutral."

"Are you able to match the \$30K we have received from Herbalife?" Juan Andrade Jr., the president of the Institute, wrote to the consultant. "If Herbalife says neutrality is unacceptable and wants their money back, are you able to replace it?"

One of Mr. Ackman's consultants at Dewey Square suggested in a note to Mr. Ackman's lawyer that "I think it would be worthwhile to keep them neutral." But a spokesman for Mr. Ackman said that the company refused to pay Mr. Andrade's group, arguing that he is paying groups to help find victims, not for their allegiance to his cause.

For now Mr. Ackman shows no sign of backing down. In fact, he has just agreed to increase the payments for the victim identification effort.

Mr. Ackman said that even if he decides at some point in the future to shift his investments and financially back out of the fight with Herbalife, he is

not going to give up on the campaign.

“I am going to personally pursue the Herbalife matter to the end of the earth — meaning I think this company is a criminal operation, I think they are harming people,” Mr. Ackman said. “This is something that angers me. I am going to pursue that.”

Correction: March 12, 2014

An article on Monday about an effort by a New York hedge fund executive, William A. Ackman, to push regulators to investigate Herbalife misidentified one of the groups that wrote a letter urging an investigation. It is the National Consumers League — not the Consumer Federation (formally known as the Consumer Federation of America). The article also misstated the position at the Indago Group held by Christine Richard, who did research on Herbalife that helped inspire Mr. Ackman. She worked there, but she did not set up the company. An earlier version of this correction referred incorrectly to the Consumer Federation. It is formally — not “formerly” — known as the Consumer Federation of America.

A version of this article appears in print on March 10, 2014, on page A1 of the New York edition with the headline: After Big Bet, Hedge Fund Pulls the Levers of Power.

EXHIBIT B



Bill Ackman's Secret \$ Deal for Herbalife Whistleblower

Former Insider Used in Hedge Fund Campaign Against Controversial Company; Feared Retribution

By MATTHEW MOSK and BRIAN ROSS

April 22, 2014 —

In his year-long campaign against the embattled Herbalife company, Wall Street hedge fund manager Bill Ackman secretly promised a disgruntled former company executive as much as \$3.6 million over 10 years if he lost his job after providing information to government investigators and the media.

Ackman's firm so far has paid the whistleblower \$80,000 under the arrangement, according to the former Herbalife executive's lawyer.

"It was the right thing to do," Ackman told ABC News.

The hedge fund run by the prominent Wall Street investor, known for his "short" positions, stands to make \$1 billion if the price of Herbalife's stock collapses as a result of his allegations the company is a fraud, a charge the company strongly denies.

The agreement between Ackman and the former executive, Giovanni Bohorquez, was signed in June 2013 but required both sides to keep it confidential.

Two months later, the New York Times published a critical article about an alleged problem in 2011 at an Herbalife manufacturing plant based on internal documents provided by a person described only as a "former employee, who was granted anonymity out of fear of retribution from the company."

Herbalife says the former employee is Bohorquez and that any alleged manufacturing problems were quickly and safely resolved.

The article said the former employee's legal bills were being paid by Ackman.

In December, after extensive discussions with his attorney, Bohorquez agreed to be interviewed on camera by ABC News for a report about his experience inside the Herbalife executive offices.

During the on-camera interview, which Ackman's public relations team helped to arrange and which Bohorquez's attorney attended, Bohorquez flatly denied he was being paid anything by Ackman or receiving any benefit other than his travel expenses and lawyers' fees and legal costs.

"I'm not getting a benefit," he said.

Asked last week why he did not disclose the additional arrangement with Ackman during the interview, Bohorquez said his answers were truthful because he had not invoked the provisions at the time and so had not yet collected any money.

"I didn't tell you because I was not looking at using it," he said.

His lawyer, Stephen D. Alexander, said ABC News did not ask "the right questions" and should have assumed there was more to the indemnification arrangement for Ackman to cover legal costs than Bohorquez said.

"We described the fact that he was indemnified for litigation," Alexander said, but added, "We never told you, I admit, about the terms of the indemnification agreement."

Bohorquez, who left Herbalife in 2011, said he lost his new job at a chain of laundromats before the ABC News interview due to the stress of being whistleblower. He said he began collecting the \$20,000 monthly payments under his arrangement with Ackman a few weeks after the ABC News interview because his wife had also lost her job.

"This opportunity to do justice to the things that I saw came up, and Pershing Square [Ackman's hedge fund] indemnified me from what would happen if I were to lose my job," Bohorquez said.

Ackman said he thought Bohorquez and his lawyer had disclosed the deal.

"He should disclose it, absolutely. Absolutely," said Ackman.

But Ackman's own public relations team also failed to reveal the secret arrangement prior to the interview.

Bohorquez's lawyer, Alexander, finally revealed the secret arrangement to ABC News in March after a New York Times story raised questions about financial ties between Ackman and others speaking publicly against Herbalife.

Ackman said he agreed to the deal after Bohorquez balked at going public because he feared his disclosures could make it difficult for him to find work at an executive level.

"Giovanni could not afford to take the company on. We thought his story was important," Ackman told ABC News. "Being a whistleblower is a very dangerous thing to do if you want to get a job."

Bohorquez is one of the few insiders to ever talk critically about Herbalife.

ABC News had encouraged Bohorquez to speak publicly after he was introduced by Ackman's public relations team.

He has been used by Ackman in the hedge fund's campaign to generate negative news reports about the company and prod state and federal agencies to investigate the company.

Bohorquez's lawyer says there was no quid pro quo arrangement with Ackman to do an interview with ABC News.

According to the New York Times story last August, the anonymous executive who Herbalife says is Bohorquez, was subpoenaed by the New York State Attorney General's Office.

Bohorquez's lawyer, Alexander, would not say whether his client had spoken to government investigators or whether they were told of the secret financial arrangement with Ackman to gain his cooperation.

He stopped the most recent interview with Bohorquez when ABC News tried to ask the former executive whether he had informed various investigative agencies of his secret deal with Ackman.

"We're done," Alexander said. "We told you we're not talking about what he talked about to federal agencies."

Under the terms of the generous deal, a copy of which was provided by Ackman, Bohorquez was entitled to receive as much as \$250,000 a year for 10 years if he lost his then-current job at a national chain of laundromats as a result of his disclosures to the media or the government.

The contract provides a five percent raise every year, and \$500,000 more if he loses out on possible public offerings from his then-employer.

If he finds a new job that pays him less than \$250,000 a year, Pershing will make up the difference.

Taken together, the total value to Bohorquez over 10 years could be as much \$3.61 million.

The deal requires Bohorquez to actively look for work and to be truthful in all of his statements about Herbalife to the media and government.

"You should judge for yourself whether Giovanni is an honest man or not," Ackman said. "I think Giovanni will be viewed as a hero."

Ackman acknowledges spending more than \$20 million in a lobbying and media campaign against Herbalife.

"I will pursue Herbalife to the end of the earth," he told ABC News.

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EXHIBIT C

From: Greisman, Lois C. </O=FTCEXCHANGE/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=LGREISMAN>
Sent: Wednesday, November 13, 2013 6:01 PM
To: Ammerman, Janet <jammerman1@ftc.gov>; Todaro, Christine <ctodaro@ftc.gov>; Vaca, Monica E. <MVACA@ftc.gov>; Vander Nat, Peter J. <PVANDERNAT@ftc.gov>; Hart, Melissa <mhart2@ftc.gov>
Subject: FW: Herbalife: A Pyramid Scheme Disguised as a Business Opportunity

From: Holley, Steven L. [mailto:HolleyS@sullcrom.com]
Sent: Wednesday, November 13, 2013 1:34 PM
To: Greisman, Lois C.
Subject: Herbalife: A Pyramid Scheme Disguised as a Business Opportunity

Hi Lois –

I thought you might be interested in a recent blog post by Brent Wilkes, National Executive Director of the League of United Latin American Citizens, about Herbalife. It appeared on Monday on the Huffington Post website: http://www.huffingtonpost.com/brent-a-wilkes/herbalife-a-pyramid-scheme_b_4220426.html

Best regards,

Steve

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From: Greisman, Lois C. </O=FTCEXCHANGE/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=LGREISMAN>
Sent: Monday, October 28, 2013 2:59 PM
To: Vander Nat, Peter J. <PVANDERNAT@ftc.gov>; Vaca, Monica E. <MVACA@ftc.gov>; Ammerman, Janet <jammerman1@ftc.gov>; Todaro, Christine <ctodaro@ftc.gov>
Subject: FW: Herbalife

From: Holley, Steven L. [mailto:HolleyS@sullcrom.com]
Sent: Monday, October 28, 2013 1:26 PM
To: Greisman, Lois C.
Subject: Herbalife

Hi Lois –

I thought you might be interested in this article by Matt Stewart, which was posted on Seeking Alpha last Friday.

Regards,

Steve

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<http://seekingalpha.com/article/1773702-has-carl-icahns-herbalife-position-left-him-exposed?>

Has Carl Icahn's Herbalife Position Left Him Exposed?

Oct 25 2013, 10:34

Matt Stewart

Full Disclosure: I am short HLF.

Up until last December I had never heard of Herbalife (HLF). It seems all of the fitness crazed Moms and Dads here in Short Hills, NJ don't see Formula 1 as the key to the fountain of youth. To this day I have never seen anyone around where I live mention or drink an F-1 shake.

I had, however, followed Mr. Ackman's investing career. I was certainly familiar with his in-depth analysis on MBIA and Ambac Financial and his success outsmarting both Warburg Pincus and Third Avenue Management on that investment. I have also read Confidence Game. Anyone who underestimates Mr. Ackman's tenacity should read this book. The story is fascinating.

So, when I heard that Mr. Ackman had made a 3 hour presentation on a new Short Sale idea I was intrigued. I did not watch the presentation live. I watched a postview. I am not affiliated with Pershing Square in any way. I have never met nor spoken to Mr. Ackman. My contact with Pershing Square begins and ends with a request from one of their analysts to link to some of my Seeking Alpha articles on factsabouth herbalife.com. Otherwise, I know nothing about their progress on this investment other than what is reported in the news.

My due diligence started by watching Pershing Square's presentation. From there I jumped to the 10ks and 10Qs and 8ks. I struck up a dialogue with some very well-informed individuals including Mr. William Keep who I highly regard and Mr. Robert Fitzpatrick. I have also been shown great kindness by other concerned citizens including Bruce Craig and Doug Brooks to name but a few.

I am a marketer by training with an MBA from Babson College. I studied retail strategy with Douglas Tigert,

the world's pre-eminent expert in his field. I used to run the marketing department for Canada's largest bank's Wealth Management Division. Marketers become experts in demographics and psychographics and consumer behavior, etc. Mostly what we are preoccupied with is the acquisition, development, and retention of customers that have a high life-time value/positive NPV.

The first time I looked at Herbalife's financials I was immediately perplexed by the following.

Herbalife prints some of the most outstanding financial metrics I have ever seen.

Specifically:

- 80% gross margins
- double digit net margins
- ROE north of 80%
- ROIC north of 50%
- executive compensation in the multiple millions of \$

Investors can review Herbalife's metrics [here](#). These metrics are what I would call "super normal".

Companies like Proctor and Gamble or Diageo would drool to get these kinds of gross margins for a consumer product. Funny, when something seems too good to be true it usually is.

So, I started digging further. The more research I did the more obvious it became to me that the reason Herbalife is able to make so much money is because their business partners make so little. In practice it is likely that most Herbalife distributors realize a negative NPV on the capital they risk.

By now you all know that the reason they all make so little is because they are deceived - deceived by a deceptive enterprise. At least that is my thesis.

Yesterday Carl Icahn was on CNBC talking about how Herbalife is undervalued. As I listened to him talk to Scott Wapner it struck me that perhaps Mr. Icahn himself has become the promoter of a fraud. More on that later.

The building blocks for the thesis that Herbalife is an illegal enterprise are as follows:

- Herbalife manufactures an array of undifferentiated weight management products.
- These products are sold to a network of individual distributors
- The company attains usurious gross margins when it sells the product.
- The company also surcharges the product with usurious Shipping, Handling and Administrative Fees
- In order to move product the company markets a business opportunity to its distributors.
- The business opportunity is outlined in the company's Marketing Plan.
- The company's Marketing Plan is a pyramid scheme

Why is the Marketing Plan a pyramid scheme?

At the top of the scheme are the plan's sponsors. These are the folks like [Doran Andre](#) and John Tartol and Leslie Stanford. These folks spend the bulk of their time traveling the globe as evangelists for the company's Marketing Plan. These individuals are the company's most senior recruiters. Let's call them the P.T. Barnums of Herbalife. To the plan's sponsors "Every Crowd Has a Silver Lining." If you are part of the Latino crowd all the better it would seem.

The first step in the Herbalife pyramid scheme is obvious - the promise of riches. Distributors up and down the Herbalife pyramid scheme routinely advance wildly exaggerated earnings claims/business prospects to naive recruits. The evidence of this kind of exaggeration is literally everywhere. For a small taste of it visit [factsaboutheralife.com](#). [Here](#) is but one small example of a recruiter romanticizing a group of new recruits.

Indicia #1 of a Pyramid Scheme - Exaggerated Earnings Claims

What is the key to achieving great wealth and prosperity? How do you too drive a Ferrari like Doran Andre?

A. Follow the Company's Marketing Plan

The company's Marketing Plan has a pathway to success. You start as a distributor at the bottom and immediately look-up to the Top of the pyramid *11 levels above you* as a newbie.

How do you advance in the plan?

Volume Points. Every time you make a purchase you acquire Volume Points. The more Volume Points you acquire the faster you advance in the plan.

Herbalife's Marketing Plan immediately encourages the purchase of Volume Points. To advance to SUPERVISOR and to acquire a 50% discount on product purchased you must acquire 4,000 Volume Points or two consecutive months at 2,500 Volume Points. Let's let John Tartol and Leslie Stanford tell you how it works.

The acquisition of Volume Points to secure a higher discount/to advance in the Marketing Plan is called Inventory Loading.

Aside: "Inventory loading" occurs when distributors make the minimum required purchases to receive recruitment-based bonuses without reselling the products to consumers.

Indicia # 2 of a Pyramid Scheme - Incentives that Promote Inventory Loading

How do you make money?

All commissions in the Herbalife Marketing plan are paid out based upon product purchases. Not a single commission is paid when product is purchased by a retail customer. Whether or not a can of shake mix is ever sold to a retail customer does not influence whether or not an upline sponsor earns a commission. As long as the upline sponsor can convince a downline recruit to make a purchase of inventory the upline sponsor makes a commission.

Indicia # 3 of a Pyramid Scheme - The payment of compensation facially unrelated to retail sales.

What is the focus of the Marketing Plan?

Legitimate Multi-Level marketing plans focus on retailing as their primary objective. Herbalife's marketing plan incentivizes recruiting.

How can we be sure?

Over 4 million new recruits have been recruited in the past two years alone.

Indicia #4 of a Pyramid Scheme - a compensation system that emphasizes recruitment over retail sales.

Do distributors make money?

According to the company's annual Statement of Compensation the promises of great riches advanced by the recruiters like Doran Andre don't exactly come to pass. Most participants don't make much money at all. As a result, most participants quit the business within a year or two.

Indicia # 5 of a Pyramid Scheme - High Churn Rates/Failure Rates

How does the company continue to grow even as it loses so many of its distributors?

A. Relentless recruiting. Specifically, Herbalife's marketing plan encourages an endless chain of recruitment. The company is now in over 88 countries around the world. The Marketing Plan has aggressively saturated most geographies globally.

Indicia # 6 of a Pyramid Scheme - a compensation system that encourages an Endless Chain of Recruitment.

Q. Is Herbalife one of the largest frauds in history operating within the jurisdiction of both the FTC and the SEC?

The answer is likely "Yes"

Why? What is unique about Herbalife is the following.

Not only does the company's Marketing Plan siphon cashflow from junior recruits into the hands of these recruits' upline sponsors, the company takes the initiative a dramatic step further.

The company has taken the cashflow produced by its Marketing Plan and issued securities to the public. Retail and institutional investors can acquire a stake in the work product of Herbalife's Marketing Plan. This is a critical observation for the following reasons.

If Herbalife is a multi-billion dollar pyramid scheme then not only are its promoters likely guilty of promoting a business opportunity fraud but in all likelihood the promoters are also guilty of promoting securities fraud.

The securities fraud would likely exist on two levels.

1) The distributorships themselves are likely fraudulent securities. Selling a business opportunity that doesn't deliver the goods due to the systemic problems manifest in a pyramid scheme is a form of securities fraud under both state and federal law.

2) The equity and debt issued by the company is also a fraud of epic proportions. Selling securities in a firm under the premise that said firm is legitimate if and when it is actually an illegitimate pyramid scheme is an obvious promotion of fraud. Today, the capitalized value of HLF common equity is around \$7 billion. Almost all of it likely financed by the churn in Herbalife's distributor base.

Which leads me to Mr. Icahn.

Mr. Icahn has taken an aggressive long position in Herbalife's common equity. Ostensibly, this sets-up Icahn Partners to be a potential victim of the fraud advanced by Mr. Johnson and the rest of Herbalife's Board of Directors. Mr. Icahn may find himself a victim as might any other long investors in Herbalife's common equity when regulators intervene, except for one thing.

Mr. Icahn crossed over the line from being an outside, passive, minority investor to being an inside, active, minority investor.

Specifically, Mr. Icahn's company has two seats on the Herbalife board and now forms an integral part of

the company's governance.

In effect, Mr. Icahn is now a promoter of the Herbalife narrative or if you prefer a promoter of the Herbalife scheme. As investors we have already seen evidence of Mr. Icahn talking his book. As recently as yesterday, Mr. Icahn repeated again publically that Herbalife is an undervalued company. This struck me as odd as we sit here 2 days before their Q3 release but what do I know?

More notably, as the Chairman of a company that has two seats on Herbalife's Board of Directors, Mr. Icahn is now a promoter of the Herbalife Marketing Plan, just as John Tartol is, just as Mike Johnson is, just as John Di Simone is and just as every other participant in the Herbalife story is.

From Webster v. Omnitrition the case law on this point is clear. Pyramid schemes not only violate a number of anti-fraud statutes but they also run contra to securities laws.

[4] In S.E.C. v. Glenn W. Turner Enters., Inc., 474 F.2d 476 (9th Cir.), cert. denied, 414 U.S. 821, 94 S.Ct. 117, 38 L.Ed.2d 53 (1973), we declared that investments in a pyramid scheme were "investment contracts" and thus securities within the meaning of the federal securities laws. If Omnitrition's program is a pyramid scheme, investments in the program's supervisor positions are securities.

If Omnitrition's program involves the sale of securities, Omnitrition is liable under § 12(1) for failing to file a registration statement. Section 12(1) imposes civil liability on one who "offers or sells a security in violation of section 77e." 15 U.S.C. § 77l(1) (1981). Section 77e(c) makes it unlawful "to offer to sell ... any security, unless a registration statement has been filed as to such security ..." 15 U.S.C. § 77e(c) (1981). There is no scienter requirement to § 12(1). Wolf v. Banco Nacional De Mexico, 549 F.Supp. 841, 853 (N.D.Cal.1982), rev'd on other grounds, 739 F.2d 1458 (9th Cir.1984), cert. denied, 469 U.S. 1108, 105 S.Ct. 784, 83 L.Ed.2d 778 (1985).

The ruling goes on to state the following:

Section 10(b) of the Securities Exchange Act of 1934 makes it unlawful "[t]o use or employ, in connection with the purchase or sale of any security ... any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe ..." 15 U.S.C. 78j(b).

Securities and Exchange Commission Rule 10b-5 prohibits engaging "in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5(c). Federal antifraud securities laws are to be construed broadly. Herman & MacLean v. Huddleston, 459 U.S. 375, 386- 87, 103 S.Ct. 683, 689, 74 L.Ed.2d 548 (1983).

[6] We hold that operation of a pyramid scheme violates 10b-5's prohibition against engaging in an "act, practice or course of business which operates as a fraud or deceit upon any person." A jury could rationally conclude that the promotion of a pyramid scheme demonstrates the necessary fraudulent intent. See In re Software Toolworks, Inc. Sec. Litigation, 50 F.3d 615, 628-29 (9th Cir.) (holding summary judgment on 10b-5 claim to be improper, even in absence of direct evidence of fraudulent intent, where evidence permitted a "reasonable inference" of scienter), cert. denied, --- U.S. ---, 116 S.Ct. 274, 133 L.Ed.2d 195 (1995).

Because there is a genuine dispute of material fact as to whether Omnitrition operated a fraudulent pyramid scheme, the district court should not have granted summary judgment on Webster's 10b-5 claims.

Section 12(2) imposes civil liability on any person who "offers or sells a security ... by means of a prospectus or **oral communication**, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading ..." 15 U.S.C. § 77l(2). There is genuine dispute over whether Omnitrition made false statements of fact when it declared Omnitrition was not a pyramid scheme. **Even absent such statements, a company which promotes an inherently fraudulent pyramid scheme "omits to state a material fact" for purposes of § 12(2) when it does not explain that the program is bound to collapse.**

Mr. Ackman is convinced that Herbalife is a pyramid scheme. I agree with this analysis. If we are correct, there are a number of second-order effects/implications for those on the other side of the trade.

To say that the members of Herbalife's management team are "all-in" reputationally with the Herbalife juggernaut would be an understatement. Nothing might be more humbling than going from making \$10 million one year to doing a perp walk the next. Even a small probability of this kind of outcome must be very stressful for Herbalife executives and their families.

One might wonder if some insider will turn state's evidence at some point along the way to mitigate his/her exposure as a whistle blower. Who knows?

As for Mr. Icahn?

It strikes me as curious as to why anyone would voluntarily want to try to pick-up reputational nickels in front

of a bulldozer. If Mr. Icahn is correct about Herbalife then he likely makes a great amount of money. If he is incorrect then it strikes me that he has now exposed himself to the potential liability that comes with being the promoter of a fraud.

After completing a significant amount of due diligence piggy-backing on the great work done by Shane Dineen and his team at Pershing Square it is obvious to me that Herbalife's Marketing Plan is a pyramid scheme. That's my take. To be long and disagree is one thing. To be long and disagree and take two seats on the company's Board of Directors is quite another.

It seems doubtful that both the SEC and the FTC will turn a blind eye to a massive fraud now that it has been brought to their attention with both thorough and rigorous amounts of investigation and evidence. How anyone can argue rationally that this company's senior distributors don't over-exaggerate earnings potential escapes me completely. These exaggerations are, of course, the first step down the Yellow Brick Road on the way to find the Wizard of Oz.

"We hear he is a wizardful Wiz if ever a Wiz there was." - at least that is what Michael Johnson tells us (metaphorically speaking).

It seems equally unlikely that the members of the Hispanic Caucus in Congress will stand by idly as their fellow citizens are victimized.

It also seems doubtful that Herbalife will be able to prove that upline recruiting rewards are financed by legitimate retail sales rather than the ongoing purchases of distributors churning and dying on the climb to Mount SUPERVISOR in pursuit of riches that will never materialize.

As for whether or not Mr. Icahn may be involved in the promotion of a fraudulent business venture?

As always, Time will Tell

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From: Greisman, Lois C. </O=FTCEXCHANGE/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=LGREISMAN>
Sent: Thursday, October 17, 2013 10:10 PM
To: Vaca, Monica E. <MVACA@ftc.gov>; Todaro, Christine <ctodaro@ftc.gov>; Ammerman, Janet <jammerman1@ftc.gov>
Subject: Fw: HLF

From: Holley, Steven L. [mailto:HolleyS@sullcrom.com]
Sent: Thursday, October 17, 2013 11:36 AM
To: Greisman, Lois C.
Subject: HLF

Hi Lois –

I thought you might be interested in reading this morning's article by Dan McCrum of the Financial Times concerning Herbalife's compliance (or lack thereof) with the 1986 California injunction requiring the company to implement a system for tracking retail sales.

Regards,

Steve

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California approves this message, Herbalife edition

Dan McCrum

FT Alphaville

10/17/13

Part of the LIVING THE HERBALIFE SERIES

California has nurtured Herbalife for more than three decades. From Los Angeles, the multi-level nutritional-milkshake marketing and distribution scheme has spread to 75 countries worldwide.

Yet the state was not always friendly. In 1986 it won a permanent injunction against the company that is still in force, and we wonder if — following a more recent California court ruling — it might look at that injunction once again.

As we reported in the last instalment of this series, a district court in the state has denied a motion from Herbalife seeking to dismiss a suit from a former salesman, Dana Bostick.

Without deciding on the merits of Mr Bostick's claims at this stage of the process, Judge Beverly Reid O'Connell indicated that there was sufficient cause for the suit to go ahead.

As we have said before, we think Herbalife's argument — that sales to fellow salespeople, known as distributors in the direct sales jargon, may be counted as true retail sales to end consumers — lacks support in the case law, and is in conflict with a key appeal court judgement known as Omnitrician.

But note this piece of legal argument in Herbalife's motion to dismiss the Bostick suit, with our emphasis:

Further—a factor not present in Omnitrition — reading the statute to mean that sales to Distributors do not “count” as legitimate sales would gut the Attorney General's approval of Herbalife's business model under this very statute.

From: Greisman, Lois C. </O=FTCEXCHANGE/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=LGREISMAN>
Sent: Wednesday, October 16, 2013 9:53 AM
To: Vaca, Monica E. <MVACA@ftc.gov>; Ammerman, Janet <jammerman1@ftc.gov>; Vander Nat, Peter J. <PVANDERNAT@ftc.gov>; Todaro, Christine <ctodaro@ftc.gov>
Subject: FW: HLF - Bostick
Attach: Bostick - Order Denying Motion to Dismiss.pdf

From: Holley, Steven L. [mailto:HolleyS@sullcrom.com]
Sent: Tuesday, October 15, 2013 6:52 PM
To: Greisman, Lois C.
Subject: HLF - Bostick

Hi Lois –

I thought you might be interested to know that the federal district court in California recently denied Herbalife's motion to dismiss the complaint in the Bostick case. In doing so, the court rejected a couple of Herbalife's central arguments. The following sections of the opinion are particularly notable:

- "Plaintiff's concession that purchasing an International Business Pack is not an investment inventory does not mean that Plaintiff cannot use this payment to satisfy the first element of the Koscot test. Rather, this payment of money satisfies both the 'significant consideration' language of Penal Code § 327 and the 'payments of money' language of Koscot— absent this payment an individual may not become a distributor within the Herbalife hierarchy. . . . Further, similar to Omnitrition, distributors in the Herbalife hierarchy can purchase large inventories of goods in order to more fully receive the benefits of the program, such as increased discounts on future purchases." (p. 8.)
- "The considerable discounts and advantages offered to supervisors presents the same risk of a recruitment focus present in Omnitrition. See Omnitrition, 79 F.3d at 782. Although Defendants contend that distributors should be classified as ultimate users, Omnitrition points out that '[i]f Koscot is to have any teeth, [a sale for a distributor's personal use] cannot satisfy the requirement that sales be to "ultimate users" of a product.' Id. at 783. Therefore, downline distributors are not ultimate users for purposes of the second element of the Koscot test. Accordingly, Plaintiff has adequately alleged that supervisors pay money to receive recruitment rewards which are unrelated to the sale of products to ultimate users." (p. 9 (footnote omitted).)

If sales to those inside the Herbalife distribution system do not count as true retail sales, then it is difficult to see how Herbalife is a legitimate MLM as opposed to an illegal pyramid scheme.

Regards,

Steve

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Subject: FW: HLF

From: Holley, Steven L. [mailto:HolleyS@sullcrom.com]
Sent: Monday, October 14, 2013 11:34 AM
To: Greisman, Lois C.
Subject: HLF

Hi Lois –

I thought you might be interested in reading this morning's article by Dan McCrum of the Financial Times concerning Herbalife's bobbing and weaving on the important issue of how many retail customers it has outside its distribution network.

Regards,
Steve

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<http://ftalphaville.ft.com/2013/10/14/1663542/thats-my-answer-and-if-you-dont-like-it-well-i-have-others-herbalife-edition/>

That's my answer and if you don't like it... well, I have others, Herbalife edition

Who are Herbalife's customers?

A fair question, yes. An innocent one, not at all. And answers came there... well many, actually.

The question has been loaded and pointed at the Los Angeles-based maker of nutritional diet shakes many times since David Einhorn appeared on an earnings call in May 2012. It is the polite way of inquiring whether Herbalife is actually a pyramid scheme.

But the answers have not been conclusive. So let's take a tour of the company's responses, with the aim of showing why the question should continue to be asked.

First though, a quick reminder of why the identity of Herbalife's customers is so crucial to the question of whether it is a pyramid scheme — something which the company denies and has said is based on a misunderstanding of its business model.

We have laid out before the underlying case law surrounding pyramid schemes in the US. The courts have repeatedly taken the view that someone is either a participant in a pyramid scheme (known as a distributor, in the jargon), or a customer of it. That definition is crucial, because a company that makes the majority of its profits from putting products into the hands of willing customers is clearly legitimate.

A direct seller that makes most of its money from sales to recruits into its multi-level enterprise, however: that one deserves a closer look at its more triangular aspects.

Furthermore, if the law allowed for muddy waters between the two, then you would become extremely difficult to prosecute. *Who me, officer? I was just sampling the taste of the smoke. I would never inhale...*

So what has Herbalife said about its customer base?

When noted hedge fund manager and short seller David Einhorn popped up on that earnings call, he asked what proportion of sales go to consumers who are not distributors. Herbalife President Desmond Walsh said:

So, we don't have an exact percentage, David, because we don't have visibility to that level of detail.

Asked for an approximation, he said potentially more than 70 per cent.

Then a day later, Herbalife lodged an 8K document with the SEC in which it gave some more detailed responses (our emphasis):

From: Greisman, Lois C. </O=FTCEXCHANGE/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=LGREISMAN>
Sent: Wednesday, September 25, 2013 7:13 PM
To: Vaca, Monica E. <MVACA@ftc.gov>; Vander Nat, Peter J. <PVANDERNAT@ftc.gov>; Ammerman, Janet <jammerman1@ftc.gov>; Todaro, Christine <ctodaro@ftc.gov>
Subject: FW: HLF

From: Holley, Steven L. [mailto:HolleyS@sullcrom.com]
Sent: Wednesday, September 25, 2013 10:23 AM
To: Greisman, Lois C.
Subject: HLF

Hi Lois –

I thought you might find the enclosed article interesting. It nails the point about Herbalife's reliance on internal consumption.

Best regards,

Steve

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Herbalife and the FTC

Dan McCrum | Sep 25 10:29 | 3 comments | ShareFT Alphaville

Which was your favourite Herbalife moment this year? The billionaire playground spat, an inside trading auditor, the dubious surveys and unanswered questions, George Soros, angry Latinas, the whistleblower, or the high profile departures and appointments?

Yet the fun has also obscured the underlying issues. While there have been some great pieces looking at parts of the story – the Verge on online scammers pitching the Herbalife business opportunity, or the NY Post on the departure of top Herbalife salesman, Shawn Dahl, for instance – there was little that got to the heart of accusations that Herbalife is a pyramid scheme.

We want to change that, starting with this post about why the question for Herbalife investors should be less about whether the FTC will investigate Herbalife and more about what the Federal Trade Commission has already said and done.

As to Herbalife shares hitting a record high, we would note that the short interest remains considerable. Declining availability of stock in official lending programmes also suggests that institutional owners have been sellers this year. We'll be very surprised if there isn't more fun to come.

So, the place to begin is the problem of law: there isn't any. Or rather there isn't one US statute that defines a pyramid scheme. Instead the FTC rules are based on broad anti-fraud statutes and case law, in particular two suits from the 1970s, but also on subsequent prosecutions.

From: Greisman, Lois C. </O=FTCEXCHANGE/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=LGREISMAN>
Sent: Friday, August 16, 2013 2:58 PM
To: Todaro, Christine <ctodaro@ftc.gov>; Ammerman, Janet <jammerman1@ftc.gov>; Vaca, Monica E. <MVACA@ftc.gov>
Subject: FW: Herbalife

From: Holley, Steven L. [mailto:HolleyS@sullcrom.com]
Sent: Friday, August 16, 2013 11:29 AM
To: Greisman, Lois C.
Subject: Herbalife

Hi Lois –

I wanted to be sure you saw the article in the Financial Times about Shawn Dahl and Online Business Systems, as well as the related blog posting. It is difficult to believe that Herbalife was unaware that Dahl was carrying on the business that that the Canadian authorities ordered his mother-in-law to shut down because it was an illegal pyramid scheme.

We are looking forward to discussing the role of senior distributors in the Herbalife scheme at our meeting next week.

Regards,

Steve

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Herbalife distribution network in the spotlight

By Dan McCrum in New York

A fraud cannot survive the truth, which is why regulators opposed to pyramid schemes have focused on the mundane but important role played by disclosure in undercutting a fraudulent sales pitch of easy riches.

So when, in 2004, a Canadian federal court convicted Global Online Systems, a promoter for the nutritional supplement seller Herbalife, of being a “scheme of pyramid selling”, included in the remedies was a requirement for more disclosure.

Representations about compensation would have to be fair, reasonable and timely in all communications. All future materials were to comply with the law by clearly disclosing “the average income actually received by all participants operating in Canada”.

Yet, by the time GOS and its two directors were convicted, their customers had been encouraged to move to a new venture, Online Business Systems.

Both promoted the business of the Los Angeles-based direct seller, finding new Herbalife recruits, and then selling lucrative services to those recruits.

Herbalife this year banned the purchase or sale of materials and business leads from OBS, but practices by its promoter before the rift go to the heart of questions surrounding Herbalife's business model, under intense scrutiny since shortseller Bill Ackman last year accused the company of being a pyramid scheme, a charge it denies.

Herbalife is a direct-selling business, one with a network of over 3m salespeople, known as distributors, responsible for its sales of diet shakes and nutritional pills.

A legitimate multi-level marketing scheme is based around selling a product to end consumers, where higher sales to happy customers mean higher profits, and Herbalife says that it is such a business.

By contrast, a pyramid scheme can still have a product, but the great majority of its sales people will not make a profit from selling it. Instead those at the top of the pyramid exploit a steady series of new recruits who invest money in their new business before eventually giving up, going bankrupt or moving on.

Those recruits might be encouraged to buy more product than they can sell in order to join the scheme and qualify for bonuses and royalties earned by a team of distributors below them. Or they might be sold expensive services to help them set up and run their own business, incurring costs that can only be recouped by more recruiting.

Such costs can be high. OBS for instance, could charge several hundred dollars a year for sales materials, and for providing websites for recruits. It could charge hundreds more for "sales leads", the contact details for potential new recruits to expand the network.

William Keep, professor of marketing at the College of New Jersey said that the lucrative sale of such leads "is the underbelly of multi-level marketing".

The profits made by powerful distributors from providing marketing services, website operations and sales leads to new recruits can, he said, over time "bias an organisation towards recruiting: the tail wags the dog".

Sales leads come from attracting recruits, which GOS found through a series of websites such as *successontherise.com*, or *freedomforgood.com*, telling visitors that "sometimes the greatest risk...is not taking one".

Before GOS's conviction in late 2004, customers were encouraged to move to Online Business Systems, and the websites were rebranded. Herbalife distributors were told that OBS's leaders had left GOS to "develop enhanced automated marketing tools to improve our system while decreasing the cost of running our businesses".

The sales pitch remained the same – as did at least some of the tactics. A potential recruit would be encouraged to sign up for a "decision package", sent at an initial cost of only \$9.95 for postage and packaging, but subject to a further \$39.95 charge if not sent back in 15 days. If they kept it, their details could then be sold as a lead to a distributor for as much as \$100 or more.

Among the testimonials of success and pictures of yachts in a recent OBS pack there are broad answers to the question of how a distributor will earn income: "You'll acquire retail customers and develop business leaders who are interested in building a lifetime of residual income".

In the small print it mentions that the income available – \$500 to \$1,000 a month from five to 10 hours per week – are "representative of some of the most successful participants and the majority of individuals earn less". There is no mention, however of the company that for almost a decade was the source of this opportunity, Herbalife, or the disclosure of all participants' average income.

Distributors aiming to build a business would need to buy enough product from Herbalife to qualify for royalties. Herbalife declined to comment on its Canadian disclosure or specific distributors.

The company said that its 350-strong compliance team ensures that distributors obey applicable laws, and that "the vast majority of Herbalife distributors are successfully creating long-term customers through the daily consumption of our nutrition products". This year, Herbalife took steps to distance itself from OBS by restricting distributors' use of leads and marketing materials provided by the company. OBS did not respond to requests for comment.

Herbalife does disclose earnings for Canadian distributors each year, but only for a subset of "active leaders" that represents a tenth of overall participants, and before any expenses paid to an organisation such as OBS. In 2011 the median gross annual earnings for that select group of distributors was C\$534 (US\$517).

<http://ftalphaville.ft.com/2013/08/15/1604391/spot-the-difference-herbalife-edition/>

Spot the difference, Herbalife edition

This guest post is submitted by Dan McCrum, the FT's US investment correspondent.

Hoisted from the web archives of the wayback machine, lets take a look at what 4u4meletsdream.com had to offer back in 2004.

In February it looked like this:

The screenshot shows the homepage of 'GLOBAL ONLINE SYSTEMS'. The header includes the company name and a navigation menu with links: 'Where's All About?', 'What's the First Step?', 'Do I Have What It Takes?', 'What's the Risk?', and 'FREE Online Presentation'. A main text block describes the opportunity, stating that it is suitable for various professions and that the system is simple enough for internet beginners. To the right, there is a 'View Our FREE Online Presentation!' section with input fields for 'FIRST NAME' and 'EMAIL', and a 'VIEW PRESENTATION' button. Below this is a 'Privacy Policy' notice. At the bottom, there are three testimonials from users, each accompanied by a small photo. The footer contains copyright information for 2004.

In October though, there was a subtle change:

The screenshot shows the homepage of 'ONLINE BUSINESS SYSTEMS'. The header includes the company name and a navigation menu with links: 'What's it All About?', 'What's the First Step?', 'Do I Have What It Takes?', 'What's the Risk?', and 'FREE Online Presentation'. A main text block describes the opportunity, stating that it is suitable for various professions and that the system is simple enough for internet beginners. To the right, there is a 'View Our FREE Online Presentation!' section with input fields for 'FIRST NAME' and 'EMAIL', and a 'VIEW PRESENTATION' button. Below this is a 'Privacy Policy' notice. At the bottom, there are three testimonials from users, each accompanied by a small photo. The footer contains copyright information for 2004.

ONLINE BUSINESS SYSTEMS

Learn how 2 moms have helped many others achieve financial freedom, working from home using the Online System. [Details Inside!](#)

[Where is All About?](#) [What's the Fast Start?](#) [Do I have What it Takes?](#) [What's the Risk?](#) [FREE Online Presentation](#)

Financial Freedom Online!

Whatever circumstances that attracted you to this opportunity, one thing is certain, there are many other people just like you. No matter what you do for a living - whether you are a teacher, a doctor, a lawyer, a secretary, housewife or construction worker - do you find yourself thinking, "there must be a better way, a less complicated way, a smoother road" - the opportunity to run your own internet business can be the answer for you.

Our system is so **simple** that even if you are an internet beginner, you can capitalize on our turnkey system.

View Our FREE Online Presentation!
 Enter your name and email:

FIRST NAME:

EMAIL:

[VIEW PRESENTATION](#)

Privacy Policy: We will NOT share your information with **ANYONE** and you can remove your name from our database at any time.

"After years of searching, we are thankful that we have found our long-term family business."

"The growth in such a short period of time has been incredible...I am looking forward to a bright future."

"I now enjoy a wonderful lifestyle and can spend quality time with my wife and three daughters."

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Did you spot it? The online system that 2 moms had used to help others achieve financial freedom was still available, it was just now offered by Online Business Systems, totally different you see from Global Online Systems.

Both were promoters of Herbalife, that nutritional supplement direct seller which says claims by a dastardly short seller that it is a pyramid scheme are the stuff of nonsense.

Global Online Systems would recruit distributors for Herbalife, and help the internet beginners build their own empire of diet shakes. Of course a turnkey website is not cheap, but when customers were urged to switch to Online Business Systems in September 2004, there were price cuts!

From the site:

+ Until September 15th, the cost to upgrade to your new OBS business tools (for those currently using GOS) is **FREE!** Not only that, but your first month's service fees will also be included for **FREE!** Your monthly fees in the future will be only \$39.99 USD. To the right, you'll find a link to detailed instructions on how to cancel your old system tools – in order to avoid paying for services you won't be needing anymore, it's very important that you do this right away!

+ The costs of all of your new OBS system tools have been greatly reduced so that everyone can take advantage of what we have to offer. Everyone will get a recruiting site, administration system, training site, retailing site, and voicemail system for only \$100.00 USD. The costs associated with the Global Online Systems tools were over \$300.00 USD and the monthly fees exceeded \$60.00 USD per month!

Why the change, a Herbalife man might have asked, well, the Q&A had the reason:

Why did we leave Global Online Systems?

A team of leaders wanted to develop enhanced automated marketing tools to improve our system while decreasing the cost of running our businesses. Our goal was to provide our groups with higher-tech marketing tools so our distributors could manage their businesses with greater efficiency. The Online Business System includes automated lead management technology, advanced recruiting/retailing sites and improved training manuals.

One of the greatest changes we've made within our new Online Business System is the superior quality of our Decision Package. Our Decision Package includes an information booklet, a DVD, an audio CD and a Video. It was developed by a team of professional writers, video producers and the Online Business Systems Leadership Team. Once you see it, you'll understand how this new Decision Package will help you

build your business to the next level.

But about those Moms. The Canadian Competition Bureau had taken a look at Global Online Systems and didn't like what it found:

It was a "scheme of pyramid selling", and the two directors, Deborah Stoltz and her sister Marilyn Thom paid a C\$150,000 fine in November of 2004. A prohibition order also prevented them from taking part in any more schemes of pyramid selling:

For the purposes of this agreement, a scheme of pyramid selling means a multi-level marketing plan that includes any of the following elements:

(a) participants in the plan give consideration, including cash or any other benefit, for the right to receive consideration when others are recruited into the plan who, in turn give consideration for the same right. For greater certainty, consideration may include profit derived from the sale of all marketing material including all videos, audio tapes, distribution packages and promotional booklets.

The rest is in the prohibition order.

That judgement is in line with Canadian Law, but it didn't specifically apply to Online Business Systems, which has a totally different name and was run by the daughter of Ms Stoltz, Nicole Dahl and husband Shawn Dahl.

Team Dahl went on to become one of the most important distributors in Herbalife's network, gracing the cover of its 2009 magazine when they entered the elite Chairman's Club, so we were sure that Herbalife checked it out and made certain everything was above board, before the company took steps to cut Online Business Systems out of its network of distributors in February this year.

The company gave us this statement:

We believe this story is yet another desperate example of Pershing Square's reckless \$1 billion bet against Herbalife, which according to recent media estimates currently represents an approximately \$350 million loss for Mr. Ackman's fund.

Herbalife's 350-strong global Distributor Business Practices and Compliance team takes proactive and responsive measures to identify, research, and address each and every infraction of Herbalife's Distributor Rules and applicable regulation and law. Their efforts range from counseling and education to sanctions such as suspensions, fines, and even termination of distributorships. The vast majority of Herbalife distributors are successfully creating long-term customers through the daily consumption of our nutrition products and the unique support they provide.

We've asked Online Business Systems, Ms Stoltz, Ms Thom and Mr & Mrs Dahl for comment, but no response has yet arrived.

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From: Greisman, Lois C. </O=FTCEXCHANGE/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=LGREISMAN>
Sent: Tuesday, June 18, 2013 5:31 PM
To: Ammerman, Janet <jammerman1@ftc.gov>; Vander Nat, Peter J. <PVANDERNAT@ftc.gov>; Todaro, Christine <ctodaro@ftc.gov>; Vaca, Monica E. <MVACA@ftc.gov>
Subject: FW: Pershing Square Press Release
Attach: Press Release re HLF Surverys Final 6 18 13.pdf

From: Holley, Steven L. [mailto:HolleyS@sullcrom.com]
Sent: Tuesday, June 18, 2013 1:30 PM
To: Greisman, Lois C.
Subject: Pershing Square Press Release

Hi Lois –

I am sending along a press release that Pershing Square just issued concerning the latest survey commissioned by Herbalife on the issue of retail sales to customers outside Herbalife's distribution network. The strange thing about the continued use of such surveys is that Herbalife has the contractual right to obtain detailed data about actual retail sales from its distributors under the plain terms of its Sales and Marketing Plan. It seems fair to infer that the company's refusal to use such readily accessible data is based on its concern about what the data will show, namely, that very few products are sold to actual retail customers as opposed to aspiring distributors.

Regards,

Steve

Steven L. Holley | Sullivan & Cromwell LLP
125 Broad Street, New York, NY 10004-2498
☎ (212) 558-4737 | ✉ (212) 291-9074
✉ holleys@sullcrom.com

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From: Greisman, Lois C. </O=FTCEXCHANGE/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=LGREISMAN>
Sent: Friday, June 7, 2013 4:41 PM
To: Todaro, Christine <ctodaro@ftc.gov>; Vaca, Monica E. <MVACA@ftc.gov>; Ammerman, Janet <jammerman1@ftc.gov>
Subject: FW: Open Letter from Pyramid Scheme Alert to Direct Selling Association Regarding Herbalife
Attach: Pyramid_scheme_alert_4_29.pdf

From: Holley, Steven L. [mailto:HolleyS@sullcrom.com]
Sent: Thursday, June 06, 2013 12:04 PM
To: Greisman, Lois C.
Subject: Open Letter from Pyramid Scheme Alert to Direct Selling Association Regarding Herbalife

Hi Lois –

You may have seen this already, but attached is a letter that details the serious economic harm being inflicted on U.S. consumers by Herbalife, and specious nature of the claim that Herbalife is providing a livelihood for large numbers of Americans. The sad truth is that even among distributors who reach the level of Supervisor, only a small fraction earn gross compensation in excess of what they would earn in a job paying the minimum wage, and that is before deducting expenses and inventory purchases. In practice, Herbalife functions as a money transfer scheme in which the lost investments of large numbers of aspiring distributors end up in the hands of a small number of wealthy recruiters at the top of the pyramid.

Regards,

Steve

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From: Greisman, Lois C.
Sent: Friday, May 10, 2013 4:07 PM
To: Ammerman, Janet; Todaro, Christine; Vaca, Monica E.; Vander Nat, Peter J.
Subject: FW: HLF
Attachments: Haaretz Full Text.docx

From: Holley, Steven L. [<mailto:HolleyS@sullcrom.com>]
Sent: Friday, May 10, 2013 2:52 PM
To: Greisman, Lois C.
Subject: HLF

Hi Lois –

I thought you might find interesting the attached story about Herbalife that appeared yesterday on the Israeli new website Haaretz. Although the story concerns events in Israel, it points out the importance of senior distributors and their organizations in generating new recruits for the Herbalife pyramid scheme. The story also discusses some of the unorthodox methods those senior distributors use to recruit and retain new distributors, and the large amounts of money they earn in the process.

Regards,

Steve

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From: Greisman, Lois C.
Sent: Wednesday, March 27, 2013 3:46 PM
To: Ammerman, Janet; Todaro, Christine; Vaca, Monica E.; Vander Nat, Peter J.
Subject: FW: HLF

FYI

From: Holley, Steven L. [<mailto:HolleyS@sullcrom.com>]
Sent: Wednesday, March 27, 2013 3:11 PM
To: Greisman, Lois C.
Subject: HLF

Hi Lois –

I wanted to call your attention to an interesting article that was published today on a website called The Verge. The article discusses in detail how lead generation businesses associated with senior Herbalife distributors operate to the detriment of unwitting consumers.
<http://www.theverge.com/2013/3/27/4099100/income-at-home-herbalife-scamworld-biz-opp>
Pershing Square continues to believe that these lead generation businesses have operated for many years with the full knowledge and at least tacit approval of Herbalife.

Regards,

Steve

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From: Greisman, Lois C.
Sent: Tuesday, March 19, 2013 6:07 PM
To: Vaca, Monica E.; Vander Nat, Peter J.; Todaro, Christine; Ammerman, Janet
Subject: FW: HLF

From: Holley, Steven L. [mailto:HolleyS@sullcrom.com]
Sent: Tuesday, March 19, 2013 12:08 PM
To: Greisman, Lois C.
Subject: HLF

Hi Lois –

You probably are aware of Matt Stewart's postings about Herbalife on the Seeking Alpha website, but this one posted yesterday morning struck me as particularly lucid. The guy could use a good editor because he tends to repeat himself, but his analysis of the situation faced by new Herbalife distributors, from a commonsense perspective, is quite compelling.

Regards,

Steve

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Herbalife: 5 Common Sense Arguments

Mar 18 2013, 08:06 by: Matt Stewart

Seeking Alpha

I have written numerous articles arguing that Herbalife (HLF) is a pyramid scheme. Many Seeking Alpha contributors have tried to analyze the data to either confirm or deny the idea that Herbalife is either a legitimate or an illegitimate business. Analysts have poured through court cases, financial models, etc. Sometimes the shortest distance between two points is common sense.

In this article, I would like to summarize my thesis and try to use basic common sense to articulate concisely why my analysis leads me to conclude that Herbalife

From: Holley, Steven L. <HolleyS@sullcrom.com>
Sent: Thursday, February 7, 2013 11:11 AM
To: Greisman, Lois C. <LGREISMAN@ftc.gov>
Subject: [WARNING: MESSAGE ENCRYPTED]Herbalife
Attach: Herbalife_Questions.pdf; StatementAverageCompensation2011EN.pdf

Hi Lois –

It was nice speaking with you on the telephone yesterday. I am still figuring out who will be attending the March 4 meeting on our side, but I will let you know soon.

You are probably aware of this, but I wanted to be sure you saw the new Statement of Gross Compensation for U.S. Distributors released by Herbalife yesterday, as well as some initial reaction to it on the Seeking Alpha website. <http://seekingalpha.com/article/1163881-herbalife-s-disclosures-don-t-add-up-again?source=yahoo> Also, in response to the invitation from Herbalife's president Des Walsh, Pershing Square has posed a long series of questions to Herbalife about its business. A copy of those questions, which are now up on the Facts About Herbalife website, are attached. Please let me know if you have any questions about these materials.

Regards,

Steve

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EXHIBIT D

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June 5, 2013

Via FedEx

Lois C. Greisman, Esq.,
Associate Director, Division of Marketing Practices,
Federal Trade Commission – Bureau of Consumer Protection,
600 Pennsylvania Avenue, N.W.,
Washington, D.C. 20580.

Re: Herbalife

Dear Lois:

I write on behalf of our client Pershing Square Capital Management, L.P. (“Pershing Square”) to bring to your attention an interesting development in the class action filed against Herbalife recently in federal district court in Los Angeles on behalf of lower-level Herbalife distributors. The complaint in that case, captioned *Bostick v. Herbalife International of America*, Case No. 13-cv-02488 BRO (RZx) (attached as Exhibit A), is worth reading because it contains a detailed explanation of why Herbalife is an inherently fraudulent pyramid scheme. The central claim asserted against Herbalife in the *Bostick* case is for violations of California’s Endless Chain Scheme Law, Cal. Penal Code § 327, but the analysis in the complaint is broadly applicable to other laws—federal and state—proscribing pyramid schemes and deceptive practices.

Late last week, Herbalife filed a motion to dismiss the complaint in the *Bostick* case. (A copy of the motion to dismiss (“MTD”) is attached as Exhibit B.) The motion to dismiss is notable in a number of respects.

First, Herbalife’s principal line of defense is that it should have been apparent to the plaintiff that the majority of Herbalife distributors fail, and that even those who do not fail make very little money. Herbalife makes this point repeatedly in the motion to dismiss. *See, e.g.*, MTD at 3 (“Bostick claims he was the victim of a business that . . . made it clear to him that only a small percentage of individuals similarly situated could expect to—as is true—generate significant income as a result of their relationship

with Herbalife.”); *id.* at 10 (“Bostick was well-informed . . . that most Distributors do not achieve Sales Leader status, and even of those that do, most make only modest, if any, income from commissions.”); *id.* (“Bostick knew that . . . most of even Herbalife’s most successful leaders made only modest amounts of commission income.”); *id.* at 11 (“Bostick knew that even the top Herbalife Distributors, on average, earn only a modest amount of income.”); *id.* at 15 (“The Complaint’s own documents show that Herbalife makes clear that even active Distributors are likely to earn, at most, only modest commissions income.”). Indeed, Herbalife contends that “no reasonable consumer could have believed that success was guaranteed, or (as with most business ventures) even likely.” MTD at 21.

The concession that the vast majority of Herbalife distributors are unable to generate “significant income” underscores the deceptive nature of Herbalife’s recruiting materials. As we have shown you in the past, those recruiting materials convey the impression that anyone can make significant income as an Herbalife distributor if he or she is willing to devote sufficient time and effort to the business. Such recruiting materials prominently feature testimonials from people who claim to be making very substantial amounts of money as Herbalife distributors, and those distributors are shown enjoying lavish lifestyles and all the trappings of wealth. *See* Compl. ¶¶ 138-50. The reality is very different. As Herbalife now admits, the chances of earning “quit your job type money” as an Herbalife distributor are remote, and the chances of a new Herbalife distributor making enough money to drive around in a Bentley or a Ferrari are zero.

By emphasizing in the motion to dismiss the low probability that a new Herbalife distributor will ever make significant amounts of money, Herbalife confirms that it is a pyramid scheme. This conclusion flows directly from Herbalife’s acceptance of the principle that “pyramid schemes are inherently fraudulent in nature because the futility of the plan is not apparent to the participant,” and that “an endless chain perpetuates itself because the participants do not realize that most are doomed to failure.” MTD at 5 (quotations omitted). Having acknowledged that most of its distributors are likewise “doomed to failure,” Herbalife places itself squarely within its own definition of a pyramid scheme.

Herbalife seeks to avoid responsibility for its misleading recruiting materials by relying on boilerplate disclaimers in small print and on its Statement of Average Gross Compensation, *see, e.g.*, MTD at 10-11, 21, but Herbalife’s position is unpersuasive. As an initial matter, Herbalife ignores established law that boilerplate disclaimers do not immunize a defendant from liability for making deceptive income claims. For example, in *FTC v. Equinox International*, No. CV-S-990979HBR (RLH), 1999 WL 1425373, at *6 (D. Nev. Sept. 14, 1999), the court noted that “Equinox, in its recruitment and training seminars, emphasizes the promise of lucrative rewards for recruiting others. Distributors are given unrealistic hypothetical examples that their profits will increase geometrically if distributors focus on recruitment rather than retail

sales. Equinox's video presentations and certain materials provided by Equinox contain disclaimers as to the amount of profits obtainable. These disclaimers, however, are difficult to read, do not accurately indicate the actual amount of earnings that can be expected and do not immunize Equinox's exaggerated claims of income."¹ The same could be said of Herbalife's recruiting materials, which convey the impression that it is easy to get rich being an Herbalife distributor. For example, in the issue of the *Herbalife Today* magazine distributed in late 2012, Chairman's Club member Paulina Riveros is described as "earning amazing income" and having "a lifestyle that she couldn't have imagined in her wildest dreams." Compl. ¶ 144.

Herbalife's argument that its Statement of Average Gross Compensation neutralizes its misleading recruiting materials is equally misplaced. As we explained in the presentation entitled "Herbalife's Disclosure of Distributor Earnings is Inadequate" (attached as Exhibit C), Herbalife's latest Statement of Average Gross Compensation, published in February 2013, is not only an implicit concession that prior versions of the document in use for many years were misleading, but is itself misleading in numerous respects. *See also* Compl. ¶¶ 158-71.

Second, Herbalife seeks to distance itself from actions of its senior distributors, including members of the Founder's Circle and Chairman's Club, by referring to them as "third part[ies]" and asserting that they are "not associated" with the company. MTD at 10. As a factual matter, Herbalife's position is baseless because these senior distributors are very closely affiliated with the company, and they are prominently featured in Herbalife's recruiting materials. *See, e.g.*, Compl. ¶¶ 151-57. As a legal matter, Herbalife's position is baseless because Herbalife bears responsibility for the actions of senior distributors whom it cloaks with apparent authority to speak on its behalf. As the court held in *FTC v. Five-Star Auto Club*, 97 F. Supp. 2d 502, 527 (S.D.N.Y. 2000), "[f]or purposes of liability under the FTC Act, it does not matter whether Mr. Cole and Mr. Bewley would be considered at law as employees of the company or independent contractors. The law is clear that under the FTC Act, a principal is liable for misrepresentations made by his/her agents (i.e., those with the actual or apparent authority to make such representations) regardless of the unsuccessful efforts of

¹ *See also* *FTC v. Medicor LLC*, 217 F. Supp. 2d 1048 (C.D. Cal. 2002) (holding, with respect to a "results may vary" disclaimer, that "assuming that their advertisements did include such language, the advertisements are still misleading because consumers could reasonably believe that the statements of earnings potential represent typical or average earnings"); *FTC v. Davidson Associates*, 431 F. Supp. 2d 548, 556 (W.D. Pa. 2006) ("The disclaimers used by defendants, both in written and oral form, to the effect that there are no guarantees of financial success or of a license are not sufficiently prominent and unambiguous and do not clearly, conspicuously, and directly address the misrepresentations made regarding defendants' track record, and are, therefore, ineffective."); Guides Concerning the Use of Endorsements and Testimonials in Advertising, 73 Fed. Reg. 72374, 72379 (proposed Nov. 28, 2008) (discussing results of two FTC studies confirming the ineffectiveness of even prominent disclaimers).

the principal to prevent such misrepresentations. Indeed, it would be inappropriate for Defendants to hold out Mr. Cole and Mr. Bewley as Five Star representatives and to reap the fruits from their acts and doings without incurring such liabilities as attach thereto.” See also *FTC v. Medical Billers Network, Inc.*, 543 F. Supp. 2d 283, 319 (S.D.N.Y. 2008); *FTC v. Stefanchik*, No. C04-1852RSM, 2007 WL 1058579, at *8 (W.D. Wash. Apr. 3, 2007) (“It is well-settled that a principal is liable under the FTC Act for misrepresentations made by its agents, even if those agents do not fall within the traditional definition of agency.”).

Third, Herbalife argues that purchases of products by distributors purportedly for their own personal use should be viewed as retail sales in deciding whether Herbalife is a pyramid scheme. See MTD at 14-16. That argument is wrong because it permits Herbalife to reclassify purchases made by failed distributors as retail sales, even if the products end up stored in attics and garages or are dumped at steep discounts on eBay. The argument is also inconsistent with the holding in *Webster v. Omnitrition*, 79 F.3d 776 (9th Cir. 1996), in which the court held that “[i]f *Koscot* is to have any teeth, such a sale cannot satisfy the requirement that sales be to ‘ultimate users’ of a product.” *Id.* at 783 (citing *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106 (1975)). Herbalife tries to sidestep this holding by arguing that it was “fundamentally tied to the facts of Omnitrition and its plan’s ‘recruitment focus’” (MTD at 15), but that argument is unavailing given the “recruitment focus” of Herbalife’s own marketing plan.

Recent statements by the FTC have reemphasized the critical role of retail sales to customers outside the distribution network in determining whether a multi-level marketing company constitutes an illegal pyramid scheme. For example, on January 24, 2013, the FTC and three state attorneys general filed a complaint alleging that Fortune Hi-Tech Marketing (“FHTM”) was an illegal pyramid scheme. See Complaint in *FTC v. Fortune Hi-Tech Marketing, Inc.*, No. 13cv578 (N.D. Ill.) (“FHTM Compl.”), attached as Exhibit D. That Complaint alleges as follows:

36. FHTM induces new recruits to join FHTM by representing that such recruits will be able to resell FHTM products and services to people not affiliated with FHTM for a profit and simultaneously earn large commissions. FHTM claims that its representatives will be able to easily sell its products and services to consumers not affiliated with FHTM. In fact, few of FHTM’s products and services are ever sold to anyone other than the Reps themselves. Furthermore, Reps receive minimal financial rewards from FHTM for selling the products and services to outside consumers.

FHTM Compl. ¶ 36.

On April 1, 2013, the FTC filed its opposition brief in an appeal from a decision embracing the FTC's position that BurnLounge, Inc. was an illegal pyramid scheme. *See* 2d Cross-Appeal and Answering Br. of Pl.-Appellee FTC, *FTC v. BurnLounge, Inc.*, Nos. 12-55926, 12-56197, 12-56288 (9th Cir.) ("BurnLounge Br."), attached as Exhibit E. In that brief, the FTC confirms that sales to distributors do not constitute retail sales: "If *Koscot* is to have any teeth, such a sale *cannot satisfy the requirement that sales be to 'ultimate users' of a product.*" BurnLounge Br. at 42 (emphasis in original) (quoting *Omnitrition*, 79 F.3d at 783). In its motion to dismiss, Herbalife ignores the FTC's interpretation of *Omnitrition* and the need to establish that Herbalife has actual retail sales. Despite Herbalife's denials, it plainly matters that relatively few Herbalife products are sold to people other than aspiring Herbalife distributors.

Fourth, Herbalife ignores the allegations in the complaint that Herbalife artificially inflates the Suggested Retail Price ("SRP") of its products, which has the dual effect of masking the recruiting focus of Herbalife's marketing plan and misleading potential distributors into believing they can make money selling the products at retail. *See, e.g.*, Compl. ¶¶ 26-27, 41, 172-74. Rather than answering these allegations, which are true, Herbalife pretends they do not exist: "[t]here is no allegation, other than a few conclusory assertions, that Herbalife inflates the prices at which its Distributors sell products." MTD at 3. As the plaintiff in *Bostick* will be able to demonstrate, Herbalife inflates the SRP of its products—upon which Herbalife calculates various distributor discounts, fees and rewards—but that SRP bears no relationship to the prices at which distributors actually sell Herbalife products.

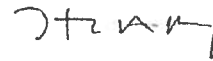
Fifth, Herbalife's argument that it is not a pyramid scheme because it merely "encourages" but does not "require[]" large inventory purchases by distributors in order to qualify for Supervisor, *see* MTD at 12-13, is at odds with the maxim that "[w]hether a multi-level marketing plan operates as illegal pyramid scheme is determined by how it functions in practice." *Whole Living, Inc. v. Tolman*, 344 F. Supp. 2d 739, 744 (D. Utah 2004) (citations omitted). In practice, Herbalife distributors are strongly encouraged to make large inventory purchases in order to qualify as a Supervisor quickly and thereby become eligible to receive recruiting rewards. *See, e.g.*, Compl. ¶¶ 190-93.

Sixth, Herbalife argues that the plaintiff in *Bostick* cannot rely on *Omnitrition* because "a Distributor can become a supervisor (which is required to earn certain types of commissions) 'without purchasing or reselling any Herbalife products.'" MTD at 12. Of course, the fact that a distributor, theoretically, can become a Supervisor based solely on purchases made by lower-level distributors who were recruited by the relevant distributor into Herbalife merely confirms that Herbalife pays compensation which is facially unrelated to the sale of product to ultimate consumers, *i.e.*, precisely the sort of "recruitment focus" that led the court to conclude that *Omnitrition's* marketing plan "appears to be a pyramid scheme." *See Omnitrition*, 79 F.3d at 782.

Seventh, in an effort to avoid the RICO claim asserted in the *Bostick* case, Herbalife concedes that “investments in a pyramid scheme constitute an ‘investment contract,’” both under California law and under federal securities laws. MTD at 23-24. Because Herbalife is a pyramid scheme—as Herbalife effectively concedes by acknowledging that the vast majority of its distributors fail to earn significant income—the operation of Herbalife’s marketing plan is subject to attack under securities laws as well as consumer protection laws. *See* MTD at 23-24 (quoting *Omnitrition*, 79 F.3d at 784 (“We hold that operation of the pyramid scheme violates 10b-5’s prohibition against engaging in an ‘act, practice or course of business which operates as a fraud or deceit upon any person.’”))).

In short, rather than establishing that the attacks on its marketing plan are without merit, Herbalife’s motion to dismiss confirms that Herbalife is an inherently fraudulent pyramid scheme.

Yours sincerely,

A handwritten signature in black ink, appearing to read "St. L. Holley", written in a cursive style.

Steven L. Holley

(Attachments)

SULLIVAN & CROMWELL LLP

TELEPHONE: 1-212-558-4000
FACSIMILE: 1-212-558-3588
WWW.SULLCROM.COM

*125 Broad Street
New York, NY 10004-2498*

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October 1, 2013

Via FedEx

Lois C. Greisman, Esq.,
Associate Director, Division of Marketing Practices,
Federal Trade Commission – Bureau of Consumer Protection,
600 Pennsylvania Avenue, N.W.,
Washington, D.C. 20580.

Re: Herbalife

Dear Lois:

I write on behalf of our client Pershing Square Capital Management, L.P. (“Pershing Square”) to bring to your attention the enclosed bankruptcy petition filed by senior Herbalife distributor Michael Burton and his wife Michelle in the Eastern District of Texas, Case No. 13-41669.

By way of background, Michael Burton is a member of Herbalife’s Senior Executive President’s Team and part of the downline of Chairman’s Club member Dan Waldron. I enclose a disc containing slides that detail some of the deceptive practices engaged in by Burton and Herbalife’s complicity in those practices.¹

Burton’s bankruptcy petition is interesting in several respects, including the following:

- Burton, who tells potential recruits that he has made millions of dollars with Herbalife and enjoys a lavish lifestyle, has assets of \$74,135.92 and liabilities in excess of \$7.1 million.

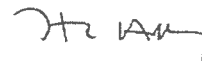
¹ Sources for the materials featured in those slides are provided in the Comments field.

- Burton owes the Internal Revenue Service an enormous amount of money, including \$938,097 for the years 2004-2008, \$63,410 for 2009, and an undetermined amount for the years 2010-2012.
- Burton owes exactly \$500,000 to a total of ten individuals or entities. These debts, which are all in the amounts of \$25,000, \$50,000 or \$100,000, are either not described at all in the bankruptcy petition or are vaguely described as "Debt of Corporate Affiliate." Two of the creditors on these debts are based in the Bahamas.
- Burton owes money not only to his own online recruiting businesses (which are described in the enclosed slides), but also owes money to other companies that we believe are involved in selling leads and other business tools to Herbalife distributors, including eHome Business Network (associated with Anthony Powell) and On-Line Marketing Solutions/Centurion Media (associated with Shawn Dahl).
- Burton owes a very large amount of money to courier services, including \$196,110 to FedEx, \$405,311 to UPS and \$288,000 to Worldwide Express.
- Burton owes \$1,472,203 to something called LG Technology and \$746,374 to something called Revshare, both of which are based at the same address in Temecula, California.

Similar to John Beall, who recently went through personal bankruptcy despite being a senior lieutenant under Anthony Powell, Burton professes in his videos to be making millions of dollars through Herbalife while in fact incurring millions of dollars of debt (much of which appears to be related to operating his Herbalife business.)

In short, Burton's bankruptcy petition provides a number of interesting angles for investigating the activities of senior Herbalife distributors, many of whom are connected with one another in various ways and are likely to have the same issues as Burton with the Internal Revenue Service and other creditors.

Yours sincerely,



Steven L. Holley

(Enclosures)

EXHIBIT E

Witherington, James

From: Todaro, Christine
Sent: Monday, July 15, 2013 11:47 AM
To: Greisman, Lois C.; Ammerman, Janet; Vaca, Monica E.; Anguizola, Roberto
Subject: RE: FYI: NY Post story re Herbalife

I find it interesting that the story says Jessica may attend because I didn't tell Sally that until this morning.

From: Greisman, Lois C.
Sent: Monday, July 15, 2013 10:54 AM
To: Todaro, Christine; Ammerman, Janet; Vaca, Monica E.; Anguizola, Roberto
Subject: FW: FYI: NY Post story re Herbalife

From: Dorman, Frank
Sent: Monday, July 15, 2013 10:22 AM
To: Greisman, Lois C.
Subject: FYI: NY Post story re Herbalife

http://www.nypost.com/p/news/business/groups_ftc_to_talk_herbalife_probe_keVtZm0e8x3EPhOZHgT4aJ

EXHIBIT F

NEW YORK POST

Groups, FTC to talk Herbalife Probe

By Michelle Celarier

July 12, 2013

Consumer advocates are planning to ask regulators on Monday for their commitment to investigate allegations that Herbalife is a pyramid scheme, The Post has learned.

The National Consumers League — the first group to call for an investigation in a March 12 letter — asked for the meeting with the Federal Trade Commission, according to sources. The Hispanic Federation, the League of United Latin American Citizens (LULAC) and Consumer Action are also expected to attend.

The activists are set to meet with Lois Greisman, the FTC's head of consumer fraud. Jessica Rich, the new director of the Bureau of Consumer Protection, may also be there.

The debate about Herbalife has been raging since hedge-fund activist Bill Ackman called the company a pyramid scheme in December and placed a \$1 billion short bet against the stock.

Herbalife has consistently denied his charges.

Still, at least six different letters have been sent to the FTC asking it to probe Herbalife's practices.

Most of the concern has come from the Hispanic community, including local, state and federal lawmakers as well as consumer groups concerned that Herbalife is targeting minorities.

"I'm mad," said LULAC's National Executive Director Brent Wilkes. "I've seen Latinos ripped off by banks and others, but this scheme really takes the cake."

After talking with Herbalife "and not getting the answers I wanted to hear, I concluded they are defrauding upwards of 300,000 Latinos a year," he said.

Another consumer activist planning to attend the meeting said, "We think the problem is getting worse, and we think that the FTC is really important."


Several sources told The Post that they believe the FTC is reluctant to launch an investigation of Herbalife because of the company's financial resources and legal firepower.

Some FTC officials have even suggested to consumer activists that a plaintiff lawsuit against Herbalife would be a preferable way to address their concerns, according to sources.

EXHIBIT M

Retrophin Founder Said Probed Over Securities Dealings

Don't Miss Out —

Follow us on: 

by Christie Smythe
2:32 PM EST
January 7, 2015



Martin Shkreli sits behind a chess board in New York, on Aug. 10, 2011.
Photographer: Paul Taggart/Bloomberg

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<http://www.bloomberg.com/news/articles/2015-01-07/retrophin-founder-said-probed-on-possible-securities-violation>



FOMC Preview: From Patience to Reasonable Confidence



The Fuzzy, Insane Math That's Creating So Many Billion-Dollar Tech Companies



Which Countries Are Most Vulnerable to a China Slowdown?

(Bloomberg) -- Retrophin Inc. founder Martin Shkreli, replaced last year as chief executive officer of the biopharmaceutical company, is under investigation by U.S. prosecutors in Brooklyn, New York, for possible securities law violations, according to a person familiar with the matter.

Shkreli, a one-time short-seller who started New York-based Retrophin at 28, left his CEO post in September. Investors claimed in later lawsuits against him and the company that he distributed stock without the consent of shareholders.

Shkreli said in an interview today that he's unaware of the probe and denied wrongdoing, including allegations in the lawsuits. Shkreli said he had a "difference of opinion" with his board over investing capital and stock options.

... reported by
BloombergBusiness Now Reading: **Retrophin Found** t is no longer

Shkreli also faces a probe by the U.S. Securities and Exchange Commission, according to the

person, who requested anonymity because the investigation isn't public.

Nellin McIntosh, a spokeswoman for U.S. Attorney Loretta Lynch in Brooklyn; Judith Burns, a spokeswoman for the SEC; and Tom Fernandez, a spokesman for Retrophin, declined to comment on the investigations.

Fund Manager

Shkreli, who previously managed hedge fund MSMB Capital Management LLC, has faced criticism of his trading. In 2012, Citizens for Responsibility and Ethics in Washington, a watchdog group, asked U.S. Attorney Preet Bharara in Manhattan to investigate whether Shkreli manipulated shares of biotechnology and pharmaceutical companies by badmouthing them in order to drive down prices.

The group claimed Shkreli made postings on the website SeekingAlpha.com that spread "unfounded and inaccurate rumors about drugs owned by companies he was shorting," and that he "inserted himself" into the Food and Drug Administration approval process for pending pharmaceuticals.

Betsy Feuerstein, a spokeswoman for Bharara, declined to comment on whether Shkreli was investigated. Stephen Santulli, a spokesman for the watchdog group, said in an e-mail that the group didn't hear back after making the request.

According to an April 2014 profile in Bloomberg Businessweek, Shkreli, the child of working-class immigrants from Albania and Croatia, grew up in the Sheepshead Bay section of Brooklyn. As a college intern at a hedge fund formerly managed by Jim Cramer, the host of CNBC's Mad Money, he made a name for himself by successfully recommending the short-sale of a biotech stock, according to Businessweek.

Retrophin focuses on the development, acquisition and sales of therapies for treating rare and serious diseases. It transitioned into a publicly traded company through a reverse merger with Desert Gateway Inc. in 2012. The company acquired Manchester

Pharmaceuticals LLC for a total of \$625 million last year

1. RETROPHIN REPORTEDLY PAID A TOTAL OF \$62.5 MILLION LAST YEAR.

To contact the reporter on this story: Christie Smythe in Brooklyn at csmythe1@bloomberg.net

To contact the editors responsible for this story: Michael Hytha at mhytha@bloomberg.net
David Glovin, Andrew Dunn

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The FTC declined to comment.

Herbalife has been sued over allegations that it is a pyramid scheme five times. It was found guilty in a Belgian court, a ruling that is on appeal. Other cases have been settled out of court while one is pending.

Critics say that litigation has not addressed their issues.

“Our plaintiffs have been injured because the FTC is not actively involved in regulating this industry,” said Phil Dracht, the lawyer for a failed California distributor who sued Herbalife in April.

EXHIBIT G

03

ORIGINAL 1

1 UNITED STATES SECURITIES AND EXCHANGE COMMISSION

2

3

4 In the Matter of:)

5) File No. HO-9523

6 GOTHAM PARTNERS MANAGEMENT)

7 COMPANY, LLC)

8

9 WITNESS: William Ackman

10

11 PAGES: 1 through 189

12

13 PLACE: 450 5th Street, N.W., Room 1403

14 Washington, DC

15

16 DATE: Thursday, June 5, 2003

17

18

19 The above-entitled matter came on for hearing, pursuant

20 to notice, at 8:55 a.m.

21 Diversified Reporting Services, Inc.

22 (202) 467-9200

23

24

25

1 APPEARANCES:

2 On behalf of the Securities and Exchange Commission:

3 (b)(7)(C)

4 (b)(7)(C)

5 (b)(7)(C)

6 Securities and Exchange Commission

7 Division of Enforcement

8 450 Fifth Street, N.W.

9 Washington, D.C. 20549

10 (202) 942-7189

11

12 On behalf of the Witness:

13 (b)(7)(C)

14 (b)(7)(C)

15 Fried, Frank, Harris, Shriver and Jacobson

16 One New York Plaza

17 New York, NY 10004

18 (212) 859-8000

19

20

21

22

23

24

25

C O N T E N T S

1			
2	WITNESSES:		EXAMINATION
3	William Ackman		194
4			
5	EXHIBITS:	DESCRIPTION	IDENTIFIED
6	43	Research report of MBIA, prepared	
7		by Gotham, "Is MBIA Triple-A"	278
8			
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1 Q And what happened after she wrote that story?

2 A I started writing my report.

3 Q Did you talk to any other reporters, other than
4 Henny Sender?

5 A During this period of time?

6 MR. STEIN: Prior to the report?

7 BY MR. KINSEY:

8 Q Yes. Prior to the release of the research report.

9 A I think a couple of days before the Journal
10 published the story, I told Allison Cowan, at the New York
11 Times, on what I would call an embargoed basis, that I had
12 given the story to the Journal sort of as a courtesy because
13 I had a relationship with her. I explained to her why I had
14 given it to the Journal. And I think I mentioned it to a
15 Reuters person, although I didn't identify the company, about
16 a week before the story came out.

17 Q But your primary motivation for giving the story to
18 Henny Sender was to help your position at Gotham with respect
19 to your investment in MBIA.

20 A To expose the facts in MBIA. And we thought that
21 would lead to -- we would profit by virtue of the investment
22 we had taken.

23 Q All right. What happened after -- did you talk to
24 anybody else, other than Henny Sender, about MBIA before you
25 published your report?

1 Q And Mr. Steinberg is one of your investors?

2 A Yes. They also own a New York State regulated
3 insurance company. And I had spent time talking to Joe about
4 the legal -- insurance related legal issues at MBIA. And he
5 arranged a meeting through their principal regulatory person.
6 They called the superintendent of insurance and set up a
7 meeting for me to meet with the person responsible for
8 overseeing MBIA.

9 Q Okay. Let's go back. Mr. Steinberg. What is his
10 position?

11 A He is a CEO of Leucadia National Corp.

12 Q And what is the name of the insurance company?

13 A They have a company called Empire Insurance. They
14 may own other insurance companies, but that is the New York
15 one that I am aware of.

16 Q So when you were doing -- during the course of your
17 research for this report, you talked to Mr. Steinberg --

18 A Yes.

19 Q -- about MBIA.

20 A I spoke -- he is one of the investors in Gotham
21 Credit Partners.

22 Q And so he suggested that you talk to the New York
23 Insurance Department.

24 A That is correct.

25 Q And what was -- why did he suggest that, do you

1 know?

2 A I mean, it is really the same. You know, as I
3 spoke about in my last interview, it was, I call, shining
4 sunlight on the problem. If the New York State Insurance
5 Department came to the same conclusion we did about various
6 insurance related issues at the company, it might shut down
7 MBIA and that would certainly help our investment.

8 Q What did Mr. Steinberg tell you about -- when you
9 talked to him about this insurance issue that you have at
10 MBIA, what did he tell you?

11 A He was incredulous.

12 Q Well, let's talk about the issue for a minute.
13 What is the insurance issue that you found in the course of
14 research that you thought was a problem?

15 A Well, there are a couple of issues, but the one I
16 was focused on from a pure legal -- there is a disclosure
17 issue I would say with respect to the SPVs and the SPV debts
18 and there is a legal issue that is relevant both to MBIA as a
19 monoline insurance company and MBIA as an insurance -- New
20 York State insurance company generally. And the issue is --

21 Q Well, focus on the legal issue first.

22 A Okay.

23 Q Okay?

24 A Fine.

25 Q All right.

1 Q Did you tell Whitney Tilson about your meeting at
2 the insurance?

3 A I may have. He is one of the Gotham Credit
4 Partners.

5 Q Oh, that is right. What about Mr. Einhorn?

6 A It is possible. I don't remember if I specifically
7 did.

8 Q What about Mr. Spier?

9 A Yes.

10 Q Okay. How do you know Alice Schroeder?

11 A How do I know her now or how did I know her then?

12 Q How did you first meet her?

13 A I sent her an e-mail.

14 Q Was it your -- you sent her an e-mail with respect
15 to MBIA?

16 A Yes.

17 Q When did that -- when did you do that?

18 A November.

19 Q And why did you do -- why did you send her an
20 e-mail?

21 A I thought it would be valuable to have. She is the
22 number one ranked or was the number one ranked insurance
23 analyst. She is the only analyst that Buffett sort of
24 allowed to write a research report on Berkshire Hathaway.
25 And that means something to me. And I had read a lot of the

1 stuff that she had written on the insurance industry and some
2 of the stuff they had written -- that one of her analysts had
3 written on MBIA. And I liked the quality of her work. And I
4 thought if I could convince her that I was right, it would be
5 very valuable to have the number one ranked analyst agree
6 with me.

7 Q And what was the substance of your e-mail to her?

8 A I wrote her an e-mail sort of introducing myself
9 saying, "I am writing about MBIA and, you know, there is some
10 very significant issues at MBIA."

11 Q All right. So your primary motivation in
12 contacting Ms. Schroeder was essentially to tell her what you
13 had found in your research and basically help your investment
14 position in MBIA.

15 A Yes. It would help me a lot if someone -- some
16 third party, particularly someone perceived as more objective
17 than I am, adopted our views.

18 Q After you sent her the e-mail in November, did she
19 respond?

20 A She did.

21 Q How did she respond?

22 A She left me a voice mail.

23 Q Okay. And what happened?

24 A Well, she left me a voice mail saying that she was
25 very adverse to being part of some market manipulation scheme

1 by a short seller, but she was going to check out my
2 references and get back to me as to whether she would meet.

3 Q And what happened after that?

4 A I called Byron Wien, who is, I guess, their market
5 strategist. He is a guy who has been there for 35 years and
6 I have known 10. Not incredibly well, but he knew of me in
7 the investment business. And I asked Byron if he would call
8 Alice and just vouch for me as an honorable, you know, person
9 and also someone who is a good analyst.

10 And, you know, and then Alice did call me back
11 later. She had spoken to a number of people that -- I put
12 Joe Steinberg and Ian Cumming on that list as well as Jack
13 Byrne at White Mountain and a couple of other well known
14 people in the insurance business. She called back and said
15 she checked out the references, they checked out and that she
16 would be willing to meet and she was interested to hear what
17 I had to say. And we set up a meeting.

18 Q And when did you meet with her?

19 A I am not sure. Yes, that was a telephone call. I
20 am pretty sure about that. Shortly thereafter.

21 Q And --

22 A It was in mid November.

23 Q Where was the meeting held?

24 A At her office at Morgan Stanley in a conference
25 room.

EXHIBIT H

THE WALL STREET JOURNAL.

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<http://www.wsj.com/articles/prosecutors-interview-people-tied-to-ackman-in-probe-of-potential-herbalife-manipulation-1426196822>

DEALS & DEAL MAKERS

Prosecutors Interview People Tied to Ackman in Probe of Potential Herbalife Manipulation

U.S. attorney's office and FBI are probing remarks about Herbalife

By **CHRISTOPHER M. MATTHEWS**

Updated March 12, 2015 6:18 p.m. ET

Federal prosecutors and the Federal Bureau of Investigation are probing potential manipulation of Herbalife Ltd. stock and have interviewed people hired by hedge-fund billionaire William Ackman, who has led a long-running campaign against the nutritional-products company, people familiar with the matter said.

Prosecutors in the Manhattan U.S. attorney's office and New York field office of the FBI have conducted interviews and sent document requests in recent months in connection with the investigation, which is looking into whether people, including some hired by Mr. Ackman, made false statements about Herbalife's business model to regulators and others in order to spur investigations into the company and lower its stock price, the people said. Mr. Ackman's firm, Pershing Square Capital Management LP, has made a huge bet on Herbalife shares declining.

One of the people familiar with the matter said investigators are scrutinizing public statements and allegations relayed to regulators by the array of consultants and activists who have lobbied against Herbalife, as well as any connections or potential collaboration between those people and Pershing Square.

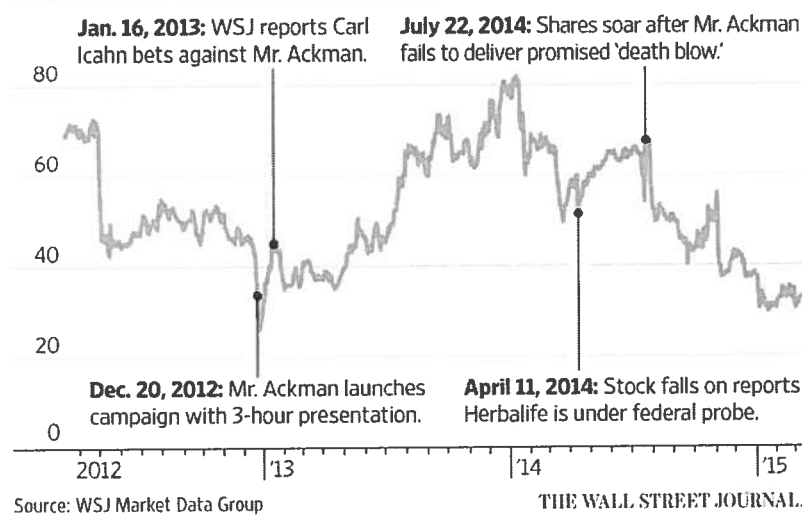
Neither Mr. Ackman nor Pershing Square has been served with a subpoena or

been visited by FBI agents in connection with the probe, another person familiar with the matter said. The investigation could end with no charges being filed.

Eye of the Storm

Herbalife stock has zigged and zagged since investor William Ackman targeted the firm.

\$100



Market manipulation can be a fraught area of the law, legal experts say. Attempting to discredit a company, even through false statements, isn't illegal, nor is paying others to make such statements on your behalf. Market manipulation cases rise and fall on the "intentionality and deliberateness" of making false

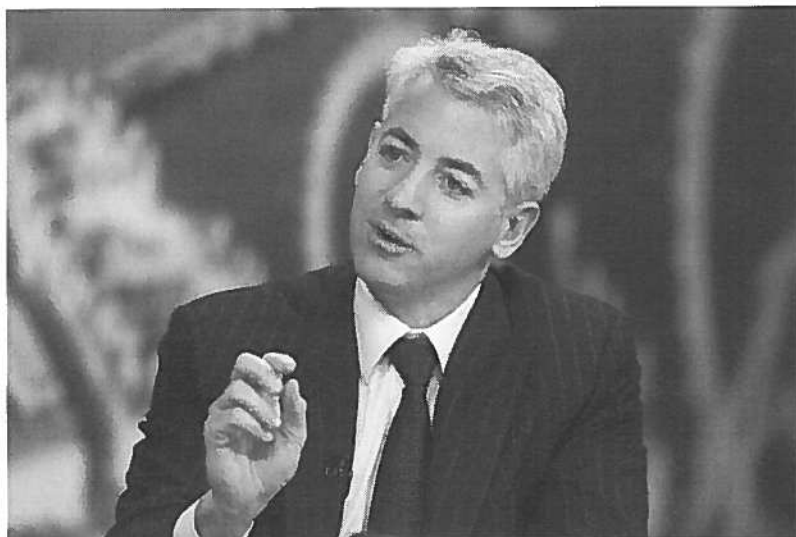
statements to affect a stock price, said Columbia Law School Prof. Daniel Richman.

In a statement, a Pershing Square spokesman said the firm was proud of "exposing the pervasive victimization by Herbalife of millions of people and would welcome any scrutiny of those efforts."

"We have been completely transparent about our position and our research, and we have acted lawfully in every respect," he said.

Herbalife Executive Vice President Alan Hoffman said in a statement that Mr. Ackman and Pershing Square had spent tens of millions "orchestrating a false and fabricated attack against Herbalife."

"Mr. Ackman has a \$1 billion bet against Herbalife and a direct financial interest in hurting our company," Mr. Hoffman said.



William Ackman, founder and chief executive of Pershing Square Capital Management LP, during a Bloomberg Television interview in January. *PHOTO: BLOOMBERG NEWS*

MORE READING

- Ackman Says Buying Salix at \$170 Is a Mistake (<http://blogs.wsj.com/moneybeat/2015/03/13/ackman-says-buying-salix-at-170-is-a-mistake/>)

-

The investigation is a significant turn in the long-running battle over Herbalife. The Federal Trade Commission has been investigating for at least a year allegations made by Mr. Ackman and others that Herbalife is a pyramid scheme. That probe is continuing, as is a related investigation by the Securities and Exchange Commission that is focused on whether the company's business practices have violated any securities laws.

Spokesmen for the SEC and the trade commission declined to comment.

The New York-based investigation is the first known criminal probe into potential market manipulation of Herbalife's stock. Spokesmen for the FBI and the Manhattan U.S. attorney's office declined to comment.

Mr. Ackman has led a high-profile campaign to prove Herbalife is a pyramid scheme, backing it up with a \$1 billion bet that the company's stock will fall. Herbalife has denied the accusations and accused the investor of manipulating its stock.

Both sides have been vociferous in their attacks on each other and have pushed

regulators to look at the other's actions.

After publicly coming out against Herbalife in 2012, Mr. Ackman says he has spent more than \$50 million to research and publicize his fund's negative view of Herbalife. He has hired a team of lobbyists and consultants to contact a host of politicians and regulators and encourage investigations into the company. Herbalife, in turn, has said it has spent more than \$54 million defending itself and pushing for investigations into Pershing Square's actions.

In a series of public presentations, Mr. Ackman has made his case that the company is a pyramid scheme in which millions of salespeople have failed to make money selling its products, while top recruiters have taken home fortunes for signing up sellers.

"Under any real examination, Herbalife's business cannot survive," a Pershing Square spokesman said Wednesday. "More than 1,000 U.S. victims have come forward."

"We are confident in the strong fundamentals of our business model and have remained committed to helping people and communities improve their nutrition," Herbalife's Mr. Hoffman said.

The battle has captivated Wall Street for more than two years. Mr. Ackman first made a presentation, titled "Who wants to be a Millionaire" and disclosing his so-called short bet against the stock, in December 2012, sending shares plunging. In a short bet, investors typically borrow stock and then sell it, hoping the share price falls and they will be able to buy stock more cheaply to return to the lender, pocketing the difference.

Herbalife's stock soared in the year after Mr. Ackman established his big short position, as investors like Carl Icahn, George Soros and Daniel Loeb established bullish positions, leaving Mr. Ackman with big losses on paper.

The stock fell after the company said in late February that its sales were flat in the last three months of 2014 and that its 2015 profit would be hurt by changing foreign-exchange rates, particularly in Venezuela. Underwhelming earnings reports in July and November also sent the company's shares lower. The stock, which was trading around \$65 a share in mid-July, priced Thursday at \$33.30.

At recent prices, Mr. Ackman's bet would be profitable, though his expenses on

the investment have driven up his initial cost, he said earlier this year. He has pledged to continue his campaign against Herbalife until the stock is wiped out.

Prosecutors and the FBI began looking at the allegations from both camps in early 2014, according to people familiar with the matter. The investigation's focus shifted to potential market manipulation by Herbalife's accusers around the beginning of this year, one of the people said.

With about \$20 billion in assets under management, Mr. Ackman manages one of the largest activist funds, which buy stakes in companies and urge changes like stock buybacks, management shake-ups or outright sales.

Activists, consultants and others have submitted letters to regulators and politicians around the country accusing Herbalife of wrongdoing and asking for investigations.

In Connecticut, for example, the office of Attorney General George Jepsen received about 26 letters accusing Herbalife of being a pyramid scheme and asking for an investigation, Mr. Jepsen said in an interview. Pershing Square paid a government-relations firm in that state to lobby Mr. Jepsen and other offices, according to state lobbying disclosures. Many of the letters were submitted by that firm, Mr. Jepsen said.

Mr. Jepsen described the majority of the letters as nearly identical "form letters." He said his office investigated the allegations in every letter and was unable to substantiate any of them. His office has no active investigation into Herbalife, Mr. Jepsen said.

There isn't anything illegal about directing a letter-writing campaign or submitting form letters, a common lobbying tactic that is protected by the First Amendment.

Mr. Jepsen, who said he met with Mr. Ackman in October 2013 to discuss Herbalife, said his office didn't form any conclusions about Herbalife's business model and could re-open an investigation if it received "organic complaints" not solicited by a letter-writing campaign. He also said he had met with representatives of Herbalife.

—David Benoit contributed to this article.

Write to Christopher M. Matthews at christopher.matthews@wsj.com

Corrections & Amplifications:

Investor William Ackman has pledged to continue his campaign against Herbalife until the stock is wiped out. An earlier version of this article incorrectly stated Mr. Ackman had pledged to hold his personal part of the Herbalife investment until the stock is wiped out.

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EXHIBIT I



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
STATION PLACE
100 F STREET, NE
WASHINGTON, DC 20549-2736

Office of FOIA Services

March 18, 2013

Jeffrey Gardner

Re: Freedom of Information Act (FOIA), 5 U.S.C. § 552
Request No. 13-04533-FOIA

Dear Mr. Gardner:

This letter partially responds to your request, dated and received in this office on February 19, 2013, for records of certain investment/trading activity regarding Pershing Square Capital Management, L.P., Herbalife, and/or William Ackman, from December 1, 2012 through February 15, 2013.

We are withholding records responsive to your request under 5 U.S.C. § 552(b)(7)(A), 17 C.F.R. § 200.80(b)(7)(i). This exemption protects from disclosure records compiled for law enforcement purposes, the release of which could reasonably be expected to interfere with enforcement activities. Since Exemption 7(A) protects the records from disclosure, we have not determined if other exemptions apply. Therefore, we reserve the right to assert other exemptions when Exemption 7(A) no longer applies.

Because the underlying circumstances may change, we may later disclose some of the exempt records. If you wish, you may request them again six months from the date of this letter.

I am the deciding official regarding this adverse determination. You have the right to appeal our decision to our General Counsel under 5 U.S.C. § 552(a)(6), 17 C.F.R. § 200.80(d)(5) and (6). Your appeal must be in writing, clearly marked "Freedom of Information Act Appeal," and should identify the requested records. The appeal may include facts and authorities you consider appropriate.

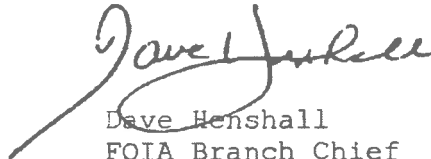
Jeffrey Gardner
March 18, 2013
Page Two

13-04533-FOIA

Send your appeal to the Office of FOIA Services of the Securities and Exchange Commission located at Station Place, 100 F Street NE, Mail Stop 2736, Washington, D.C. 20549, or deliver it to Room 1120 at that address. Also, send a copy to the SEC Office of the General Counsel, Mail Stop 9612, or deliver it to Room 1120 at the Station Place address.

We are still consulting with other Commission staff regarding information that may be responsive to your request. In the interim, if you have any questions, please contact Clarissa Anderson of my staff at andersonc@sec.gov or (202) 551-8315. You may also contact me at foiapa@sec.gov or (202) 551-7900.

Sincerely,



Dave Henshall
FOIA Branch Chief

EXHIBIT J

CREW | citizens for responsibility and ethics in washington

February 9, 2011

By Facsimile (without exhibits) (202-772-9279) and hand-delivery

Robert Khuzami
Director
Division of Enforcement
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Dear Mr. Khuzami:

Citizens for Responsibility and Ethics in Washington (CREW) requests that the Securities and Exchange Commission (SEC) open an investigation into the short-selling activities of hedge fund managers to determine if they have been illegally manipulating the market price of stock in the for-profit education industry. Publicly available data as well as documents CREW obtained through a Freedom of Information Act (FOIA) request to the U.S. Department of Education suggest substantial and highly suspicious market activity in the for-profit industry and behind-the-scenes efforts by short-sellers to manipulate that market.

CREW was first alerted to this problem by the congressional testimony of Steven Eisman, a hedge fund manager for FrontPoint Financial Services Fund and known short-seller of stocks in for-profit education companies, before the Senate Committee on Health, Education, Labor and Pensions on June 24, 2010. Despite a complete lack of expertise in education policy, Mr. Eisman sought to be included as a committee hearing witness, during which he offered a scathing attack on the for-profit education industry. Describing that industry as “fundamentally unsound,” Mr. Eisman predicted that over the next 10 years, defaults of Title IV loans would total \$275 billion.¹ Of note, although Mr. Eisman acknowledged during the Senate hearing that his hedge fund has shorted stocks of certain for-profit colleges, he did not identify any specific companies he was shorting or the dollar amount of short positions he held, nor did anyone ask him to do so.² After

¹ Testimony of Steven Eisman before the U.S. Senate Committee on Health, Education, Labor and Pensions, June 24, 2010, available at <http://help.senate.gov/hearings>.

² See David A. Kaplan, [Short-Sellers Get Snagged in Education Litigation](#), *Fortune.com*, October 16, 2010, available at http://money.cnn.com/2010/10/15/news/eisman_education_lawsuit.fortune/index.htm.

Mr. Eisman's congressional testimony, stocks of for-profit companies fell significantly.³ This market reaction was predictable given that shares in for-profit education institutions also fell several weeks earlier, when Mr. Eisman offered a similar characterization of for-profit education institutions as resting on shaky financial footing in a May 26, 2010 speech at the Ira Sohn Investor Conference, "Subprime Goes to College."⁴

Documents CREW obtained from a lawsuit brought to compel the Department of Education to comply with its FOIA obligations reveal that beyond his congressional testimony, Mr. Eisman worked actively behind the scenes to affect the outcome of Education's regulatory process. Not only did Mr. Eisman meet with top Education Department officials leading the regulatory charge (by telephone and in-person) in early April 2010, including then Deputy Undersecretary Robert Shireman, he also circulated widely within the Education Department analyses he and his firm prepared of the for-profit education industry.⁵ This was all part of his lobbying effort for specific and more stringent gainful employment regulations that, if adopted, are likely to have a substantial negative effect on the market price of shares in for-profit education companies.⁶ As someone who is neither regulated by nor affected directly by the for-profit regulations, Mr. Eisman appears to have injected himself into the agency's process for the sole purpose of causing a specific outcome to advance his own financial interests.

³ For example, shares of the Apollo Group, the parent company of the University of Phoenix, were trading at \$46.33 per share at the close of June 23, 2010 – the day before Mr. Eisman's congressional testimony – and had dropped to \$43.75 per share by the close of June 25, a drop in value of over 9.4%. See <http://www.bloomberg.com/apps/quote?ticker=APOL:US>. The overall decline in the stocks of for-profit education companies in the 24 hours following Mr. Eisman's congressional testimony has been placed at between 6% and 8%. Kaplan, *Fortune.com*, Oct. 16, 2010.

⁴ See Kaplan, *Fortune.com*, Oct. 16, 2010.

⁵ At a speech Mr. Shireman gave to state regulators several weeks after this meeting, which Mr. Shireman attended by telephone, he borrowed a page directly from Mr. Eisman's "Subprime Goes to College" theme by comparing the for-profit education industry to Wall Street firms responsible for the financial meltdown. See Comparing Higher Ed to Wall Street, *Inside Higher Ed*, April 29, 2010 (attached as Exhibit A).

⁶ The specific steps taken by Mr. Eisman and others acting on his behalf are set forth in CREW's letter of January 19, 2011, to Secretary of Education Arne Duncan requesting an investigation into the role hedge fund managers and outside interest groups have played in the agency's formulation of regulations governing the for-profit education industry (Duncan Letter). A copy of the Duncan letter is attached as Exhibit B.

Additional documents suggest other hedge funds also shorting stocks in the for-profit education industry pursued similar strategies. For example, emails show a lobbyist and analysts for CPMG, a Dallas-based hedge fund, also met with Education officials on these issues and worked with them to gather student testimonials designed to illustrate the problems with for-profit education institutions.⁷ CPMG's criticism of the for-profit education industry was aided by research put together by Alternative Research Services, a firm that has openly acknowledged its underlying financial motivation in seeking stock prices decrease.⁸ Another hedge fund short-selling stock in the for-profit education industry, QuilCap Corp., wrote to the Education Department with concerns over the business models used by certain publicly traded for-profit schools.⁹ Like FrontPoint, neither CPMG nor QuilCap is directly affected by the regulations in question, and both appear to be attempting to enhance their financial interests through actions likely to negatively affect the market price of for-profit education institutions.

The for-profit education industry, although a discrete segment of the financial market, generates substantial revenue. Correspondingly, stocks in for-profit education companies have suffered substantial losses dating back to Mr. Eisman's June 24, 2010 congressional testimony. One financial services firm that invests in the for-profit industry has calculated that stocks fell by \$7.9 billion from June 21 through December 17, 2010, a loss of 27 percent.¹⁰ Some in the for-profit industry were particularly hard hit: Corinthian College, for example, experienced a 60% drop in its stock price during that period.¹¹ At the same time, investors like Mr. Eisman have substantial short holdings in for-profit institutions, as illustrated by the attached charts, drawn from publicly available NASDAQ information, showing short positions in specified for-profits

⁷ See Duncan Letter at p. 7. See also Mary Pilon, Jonathan Weisman, and Brody Mullins, A 'Short' Plays Washington, *The Wall Street Journal*, January 25, 2011 (copy attached as Exhibit C).

⁸ See Pilon, Weisman and Mullins, *The Wall Street Journal*, Jan. 25, 2011.

⁹ Duncan Letter at pp. 7-8.

¹⁰ See Richard Vedder, An \$8 Billion Misunderstanding, *Forbes.com*, available at <http://blogs/forbes.com/ccap/2010/12/22/an-8-billion-misunderstanding/>. Mr. Vedder's blogpost was based on data and analysis prepared by Arcady Bay Partners (Arcady Bay Report), a copy of which is available at www.arcadybay.com and attached as Exhibit D. According to the Arcady Bay Report, "it seems that the Senate hearings have had their intended impact and slowed down the growth of the for-profit colleges. The overhang of the Gainful Employment rules should continue to pressure stock prices and in all probability increase operating costs for the for-profit sector, if increase reporting is required." *Id.*

¹¹ Arcady Bay Report at p. 3.

Robert Khuzami
February 9, 2011
Page Four

for the period November 2009 through December 2010.¹² Simply stated, there are significant sums of money to be made by shorting stocks in the for-profit education industry, as evidenced by the short-selling activities of such notables as Mr. Eisman, who reaped similar financial gains by shorting the mortgage industry before its collapse.

The limited nature of publicly available information about short sales in the for-profit education industry makes it impossible for groups like CREW, unversed in the intricacies of the financial markets, to prove improper financial manipulation by short-sellers. At least one analyst has suggested to us a careful examination of this market will reveal wild swings in trading activity that, when coupled with the actions to date of certain short-sellers such as FrontPoint and CPMG and the substantial profits to be made from short-selling, raise the possibility of illegal market manipulation. Accordingly, we respectfully ask the SEC to conduct this analysis as part of an investigation into possible market manipulation in the stock of for-profit education institutions.

The SEC should ask FrontPoint and other hedge funds associated with the for-profit education industry to disclose their holdings and how they changed as the fund managers were attempting to influence the outcome of the Department of Education's regulatory process. A comparison of the buying patterns of stock options or short positions of these funds may reveal evidence of collusion relevant to a determination of market manipulation.

As Linda Chatman Thomsen, one of your predecessors, stated in 2008 when announcing the expansion of a probe into market manipulation in financial institutions, "Abusive short selling market manipulation and false rumor mongering for profit by any entity cuts to the heart of investor confidence in our markets."¹³ These words are even more true today, with public confidence in Wall Street at an all-time low. During these difficult economic times, brought on at least in part by the overly aggressive and unscrupulous behavior of some Wall Street investors, it is imperative that the SEC thoroughly and fairly investigate any possible market manipulation. Americans need to have faith that our government will never again turn a blind eye to the suspicious conduct of finance professionals.

¹² These charts are attached as Exhibit E. The data does not identify who has these short holdings, just the total short interest.

¹³ Press Release, SEC Expands Sweeping Investigation of Market Manipulation, September 19, 2008 (statement of Linda Chatman Thomsen, Director of the SEC's Division of Enforcement), available at <http://www.sec.gov/news/press/2008/2008-214.htm>.

Robert Khuzami
February 9, 2011
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Thank you for your prompt attention to this important matter.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Anne L. Weismann', with a long, sweeping horizontal stroke at the end.

Anne L. Weismann
Chief Counsel

Enclosures

EXHIBIT K

CREW | citizens for responsibility and ethics in washington

January 19, 2011

By Fax (202) 401-2854 (without exhibits) and Hand Delivery

Arne Duncan
Secretary of Education
U.S. Department of Education
400 Maryland Avenue, S.W.
Washington, D.C. 20202

Dear Secretary Duncan:

Citizens for Responsibility and Ethics in Washington ("CREW") respectfully requests that you examine the role hedge fund managers and outside interest groups have played in the Department of Education's (Education) formulation of regulations governing the for-profit education industry. Agency records CREW obtained recently from Education in response to a Freedom of Information Act (FOIA) request and records made public as a result of a private Florida lawsuit¹ reveal certain hedge fund managers had direct and sustained input into the regulatory process in furtherance of their own financial interests. More troubling, Education officials knew of this involvement and the financial motivations of the short sellers, yet continued to solicit and receive their input. The FOIA documents also reveal the extraordinary degree to which Education has been captivated by outside groups in the development of its regulations. These groups essentially functioned as agency decision-makers with unprecedented access to high-level Education officials. This backdrop raises a serious question about the propriety of Education's regulatory process and the regulations that process produced.

Role of Steven Eisman and His Hedge Fund at Education

CREW was first alerted to this problem by the testimony of Steven Eisman before the Senate Committee on Health, Education, Labor and Pensions (HELP Committee). Mr. Eisman is a portfolio manager of a hedge fund, FrontPoint Financial Services Fund, known to short-sell stocks in for-profit education companies. Despite his lack of expertise in education policy, Mr. Eisman, after contacting Chairman Tom Harkin, was invited to testify at a June 24, 2010 hearing on federal spending on for-profit education. Mr. Eisman offered a scathing attack on an industry he described as "fundamentally unsound" and predicted that over the next ten years, defaults of Title IV loans would total \$275 billion.² Previously, when Mr. Eisman offered similar

¹ Those documents are posted at <http://www.careercollegecentral.com/keiser-university-lawsuit-repository/document-index>.

² Testimony of Steven Eisman before the U.S. Senate Committee on Health, Education, Labor and Pensions, June 24, 2010, available at <http://help.senate.gov/hearings>.

characterizations of the for-profit education institutions as resting on shaky financial footing at a May 26, 2010 speech at the Ira Sohn Investor Conference (“Sohn Speech”), share values of the named companies plummeted and Mr. Eisman reaped huge profits from short-sales in those companies.³ Mr. Eisman’s June 24th congressional testimony had a similar affect on the stocks of for-profit companies.⁴

Documents CREW obtained through a Freedom of Information Act lawsuit filed against Education reveal that beyond his congressional testimony, Mr. Eisman worked actively behind the scenes to affect the outcome of Education’s regulatory process. In early April 2010, Mr. Eisman sought a meeting with then-Education Deputy Undersecretary Robert Shireman, who was leading the regulatory effort at Education, and Policy and Budget Development Staff Director David Bergeron to provide the results of his firm’s research on the for-profit education industry.⁵ During the meeting that followed on April 16, at which Mr. Bergeron was present in person and Mr. Shireman participated by telephone, Mr. Eisman provided his “Subprime Goes to College” slide deck and data on the for-profit industry.⁶ Of note, at a speech Mr. Shireman gave to state

³ David A. Kaplan, Short-Sellers Get Snagged in Education Litigation, *Fortune.com*, October 16, 2010, available at http://money.cnn.com/2010/10/15/news/eisman_education_lawsuit.fortune/index.htm.

⁴ For example, shares of the Apollo Group, the parent company of the University of Phoenix, were trading at \$46.33 per share at the close of June 23, 2010 – the day before Mr. Eisman’s congressional testimony – and had dropped to \$43.75 per share by the close of June 25, a drop in value of over 9.4%. See <http://www.bloomberg.com/apps/quote?ticker=APOL:US>. The overall decline in the stocks of for-profit education companies in the 24 hours following Mr. Eisman’s congressional testimony has been placed at between 6% and 8%. Kaplan, *Fortune.com*, Oct. 16, 2010. The share value of for-profit education stocks experienced a similar decline after Mr. Eisman’s Sohn Speech. *Id.*

⁵ See email from David Bergeron to Kathleen Smith and Robert Shireman, April 7, 2010 (suggesting to Mr. Shireman that “we take this meeting”); email from David Bergeron to Diane Schulman, April 7, 2010 (confirming Mr. Bergeron’s ability to attend the meeting) (both attached as Exhibit A).

⁶ See email from Chris Susanin (of FrontPoint) to Bob Shireman, April 19, 2010 (thanking him for reviewing the slides, financial analysis and data, and describing Steve Eisman as “a character”); email from Andrew Black (of FrontPoint) to Bob Shireman, April 16, 2010 (forwarding FrontPoint’s slide presentation). FrontPoint updated the slides a week later. Email from Matthew Leahy (of FrontPoint) to David Bergeron and Bob Shireman, April 22, 2010 (providing “new analyses” as an update from the prior week). See also David A. Kaplan, Did Steve Eisman Unduly Influence the Education Dept.?, *Fortune*, November 2, 2010 (all attached

Honorable Arne Duncan
January 19, 2011
Page Three

regulators several weeks later, he reportedly compared the for-profit education industry to Wall Street firms responsible for the financial meltdown, apparently borrowing a page directly from Mr. Eisman's book and foreshadowing Mr. Eisman's May 26 Sohn Speech.⁷ Mr. Eisman's "Subprime Goes to College" theme would be echoed repeatedly during the regulatory process, particularly by non-profit groups seeking the most restrictive gainful employment regulations.

This was the beginning of a months-long correspondence between Mr. Eisman, others at FrontPoint and key Education officials at a critical point in the debate over Education's treatment of gainful employment at for-profit schools. At times, Mr. Eisman merely forwarded articles and news of interest.⁸ At other times FrontPoint and Mr. Eisman provided Education officials with substantive analysis of the for-profit industry to justify their views on the percentage Education should adopt for the gainful employment regulations. For example, on May 26, 2010, Mr. Eisman sent an email to numerous Education officials, including you and David Bergeron, advising that his Sohn Speech of that afternoon had been "very negative on the industry." Mr. Eisman included his speech and power point presentation as an attachment.⁹

Two days later, Mr. Eisman sent another email to numerous Education officials, including Dan Madzelan, then-Acting Assistant Secretary for the Office of Postsecondary Education, and David Bergeron, calling attention to his views on the for-profit education industry. He also included an analysis completed by FrontPoint of the gainful employment regulations then under review at Education, focusing on what he termed "key metrics (specifically the debt service percentage and the repayment period)."¹⁰ As you know, the gainful employment regulations have been the most controversial in the regulatory package with the potential to have the greatest economic impact on the for-profit education industry, as the percentage Education chooses could cause for-profit institutions to lose access to the bulk of their revenue, which comes from federal

as Exhibit B).

⁷ See Comparing Higher Ed to Wall Street, *Inside Higher Ed*, April 29, 2010 (attachment to email from Susan Lehr to Mark Bailey, April 29, 2010 (attached as Exhibit C)).

⁸ See, e.g., email from Steven Eisman to David Bergeron, April 20, 2010 (forwarding write-up by Height Analytics of lawsuit involving for-profit education institute) (attached as Exhibit D).

⁹ A copy of this email and the attached speech, *Subprime Goes to College*, are attached as Exhibit E.

¹⁰ A copy of this email, which begins "My name is Steven Eisman," and goes on to discuss highlights of his enclosed analysis of the gainful employment proposal, is attached as Exhibit F.

financial aid.¹¹

The documents CREW obtained also reveal that Education officials were well aware of the economic interests Mr. Eisman was attempting to further as he contacted Education officials, although he himself never revealed those interests. For example, Mr. Bergeron was sent a copy of a *Bloomberg Businessweek* article entitled “FrontPoint’s Eisman Bets Education Stocks to Fall on Loan Rules” that outlines how Mr. Eisman is pursuing the same investment strategy he did with the housing market – shorting shares of for-profit education companies.¹² Similarly, a June 14, 2010 email from Mark Kantrowitz, the publisher of FinAid.org and FastWeb.com, to Mr. Shireman, among others, states: “I mentioned previously that Steve Eisman, an analyst with some fame for shorting subprime mortgages, is now shorting for-profit higher education . . . Keep in mind that this guy is a short-seller . . .”¹³

Contacts Between Steven Eisman, His Hedge Fund , and Non-Profit Groups

Other documents show the role of The Indago Group, a small research company used by FrontPoint that worked behind the scenes to obtain information and entree to Washington lawmakers to help FrontPoint gain a further economic advantage.¹⁴ Beyond contacting Education

¹¹ See, e.g., Goldie Blumenstyk, Education Dept. to Delay Issuing ‘Gainful Employment’ Rules Opposed by For-Profit Colleges, *Chronicle of Higher Education*, September 24, 2010, available at <http://chronicle.com/article/Education-Dept-to-Delay/124617/>.

¹² This document was an attachment to an email from Peter Warren to David Bergeron and is attached as Exhibit G.

¹³ See email from Mark Kantrowitz to Bob Shireman and James Kvaal (Deputy Undersecretary of Education) entitled “Talk at Ira Sohn Conference,” June 14, 2010 (attached as Exhibit H). Mr. Kantrowitz and Mr. Shireman talked so frequently that Mr. Shireman was on Mr. Kantrowitz’s “speed dial.” See email from Bob Shireman to Mark Kantrowitz entitled “Morgan Stanley on NPRM publication data and contents,” June 14, 2010 (also attached as Exhibit H).

¹⁴ FrontPoint also appears to have used the services of another research firm, Alternative Research Services, headed by Rob MacArthur. In a February 23, 2010 letter to a number of non-profits and Education officials, including Zakiya Smith, Policy Advisory to the Assistant Secretary, Mr. MacArthur commented on a GAO letter issued that day regarding schools participating in federal student aid programs that had violated the ban on making incentive compensation payments. Mr. MacArthur noted distribution of this letter “may affect the stock prices in the industry if the market believes there will be increased scrutiny from various parts of the federal government.” See email from Rob MacArthur to Barmak Nassirian (Associate

officials directly, Diane Schulman of The Indago Group and Mr. Eisman formed alliances with a small group of non-profits and community colleges (collectively “non-profits group”) seeking to ensure that Education adopted the most stringent regulations of the for-profit education industry, particularly the gainful employment rules. As outlined below, this group had an enormous impact on the scope and direction of the regulations and Education officials essentially allowed the group to function as agency officials, completely eviscerating the line between the agency and outside groups pursuing their own agenda.

As part of The Indago Group’s efforts, Ms. Schulman shared with the non-profits group FrontPoint’s analysis of the issue, which was in sync with the view of the non-profits group that the gainful employment level should be eight percent.¹⁵ Ms. Schulman also shared Mr. Eisman’s Sohn Speech with the group, which provoked the following enthusiastic reaction from Susan Lehr, Vice President of Government Relations at Florida State College, as to its likely affect on the market:

This is a speech given to Wall Street today that will rock the market. Eisman was one of the first ones to see the mortgage crisis coming – he is a Wall Street big time guy profiled in the book The Big Short. Thought you would like to see this. It is very WOW! . . .¹⁶

The group also obtained an advance copy of Mr. Eisman’s June 24, 2010 congressional testimony that Ms. Lehr circulated internally two days ahead of the hearing with the gushing

Executive Director, American Association of Collegiate Registrars and Admissions Officers), et al. entitled “GAO report,” February 23, 2010 (attached as Exhibit I). Of course, this is the market effect FrontPoint, as a short seller, was hoping for.

¹⁵ See email from Diane Schulman to Deanne Loonin (staff attorney at the National Consumer Law Center), James Simpson (Vice President of Florida State College), Susan Lehr entitled “Gainful Employment Analysis,” May 21, 2010 (email and attachment attached as Exhibit J). A regulation dictating an eight percent gainful employment level would mean that students at for-profit institutions would be eligible for federal student loans only if Education determined their career programs prepare them for gainful employment in an occupation with expected pay scales that would establish a debt-to-earnings ration of eight percent or less.

¹⁶ See email from Susan Lehr to Joe Jangro of Water Street Capital entitled “Wall Street Speech today on For Profit Education Industry,” May 26, 2010; email from Diane Schulman to Susan Lehr and James Simpson (forwarding Sohn Speech), May 26, 2010 (both attached as Exhibit K).

description of Mr. Eisman as “my hero.”¹⁷ Days before Education released the proposed regulations on gainful employment, Ms. Schulman forwarded to some group members what she described as “some of the speculation” on the effect of the gainful employment regulations on education stocks, laying out the effects of the two proposals Education was considering.¹⁸

Like the Education officials, the non-profits group was well aware of Mr. Eisman’s underlying financial motives. The group’s head, Pauline Abernathy, Vice President of The Institute for College Access and Success (TICAS), an organization she co-founded with Robert Shireman, sent a cautionary email to Ms. Lehr advising that while Mr. Eisman “and his folks sometimes have useful info . . . I try to be careful what I share since he has a financial interest we do not, and he may make money based on what happens in the market each day while we only care about the final outcome.”¹⁹ Nevertheless, Mr. Eisman remained tuned in to the group’s efforts, giving him an inside track on the progress of the regulations, most particularly the gainful employment regulations of greatest interest to both.

While it is not known whether Mr. Eisman received an advance copy of the gainful employment regulations from Education officials prior to their issuance on July 23, 2010, at least some in the non-profits group received an advance copy and spoke with Mr. Eisman around this time. A July 21, 2010 email from Ms. Lehr to Ms. Abernathy conveys Ms. Lehr’s understanding that the gainful employment regulation was coming out at midnight the following evening with the subsequent request “don’t pass on beyond our group.” A later email that day from Ms. Lehr conveys her expectation she would receive an embargoed copy before its official release and notes “Jim met by phone with Eisman yesterday for a very interesting conversation.” Another email sent the following morning states “We expect lots of market churn” from the issuance of the gainful employment regulations. That same morning, Ms. Lehr told Ms. Abernathy “Eisman had questions for Jim on Wednesday . . . they spoke for about an hour . . .”²⁰ This email chain

¹⁷ See email from Susan Lehr to Doug Cooley and Doug Axteil, June 22, 2010 (attached as Exhibit L).

¹⁸ See email from Diane Schulman to James Simpson and Susan Lehr entitled “Here’s some of the speculation,” July 20, 2010 (attached as Exhibit M).

¹⁹ Email from Pauline Abernathy, to Susan Lehr, July 22, 2010 (attached as Exhibit N).

²⁰ Email from Susan Lehr to Pauline Abernathy entitled “GE out Tomorrow,” July 21, 2010; email from Susan Lehr to CEO entitled “Gainful Employment,” July 21, 2010; email from CEO to Gilchrist Berg entitled “Gainful Employment,” July 22, 2010; email from Susan Lehr to Pauline Abernathy entitled “GE-ED briefing hill staff at 6pm tonight!,” July 22, 2010 (all attached as Exhibit O).

suggests, at a minimum, Mr. Eisman likely knew Education was about to issue the long-awaited regulations.

Role of Other Hedge Funds

FrontPoint is by no means the only hedge fund to both actively short-sell stock in the for-profit education industry and attempt to influence Education's regulation of that industry. Partners of a Dallas-based hedge fund, CPMG, also met with Education officials and traded information and data extensively with non-profit group members on the negotiated regulations committee ("NegReg Committee") Education established to make recommendations on the regulatory package. A March 31, 2010 email from Pauline Abernathy to NegReg Committee members describes efforts to coordinate with Education to gather gainful employment examples, such as individuals who took on debt to pursue education at a for-profit institution and then could not find jobs in their promised fields. Ann Manheimer, Director of Education's Management Systems Improvement Group, was coordinating the effort and the email noted Education officials already had met with a lobbyist and analysts for short-seller CPMG, including Antal Desai, as part of this effort.²¹ Mr. Desai had been working on gathering student testimonials for the past year, as reflected in a July 8, 2009 email from James Simpson to Susan Lehr and Elizabeth Baldwin.²² That email describes CPMG as "a mid size investment company" with "some investments (stocks) of publically [sic] traded education companies," and explains "they [CPMG] are trying to determine the amount of risk that may be associated with these investments."²³ By actively injecting itself into the regulatory process, it appears CPMG was doing more than assessing the risk of its investments – it apparently was trying to cause a specific regulatory outcome.²⁴

Another hedge fund that claimed to have followed the education and student loan companies for over a decade, QuilCap Corp., also voiced its growing concern "over the viability

²¹ See email from Pauline Abernathy to Susan Lehr, et al. regarding Neg reg follow up info and docs for review by Friday COB, March 31, 2010 (enclosed as Exhibit P).

²² See email from James Simpson to Susan Lehr and Elizabeth Baldwin entitled "Student Testimonials," July 8, 2009 (attached as Exhibit Q).

²³ *Id.*

²⁴ Moreover, at least some in the non-profits group were willing to overlook the fact that CPMG was acting in pursuit of its own financial interests. A July 28, 2009 email from Barmak Nassirian to Susan Lehr (attached as Exhibit R) states: "I know Antal [Desai] and have been impressed with him and his firm. I don't care – or fully understand – what their financial interests in these matters might be . . ."

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of certain publicly traded for-profit schools' business models" in a June 9, 2009 letter to Education.²⁵ QuilCap's annual report outlines its strategy and rationale for pursuing short sales of the for-profit education industry.²⁶

Role of Non-Profits Group at Education

At the same time, the non-profits group and others in the non-profit education community enjoyed an inordinate amount of influence over Education's internal deliberations and decision-making. Their influence began with Robert Shireman serving as Senior Advisor to the Secretary, starting at the beginning of the Obama administration. While in his capacity as a consultant to Education, Mr. Shireman remained on the board of TICAS, a group leading the charge in advocating for more stringent gainful employment regulations. A few months later in April, 2009, Mr. Shireman was appointed Deputy Undersecretary. A day before his appointment was announced, he sent an email to TICAS officials advising them of his appointment to the position where he would have "responsibility for financial aid policy and operations as well as higher education and related initiatives."²⁷ While Mr. Shireman noted he would "have no further official connection to TICAS," he also expressed his intent "to make myself available as a volunteer in my personal time. Let me know how I can be helpful."²⁸

In fact, however, Mr. Shireman did not limit his assistance to his "personal time." Instead, as reflected in numerous documents Education released to CREW under the FOIA, Mr. Shireman had ongoing contacts with TICAS and others working with TICAS to push a specific regulatory agenda, even during sensitive internal agency deliberations over the regulations. Among the many examples, on November 10, 2009, just after the first negotiating committee meeting, TICAS Vice President Pauline Abernathy sent Mr. Shireman and others an article on for-profits with the notation, "Apollo Group and other for-profit colleges will find it harder to make the grade – especially as they come under scrutiny for aggressive enrollment practices."²⁹

²⁵ Letter to Wendy Macias, U.S. Department of Education, from QuilCap (name of signator has been redacted), June 9 2009 (attached as Exhibit S).

²⁶ QuilCap's annual Report of January 2009 is enclosed as Exhibit T.

²⁷ Email from Robert Shireman to Roger Nozaki, et al., April 19, 2009 (attached as Exhibit U).

²⁸ *Id.*

²⁹ Email from Pauline Abernathy to Luke Swarthout (HELP Committee), James Kvaal, Bob Shireman, Dan Madzellan entitled "Baron's cover article on for-profits," November 10, 2009 (attached as Exhibit V).

In February 2010, once the NegReg Committee completed its work by making recommendations to Education, Ms. Abernathy reconvened many in the group telephonically along with Education officials such as Mr. Shireman – who asked specifically to be included in the call,³⁰ – then-White House official James Kvaal, and HELP Committee staffer Luke Swarthout, to develop a strategy for dealing with the for-profit industry, which was expected to fight back hard against the rule.³¹ The following month, Ms. Abernathy solicited help from Mr. Shireman, Mr. Bergeron, and other Education officials to respond to the “firestorm” she feared would result from a newly released paper by Mr. Kantrowitz critiquing Education proposals on gainful employment as “a little bit too harsh.”³² Two months later, on April 13, 2010, Ms. Abernathy complained to Education officials Shireman, Madzelan, and Manheimer about Education’s failure to provide “consumer, student and workforce stakeholders” with the same information Education had provided to industry groups.³³ In response, Ms. Manheimer – who serves on Mr. Shireman’s staff – quickly provided Ms. Abernathy with answers to her questions about how the gainful employment regulation would affect bachelor of arts programs at for-profit schools.³⁴

Most troubling, in April 2010, Mr. Shireman accepted an invitation from TICAS to travel to California for a two-day small “brainstorming session” to discuss “consumer and taxpayer issues related to distressed borrows and identify our own research and/or policy priorities.”³⁵

³⁰ See email from Bob Shireman to Pauline Abernathy, et al. entitled “Height Analytics – For-Profit Ed. Gainful Employment Means,” February 3, 2009 (Mr. Shireman stated “If I’m available when you have your call I’d like to listen in.”) (attached as Exhibit W).

³¹ See email from Bob Shireman to David Bergeron entitled “Height Analytics – ForProfit Ed. Gainful Employment Means,” February 5, 2010 (entire email chain together with analysis by Height Analytics attached with Exhibit W).

³² See email from Pauline Abernathy to Bob Shireman, et al. entitled “What is Gainful Employment? What is Affordable Debt?,” March 2, 2010 (included with Mr. Kantrowitz’s analysis as Exhibit X).

³³ See email from Pauline Abernathy to Dan Madzelan, et al. entitled “Industry take on what was submitted to OMB on Friday on GE,” April 13, 2010 (attached as Exhibit Y).

³⁴ See email from Ann Manheimer to Pauline Abernathy entitled “Application of GE,” April 14, 2010 (attached as Exhibit Z).

³⁵ See email from Lauren Asher (TICAS) to Bob Shireman, et al., May 11, 2010 (describing the April 29-30 session) (attached as Exhibit AA).

Other attendees included Margaret Reiter, a negotiator for the NegReg Committee and former Deputy Attorney General for the California Attorney General's Office; Deanne Loonin, staff attorney at the National Consumer Law Center, alternate negotiator for the NegReg Committee, and frequent email correspondent with Ms. Schulman; Tim Ranzetta, founder and president of Student Lending Analytics; Jamiene Studley, President of Public Advocates, Inc.; and Michelle Rodriguez, a staff attorney at Public Advocates, Inc. No one from the for-profit industry was included. Mr. Shireman's participation in this two-day session belies his claim that he would limit his assistance to TICAS to his "personal time," and demonstrates that by that time, the interests of the outside non-profit groups and Education were so aligned there no longer was any distinction between the two.

The non-profits group had extensive contacts with other Education officials throughout the regulatory process, as documented in the records Education provided in response to CREW's FOIA request.³⁶ Those contacts paid off handsomely for the non-profits. For example, on the eve of Education's June 16, 2010 publication of its notice of proposed rulemaking Ms. Lehr and others had managed to obtain an embargoed copy of the rulemaking.³⁷ And when TICAS was preparing its public comments on the gainful employment regulations in September 2010, David Bergeron responded readily to Ms. Abernathy's inquiry about "what share of the more than 26,000 public comments received so far support the reg and/or making it stronger."³⁸ These are just some of the many examples illustrating the inside track TICAS and other non-profits had with Mr. Shireman and other Education officials in their combined effort to tighten the gainful employment regulations.

Conclusion

In sum, Education employed a deeply flawed process to formulate these regulations, regardless of their underlying merit. Education officials knowingly allowed that process to be tainted by the undisclosed role of short-sellers, seeking to use the regulatory arena to manipulate the financial markets and drive down the share value of for-profit education companies, all for their own personal gain. Further, Education officials at the highest levels of this process put

³⁶ Those documents are posted at http://www.scribd.com/document_collections/2742136.

³⁷ See email from Susan Lehr to Michele Bowles and Mary Cauley entitled "Here are the regs!," June 15, 2010 (attached as Exhibit BB).

³⁸ See email from Pauline Abernathy to David Bergeron entitled "Today's NYT article," September 4, 2010, and email from David Bergeron to Pauline Abernathy entitled "Today's NYT article," September 7, 2010 (attached as Exhibit CC).

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aside their responsibilities to the agency to examine these issues impartially, and instead formed a collaboration with and ceded authority to outside groups advancing their own specific agenda. Americans' confidence in the regulatory system is severely undermined when Wall Street investors with no policy expertise are allowed to insinuate themselves into the regulatory process. We therefore ask that you immediately launch an investigation not only into this matter, but also into whether other Education regulations similarly are being manipulated by outsiders. It is imperative that you act quickly to restore integrity to Education's rulemaking process.

Thank you for your attention to this very important matter.

Very truly yours,

A handwritten signature in dark ink, appearing to read 'Anne L. Weismann', with a long, sweeping horizontal stroke at the end.

Anne L. Weismann
Chief Counsel

cc: Chairman Tom Harkin
Ranking Member Michael B. Enzi
Senate Committee on Health, Education, Labor, and Pensions
Chairman John Kline
Ranking Member George Miller
House Committee on Education and the Workforce

Enclosures

EXHIBIT L

CREW | citizens for responsibility and ethics in washington

July 9, 2012

By Facsimile (without exhibits) (212) 637-2932 and First-Class Mail

Preet Bharara
United States Attorney
U.S. Attorney's Office for the
Southern District of New York
One St. Andrew's Plaza
New York, New York 10007

Dear Mr. Bharara:

Citizens for Responsibility and Ethics in Washington (CREW) respectfully requests that your office initiate an investigation into the short-selling activities of hedge fund manager Martin Shkreli and possibly others to determine if there has been illegal manipulation of the market price of stock in the biotechnology and pharmaceutical industries. Publicly available data, documents CREW obtained through a Freedom of Information Act (FOIA) request to the U.S. Food and Drug Administration (FDA), and information provided by an individual whose company has been affected by Mr. Shkreli's actions suggest he has engaged in behind-the-scenes efforts to manipulate the biotech industry market for financial gain.

Mr. Shkreli is the chief investment officer for the New York-based hedge fund MSMB Capital Management LLC.¹ MSMB Capital Management has been described as "a leading investment firm focused on global healthcare and biotechnology opportunities and long-term investments."² As its chief investment officer, Mr. Shkreli has taken a number of steps aimed at influencing the stock value of biotech companies in which he held a financial interest. These include his contributions to a blog on a well-known investing website sharply criticizing stocks in which he held short positions and efforts to insert himself into the FDA approval process for at least four pending drugs in which he held short positions.

Specifically, on June 2, 2011, Mr. Shkreli took the unusual action of submitting a citizen petition to the FDA asking the agency not to approve the New Drug Application (NDA) for

¹ Mr. Shkreli's website indicates his firm is based at 330 Madison Avenue, New York, New York. <http://www.msmbhealthcare.com/>.

² MSMB Capital Proposed Acquisition of Amag Pharmaceuticals for \$18 Per Share, *Business Wire*, August 3, 2011 (available at <http://www.businesswire.com>).

Lymphoseek, a lymph-node mapping agent developed by the Ohio-based biotech firm Neoprobe (now known as Navidea Biopharmaceuticals, Inc.). Mr. Shkreli claimed Lymphoseek was not properly and scientifically tested against the current standard “blue dye” method of finding lymph nodes.³ In his filing, Mr. Shkreli did not claim – as, indeed, he could not – to be an expert in medicine or biological sciences.⁴ Further, he acknowledged his hedge fund, MSMB Capital, would gain financially from a decline in the company’s stock price.⁵

In addition to contacting the FDA directly, Mr. Shkreli used a well known investing website, SeekingAlpha.com, to influence the stock price of Neoprobe. SeekingAlpha.com offers stock tips and trading advice, and receives nearly four million visitors in the U.S. each month.⁶ Mr. Shkreli’s opinions were published frequently on SeekingAlpha.com during the summer of 2011. In his June 2, 2011 blog post Mr. Shkreli argued the value of Neoprobe stock was highly inflated, and predicted its price would drop dramatically because Lymphoseek would not win FDA approval as a result of numerous shortfalls Mr. Shkreli identified in the testing process. His controversial blog post sparked a sharp backlash from other investors, who argued his so-called scientific claims were biased and possibly fraudulent. In addition, several of his critics noted he was a short seller and therefore not a reliable source.⁷

Nevertheless, Mr. Shkreli’s tactics worked; after he posted his blog on SeekingAlpha.com and filed his citizen petition with the FDA the following day, shares of Neoprobe began to fall significantly. According to Google Finance, after trading at \$5.48 on May 31 – an all-time high – Neoprobe dropped to \$4.93 the next day. By August 8, after a steady drop, Neoprobe stock was trading at a low of \$1.95.⁸

³ MSMB Capital Management LLC, Citizens Petition to the Division of Dockets Management, Food and Drug Administration, filed by Martin Shkreli on June 2, 2011 (attached as Exhibit A).

⁴ *Id.*

⁵ *Id.*

⁶ <http://www.quantcast.com/seekingalpha.com>.

⁷ <http://seekingalpha.com/article/272708-the-short-case-for-neoprobe-skeptical-of-its-primary-assets-s-success>; <http://www.massdevice.com/blogs/medcity-news/neoprobe-does-stocks-40-percent-drop-validate-its-biggest-critic>.

⁸ See <http://finance.yahoo.com/q/bc?s=NEOP&t=1y>. Mr. Shkreli called off his short sale recommendation of Neoprobe on August 5, 2011, indicating the share price had fallen far enough. See <http://seekingalpha.com/article/272708-the-short-case-for-neoprobe-skeptical-of-its>

Mr. Shkreli made similar use of his blog post to drive down the stock price of other biotech firms he was shorting, including Avanir, Zalicus, and Mesoblast. On May 31, 2011, Mr. Shkreli posted an article on SeekingAlpha.com describing the biopharmaceutical firm Avanir (symbol: AVNR) as a “compelling short sale opportunity.”⁹ He calculated the fair value of the stock at \$1.00, despite its then market value of \$4.62.¹⁰ As he did with Neoprobe, Mr. Shkreli outlined his reasons for labeling the stock overvalued, including his claim the firm’s drug Nuedexta was only mildly effective and would experience weak sales in a brief intellectual property life.¹¹ As with Neoprobe, critics of Mr. Shkreli argued his claims were intentionally false and purposely ignored important data.¹²

Just as they did with Neoprobe, Mr. Shkreli’s efforts resulted in a stark decline in stock prices. On May 27, 2011, four days prior to Mr. Shkreli’s blog post, Avanir was trading at \$4.67, its highest price since early November 2010. During trading the day following Mr. Shkreli’s post, the stock price dropped to \$4.39. On June 3, the stock price rose slightly on heavy trading to \$4.46 a share, but then began a precipitous slide. By November 25, shares of Avanir were selling for \$2.00, having never fully recovered to May levels.¹³ From May 31 to November 28, Avanir lost 45% of its value.¹⁴

primary-assets-s-success.

⁹ <http://seekingalpha.com/article/272463-avanir-pharmaceuticals-compelling-short-sale-opportunity>.

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ <http://www.google.com/finance?q=NASDAQ%3AAVNR>.

¹⁴ *Id.* Other factors also may have affected the stock price of Avanir. For example, on May 25, 2011, Senator Herb Kohl (D-WI) sent a letter to Avanir concerning allegations of unfair pricing of Nuedexta that had begun to surface. *See* <http://www.thestreet.com/story/11132797/1/avanir-congress-gripes-about-drug-price.html>. Avanir’s stock price, however, reached its all-time high on May 27, two days after the letter was reported. <http://www.google.com/finance?q=NASDAQ%AAVNR>. By contrast, the price began to decline the day after Mr. Shkreli’s blog post appeared. *Id.* On November 27, 2011, Mr. Shkreli published an article on Seeking Alpha in which he called off his short on Avanir. *See* <http://seekingalpha.com/article/310348-avanir-closing-short-position>.

Documents CREW obtained from Mr. Shkreli himself reveal that beyond his citizen petition against Neoprobe, he also worked actively behind the scenes to affect the outcome of the FDA's regulatory process with other drugs where he had substantial financial conflicts of interest.¹⁵ In September 2010, Mr. Shkreli asked to be included on a panel discussion on Arena Pharmaceuticals' weight-loss drug Lorcaserin.¹⁶ He also submitted a slide show presentation to the FDA that claimed Lorcaserin had not been tested properly, and requested his findings be considered by the advisory committee.¹⁷ Part of his presentation included a conflict of interest statement in which he stated: "I am a fund manager who would likely benefit financially if the FDA requested Arena conduct an outcomes-based study."¹⁸

Similarly, on December 25, 2010, Mr. Shkreli sent a presentation via email to 12 FDA officials, including Commissioner Margaret Hamburg, asking the FDA to deny approval of the inhaled insulin drug Afrezza based on his claim trials conducted by the company's manufacturer, MannKind, failed "to meet required efficacy primary endpoints."¹⁹ An FDA denial of a new drug presumably would cause the company's stock price to decline, resulting in a direct profit for Mr. Shkreli. Again, Mr. Shkreli acknowledged his "substantial financial conflicts of interest" as he would "benefit substantially if the FDA adopts [his] viewpoint."²⁰ Apparently, Mr. Shkreli was short selling the stock of both Arena Pharmaceuticals and MannKind. However, acknowledging these conflicts did not make them disappear.

More recently, CREW was advised about another company targeted by Mr. Shkreli through a blog post on SeekingAlpha.com, Nektar Therapeutics. In a June 18, 2012 blog post, Mr. Shkreli stated boldly, "[s]horting Nektar is a good investment," based on his claim of

¹⁵ Email from Martin Shkreli to FDA Commissioner Margaret Hamburg, et al., Afrezza Review for DMEP/CDER/FDA - Personal Letter and pending Citizen's Petition request for Complete Response Letter pending further Afrezza studies, sent December 25, 2010 (attached as Exhibit B).

¹⁶ Email from Martin Shkreli to Paul Tran and Cicely Reese, Re: Lorcaserin AdCom Presentation Request, September 9, 2010 (attached as Exhibit C).

¹⁷ See Exhibit B.

¹⁸ *Id.* at slide 16.

¹⁹ See Exhibit A.

²⁰ Martin Shkreli, Afrezza Review for FDA DMEP Consideration by Martin Shkreli, sent to FDA officials on December 25, 2010 (attached as Exhibit D).

“material deficiencies” with its NKTR-118 drug.²¹ According to Mr. Shkreli, the drug will fail “to achieve Phase III clinical trial primary endpoints.” Therefore, he argued, Nektar’s stock was worth roughly \$1 per share, not the \$8 per share at which it was then trading.²² Further, Mr. Shkreli hyped the success of Nektar’s competitors and dismissed any positive attributes of NKTR-118 as not “clinically meaningful.”²³ In essence, despite his lack of expertise, Mr. Shkreli contested the results of clinical trials conducted by Nektar in language intended to convey scientific certainty.

According to a Nektar Therapeutics representative, Mr. Shkreli’s post was based on mischaracterizations of NKTR-118’s Phase III drug trials and erroneous conclusions about the nature and extent of Nektar’s competitors. Thus, it appears that once again, Mr. Shkreli is using SeekingAlpha.com to spread unfounded or inaccurate rumors designed to depress the price of a stock in which he holds short positions.

Beyond NKTR-118 drug, Mr. Shkreli also attacked some of Nektar’s other products, specifically NKTR-102 and NKTR-061, claiming they are in difficult markets and have low sales potential.²⁴ More broadly, Mr. Shkreli criticized Nektar’s structure and cash flow, claiming the company’s stock rarely moves.²⁵

Once again Mr. Shkreli hit his target. On June 15th, the Friday before his blog post, Nektar’s stock closed at \$8.01. On Monday, June 18th, when he posted his blog, it opened at \$7.93, shot up to \$8.11 by 1:00 p.m., but then took a dive and by the close of trading Nektar’s stock had dropped a total of \$.33, losing 4.12% of its value.

While biotech and pharmaceutical industries generate a substantial amount of revenue, they also face the possibility of substantial losses, which can result in wildly fluctuating stock prices. The FDA must approve all new drugs through a process that takes place after the company has invested a considerable amount of money in the research and development necessary to bring a new drug to market. This creates significant opportunities for short sellers. Adam Feuerstein, a senior columnist for *The Street*, wrote in an October 4, 2011 article that short sellers were “piling into biotech stocks” because of a weak economy and the “challenge of selling

²¹ <http://seekingalpha.com/article/666541-nektar-phase-iii-trials-at-risk>.

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ <http://seekingalpha.com/article/666541-nektar-phase-iii-trials-at-risk>.

new drugs in an uncertain environment of health care reform and high drug prices.”²⁶ His list of the ten most heavily shorted stocks in the biotech industry included Avanir and Oncothyreon,²⁷ both profiled by Mr. Shkreli on SeekingAlpha.com as promising short opportunities.

Taken as a whole, this evidence suggests a pattern of suspicious behavior in the trading of biotech stocks that warrants a thorough investigation. Given the lack of transparency in the holdings of hedge funds, it is impossible for CREW to shed further light on this issue. Accordingly, in January of this year, CREW requested that the U.S. Securities and Exchange Commission investigate possible market manipulation in the stocks of biotechnology firms.²⁸ To our knowledge, however, the SEC has yet to act on our request, but a comparison of the buying patterns of stock options or short positions by MSMB Capital Management and other hedge funds associated with the biotech industry may reveal further evidence of collusion relevant to determining whether Mr. Shkreli engaged in market manipulation. The U.S. Attorney’s Office for the Southern District of New York, which has aggressively pursued those involved in insider trading, is perfectly positioned to investigate the potentially illegal conduct of short sellers as well.

²⁶ Adam Feuerstein, 10 Most Shorted Stocks in Biotech, *The Street*, October 4, 2011 (attached as Exhibit E).

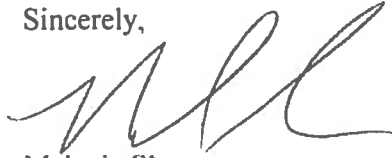
²⁷ Mr. Shkreli went after Oncothyreon (ONTY) in a blog post of July 25, 2011, criticizing the Merck cancer drug Stimuvax in which Oncothyreon has an 8-12% royalty. According to Mr. Shkreli, Stimuvax was not “well-designed,” does not generate a sufficient immune system response to cancer in humans, and does not seem to have a mechanism to prevent metastasis. See <http://seekingalpha.com/article/281421-oncothyreon-phase-iii-unlikely-to-show-survival-benefit>. Once again, Mr. Shkreli hid behind a hodgepodge of scientific jargon to justify his conclusion that Oncothyreon’s market cap was too high. *Id.* And once again the market reacted. On the day of Mr. Shkreli’s post, Oncothyreon’s stock experienced a 14.14% drop, from \$9.69 to \$8.32, and steadily declined over the next several months. <http://www.google.com/finance?q-Oncothyreon>.

²⁸ A copy of CREW’s letter is attached as Exhibit F.

Preet Bharara, Esq.
July 9, 2012
Page Seven

Thank you for your prompt attention to this important matter.

Sincerely,

A handwritten signature in black ink, appearing to read 'MS', is written over the word 'Sincerely,'.


Melanie Sloan
Executive Director

Enclosures

EXHIBIT M

Retrophin Founder Said Probed Over Securities Dealings

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by Christie Smythe
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January 7, 2015



Martin Shkreli sits behind a chess board in New York, on Aug. 10, 2011.
Photographer: Paul Taggart/Bloomberg

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Which Countries Are Most Vulnerable to a China Slowdown?

(Bloomberg) -- Retrophin Inc. founder Martin Shkreli, replaced last year as chief executive officer of the biopharmaceutical company, is under investigation by U.S. prosecutors in Brooklyn, New York, for possible securities law violations, according to a person familiar with the matter.

Shkreli, a one-time short-seller who started New York-based Retrophin at 28, left his CEO post in September. Investors claimed in later lawsuits against him and the company that he distributed stock without the consent of shareholders.

Shkreli said in an interview today that he's unaware of the probe and denied wrongdoing, including allegations in the lawsuits. Shkreli said he had a "difference of opinion" with his board over investing capital and stock options.

... reported by
BloombergBusiness Now Reading: **Retrophin Foun**    t is no longer

Shkreli also faces a probe by the U.S. Securities and Exchange Commission, according to the

person, who requested anonymity because the investigation isn't public.

Nellin McIntosh, a spokeswoman for U.S. Attorney Loretta Lynch in Brooklyn; Judith Burns, a spokeswoman for the SEC; and Tom Fernandez, a spokesman for Retrophin, declined to comment on the investigations.

Fund Manager

Shkreli, who previously managed hedge fund MSMB Capital Management LLC, has faced criticism of his trading. In 2012, Citizens for Responsibility and Ethics in Washington, a watchdog group, asked U.S. Attorney Preet Bharara in Manhattan to investigate whether Shkreli manipulated shares of biotechnology and pharmaceutical companies by badmouthing them in order to drive down prices.

The group claimed Shkreli made postings on the website SeekingAlpha.com that spread "unfounded and inaccurate rumors about drugs owned by companies he was shorting," and that he "inserted himself" into the Food and Drug Administration approval process for pending pharmaceuticals.

Betsy Feuerstein, a spokeswoman for Bharara, declined to comment on whether Shkreli was investigated. Stephen Santulli, a spokesman for the watchdog group, said in an e-mail that the group didn't hear back after making the request.

According to an April 2014 profile in Bloomberg Businessweek, Shkreli, the child of working-class immigrants from Albania and Croatia, grew up in the Sheepshead Bay section of Brooklyn. As a college intern at a hedge fund formerly managed by Jim Cramer, the host of CNBC's Mad Money, he made a name for himself by successfully recommending the short-sale of a biotech stock, according to Businessweek.

Retrophin focuses on the development, acquisition and sales of therapies for treating rare and serious diseases. It transitioned into a publicly traded company through a reverse merger with Desert Gateway Inc. in 2012. The company acquired Manchester

Pharmaceuticals LLC for a total of \$625 million last year

1. RETROPHIN REPORTEDLY PAID A TOTAL OF \$62.5 MILLION LAST YEAR.

To contact the reporter on this story: Christie Smythe in Brooklyn at csmythe1@bloomberg.net

To contact the editors responsible for this story: Michael Hytha at mhytha@bloomberg.net
David Glovin, Andrew Dunn

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