

ITT EDUCATIONAL SERVICES INC

Form 10-K

May 29, 2015

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K**

**ANNUAL REPORT**

**(Mark One)**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2014**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 1-13144**

**ITT EDUCATIONAL SERVICES, INC.**

**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**36-2061311**  
**(I.R.S. Employer**  
**Identification No.)**

**13000 North Meridian Street**

**Carmel, Indiana**  
**(Address of principal executive offices)**

**46032-1404**  
**(Zip Code)**

**Registrant's telephone number, including area code (317) 706-9200**

**Securities registered pursuant to Section 12(b) of the Act:**

**Title of each class**  
**COMMON STOCK, \$.01 PAR VALUE**

**Name of each exchange on which registered**  
**NEW YORK STOCK EXCHANGE, INC.**

**Securities registered pursuant to Section 12(g) of the Act:**

**NONE**

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

**\$387,786,692**

Aggregate market value of the voting stock held by nonaffiliates of the registrant based on the last sale price for such stock at June 30, 2014 (assuming solely for the purposes of this calculation that all Directors and executive officers of the registrant are affiliates).

**23,552,426**

Number of shares of Common Stock, \$.01 par value, outstanding at April 30, 2015.

**DOCUMENTS INCORPORATED BY REFERENCE**

None

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**ITT EDUCATIONAL SERVICES, INC.**

**Carmel, Indiana**

**Annual Report to Securities and Exchange Commission**

**December 31, 2014**

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**PART I**

**Item 1. Business.**

*Forward-Looking Statements: All statements, trend analyses and other information contained in this report that are not historical facts are forward-looking statements within the meaning of the safe harbor provision of the Private Securities Litigation Reform Act of 1995 and as defined in Section 27A of the Securities Act of 1933 (the Securities Act ) and Section 21E of the Securities Exchange Act of 1934 (the Exchange Act ). Forward-looking statements are made based on our management s current expectations and beliefs concerning future developments and their potential effects on us. You can identify those statements by the use of words such as could, should, would, may, will, project, believe, anticipate, expect, plan, estimate, forecast, potential, intend, continue, and contemplate, as well as similar words and expressions. Forward-looking statements involve risks and uncertainties and do not guarantee future performance. We cannot assure you that future developments affecting us will be those anticipated by our management. Among the factors that could cause actual results to differ materially are the following:*

*the impact of adverse actions by the U.S. Department of Education related to lawsuits against us, our failure to submit our 2013 audited financial statements and 2013 compliance audits to it by the due date, and any failure to submit our 2014 audited financial statements and 2014 compliance audits to it by the due date;*

*the impact of our consolidation of variable interest entities on us and the regulations, requirements and obligations that we are subject to;*

*our inability to obtain any required amendments or waivers of noncompliance with covenants under our financing agreement;*

*our failure to comply with the extensive education laws and regulations and accreditation standards that we are subject to;*

*actions by the New York Stock Exchange to delist our common stock;*

*our inability to remediate material weaknesses, or the discovery of additional material weaknesses, in our internal control over financial reporting;*

*the impact of our late filings with the U.S. Securities and Exchange Commission;*

*issues related to the restatement of our financial statements for the first three quarters of 2013;*

*our exposure under our guarantees related to private education loan programs;*

*the outcome of litigation, investigations and claims against us;*

*the effects of the cross-default provisions in our financing agreement;*

*changes in federal and state governmental laws and regulations with respect to education and accreditation standards, or the interpretation or enforcement of those laws and regulations, including, but not limited to, the level of government funding for, and our eligibility to participate in, student financial aid programs utilized by our students;*

*business conditions in the postsecondary education industry and in the general economy;*

*effects of any change in our ownership resulting in a change in control, including, but not limited to, the consequences of such changes on the accreditation and federal and state regulation of our campuses;*

*our ability to implement our growth strategies;*

*our ability to retain or attract qualified employees to execute our business and growth strategies;*

*our failure to maintain or renew required federal or state authorizations or accreditations of our campuses or programs of study;*

*receptivity of students and employers to our existing program offerings and new curricula;*

*our ability to repay moneys we have borrowed; and*

*our ability to collect internally funded financing from our students.*

*Readers are also directed to other risks and uncertainties discussed in "Risk Factors" and elsewhere in this Annual Report and those detailed from time to time in other documents we file with the U.S. Securities and Exchange Commission ( "SEC" ). We undertake no obligation to update or revise any forward-looking information, whether as a result of new information, future developments or otherwise.*

*You should keep in mind the following points as you read this report:*

*References in this document to we, us, our and ITT/ESI refer to ITT Educational Services, Inc., its subsidiaries and any variable interest entity ( VIE ) that it consolidates in its consolidated financial statements, unless the context requires or indicates otherwise.*

*The term PEAKS Trust means the PEAKS Trust 2009-1, which is a VIE that purchased, owns and collects private education loans made under the PEAKS Private Student Loan Program (the PEAKS Program ) and that we consolidate in our consolidated financial statements beginning on February 28, 2013.*

*The term CUSO means Student CU Connect CUSO, LLC, which is a VIE that purchased, owns and collects private education loans made under a private education loan program for our students (the CUSO Program ) and that we consolidate in our consolidated financial statements beginning on September 30, 2014. In prior filings and disclosures, we referred to the CUSO as the 2009 Entity, but we refer to this entity as the CUSO in this filing to enhance the readability.*

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*The terms ITT Technical Institute or Daniel Webster College (in singular or plural form) refer to an individual school or campus owned and operated by ITT/ESI, including its learning sites, if any.*

*The term institution (in singular or plural form) means a main campus and its additional locations, branch campuses and/or learning sites, if any.*

*References in this document to education programs refer to degree or diploma programs of study that have been, or may be, offered by an ITT Technical Institute or by Daniel Webster College; and references in this document to training programs refer to the non-degree, short-term programs that have been, or may be, offered through the Center for Professional Development @ ITT Technical Institute (the CPD ).*

## **Background**

We are a Delaware corporation incorporated in 1946. Our principal executive offices are located at 13000 North Meridian Street, Carmel, Indiana 46032-1404, and our telephone number is (317) 706-9200. From 1966 until our initial public offering on December 27, 1994, we were wholly owned by ITT Corporation, an Indiana corporation, formerly a Delaware corporation and formerly known as ITT Industries, Inc. ( Old ITT ). On September 29, 1995, ITT Corporation, a Nevada corporation ( ITT ), succeeded to the interests of Old ITT in the beneficial ownership of 83.3% of our common stock. ITT s beneficial ownership of our common stock ended in February 1999.

## **Overview**

We are a leading proprietary provider of postsecondary degree programs in the United States based on revenue and student enrollment. As of December 31, 2014, we were offering:

master, bachelor and associate degree programs to approximately 53,000 students; and

short-term information technology and business learning solutions for career advancers and other professionals.

As of December 31, 2014, we had 144 college locations in 39 states. In addition, during 2014 we offered one or more of our online programs to students who are located in all 50 states. All of our college locations are authorized by the applicable education authorities of the states in which they operate, and are accredited by an accrediting commission recognized by the U.S. Department of Education ( ED ). We design our education programs, after consultation with employers and other constituents, to help graduates prepare for careers in various fields involving their areas of study. We have provided career-oriented education programs since 1969 under the ITT Technical Institute name and since 2009 under the Daniel Webster College ( DWC ) name.

In 2014, we did not begin operations at any new ITT Technical Institute campuses or learning sites. As part of our efforts to maximize the efficiency and effectiveness of our current campus locations, during 2014, we:

relocated three of our campuses into existing facilities of other ITT Technical Institute campuses;



converted one of our learning sites into an ITT Technical Institute campus;

closed one of our learning sites;

closed four of our ITT Technical Institute campuses; and

decreased the number of our campuses that offer bachelor degree programs from 134 to 130.

In 2014, we continued our efforts to diversify our program offerings by developing education programs at different credential levels in technology and non-technology fields of study that we intend to offer at our campuses and deliver entirely in residence, entirely online over the Internet or partially in residence and partially online.

In 2014, we continued to develop and offer training programs to career advancers and other professionals through the CPD.

In June 2014, we determined that, beginning on February 28, 2013, we should have consolidated the PEAKS Trust in our consolidated financial statements (the PEAKS Consolidation ). Our results of operations, financial condition and cash flows for periods after February 28, 2013 reflect the results of operations, financial condition and cash flows of the PEAKS Trust. We do not, however, actively manage the operations of the PEAKS Trust, and the assets of the PEAKS Trust can only be used to satisfy the obligations of the PEAKS Trust. See Risk Factors, Management's Discussion and Analysis of Financial Condition and Results of Operations and our Notes to Consolidated Financial Statements for further information about the PEAKS Consolidation.

In addition, we have determined that, effective September 30, 2014, we should begin consolidating the CUSO in our consolidated financial statements (the CUSO Consolidation and, together with the PEAKS Consolidation, the Consolidations ). Our results of operations, financial condition and cash flows for periods after September 30, 2014 reflect the results of operations, financial condition and cash flows of the CUSO. We do not, however, actively manage the operations of the CUSO, and the assets of the CUSO can only be used to satisfy the obligations of the CUSO. See Risk Factors, Management's Discussion and Analysis of Financial Condition and Results of Operations and our Notes to Consolidated Financial Statements for further information about the CUSO Consolidation.

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**Business Strategy**

Our strategy is to pursue multiple opportunities for growth. We are implementing a growth strategy designed to:

improve the academic outcomes of our students;

increase the value proposition of our education programs for our students; and

increase access to high-quality, career-based education.

We intend to pursue this strategy by:

increasing student enrollment in existing programs at existing campuses;

increasing the number and types of program and other educational offerings that are delivered in residence and/or online;

increasing our students' engagement in their programs of study;

enhancing the relevancy of our educational offerings;

assessing student achievement and learning;

improving the flexibility and convenience of how our institutions deliver their educational offerings;

helping our graduates obtain entry-level employment involving their fields of study at higher starting annual salaries;

operating new campuses across the United States; and

investing in other education-related opportunities.

Our ability to execute on this strategy is subject to extensive regulations and restrictions, as discussed further under Highly Regulated Industry. The principal elements of this strategy include the following:

***Enhance Results at Each Institution.***

*Increase Enrollments at Existing Campuses.* We intend to increase recruiting efforts that are primarily aimed at delivering high-quality, career-based education to multiple adult-learner audiences.

*Develop and Deliver Different Education Program Offerings.* We intend to develop and deliver different education program offerings that we believe offer graduates attractive returns on their educational investments.

As part of this strategy, we intend to further diversify our offerings by developing new education programs in both technology and non-technology fields, but primarily in technology- and healthcare-related disciplines. We believe that those programs of study will be at different education levels and delivered in a variety of formats, including entirely in residence, entirely online or partially in residence and partially online.

Part of our strategy is to increase the number of education programs that we offer to our students across our campuses. In 2014, we added a total of 146 associate and bachelor degree programs among 84 campuses.

We believe that developing new programs of study, delivering programs in different formats and increasing the number of programs from which prospective students may choose, can:

attract more, and a broader base of, students to our institutions;

motivate current students to extend their studies;

help improve student outcomes;

increase the value proposition of our programs of study to our students;

increase access to high-quality, career-based education; and

improve the utilization of our facilities.

*Improve Student Outcomes.* We strive to improve the graduation and graduate employment rates of our ITT Technical Institute and DWC students by:

providing academic and career services;

dedicating administrative resources to those services;

increasing our students' engagement in their programs of study;

enhancing the relevancy of our educational offerings;

assessing student achievement and learning; and

increasing our students' access to financial aid.

***Provide Education-Related Services.*** We plan to continue to develop and provide education-related services to students and other constituencies. These services may involve a variety of activities. Through the CPD, we are offering training programs to career advancers and other professionals. We are delivering assessments, consulting and authorized and customized training programs and curricula in the areas of information technology ( IT ), information technology infrastructure library ( ITIL ), development, business analysis, project management and leadership development. On January 31, 2014, we acquired certain assets and assumed certain liabilities of Great Equalizer, Inc. and CompetenC Solutions, Inc., two companies that offered short-term IT and business learning solutions for career advancers and other professionals, primarily under the name of Ascolta. We have integrated these acquired operations in the CPD, along with the operations of Cable Holdings, LLC, which we acquired in August 2013.

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In August 2014, we became the education management organizer ( EMO ) for a public charter high school in Michigan, which offers high school students an opportunity to concurrently earn both a high school diploma and an associate degree. These services are being offered under The Early Career Academy @ ITT Technical Institute ( Early Career Academy ) name.

**Programs of Study**

As of December 31, 2014, the ITT Technical Institutes were offering 51 education programs in various fields of study across the following schools of study:

Business;

Drafting and Design;

Electronics Technology;

Criminal Justice;

IT; and

Breckinridge School of Nursing and Health Sciences.

We design our education programs to help graduates prepare for careers in various fields by offering students a broad-based foundation in a variety of skills used in those fields. The following table sets forth examples of various fields involving the subject matter of education programs within a particular school of study in which graduates have obtained entry-level positions:

| <b>School of Study</b> | <b>Fields</b>  |
|------------------------|--|
| Business               | accounting<br>business administration<br>financial services<br>manufacturing<br>marketing and advertising<br>sales             |
| Drafting and Design    | architectural and construction<br>drafting<br>civil drafting<br>computer-aided drafting<br>electrical and electronics drafting |

|   |   |
|---|---|
|   | industrial engineering technology             |
|   | interior design                               |
|   | landscape architecture                        |
|   | mechanical drafting                           |
|   | multimedia communications                     |
| Electronics Technology                                | communications                                |
|   | computer technology                           |
|   | electronics product design and<br>fabrication |
|   | industrial electronics                        |
|   | instrumentation                               |
|   | telecommunications                            |
| Criminal Justice                                      | corrections                                   |
|   | cyber security                                |
|   | investigations                                |
|   | security and policing                         |
| IT  | communications                                |
|   | network administration                        |
|   | network technology                            |
|   | software development                          |
|   | systems technology                            |
|   | technical support                             |
| Breckinridge School of Nursing and<br>Health Sciences | health information technology                 |
|   | medical assisting and<br>administration       |
|   | nursing                                       |

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At the vast majority of our campuses, we generally organize the academic schedule for education programs of study on the basis of four 12-week academic quarters in a calendar year, with new students beginning at the start of each academic quarter. At these campuses, students taking a full-time course load can complete our associate degree programs in seven or eight academic quarters, bachelor degree programs in 14 or 15 academic quarters and a master degree program in seven academic quarters. We typically offer classes in most residence education programs in:

3.5- to 5.5-hour sessions three days a week, Monday through Saturday, with all program courses taught entirely or partially in residence; or

sessions that are scheduled two to three days a week, Monday through Saturday, with certain program courses taught entirely or partially online over the Internet most academic quarters.

Depending on student enrollment, class sessions at the vast majority of our ITT Technical Institute campuses are generally available during the day and evening. The courses for education programs that are taught online over the Internet are delivered through an asynchronous learning network and have a prescribed schedule for completion of the coursework. At the vast majority of our ITT Technical Institute campuses, the class schedule for our education program residence courses and the coursework completion schedule for our education program online courses generally provide students with the flexibility to maintain employment concurrently with their studies. Based on student surveys, we believe that a majority of our ITT Technical Institute students work at least part-time during their programs of study.

Most of our education programs of study blend traditional academic content with applied learning concepts and have the objective of helping graduates prepare for a changing economic and/or technological environment. A significant portion of most education programs offered at our campuses involves practical study in a lab environment.

The learning objectives of most courses in each education program are substantially the same among the vast majority of our campuses to provide greater uniformity and to better enable students to transfer, if necessary, to other ITT Technical Institute campuses offering the same programs with less disruption to their education. We regularly review each curriculum to respond to changes in technology and industry needs. Each of the ITT Technical Institutes establishes an advisory committee for each field of study for education programs taught at that campus, which is comprised of representatives of local employers and other constituents. These advisory committees assist the ITT Technical Institutes in assessing curricula, equipment and laboratory design, and updating the curricula. In addition to courses directly related to a student's program of study, our education programs also include general education courses in the humanities, composition, mathematics, the sciences and the social sciences.

Gross tuition for a student entering an undergraduate residence education program at an ITT Technical Institute in December 2014 for 36 quarter credit hours (the minimum course load for a full-time student for an academic year consisting of three academic quarters) was \$17,748 for all ITT Technical Institute undergraduate residence education programs, except as adjusted in one state to reflect applicable taxes and fees. Gross tuition for a student entering an undergraduate residence education program at DWC in September 2014 for 24 semester credit hours (the minimum course load for a full-time student for an academic year consisting of two academic semesters) was \$15,630 for all DWC undergraduate residence education programs. The gross tuition amounts discussed above do not reflect institutional scholarships and awards, which reduce the amount of gross tuition that students pay to attend our institutions. In the academic year beginning in December 2014 and ending in September 2015, we believe that institutional scholarships and awards for ITT Technical Institute students will average approximately \$1,169 per student, based on the number of students estimated to be enrolled in education programs in each of the three months



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ended March 31, 2015, June 30, 2015 and September 30, 2015. We have not increased gross tuition rates for our ITT Technical Institute education programs of study since 2010, and we do not intend to increase gross tuition rates for our ITT Technical Institute education programs of study in 2015. The majority of students attending residence programs at our campuses lived in that campus metropolitan area prior to enrollment. The only student housing that we provide is at the Nashua, New Hampshire campus of DWC.

As of December 31, 2014, the CPD was offering 2,690 training programs in the following areas:

- |                    |                               |
|--------------------|-------------------------------|
| IT                 | Leadership development        |
| ITIL               | Professional development      |
| Development        | Business software application |
| Business analysis  | Process and productivity      |
| Project management | Graphic design and media      |

The length of these programs ranges from four hours to 40 hours. These programs are taught primarily through instructor-led sessions delivered in person and virtually.

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### **Student Recruitment**

With respect to education programs offered at the ITT Technical Institute and DWC, we strive to attract students with the motivation and ability to complete the career-oriented educational programs. To generate interest among potential students, we engage in a broad range of activities to inform potential students and their parents about our campuses and the programs they offer. These activities include television, Internet and other media advertising, social media, direct mailings and high school presentations. As of December 31, 2014, we employed approximately 1,350 full- and part-time recruiting representatives to assist in recruiting efforts.

Recruiting representatives pursue expressions of interest from potential students for our residence education programs by contacting prospective students and arranging for interviews at the campus. Occasionally, we also pursue expressions of interest from students for our residence education programs by contacting them and arranging for their attendance at a seminar providing information about the campus and its programs. We pursue expressions of interest from potential students for our online education programs by providing program and resource information on our websites and through telephone calls, electronic mail, social media and postal delivery.

Student recruitment activities are subject to substantial regulation at both the state and federal level and by our accrediting commissions. Certain states have bonding and licensing requirements that apply to many of our representatives and other employees involved in student recruitment. Our National Director of Recruitment and Regional Directors of Recruitment oversee the implementation of recruitment policies and procedures. In addition, our compliance department reviews student recruiting practices at each of our campuses on at least an annual basis.

Representatives of the CPD periodically communicate with national and local employers, primarily through face-to-face meetings, phone calls and emails, to identify their training needs. These needs arise through new IT systems implementations, employee turnover, and a desire by employers and employees to expand their skills. The CPD also hosts informational webinars and conferences that help identify training opportunities. Additionally, individuals and employers contact the CPD through information found on its website.

### **Student Admission and Retention**

We require all applicants for admission to any of our campus education programs to have a high school diploma or a recognized equivalent. Depending on the program of study and the campus, applicants may also be required to:

pass an admission examination;

possess a designated number of credit hours or degree with a specified overall cumulative grade point average from an accredited postsecondary educational institution;

complete the Scholastic Assessment Test or American College Testing examination; and

tour the campus.

The following table sets forth the demographics of students at the ITT Technical Institutes as of the dates indicated:

| Student Demographics | Approximate Percent of Student Census |                   |
|----------------------|---------------------------------------|-------------------|
|                      | December 31, 2014                     | December 31, 2013 |
| <b>Age</b>           |                                       |                   |
| 19 or less           | 3%                                    | 3%                |
| 20 through 24        | 23%                                   | 25%               |
| 25 through 30        | 29%                                   | 29%               |
| 31 or over           | 45%                                   | 43%               |
| <b>Gender</b>        |                                       |                   |
| Male                 | 55%                                   | 72%               |
| Female               | 45%                                   | 28%               |
| <b>Race</b>          |                                       |                   |
| Caucasian            | 42%                                   | 43%               |
| Other (1)            | 58%                                   | 57%               |

(1) Based on applicable federal classifications.

The faculty and staff at each of our campuses strive to help students overcome obstacles to the completion of their education programs. As is the case in other postsecondary institutions, however, students often fail to complete their education programs for a variety of personal, financial or academic reasons. Student withdrawals prior to education program completion not only affect the students, they also have a negative regulatory and financial effect on the campus and the entire institution. To minimize these student withdrawals, each of our campuses devotes staff resources to assist and advise students regarding academic and financial matters. We encourage academic advising and tutoring in the case of students experiencing academic difficulties. We also offer assistance and advice to students in our residence education programs who are looking for part-time employment and housing.

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The CPD assesses a prospective student's skill set and goals to determine the program that would best meet the individual's objectives and experience before enrolling a student in a program.

## **Graduate Employment**

We believe that the success of our ITT Technical Institute and DWC graduates who begin their careers in fields involving their education programs is critical to the ability of our campuses to continue to recruit students for our education programs. We try to obtain data on the number of students employed following graduation from an ITT Technical Institute or DWC. The reliability of such data depends largely on information that students and employers report to us. Based on this information, we believe that approximately 70% of the Employable Graduates (as defined below) in 2013 had obtained employment by April 30, 2014 in positions that required the direct or indirect use of skills taught in their education programs, compared to approximately 66% of the Employable Graduates in 2012 who had obtained employment by April 30, 2013.

Employable Graduates are defined in accordance with the graduate employment metrics that we are required to report by one of the accrediting commissions that accredits our institutions and include all of the graduates from the ITT Technical Institutes' education programs in the applicable year, except for those graduates who:

were pregnant, died or suffered other health-related conditions that prevented them from working;

continued their education;

were engaged in active U.S. military service;

moved out of the United States with a spouse or parent who was engaged in active U.S. military service;

were incarcerated in a correctional institution (other than a half-way house) for more than 30 consecutive days; or

possessed visas that did not permit them to work in the United States following graduation.

Each of our campuses employs personnel to offer career services to students and graduates from our education programs. These persons assist in job searches, solicit employment opportunities from employers and provide information on job search techniques, where to access employer information, writing resumes and how to prepare for, appear at and conduct oneself during job interviews.

Based on information from graduates and employers who responded to our inquiries, the reported annualized salaries initially following graduation averaged approximately \$33,398 for the Employable Graduates in 2013 who, as of April 30, 2014, had obtained employment in positions that required the direct or indirect use of skills taught in their education programs, compared to approximately \$32,612 for the Employable Graduates in 2012 who, as of April 30, 2013, had obtained employment in positions that required the direct or indirect use of skills taught in their education

programs. The average annual salary initially following graduation for our Employable Graduates may vary significantly among the ITT Technical Institutes depending on local employment conditions and each Employable Graduate's particular education program, background, prior work experience and willingness to relocate. Initial employers of Employable Graduates from education programs at the ITT Technical Institutes include small, medium and large companies and governmental agencies.

**Faculty**

We hire faculty members for our education programs in accordance with criteria established by us, the accrediting commissions that accredit our campuses and the state education authorities that regulate our campuses. We hire faculty with relevant work experience and/or academic credentials to teach most technical subjects. Faculty members for our education programs at each campus typically include the chairperson for each school or education program and various categories of instructors, including full-time and adjunct.

**Administration and Employees**

Each of our campuses is managed by a person who has overall responsibility for the operation of the campus. The administrative staff of each campus also includes managers in the major functional areas of that campus, including recruitment, finance, registration, academics and career services. As of December 31, 2014, we had approximately 4,400 full-time and 4,500 part-time employees. None of our employees are represented by labor unions.

Our headquarters provides centralized services to all of our campuses in the following areas:

- |                                |                           |
|--------------------------------|---------------------------|
| accounting                     | legal                     |
| marketing                      | regulatory                |
| public relations               | legislative affairs       |
| curricula development          | real estate               |
| management information systems | human resources           |
| purchasing                     | compliance/internal audit |

In addition, national managers of each of the following major campus functions reside at our headquarters and develop policies and procedures to guide these functions at our ITT Technical Institute campuses:

- |                  |                    |
|------------------|--------------------|
| recruiting       | career services    |
| financial aid    | learning resources |
| academic affairs | registration       |

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Managers located at our headquarters monitor the operating results of each of our campuses and regularly conduct on-site reviews.

## **Competition**

The postsecondary education and professional training markets in the United States are highly fragmented and competitive, with no single private or public institution enjoying a significant market share. Our campuses compete for students with associate, bachelor and graduate degree-granting institutions, which include public and nonprofit private colleges and proprietary institutions, as well as with alternatives to higher education such as military service or immediate employment. We believe competition among educational institutions is based on the:

quality and reliability of the institution's programs and student services;

reputation of the institution and its programs and student services;

type and cost of the institution's programs;

employability of the institution's graduates;

ability to provide easy and convenient access to the institution's programs and courses;

quality and experience of the institution's faculty; and

time required to complete the institution's programs.

Certain public and private colleges may offer programs similar to those offered by our campuses at a lower tuition cost due in part to government subsidies, foundation grants, tax deductible contributions, tax-exempt status or other financial resources not available to proprietary institutions. Other proprietary institutions offer programs that compete with those offered by our campuses. Certain of our competitors in both the public and private sectors have greater financial and other resources than we do. In addition, recent and ongoing adverse matters affecting us and our industry, including, without limitation, investigations, claims and lawsuits, and the negative publicity associated with those matters, may make it more difficult for us to attract and retain students and to compete with institutions that are not as impacted by such matters.

The CPD competes primarily with local and national providers of IT and business skills training. We believe competition among training providers is based on the:

quality and reliability of the training provider's programs;

reputation of the training provider and its programs;

type and cost of the training provider's programs;

ability to provide easy and convenient access to the training provider's courses;

quality and experience of the training provider's instructors; and

time required to complete the training provider's programs.

### **Federal and Other Financial Aid Programs**

In 2014, approximately 80% of our revenue determined on a cash accounting basis under the 90/10 Rule calculation was from the federal student financial aid programs under Title IV (the Title IV Programs) of the Higher Education Act of 1965, as amended (the HEA). See Risk Factors Risks Related to Our Highly Regulated Industry *One or more of our institutions may lose its eligibility to participate in Title IV Programs, if the percentage of its revenue derived from those programs is too high* for a description of the 90/10 Rule. Our institutions' students also rely on scholarships and awards, family contributions, personal savings, employment, state financial aid programs, veterans' and military benefits, internal student financing offered by us, private education loan programs and other resources to pay their educational expenses associated with their education programs. The primary Title IV Programs from which the students at our campuses received grants, loans and other aid to fund the cost of their education programs in 2014 included:

the William D. Ford Federal Direct Loan (the FDL) program, which represented, in aggregate, approximately 57% of our cash receipts; and

the Federal Pell Grant (the Pell) program, which represented, in aggregate, approximately 24% of our cash receipts.

Other sources of financial aid used by our students in 2014 to help pay the costs associated with their education programs included:

state financial aid programs, veterans' and military service member benefit programs and other sources, which represented, in aggregate, approximately 14% of our cash receipts;

employment, personal savings and family contributions, which represented, in aggregate, approximately 4% of our cash receipts; and

private education loan programs, which represented approximately 1% of our cash receipts.

Institutional scholarships and awards, which our students use to help reduce their educational expenses, amounted to, in aggregate, approximately \$261.2 million in 2014. Institutional scholarships and awards for ITT Technical Institute students averaged approximately \$1,177 per student in the year ended December 31, 2014, based on the number of

students enrolled in education

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programs in each of the three months ended March 31, 2014, June 30, 2014, September 30, 2014 and December 31, 2014. We also provided internal student financing to our students in 2014, which consists of non-interest bearing, unsecured credit extended to our students. The amount of internal student financing that we have provided has decreased and will continue to decrease significantly, as the amount of institutional scholarships and awards that our students receive increases.

We believe that the employers of the vast majority of individuals enrolled in the training programs offered through the CPD pay for the individuals' costs of those programs either directly to the CPD or through employee reimbursements.

## **Highly Regulated Industry**

The training programs offered through the CPD require approval from certain state education agencies and the accrediting commission that accredits our ITT Technical Institutes. Individuals who enroll in the training programs offered by the CPD are not eligible to receive funds under the Title IV Programs for those training programs. The discussion in the remainder of this section applies to the ITT Technical Institutes and DWC, and the education programs offered by those institutions.

Our institutions are subject to extensive regulation by the ED, the state education and professional licensing authorities (collectively, the SAs) and the accrediting commissions that accredit our institutions (the ACs). The statutes, regulations and standards applied by the ED, SAs and ACs are periodically revised and the interpretations of existing requirements are periodically modified. We cannot predict how any of the statutes, regulations and standards applied by the ED, SAs and ACs will be interpreted and implemented.

The statutes, regulations and standards applied by the ED, SAs and ACs cover the vast majority of our operations, including our:

academic affairs;

educational programs;

facilities;

academic and administrative staff;

administrative procedures;

marketing;

student recruitment;

compensation practices; and

financial operations and financial condition.

These requirements also affect our ability to:

add new campuses;

add new, or revise or expand our existing, educational programs; and

change our corporate structure and ownership.

***Regulation by the U.S. Department of Education***

At the federal level, the HEA and the regulations promulgated under the HEA by the ED set forth numerous, complex standards that institutions must satisfy in order to participate in Title IV Programs. To participate in Title IV Programs, an institution must:

receive and maintain authorization by the appropriate SAs;

be accredited by an accrediting commission recognized by the ED; and

be certified as an eligible institution by the ED.

The purposes of these standards are to, among other things:

limit institutional dependence on Title IV Program funds;

prevent institutions with unacceptable student loan default rates from participating in Title IV Programs; and

in general, require institutions to satisfy certain criteria related to educational value, administrative capability and financial responsibility.

Most of the ED's requirements are applied on an institutional basis, with an institution defined by the ED as a main campus and its additional locations, if any. Under the ED's definition, we had three institutions as of December 31, 2014, comprised of two ITT Technical Institute main campuses and one DWC main campus. All of the remaining ITT Technical Institute campuses are additional locations of the ITT Technical Institute main campuses under the ED's regulations. As of December 31, 2014, one ITT Technical Institute institution had 139 additional locations and the second ITT Technical Institute institution had two additional locations. The HEA requires each institution to periodically renew its certification by the ED to continue its participation in Title IV Programs. As of December 31, 2014, all 144 of our campuses participated in Title IV Programs.

Each of the campuses that we added from 2010 through 2012 constitutes an additional location under the ED's regulations. The HEA requires a proprietary institution to operate for two years before it can qualify to participate in Title IV Programs. If an

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institution that is certified to participate in Title IV Programs establishes an additional location and receives all of the necessary SA and AC approvals for that location, that additional location can participate in Title IV Programs immediately upon being reported to the ED, unless the institution will offer at least 50% of an entire educational program at that location and any one of the following restrictions applies, in which case the ED must approve the additional location before it can participate in Title IV Programs:

the institution is provisionally certified to participate in Title IV Programs;

the institution receives Title IV Program funds under the ED's heightened cash monitoring or reimbursement system of payment;

the institution acquired the assets of another institution that provided educational programs at that location during the preceding year and participated in Title IV Programs during that year;

the institution would be subject to loss of eligibility to participate in Title IV Programs, because the additional location lost its eligibility to participate in Title IV Programs as a result of high student loan cohort default rates under the Federal Family Education Loan ( FFEL ) and/or the FDL programs; or

the ED previously notified the institution that it must apply for approval to establish an additional location.

One of the ED's regulations applicable to our institutions is that each institution must submit to the ED on an annual basis its audited, consolidated financial statements and a compliance audit of the institution's administration of the Title IV Programs in which it participates ( Compliance Audit ). The financial statements and Compliance Audit must cover one fiscal year and must be submitted to the ED within six months after the end of the fiscal year. Our institutions did not submit their 2013 audited consolidated financial statements and Compliance Audits to the ED by June 30, 2014 and, as a result, the ED determined in August 2014 that our institutions were not financially responsible, which resulted in, among other things, our institutions being:

required to submit a letter of credit payable to the ED;

placed on heightened cash monitoring by the ED, instead of the ED's standard advance payment method; and

provisionally certified by the ED to participate in Title IV Programs.

Our institutions' participation in the Title IV Programs will remain provisional until at least November 4, 2019. *See Risk Factors Risks Related to our Highly Regulated Industry Our institutions' failure to submit their 2013 audited consolidated financial statements and Compliance Audits to the ED by the due date resulted in sanctions imposed by the ED on our institutions that include, among other things, our institutions having to post a letter of credit, being*

*placed on heightened cash monitoring and being provisionally certified.*

Any one or more of the sanctions or actions described above could have a material adverse effect on our financial condition, results of operations and cash flows.

The HEA and its implementing regulations require each institution to periodically reapply to the ED for continued certification to participate in Title IV Programs. The ED recertifies each institution deemed to be in compliance with the HEA and the ED's regulations for a period of six years or less. Before that period ends, the institution must apply again for recertification. The current provisional certifications of our three institutions expire on June 30, 2017. If an institution successfully participates in Title IV Programs during its period of provisional certification, but fails to satisfy the full certification criteria, the ED may renew the institution's provisional certification. The ED has informed our institutions that, due to their failure to submit their 2013 audited consolidated financial statements and Compliance Audits to the ED by June 30, 2014, the ED will not consider our institutions to have satisfied the ED's eligibility standards relating to financial responsibility before November 4, 2019. As a result, our institutions' participation in the Title IV Programs will continue to be provisional, if our institutions are recertified when their current provisional certifications expire on June 30, 2017.

The ED may revoke an institution's provisional certification without advance notice, if the ED determines that the institution is not fulfilling all material requirements. If the ED revokes an institution's provisional certification, the institution may not apply for reinstatement of its eligibility to participate in Title IV Programs for at least 18 months. If the ED does not recertify the institution following the expiration of its provisional certification, the institution loses eligibility to participate in Title IV Programs, until the institution reapplies to participate and the ED certifies the institution to participate.

The HEA and applicable regulations permit students to use Title IV Program funds only to pay the cost associated with enrollment in an eligible program offered by an institution participating in Title IV Programs. A proprietary institution that is eligible to participate in Title IV Programs can generally add a new educational program without the ED's approval, if that new program:

leads to an associate level or higher degree and the institution already offers programs at that level; or

prepares students for gainful employment in the same or a related occupation as an educational program that had been previously designated as an eligible program at the institution and meets minimum length requirements.

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Otherwise, the proprietary institution has to obtain the ED's approval before it can disburse Title IV Program funds to students enrolled in the new program. Any institution provisionally certified by the ED, however, must apply for and receive approval by the ED for any substantial change before the institution can award, disburse or distribute Title IV Program funds based on the substantial change. Substantial changes generally include, but are not limited to:

the establishment of an additional location;

an increase in the level of academic offering beyond those listed in the institution's Eligibility and Certification Approval Report with the ED;

an addition of any non-degree program or short-term training program; or

an addition of a degree program by a proprietary institution.

If an institution applies for the ED's approval of a substantial change, the institution must demonstrate that it has the financial and administrative resources necessary to assure the institution's continued compliance with the ED's standards of financial responsibility and administrative capability.

If we are unable to obtain the required approvals from the ED for any new campuses, or any new program offerings, or to obtain those approvals in a timely manner, our ability to operate the new campuses or offer new programs as planned would be impaired, which could have a material adverse effect on our expansion plans. See Risk Factors **Risks Related to Our Highly Regulated Industry** *We cannot operate new campuses or offer new programs, if they are not timely authorized by our regulators, and we may have to repay Title IV Program funds disbursed to students enrolled at any of those locations or in any of those programs, if we do not obtain prior authorization.*

***Regulation by Department of Defense and State Approving Agencies for Veterans Benefits***

Some of our students who are veterans and/or their dependents use their benefits under the Montgomery GI Bill ( MGIB ) or the Post-9/11 Veterans Educational Assistance Act of 2008, as amended ( Post-9/11 GI Bill ) (collectively the GI Bill Programs ), to cover all or a portion of their tuition. A certain number of our students are also eligible to receive funds from other education assistance programs administered by the U. S. Department of Veterans Affairs ( VA ).

Department of Veterans Affairs. The VA administers education benefits provided by federal law, including the GI Bill Programs. Pursuant to federal law related to these programs, our campuses are approved to provide education to veterans and their dependents under these benefit programs by the state approving agencies in the applicable state.

The Post-9/11 GI Bill expanded education benefits for veterans who have served on active duty since September 11, 2001, including reservists and members of the National Guard, beyond the benefits available under the MGIB. The Post-9/11 GI Bill also allows service members to transfer their benefits to family members. The Post-9/11 GI Bill also provides veterans up to \$1,000 per academic year for books, supplies, equipment and other education costs. The Post-9/11 Veterans Educational Assistance Improvements Act of 2010, or Improvements Act, revised the calculations of benefits related to tuition and fees under the Post-9/11 GI Bill. For a veteran attending a non-public U.S. institution, the Improvements Act provides tuition and fees based on the net cost to the veteran (after accounting for state and

federal student financial aid, scholarships, institutional aid, fee waivers, and similar assistance), up to \$20,235.02 for the 2014-2015 year. Veterans pursuing a program of education on a more than half-time basis at an on-campus location are also eligible for a monthly housing allowance equal to the basic allowance for housing available to service members who are at a military pay grade E-5 and have dependents. In addition, eligible veterans pursuing an educational program solely through distance learning are eligible to receive a monthly housing allowance equal to half the amount available to students attending certain traditional classroom-based programs or programs that combine classroom learning and distance education.

The Post-9/11 GI Bill also established the Yellow Ribbon Program. This program allows institutions of higher learning (degree-granting institutions) in the U.S. or a branch of such institutions located outside of the U.S. to voluntarily enter into an agreement with the VA to partially or fully fund tuition and fee expenses that exceed the established tuition and fee amounts payable under the Post-9/11 GI Bill. The institution may contribute a specified dollar amount of these expenses, and the VA will match the contribution, not to exceed 50% of the difference. Only veterans (or dependents under the transfer of entitlement provisions) who are at the 100% benefit rate, as determined by service requirements, qualify to participate in the Yellow Ribbon Program. The VA issues payments for tuition and fees and the Yellow Ribbon Program match directly to the institution on behalf of the student. Most ITT Technical Institutes participate in the Yellow Ribbon Program.

On April 27, 2012, President Obama signed Executive Order 13607, Establishing the Principles of Excellence for Educational Institutions Serving Service Members, Veterans, Spouses, and Other Family Members ( EO 13607 ). EO 13607 addresses key areas concerning federal military and veterans educational benefits. Pursuant to EO 13607, for students who are eligible to receive federal military and veterans educational benefits, the institution must:

provide a standardized cost form, the Financial Aid Shopping Sheet, prior to enrollment;

advise the student of the availability of and their potential eligibility for federal financial aid before recommending or offering private student loans;

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comply with ED's Title IV program integrity rules, including rules related to incentive compensation and misrepresentation;

obtain approval from its accreditor, as required under the accreditor's standards, for new courses or programs before offering and enrolling students in such courses or programs;

establish a readmissions policy that allows service members and reservists who are unable to attend class or experience short term absences due to service obligations to be readmitted to their program of study;

agree to an institutional refund policy that is aligned with the Return of Title IV policy for students who withdraw prior to term completion;

provide individual education plans that detail the requirements necessary to graduate, information about transfer of credit and expected timeline of completion; and

provide a designated point of contact for academic and financial advising to assist with completion of studies and job search activities.

While the VA did not implement new regulatory requirements to effectuate the requirements of EO 13607, it did ask institutions to voluntarily agree to comply with those requirements and it routinely assesses compliance by institutions that volunteered to comply. All of our institutions volunteered to comply with the requirements of EO 13607.

*Department of Defense.* Service members of the United States Armed Forces are eligible to receive tuition assistance from their branch of service through the Uniform Tuition Assistance Program of the Department of Defense ( DoD ), or DoD tuition assistance programs. Each institution participating in DoD tuition assistance programs is required to sign a Memorandum of Understanding ( MOU ), outlining certain commitments and agreements between the institution and DoD prior to being permitted to participate in the DoD tuition assistance programs. In 2014, the DoD revised the MOU and required participating institutions to execute a new MOU. We participate in the DoD tuition assistance programs under the revised MOU. We executed the required revised MOUs on or before the September 2014 deadline and, therefore, all of our campuses are party to an executed revised MOU.

Pursuant to the MOU, among other requirements, the institution must provide each prospective military student with specific information prior to enrollment regarding certain ED and U.S. Consumer Financial Protection Bureau ( CFPB ) tools, such as ED's College Navigator website, the College Scorecard website and the CFPB's Paying for College website; and, in certain circumstances, return tuition assistance funds to the DoD (such as when a student ceases to attend or an institution cancels a course). The MOU also provides that an institution may only participate in the DoD tuition assistance programs if it is accredited by an accrediting agency recognized by ED, approved for funding by the VA, and a participant in the Title IV programs administered by ED.

On January 30, 2014, the DoD, VA, ED, and Federal Trade Commission, in collaboration with the CFPB and Department of Justice, announced a new online student complaint system for service members, veterans, and their families to report negative experiences at education institutions and training programs administering the Post-9/11 GI Bill, DoD tuition assistance programs, and other military-related education benefit programs. The complaint system is designed to help the government identify and address unfair, deceptive, and misleading practices. The complaint



system was developed pursuant to EO 13607, which requires federal agencies to create a centralized complaint system for students receiving federal military and veterans educational benefits to register complaints that can be tracked and responded to by relevant agencies. An institution having recurring substantive complaints, or demonstrating an unwillingness to resolve complaints, may face a range of penalties, including revocation of its MOU and removal from participation in the VA educational benefits and DoD tuition assistance programs.

The VA, the DoD and the applicable state approving agency also periodically review a location's compliance with laws, regulations and applicable guidance. The scope of the reviews vary, and noncompliance may result in the assessment of repayment liabilities to students receiving DoD or VA educational benefits, as well as locations being subjected to corrective action, fines and/or suspensions, including the location no longer being an approved location for students to access their DoD or VA educational benefits, and the potential loss of program and institutional eligibility for such benefits.

Effective May 11, 2015, the California State Approving Agency for Veterans Education (CSAAVE), a division of the California Department of Veterans Affairs, gave notice to all of our campuses in California, suspending the approval of their courses for receipt of veterans educational program benefits under the GI Bill Programs. The basis for the suspension was CSAAVE's determination that the campuses did not fully comply with the financial stability standards for accreditation published by the ACICS. The notice of suspension precludes our California campuses from future enrollment or re-enrollment of veterans or their dependents intending to utilize the GI Bill Programs education benefits to pay in whole or in part for their enrollment in the institution. We have been in contact with CSAAVE, which requested that we submit additional financial information, including a statement of determination from the ACICS that all of our California campuses fully comply with the financial stability standards and requirements for accreditation. We have submitted the requested information to CSAAVE. If CSAAVE does not lift the suspension order, CSAAVE says that the approval of our California campuses to train veterans will be withdrawn no later than July 13, 2015. Although we have provided the requested information and do not believe there is a basis for and will continue to dispute CSAAVE's action, we cannot assure you that the suspension of our California campuses will be lifted.

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Effective May 18, 2015, the New York State Approving Agency for Veterans Education ( NYSAA ), a division of the New York Department of Veterans Affairs, gave notice to all of our campuses in New York, suspending the approval of their courses for receipt of veterans' educational program benefits under the GI Bill Programs. The basis for the suspension was NYSAA's determination that the campuses did not fully comply with the financial stability standards for accreditation published by ACICS. The notice of suspension precludes our New York campuses from future enrollment of veterans or their dependents intending to utilize the GI Bill Programs' education benefits to pay in whole or in part for their enrollment in the campus. The notice of suspension specifically allows the certification of benefits for re-enrollments. NYSAA has directed that we submit, among other things, evidence of current financial stability, consistent with the ACICS standards, as well as documentation that the campuses in New York were not participating in practices asserted by the CFPB. We have submitted the requested information to NYSAA. If NYSAA does not lift the suspension order, NYSAA says that the approval of our New York campuses to train veterans will be withdrawn no later than July 17, 2015. Although we do not believe there is a basis for and intend to dispute NYSAA's action, we cannot assure you that the suspension of our New York campuses will be lifted.

See Risk Factors Risks Related to Our Highly Regulated Industry *Our campuses' failure to comply with the requirements for receiving veterans' educational benefits or Department of Defense tuition assistance program funds could result in their loss of eligibility to receive such benefits and funds, which could materially and adversely affect our business.*

### ***Regulation by State Education Agencies and Professional Licensing Authorities***

As of December 31, 2014, we operated one or more campuses in 39 states and our campuses recruited students in all 50 states. Each of our campuses must be authorized by the applicable SAs to operate. The state laws and regulations that we must comply with in order to obtain authorization from the SAs are numerous and complex. As of December 31, 2014, each of our campuses had received authorization from one or more SAs.

The laws and regulations in most of the states in which our campuses are located treat each of our campuses as a separate, unaffiliated institution and do not distinguish between main campuses and additional locations or branch campuses, although many states recognize other locations within the state where educational activities are conducted and/or student services are provided as learning sites, teaching sites, satellite campuses or otherwise. In some states, the requirements to obtain state authorization limit our ability to establish new campuses, add instructional locations, offer new programs, recruit and offer online programs.

Campuses that confer bachelor or master degrees must, in most cases, meet additional regulatory standards. Raising the curricula of our existing campuses to the bachelor and/or master degree level requires the approval of the applicable SAs and the ACs.

State education laws and regulations affect our operations and may limit our ability to introduce programs or obtain authorization to operate in some states. If any one of our campuses lost its state authorization to operate in the state in which it is physically located, the campus would be unable to offer postsecondary education and we would be forced to close the campus. Closing multiple campuses for any reason could have a material adverse effect on our financial condition, results of operations and cash flows.

Most of the states in which our institutions are authorized to operate have laws or regulations that require institutions to demonstrate annually that they are financially stable. As a result of the delay in the submission of our 2013 audited consolidated financial statements to our Florida SA, our Florida SA determined on August 5, 2014 that our 13 campuses in Florida are not financially stable. Based on this determination, our Florida SA:

changed the authorization to operate for each of our Florida campuses from an annual license to a provisional license;

told us that it would conduct an on-site visit of each of our Florida campuses to determine the campus compliance with the Florida SA's regulations;

told us that it would require each of our Florida campuses to correct any deficiencies noted during our Florida SA's on-site visit of the campus;

required us to submit to our Florida SA any correspondence that we or any of our institutions have with the ED or the AC of our Florida campuses, within 15 days of the submission or receipt of that correspondence;

required each of our Florida campuses to submit a train-out plan to our Florida SA on or before September 4, 2014; and

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required us to report to our Florida SA, at its September 2014 meeting, on the stability of our Florida campuses and any changes that may further affect our stability or operations.

The provisional license of each of our Florida campuses extends through July 31, 2015. Upon the satisfaction of all of the requirements specified above, however, each campus may apply to our Florida SA to have the campus authorization changed back to an annual license. We cannot assure you, however, that our Florida campuses will be able to satisfy all of the requirements specified above, or that our Florida SA will change any of the campuses back to an annual license. See Risk Factors—Risks Related to Our Highly Regulated Industry *Failure of our campuses to comply with the extensive regulatory requirements for school operations could result in financial penalties, restrictions on our operations, loss of federal and state financial aid funding for our students or loss of our authorization to operate our campuses.*

***Regulation by Accrediting Commissions***

Accreditation by an accrediting commission recognized by the ED is required for an institution to become and remain eligible to participate in Title IV Programs. In addition, some states require institutions operating in the state to be accredited as a condition of state authorization. Both of our ITT Technical Institute institutions are accredited by the Accrediting Council for Independent Colleges and Schools (the ACICS ). DWC is accredited by the Commission on Institutions of Higher Education of the New England Association of Schools and Colleges (the NEASC ). Both the ACICS and the NEASC are accrediting commissions recognized by the ED.

The accreditation standards of our ACs generally permit an institution's main campus to establish additional campuses. Our campuses that are treated as additional locations of the main campus under the ED's regulations and the ACICS accreditation standards are treated as branch campuses under the accreditation standards of the NEASC. Our learning sites, if any, are classified as additional locations of the main campus under the ED's regulations, as campus additions under the ACICS accreditation standards, and as instructional locations of the main or branch campus under the NEASC accreditation standards. Under the ACICS criteria, the ACICS has classified one of our ITT Technical Institute institutions, which consists of a main campus and 139 additional locations, as a centrally controlled institution (the Centrally Controlled Institution ). During 2013, the ACICS evaluated the Centrally Controlled Institution for a renewal grant of accreditation. In April 2013, the ACICS extended the Centrally Controlled Institution's current grant of accreditation through December 31, 2017. In 2014, the ACICS also approved one ITT Technical Institute location for inclusion in the Centrally Controlled Institution's grant of accreditation.

***Accreditation Criteria.*** The HEA specifies a series of criteria that each recognized accrediting commission must use in reviewing institutions. For example, accrediting commissions must assess the length of each academic program offered by an institution in relation to the objectives of the degrees or diplomas offered. Further, accrediting commissions must evaluate each institution's success with respect to student achievement.

Under the ACICS standards, if the student retention or graduate placement rates:

of a campus fall below the ACICS benchmark standards, the campus must develop and implement a campus improvement plan and periodically report its results to the ACICS;

of a campus fall below the ACICS compliance standards, the campus must develop and implement a campus improvement plan and come into compliance within a specified time period, or the ACICS may withdraw the campus' inclusion in the institution's grant of accreditation;

of a program offering at a campus fall below the ACICS benchmark standards, the campus must develop and implement a program improvement plan for that program offering; or

of a program offering at a campus fall below the ACICS compliance standards, the program offering must develop and implement a campus improvement plan and come into compliance within a specified time period, or the ACICS may withdraw its authorization of that program offering.

Under the ACICS standards, if the Licensure Examination Pass Rate (as defined below) of a program offering that is subject to that standard at a campus:

falls below the ACICS benchmark standards, the campus is required to develop and implement a program improvement plan for that program offering; or

falls below the ACICS compliance standards, the program offering is required to come into compliance within a specified time period, or the ACICS may withdraw its authorization of that program offering.

A program offering is subject to the Licensure Examination Pass Rate standard, if graduates of the program of study who seek employment are required to have a certificate, license or registration based on an industry-sponsored examination in the applicable field.

A campus that falls below the ACICS benchmark standards is not required to obtain permission from the ACICS prior to applying to add a new program offering, but a campus that falls below the ACICS compliance standards is required to obtain permission from the ACICS prior to applying to add a new program offering.

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ACICS Institutional and Campus Accountability Report Reviews. In January 2015, the ACICS confirmed that it reviews the Institutional Accountability Report and Campus Accountability Report submitted by each of its accredited institutions to monitor performance in terms of student achievement at both the campus and program levels. Measures include Student Retention Rate, Graduate Placement Rate and the Licensure Examination Pass Rate (each as defined below), if applicable. When this review indicates that student achievement is below ACICS standards, the ACICS will require the institution to add an improvement plan that applies to either a program and/or a campus (an Improvement Plan ) within its Campus Effectiveness Plan ( CEP ) and/or its Institutional Effectiveness Plan. If the ACICS determines the institution no longer complies with the ACICS requirement for student achievement, the ACICS will issue a warning, a show-cause directive, or otherwise take action and require the institution to demonstrate compliance within a specified time frame. Any specified time frame may be extended at the sole discretion of the ACICS for good cause, including evidence that there has been significant improvement in the deficient area(s) and the applicable time frame does not provide sufficient time to demonstrate full compliance (e.g., improvement in Student Retention Rate, Graduate Placement Rate and/or the Licensure Examination Pass Rate). Institutions that are required to include an Improvement Plan within their CEPs are considered to be on Student Achievement Monitoring. Those with institutional or campus-level plans may have additional restrictions imposed if determined to be out of compliance.

Campus and Program Improvement Plans and Monitoring. Neither of our two ITT Technical Institute institutions are on probation with the ACICS, but the ACICS has taken the following actions with respect to a number of our campuses and programs:

69 ITT Technical Institute locations are subject to a campus Improvement Plan and Student Achievement Monitoring with respect to the locations Student Retention Rates (as defined below);

25 ITT Technical Institute locations are subject to a campus Improvement Plan and Student Achievement Monitoring with respect to the locations Graduate Placement Rates (as defined below);

19 ITT Technical Institute locations are subject to a campus Improvement Plan and Student Achievement Monitoring and need to raise their Student Retention Rate to at least 60% by November 1, 2015, or the ACICS may withdraw those locations inclusion in the institution s grant of accreditation (although we are no longer enrolling new students at five of these locations);

four ITT Technical Institute locations are subject to a campus Improvement Plan and Student Achievement Monitoring and need to raise their Graduate Placement Rates to at least 60% by November 1, 2015, or the ACICS may withdraw those locations inclusion in the institution s grant of accreditation;

a total of 149 program offerings at 94 ITT Technical Institute locations are subject to a program Improvement Plan with respect to the Student Retention Rates of those program offerings;

a total of 85 program offerings at 62 ITT Technical Institute locations are subject to a program Improvement Plan with respect to the Graduate Placement Rates of those program offerings;

a total of eight program offerings at eight ITT Technical Institute locations are subject to a program Improvement Plan with respect to the Licensure Examination Pass Rates of those program offerings;

a total of 250 program offerings at 103 ITT Technical Institute locations are subject to a campus Improvement Plan and Student Achievement Monitoring and need to raise their Student Retention Rates to at least 60% by November 1, 2015, or the ACICS may withdraw its authorization of those program offerings (although we have discontinued and are no longer enrolling new students in 45 of those program offerings);

a total of 94 program offerings at 62 ITT Technical Institute locations are subject to a campus Improvement Plan and Student Achievement Monitoring and need to raise their Graduate Placement Rates to at least 60% by November 1, 2015, or the ACICS may withdraw its authorization of those program offerings (although we have discontinued and are no longer enrolling new students in 50 of those program offerings); and

a total of 14 program offerings at 14 ITT Technical Institute locations are subject to a campus Improvement Plan and Student Achievement Monitoring and need to raise their Licensure Examination Pass Rates to at least 60% by November 1, 2015, or the ACICS may withdraw its authorization of those program offerings (although we have discontinued and are no longer enrolling new students in two of those program offerings).

For purposes of the standards and actions described above, the ACICS uses the following definitions:

Student Retention Rate is a calculated rate defined as Adjusted Total Enrollment, less All Other Withdrawals, divided by Adjusted Total Enrollment. Adjusted Total Enrollment is defined as total student enrollment in the program of study during the reporting period, less the number of any of those students who withdrew to enroll in another institution under common ownership. All Other Withdrawals is defined by the ACICS as the number of students enrolled in the program of study during the reporting period who withdrew from the program of study for a reason other than the student s:

call to active duty in the U.S. military;

enrollment in another institution under common ownership;

incarceration; or

death.

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Graduate Placement Rate is defined as the number of Employable Graduates who were employed in a position that required the direct or indirect use of the skills taught in the program of study during the reporting period, divided by the total number of Employable Graduates.

Licensure Examination Pass Rate is defined as the number of graduates or completers of a program of study that is subject to the Licensure Examination Pass Rate standard who attempted the examination during a calendar year and received a score necessary to obtain the required certificate, license or registration, divided by the number of graduates or completers of that program of study who attempted the applicable examination during that calendar year.

If any of our ITT Technical Institute locations and/or program offerings fall below the Student Retention Rate, Graduate Placement Rate or Licensure Examination Pass Rate compliance standards and we are unable to timely bring those locations and/or program offerings into compliance, we may have to close those locations and reduce the offerings of those programs, which could have a material adverse effect on our expansion plans, financial condition, results of operations and cash flows.

DWC was subject to a notice of concern from the NEASC with respect to DWC's financial condition from June 2009, when we acquired DWC, until April 2011. The NEASC reinstated the notice of concern with respect to DWC's financial condition in March 2013. During 2013 and the first quarter of 2014, the NEASC evaluated DWC in connection with its financial condition, but the NEASC did not remove the notice of concern. In September 2014, the NEASC conducted a focused evaluation visit at DWC to assess, in part, DWC's progress in addressing the issues that led the NEASC to reinstate the notice of concern in 2013. DWC responded to the visit report, attended the NEASC April 2015 meeting and is currently awaiting receipt of a formal letter from the NEASC with its recommendations. DWC cannot predict when or how the NEASC will rule on the subject of its financial condition.

***Reviews and Other Oversight Actions***

The internal audit function of our compliance department reviews our campuses' compliance with Title IV Program requirements and conducts an annual compliance review of each of our campuses. The review addresses numerous compliance areas, including:

student tuition refunds and return of Title IV Program funds;

student academic progress;

student admission;

student attendance;

student financial aid applications;



student financial aid awards and disbursements; and

graduate employment.

Each of our institutions' administration of Title IV Program funds must also be audited annually by an independent accounting firm, and the resulting audit report must be submitted to the ED for review.

Due to the highly regulated nature of the postsecondary education industry, we are subject to audits, reviews, inquiries, complaints, investigations, claims of non-compliance and lawsuits by federal and state governmental agencies, the ACs, present and former students and employees, shareholders and other third parties, which may allege violations of statutes, regulations or accreditation standards or common law causes of action (collectively, Claims). If the results of any Claims are unfavorable to us, we may be required to pay money damages or be subject to fines, penalties, injunctions, operational limitations, loss of eligibility to participate in federal or state financial aid programs, debarments, additional oversight and reporting, other civil and criminal penalties or other censure that could have a material adverse effect on our financial condition, results of operations and cash flows. Even if we satisfactorily resolve the issues raised by a Claim, we may have to expend significant financial and management resources, which could have a material adverse effect on our financial condition, results of operations and cash flows. Adverse publicity regarding a Claim could also negatively affect our business.

See Risk Factors Risks Related to Our Highly Regulated Industry for a discussion of particular risks associated with our highly regulated industry.

### **Shareholder Information**

We make the following materials available free of charge through our website at [www.ittesi.com](http://www.ittesi.com) as soon as reasonably practicable after such materials are electronically filed with or furnished to the SEC under the Exchange Act:

our annual reports on Form 10-K and all amendments thereto;

our quarterly reports on Form 10-Q and all amendments thereto;

our current reports on Form 8-K and all amendments thereto; and

various other filings that we make with the SEC.

You should be aware that this Annual Report on Form 10-K was filed with the SEC after the applicable filing deadline. In addition, our Quarterly Reports on Form 10-Q for the fiscal quarters ended March 31, 2014, June 30, 2014 and September 30, 2014 were each filed with the SEC after its applicable filing deadline, and our Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2015 will be filed after its filing deadline. Failure to timely file our reports with the SEC may have negative consequences. See Risk Factors Risks Related to Recent Developments.

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We also make the following materials available free of charge through our website at [www.ittesi.com](http://www.ittesi.com):

our Corporate Governance Guidelines;

the charter for each of the Audit, Compensation, and Nominating and Corporate Governance Committees of our Board of Directors; and

our Code of Business Conduct and Ethics ( Code ).

We will provide a copy of the following materials without charge to anyone who makes a written request to our Investor Relations Department at ITT Educational Services, Inc., 13000 North Meridian Street, Carmel, Indiana 46032-1404 or by e-mail through our website at [www.ittesi.com](http://www.ittesi.com):

our annual report on Form 10-K for the year ended December 31, 2014, excluding certain of its exhibits;

our Corporate Governance Guidelines;

the charter for each of the Audit, Compensation, and Nominating and Corporate Governance Committees of our Board of Directors; and

the Code.

We also intend to promptly disclose on our website at [www.ittesi.com](http://www.ittesi.com) any amendments that we make to, or waivers for our Directors or executive officers that we grant from, the Code.

**Item 1A. Risk Factors.**

*In addition to the other information contained in this report, you should consider carefully the following risk factors in evaluating us and our business before making an investment decision with respect to any shares of our common stock. This report contains certain statements that constitute forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. These forward-looking statements are based on the beliefs of, as well as assumptions made by and information currently available to, our management. All statements which are not statements of historical fact are intended to be forward-looking statements. The forward-looking statements contained in this report reflect our or our management's current views and are subject to certain risks, uncertainties and assumptions, including, but not limited to, those set forth in the following Risk Factors. Should one or more of those risks or uncertainties materialize or should underlying assumptions prove incorrect, our actual results, performance or achievements in 2015 and beyond could differ materially from those expressed in, or implied by, those forward-looking statements.*

**Risks Related to Recent Developments**

*Our management has identified material weaknesses in our internal control over financial reporting, which could, if not remediated, result in material misstatements in our future financial statements and may adversely affect our business and stock price.* Our management is responsible for establishing and maintaining adequate internal control over financial reporting ( ICFR ), as defined in Rule 13a-15(f) under the Exchange Act. As disclosed in Part II, Item 9A, Controls and Procedures of this Annual Report on Form 10-K, as of December 31, 2014, our management identified material weaknesses in our ICFR related to:

the assessment of the completeness and accuracy of the data obtained from third parties related to the private education loans that are owned by variable interest entities that we were required to consolidate;

the aggregation of design and operating effectiveness control deficiencies relating to property, plant, and equipment, including logical access controls related to information systems relevant to property, plant, and equipment, the design of controls over the impairment of long-lived assets and the design and operation of review controls over accounting for leasehold improvements, which lead to individually immaterial adjustments; and

the aggregation of control deficiencies relating to design and operation of review controls over the financial close and reporting and income tax reporting processes, which lead to individually immaterial adjustments.

A material weakness is defined as a deficiency, or combination of deficiencies, in ICFR, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. As a result of the material weaknesses discussed above, our management concluded that our ICFR was not effective as of December 31, 2014. This is the second consecutive year that our management has concluded that our ICFR was not effective. As of December 31, 2013, our management concluded that our ICFR was not effective as a result of four material weaknesses, three of which were remediated as of December 31, 2014, but one of which remained unremediated as of December 31, 2014. The unremediated material weakness was the one related to data obtained from third parties related to private education loans, as noted above. Further, we cannot assure you that additional material weaknesses in our ICFR will not be identified in the future.

Although we are implementing remedial measures designed to address the identified material weaknesses, if our remedial measures are insufficient to address the material weaknesses, or if additional material weaknesses or significant deficiencies in our ICFR are discovered or occur in the future, our consolidated financial statements may contain material misstatements. These misstatements could result in additional restatements of our consolidated financial statements, cause us to fail to meet our reporting obligations, lead to a default under our financing agreement, reduce our ability to obtain financing, increase the cost of any financing that we obtain or cause investors to lose confidence in our reported financial information, which could lead to a decline in our stock price. The likelihood of any or all of those risks may be increased as a result of the unremediated material weakness and/or the fact that we have had ineffective ICFR in two consecutive years.

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Although we are working to remedy the ineffectiveness of our ICFR, there can be no assurance as to when the remediation plan will be fully implemented or the aggregate cost of implementation. Until our remediation plan is fully implemented and considered complete, our management will continue to devote significant time and attention to these efforts. If we do not complete our remediation in a timely fashion, or at all, or if our remediation plan is inadequate, there will continue to be an increased risk that we will be unable to timely file future periodic reports with the SEC and that our future consolidated financial statements could contain errors that will be undetected. For more information relating to our ICFR (and disclosure controls and procedures) and the remediation plan undertaken by us, see Part II, Item 9A, Controls and Procedures.

***Matters relating to or arising from our review of accounting matters related to the PEAKS Program and the CUSO Program may adversely affect our business, results of operations and cash flows.*** As previously disclosed, a number of factors, including the SEC's investigation of us related to our actions and accounting associated with, among other things, the PEAKS Program and the CUSO Program, have led to us conducting additional analyses and reviews with respect to accounting matters related to those programs. As a result of such additional analyses and reviews, the Audit Committee of our Board of Directors concluded that the PEAKS Trust should have been consolidated in our consolidated financial statements beginning on February 28, 2013, and that our previously issued unaudited condensed consolidated financial statements as of and for each of the fiscal quarters ended March 31, 2013, June 30, 2013 and September 30, 2013 should be restated. Further, our more recent accounting analyses and reviews of the CUSO Program have resulted in our conclusion to consolidate the CUSO in our consolidated financial statements beginning on September 30, 2014. To date, we have incurred significant expenses related to legal, accounting and other professional services in connection with the SEC's investigation of us, the accounting analyses and the restatement and related matters, and may continue to incur significant additional expenses with regard to those matters and our remediation efforts. In addition, our Chief Executive Officer and Chief Financial Officer, as well as senior members of our finance and accounting departments, have spent substantial amounts of time and effort with regard to all of those matters. The significant amount of time and effort spent by our management team on those matters has diverted, and is expected to continue to divert, their attention from the operation of our business. The expenses incurred, and expected to be incurred, on those matters, and the diversion of the attention of the management team which has occurred and is expected to continue, have had, and could continue to have, a material adverse effect on our business, financial condition, results of operations and/or cash flows.

***The New York Stock Exchange could commence procedures to delist our common stock.*** As a result of our failure to timely file this Annual Report on Form 10-K with the SEC, on March 16, 2015, we received a notice from the New York Stock Exchange ( NYSE ) that we were subject to the procedures set forth in the NYSE's listing standards related to late filings. In accordance with the NYSE's procedures, we had six months following March 16, 2015 to file this Annual Report on Form 10-K with the SEC. Although we have filed this Annual Report on Form 10-K with the SEC within the applicable period, the listing standards of the NYSE provide the NYSE with broad discretion regarding delisting matters. One of the factors described in the NYSE's listing standards that could lead to a company's delisting is the failure of the company to make timely, adequate and accurate disclosures of information to its shareholders and the investing public. We restated our unaudited condensed consolidated financial statements as of and for each of the fiscal quarters ended March 31, 2013, June 30, 2013 and September 30, 2013. In addition, our Quarterly Reports on Form 10-Q for the fiscal quarters ended March 31, 2014 ( 2014 First Quarter Form 10-Q ), June 30, 2014 ( 2014 Second Quarter Form 10-Q ) and September 30, 2014 ( 2014 Third Quarter Form 10-Q ) were each filed after their respective due dates. Additionally, we will be filing our Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2015 ( 2015 First Quarter Form 10-Q ) after its due date, and therefore we will continue to be subject to the procedures set forth in the NYSE's listing standards related to late filings and subject to the risk of delisting. We cannot assure you that the NYSE will not commence delisting procedures with respect to our common stock as a result of those and other factors related to us. If the NYSE were to delist our common stock, the delisting could further:

decrease trading in our common stock;

adversely affect the market liquidity of our common stock;

decrease the trading price of our common stock;

increase the volatility of our common stock price;

decrease analyst coverage of our common stock;

decrease investor demand and information available concerning trading prices and volume of our common stock;

make it more difficult for investors to buy or sell our common stock; and

harm our ability to obtain financing on acceptable terms.

***Our failure to prepare and timely file our periodic reports with the SEC limits our access to the public markets to raise debt or equity capital, and could have negative consequences related to our financing agreement.*** We did not file our 2013 Form 10-K, our 2014 First Quarter Form 10-Q, our 2014 Second Quarter Form 10-Q, our 2014 Third Quarter Form 10-Q and this Annual Report on Form 10-K within the timeframes required by the SEC. We also have not yet filed our 2015 First Quarter Form 10-Q, and therefore it is delinquent. As a result of our late filings, we may be limited in our ability to access the public markets to raise debt or equity capital, which could prevent us from pursuing transactions or implementing business strategies that we believe would be beneficial to our business. We are ineligible to use shorter and less costly filings, such as Form S-3, to register our securities for sale for a period of 12 months following the month in which we regain compliance with our SEC reporting obligations. Further, pursuant to the Financing Agreement (as defined below), we must provide to our lenders our annual and quarterly financial information of the type required to be filed with our periodic reports with the SEC within 90 and 45 days, respectively, after the end of the relevant period, or certain monthly financial information within 30 days after the end of each month, subject to the extension described below.

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On December 4, 2014, we entered into a financing agreement (the Original Financing Agreement ) with Cerberus Business Finance, LLC ( Cerberus ), as administrative agent and collateral agent, the lenders party thereto and certain of our subsidiaries. On December 23, 2014, we entered into Amendment No. 1 to Financing Agreement ( Amendment No. 1 ), on March 17, 2015, we entered into Amendment No. 2 to Financing Agreement ( Amendment No. 2 ) and on May 26, 2015, we entered into a Limited Consent to Financing Agreement (the FA Consent ). The Original Financing Agreement, as amended by Amendment No. 1 and Amendment No. 2 and including the FA Consent, is referred to herein as the Financing Agreement. The FA Consent provides for an extension to June 15, 2015 of the deadline by which we are required to deliver to the lenders our financial statements and related information for the fiscal quarter ended March 31, 2015. If we are not able to deliver our financial statements for the fiscal quarter ended March 31, 2015 by June 15, 2015, or for future periods by the applicable due dates, then we would be in breach of the Financing Agreement, which could give rise to material adverse consequences to us. See *Restrictive covenants in the Financing Agreement restrict or prohibit our ability to engage in or enter into a variety of transactions, which could adversely restrict our financial and operating flexibility, and any default by us under the Financing Agreement could have a material adverse effect on our liquidity and ability to comply with our obligations.*

***As a result of the PEAKS Consolidation, our consolidated financial statements are materially different from those that we previously issued, which could have negative implications for our Financing Agreement and guarantee obligations and regulatory compliance.*** Prior to the PEAKS Consolidation, the PEAKS Trust was not included in our consolidated financial statements. As a result of the PEAKS Consolidation, beginning on February 28, 2013, our consolidated financial statements are substantially different from the consolidated financial statements that we would present, if we were not required to consolidate the PEAKS Trust. We cannot assure you that the financial impact of the PEAKS Consolidation on our consolidated financial statements in future periods will not violate the covenants under the Financing Agreement. We may not be able to obtain amendments to, or waivers of, those covenants. The PEAKS Consolidation also negatively impacted our compliance with the ED's financial responsibility measurements, primarily our institutions' composite score and our compliance with the financial requirements of certain SAs. The financial impact of the PEAKS Consolidation on our consolidated financial statements in future periods could also negatively impact our compliance with those measurements and requirements in the future. See Risks Related to Our Highly Regulated Industry. *We may be subject to sanctions, including, without limitation, an increase in the amount of the ED Letter of Credit and other limitations in order to continue our campuses' participation in Title IV Programs, state authorization and accreditation, if we or our campuses do not meet the financial standards of the ED, SAs or ACs,* for a discussion of the impact of the PEAKS Consolidation on our consolidated financial statements. Further, the PEAKS Consolidation negatively impacted the financial metrics to which we are subject under the private education loan programs under which we have provided guarantees, resulting in materially increased payment amounts. The financial impact of the PEAKS Consolidation on our consolidated financial statements in future periods could negatively impact our compliance with those financial metrics in the future, resulting in materially increased payment amounts and/or the loss of our protective rights under those programs. Any of these factors could have a material adverse effect on our results of operations, financial condition and/or cash flows.

***The CUSO Consolidation could have a material adverse effect on our consolidated financial statements and our compliance with covenants and metrics to which we are subject.*** Prior to September 30, 2014, the CUSO was not included in our consolidated financial statements because we concluded we were not the primary beneficiary of the CUSO prior to that time. The CUSO Consolidation results in a different presentation in our consolidated financial statements of our transactions with the CUSO. We cannot assure you that the CUSO Consolidation, in combination with other factors, will not have a material negative impact in future periods on our ability to comply with our covenants under the Financing Agreement, the ED's financial responsibility measurements, the financial requirements of the SAs or the financial metrics to which we are subject under the CUSO RSA and the PEAKS Guarantee (as defined below), which could result in a material adverse effect on our results of operations, financial condition and/or cash flows. See Risks Related to Our Highly Regulated Industry. *We may be subject to sanctions, including, without*

*limitation, an increase in the amount of the ED Letter of Credit and other limitations in order to continue our campuses' participation in Title IV Programs, state authorization and accreditation, if we or our campuses do not meet the financial standards of the ED, SAs or ACs,* for a discussion of the impact of the CUSO Consolidation on our consolidated financial statements.

***Restrictive covenants in the Financing Agreement restrict or prohibit our ability to engage in or enter into a variety of transactions, which could adversely restrict our financial and operating flexibility, and any default by us under the Financing Agreement could have a material adverse effect on our liquidity and ability to comply with our obligations.*** The Financing Agreement contains a number of covenants that limit our ability to take certain actions. In particular, the Financing Agreement limits the ability of us and certain of our subsidiaries (the Guarantors and together with us, the Loan Parties ) to, among other things:

incur additional indebtedness;

incur or create liens;

make investments;

dispose of assets;

pay dividends; and



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make prepayments on existing indebtedness.

The Financing Agreement also requires us to maintain compliance with a total leverage ratio and a fixed charge coverage ratio, as well as with certain educational regulatory measurements. In determining our compliance with the leverage ratio covenant, we are required to include the PEAKS Senior Debt and the CUSO Secured Borrowing Obligation (defined below) in the amount of our indebtedness, and therefore the amount of such liabilities could negatively impact our ability to comply with the leverage ratio covenant in the Financing Agreement. In addition, we are required to limit our annual payments with respect to the CUSO Program and the PEAKS Program. Further, pursuant to the Financing Agreement, we must provide the lenders with our quarterly financial statements within 45 days after the end of each fiscal quarter and our annual, audited financial statements within 90 days after the end of each fiscal year, except that, pursuant to Amendment No. 2, the deadline by which we must provide our financial statements related to the fiscal year ended December 31, 2014 was extended to May 31, 2015 and pursuant to the FA Consent, the deadline by which we must provide our financial statements related to the fiscal quarter ended March 31, 2015 was extended to June 15, 2015. If we are not able to deliver our financial statements for the fiscal quarter ended March 31, 2015 by June 15, 2015, or for future periods by the applicable due dates, we would have to seek a waiver or an additional amendment to the Financing Agreement, which we may not be able to obtain on terms acceptable to us or at all. If we cannot obtain a waiver or amendment, the failure to timely deliver our financial statements would be an event of default under the Financing Agreement.

Any or all of the covenants under the Financing Agreement could have a material adverse effect on our business by limiting our ability to take advantage of financing, merger and acquisition or other corporate opportunities. The restrictions could limit our ability to plan for, or react to, changes in market conditions or to finance future operations or capital needs. Further, our ability to comply with the covenants in the Financing Agreement may be affected by events beyond our control, including without limitation worsening economic or business conditions, unfavorable regulatory or judicial determinations, unfavorable legislation, the impact of the Consolidations or other events, and we cannot assure you that we will be able to comply with the covenants.

Our ability to make required payments on our indebtedness under the Financing Agreement is dependent on our ability to generate cash flows in the future. This, to some extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. We cannot assure you that our business will generate cash flows in amounts sufficient to enable us to pay our indebtedness or to fund our other liquidity needs. Additionally, there is an excess cash flow mandatory prepayment provision in the Financing Agreement that will also limit our ability to utilize excess cash flows for other purposes in our business or to respond to market opportunities.

In addition, based on our current estimates, we believe that we may make guarantee payments of approximately \$29.8 million in 2015 under our guarantee under the PEAKS Program. This guarantee consists of our guarantee of the payment of the principal, interest and, prior to February 2013, certain call premiums owed on the senior debt issued by the PEAKS Trust in the aggregate principal amount of \$300.0 million (the PEAKS Senior Debt ) to investors, the administrative fees and expenses of the PEAKS Trust and a minimum required ratio of assets of the PEAKS Trust to outstanding PEAKS Senior Debt (the PEAKS Guarantee ). The \$29.8 million estimated payment amount would have exceeded the annual payment limitation of \$20.0 million related to payments under the PEAKS Program contained in the Original Financing Agreement covenant, but the covenant was modified in Amendment No. 2. However, we may be required to make payments under the PEAKS Program and/or the CUSO RSA in 2015 or future years that exceed our current estimates and the modified guarantee payment limitation amount. In such event, we would have to seek a waiver or an additional amendment to the Financing Agreement, which we may not be able to obtain on terms acceptable to us or at all. If we cannot obtain a waiver or amendment, the payment of amounts under the PEAKS Guarantee in excess of the stated limitation would be an event of default under the Financing Agreement.

The Financing Agreement provides for a number of potential events of default, including violations of the covenants or other provisions in the Financing Agreement or related loan documents, a failure to pay or a default under the PEAKS Program or the CUSO RSA, certain delays in our receipt of Title IV Program funds, and the occurrence of certain regulatory events. In the case of an event of default, the lenders could declare the senior secured term loans under the Financing Agreement (the Term Loans ) then outstanding to be immediately due and payable in full. We may not be able to repay outstanding Term Loans, in which case the lenders would be entitled to recourse against the collateral security that we and the other Loan Parties have provided, to obtain payment of amounts we owe. The collateral security consists of substantially all of the Loan Parties' assets, including a pledge of the equity of the Guarantors and our other subsidiaries, and a mortgage on the Loan Parties' owned real estate. In addition, even if we were able to repay the outstanding borrowings under the Financing Agreement, the use of funds to make that repayment would have a material adverse effect on our cash position and would significantly reduce the amount of funds available to us to satisfy our obligations under the PEAKS Guarantee and the CUSO RSA (collectively, the RSAs ), which could result in a default by us under those arrangements. Any of these events could have a material adverse effect on our business, ability to meet our obligations, ability to comply with regulatory requirements, financial condition and cash flows.

A default by us under the Financing Agreement could also lead to a determination by:

the ED that our institutions are not financially responsible;

the ACs that our institutions are not financially stable; and/or

one or more of the SAs that our institutions do not satisfy the SAs' financial requirements.

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If the ED, ACs and/or SAs determines that our institutions do not satisfy the applicable financial requirements for that reason, and given the sanctions that have already been imposed on our institutions for other reasons, these agencies could:

impose monetary fines or penalties on our campuses;

terminate or limit our campuses' operations or ability to award credentials;

restrict or revoke our campuses' accreditation;

limit, terminate or suspend our campuses' eligibility to participate in Title IV Programs or state financial aid programs;

require our campuses to repay funds received under Title IV Programs or state financial aid programs;

require us to post new letters of credit or increase the amounts of or extend the duration of existing letters of credit;

increase the level of heightened cash monitoring to which our institutions are already subject by the ED;

transfer our institutions from the ED's heightened cash monitoring system of receiving Title IV Program funds to its reimbursement system, which would significantly delay our institutions' receipt of Title IV Program funds;

place a maximum limit on the amount of Title IV funding that our institutions could receive or a maximum limit on the number of students to whom our institutions could award Title IV program funds;

deny applications for our institutions to obtain Title IV eligibility for new educational programs or new campuses or educational sites; and

subject us or our campuses to other penalties.

Each of these sanctions could materially adversely affect our financial condition, results of operations and cash flows, and impose significant operating restrictions on us. If any of our campuses lost its state authorization, the campus would be unable to offer postsecondary education and we would be forced to close the campus. If all or substantially

all of our campuses lost their eligibility to participate in Title IV Programs, we likely would not be able to continue to operate our business.

***The recent filing of an enforcement action by the SEC against us, our CEO and our CFO could result in the ED or any of the SAs or ACs imposing additional sanctions on our institutions.*** On May 12, 2015, the SEC filed a civil enforcement action against us, our Chief Executive Officer and our Chief Financial Officer (the SEC Litigation). See Note 15 Commitments and Contingencies of the Notes to Consolidated Financial Statements for a further discussion of the SEC Litigation. Based on the allegations in the SEC's complaint, combined with other regulatory matters our institutions are facing by the ED, the SAs, the ACs and other federal and state agencies, it is possible that the ED or any of the SAs or ACs might impose additional sanctions against us. The ED, the SAs and the ACs have a wide range of sanctions and penalties that they can impose on institutions. See Risks Related to Our Highly Regulated Industry ***Failure of our campuses to comply with the extensive regulatory requirements for school operations could result in financial penalties, restrictions on our operations, loss of federal and state financial aid funding for our students or loss of our authorization to operate our campuses,*** for a discussion of sanctions that the ED, the SAs and the ACs could impose on our institutions as a result of the SEC Litigation.

On May 20, 2015, the ED informed us that, based on our institutions' current reporting status to the ED and due to the SEC's filing of its complaint in the SEC Litigation, the ED was requiring us to comply with additional notification requirements in order for the ED to more closely monitor our institutions' ongoing participation in the Title IV Programs. The additional requirements are that we must submit to the ED:

every two weeks, a thirteen-week projected cash flow statement that includes disclosures concerning significant transactions, important financial transactions, planned school closures, anticipated new program offerings, and other matters; and

every month, a roster of students, by campus, that includes information on each student's program of study, program start date and anticipated graduation date, enrollment status, and individual contact information.

We intend to compile the requested information and submit it to the ED according to the schedule specified by the ED. We cannot assure you that the ED will not impose further sanctions on us in light of the SEC Litigation and other matters.

### **Risks Related to Our Highly Regulated Industry**

***Failure of our campuses to comply with the extensive regulatory requirements for school operations could result in financial penalties, restrictions on our operations, loss of federal and state financial aid funding for our students or loss of our authorization to operate our campuses.*** To participate in Title IV Programs, an institution must receive and maintain authorization by the appropriate SAs, be accredited by an AC recognized by the ED and be certified as an eligible institution by the ED. As a result, our ITT Technical Institute and DWC campuses are subject to extensive regulation by the ED, SAs and ACs, which cover the vast majority of our operations. The ED, SAs and ACs periodically revise their requirements and modify their interpretations of existing requirements. We cannot predict with certainty how all of the requirements applied by these agencies will be interpreted or implemented or whether all of our campuses will be able to comply with all of the requirements in the future.

If our campuses failed to comply with any of these regulatory requirements, these agencies could:

impose monetary fines or penalties on our campuses;

terminate or limit our campuses' operations or ability to award credentials;

restrict or revoke our campuses' accreditation;

limit, terminate or suspend our campuses' eligibility to participate in Title IV Programs or state financial aid programs;

require our campuses to repay funds received under Title IV Programs or state financial aid programs;

require us to post new letters or credit or increase the amount of or extend the duration of the letter of credit that we have already posted with the ED;

increase the level of heightened cash monitoring to which our institutions are already subject by the ED;

transfer our institutions from the ED's heightened cash monitoring system of receiving Title IV Program funds to its reimbursement system, which would significantly delay our institutions' receipt of Title IV Program funds;

place a maximum limit on the amount of Title IV funding that our institutions could receive or a maximum limit on the number of students to whom our institutions could award Title IV program funds;

deny applications for our institutions to obtain Title IV eligibility for new educational programs or new campuses; and

subject us or our campuses to other civil or criminal penalties.

See Business - Highly Regulated Industry, for a discussion of the sanctions imposed on us by the ED for our failure to submit our 2013 audited consolidated financial statements and Compliance Audits to the ED by the regulatory deadline, and by our Florida SA as a result of its determination that our 13 campuses in Florida are not financially stable. The sanctions imposed by the ED and our Florida SA or any other sanctions described above that could be imposed by any agencies could materially adversely affect our financial condition, results of operations and cash flows and impose significant operating restrictions on us.

If any of our campuses lost its state authorization, the campus would be unable to offer postsecondary education and we would be forced to close the campus.

If any of our campuses lost its accreditation, it would lose its eligibility to participate in Title IV Programs and, in some states, its ability to operate. If we could not arrange for alternative financing sources for the students attending a

campus that lost its eligibility to participate in Title IV Programs, we could be forced to close that campus. Closing multiple campuses could have a material adverse effect on our financial condition, results of operations and cash flows. If all or substantially all of our campuses lost their eligibility to participate in Title IV Programs, we likely would not be able to continue to operate our business. See Business Highly Regulated Industry.

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The following are some of the specific risk factors related to our highly regulated industry:

***Our institutions' failure to submit their 2013 audited consolidated financial statements and Compliance Audits to the ED by the due date resulted in sanctions imposed by the ED on our institutions that include, among other things, our institutions having to post a letter of credit, being placed on heightened cash monitoring and being provisionally certified.*** Our institutions are subject to extensive regulation by the ED. One of the ED's regulations applicable to our institutions is that each institution must submit to the ED on an annual basis its audited, consolidated financial statements and a Compliance Audit, in each case with respect to a fiscal year within six months of the end of the fiscal year. Our institutions did not submit their 2013 audited consolidated financial statements and Compliance Audits to the ED by the June 30, 2014 due date and, as a result, the ED determined on August 21, 2014 that our institutions were not financially responsible. Based on this determination, the ED, among other things:

required our institutions to submit a letter of credit payable to the ED in the amount of \$79.7 million (the ED Letter of Credit );

placed our institutions on heightened cash monitoring by the ED, instead of the ED's standard advance payment method;

provisionally certified our institutions to participate in Title IV Programs;

requires our institutions to provide the ED with information about certain oversight and financial events, as described further below;

requires us to be able to demonstrate to the ED that, for our two most recent fiscal years, we were current on our debt payments and our institutions have met all of their financial obligations, pursuant to the ED's standards; and

could require our institutions, in future years, to submit their audited financial statements and Compliance Audits to the ED earlier than six months following the end of their fiscal year.

We caused the ED Letter of Credit to be issued on October 31, 2014 and submitted to the ED. The term of the ED Letter of Credit is for a period that ends on November 4, 2019. We will be required to adjust the amount of the ED Letter of Credit annually to 10% of the Title IV Program funds received by our institutions in the immediately preceding fiscal year. The ED may terminate our institutions' eligibility to participate in Title IV Programs, in which case we likely would not be able to continue to operate our business.

Under heightened cash monitoring ( HCM ), before any of our institutions can request or draw down Title IV Program funds from the ED, the institution must:

make disbursements to students and parents for the amount of Title IV Program funds that those students and parents are eligible to receive; and

compile borrower-level records with respect to the disbursement of Title IV Program funds to each student and parent.

Once the HCM requirements are satisfied, our institutions may request or draw down Title IV Program funds from the ED in an amount equal to the actual disbursements made by our institutions. Our institutions will be subject to HCM until at least November 4, 2019. Although we have implemented procedures to address the HCM requirements, and believe that compliance with those requirements will not impact the timing of our institutions' receipt of Title IV Program funds by more than one business day, we cannot assure you that there will not be future delays in our institutions' receipt of Title IV Program funds or that our institutions will not request or draw down Title IV Program funds from the ED before the HCM requirements are satisfied. If any of our institutions request or draw down Title IV Program funds from the ED before the HCM requirements are satisfied, the ED could impose additional sanctions on our institutions that could have a material adverse effect on our business, financial condition, results of operations and cash flows, including, among other things:

monetary fines or penalties;

limiting, terminating or suspending our institutions' eligibility to participate in Title IV Programs; and/or

transferring our institutions from the HCM method of receiving Title IV Program funds to the ED's reimbursement system, which would significantly delay our institutions' receipt of Title IV Program funds.

Any significant delay in our institutions' receipt of Title IV Program funds could materially adversely affect our financial condition, results of operations and cash flows, and could cause us to be in default of the Financing Agreement. Depending on the length of the delay, we cannot assure you that we would be able to continue to operate our business in such an event. See also *Restrictive covenants in the Financing Agreement restrict or prohibit our ability to engage in or enter into a variety of transactions, which could adversely restrict our financial and operating flexibility, and any default by us under the Financing Agreement could have a material adverse effect on our liquidity and ability to comply with our obligations.*

Our institutions will remain provisionally certified by the ED to participate in Title IV Programs until at least November 4, 2019. Any institution provisionally certified by the ED must apply for and receive approval by the ED for any substantial change, before the institution can award, disburse or distribute Title IV Program funds based on the substantial change. Substantial changes generally include, but are not limited to:

the establishment of an additional location;



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an increase in the level of academic offering beyond those listed in the institution's Eligibility and Certification Approval Report with the ED;

an addition of any non-degree program or short-term training program; or

an addition of a degree program by a proprietary institution.

If an institution applies for the ED's approval of a substantial change, the institution must demonstrate that it has the financial and administrative resources necessary to assure the institution's continued compliance with the ED's standards of financial responsibility and administrative capability. We may be unable to obtain the required approvals from the ED for any new campuses or any new program offerings, or to obtain those approvals in a timely manner. For example, in December 2014, the ED disapproved our application to offer four new degree programs at the ITT Technical Institutes due to administrative capability issues reported in recent compliance audits and ED program reviews, and in March 2015, the ED disapproved two of eight new degree programs that we applied to offer at DWC also due to administrative capability issues. If we are unable to obtain the required approvals from the ED for any new campuses or any new program offerings, or to obtain those approvals in a timely manner, our ability to operate the new campuses or offer new programs as planned would be impaired, which could have a material adverse effect on our expansion plans. See *We cannot operate new campuses or offer new programs, if they are not timely authorized by our regulators, and we may have to repay Title IV Program funds disbursed to students enrolled at any of those locations or in any of those programs, if we do not obtain prior authorization, and Failure by one or more of our institutions to satisfy the ED's administrative capability requirements could result in financial penalties, limitations on the institution's participation in the Title IV Programs, or loss of the institution's eligibility to participate in Title IV Programs.*

We are required to provide information to the ED about any of the following events within 10 days of its occurrence:

any adverse action, including probation or similar action, taken against any of our institutions by its AC, any of its SAs or any federal agency;

any event that causes us to realize any liability that was noted as a contingent liability in our most recent audited financial statements;

any violation by us of any loan agreement;

any failure by us to make a payment in accordance with our debt obligations that results in a creditor filing suit to recover funds under those obligations;

any withdrawal of our shareholders' equity or net assets by any means, including the declaration of a dividend;

any extraordinary loss by us, as defined under Accounting Principles Board Opinion No. 30; or

any filing of a petition by us for relief in bankruptcy court.

Our notice to the ED of the occurrence of any of the above events must include the details of the circumstances surrounding the event and, if applicable, the steps we have taken, or plan to take, to resolve the issue. If we fail to notify the ED within the 10 day reporting period, the ED may impose additional sanctions upon us that could negatively impact our provisional certification.

On May 20, 2015, the ED informed us that, based on our institutions' current reporting status to the ED and due to the SEC's filing of its complaint in the SEC Litigation, the ED was requiring us to comply with additional notification requirements in order for the ED to more closely monitor our institutions' ongoing participation in the Title IV Programs. The additional requirements are that we must submit to the ED:

every two weeks, a thirteen-week projected cash flow statement that includes disclosures concerning significant transactions, important financial transactions, planned school closures, anticipated new program offerings, and other matters; and

every month, a roster of students, by campus, that includes information on each student's program of study, program start date and anticipated graduation date, enrollment status, and individual contact information.

We intend to compile the requested information and submit it to the ED according to the schedule specified by the ED. We cannot assure you that the ED will not impose further sanctions on us in light of the SEC Litigation and other matters.

The sanctions imposed on us by the ED described above could have a material adverse effect on our financial condition, results of operations, cash flows and ability to meet our contractual and regulatory obligations. Further, we cannot assure you that we will be able to obtain any required increases in the amount of the ED Letter of Credit. Our provision of the cash required by the issuing bank to collateralize the ED Letter of Credit and the other outstanding letters of credit has had, and will continue to have, a material adverse effect on our liquidity, and significantly reduced the amount of cash that we will have available for other purposes, including to satisfy our future payment obligations under the RSAs. The fact that a significant amount of our cash is being held in connection with the ED Letter of Credit could also negatively affect our ability to satisfy the financial metrics of the ED, SAs and ACs to which we are subject. See *We have a significant amount of cash held as collateral for outstanding letters of credit, which has a continuing material adverse effect on our cash flows and liquidity.*

***If our institutions were to fail to timely submit their 2014 audited consolidated financial statements and Compliance Audits to the ED by the 2015 due date, this could result in more severe sanctions being imposed on our institutions by the ED, SAs and ACs.*** If our institutions were to fail to timely submit their 2014 audited consolidated financial statements and Compliance Audits to the ED by the June 30, 2015 due date, we could face additional sanctions by the ED and other regulatory agencies. For example, the ED could require that we increase the amount of the ED Letter of Credit, could extend the time period for which the ED Letter of Credit must remain in effect, and could increase the level of our existing HCM for Title IV funds or place our institutions on the reimbursement system, either of which would significantly delay our institutions' receipt of Title IV Program funds. Any significant delay in our institutions' receipt of Title IV Program funds could adversely affect our financial condition, results of operations and cash flows, and could cause us to be in default of the Financing Agreement. Depending on the length of the delay, we cannot assure you that we would be able to continue to operate our business in such an event. See also *Restrictive covenants in the Financing Agreement restrict or prohibit our ability to engage in or enter into a variety of*

*transactions, which could adversely restrict our financial and operating flexibility, and any default by us under the Financing Agreement could have a material adverse effect on our liquidity and ability to comply with our obligations.* Since the ED's regulations and policies do not envision institutions submitting their audited financial statements and Compliance Audits late two years in a row, they do not prescribe specific penalties if that situation should occur. However, the ED has a wide range of sanctions available to it for institutions that commit what the ED determines are significant violations of the ED regulations, and therefore the ED could attempt to impose additional sanctions on our institutions, including, for example, concluding that our institutions lack administrative capability under the ED's regulations, which could lead to:

the imposition of an administrative fine or penalty;

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a requirement to repay Title IV funds;

placing a maximum limit on the amount of Title IV funding that our institutions could receive or a maximum limit on the number of students to whom we can award Title IV funds;

denying applications for our institutions to obtain Title IV eligibility for new educational programs or new campuses or educational sites;

transferring our institutions to a stricter form of HCM or the reimbursement system;

initiating additional program reviews or other compliance reviews at our institutions;

more closely scrutinizing our 90/10 calculations, including the impact of our private loan programs on those calculations;

placing other limits on or terminating our institutions' eligibility to participate in Title IV Programs; and

other sanctions.

In addition, the ACs and SAs to which we are subject could impose additional penalties on our institutions, which may vary from state to state, but which could include in some states such sanctions as having to post an additional letter of credit or surety bond with the state, limiting our institutions' ability to add new programs or open new campuses, initiating more frequent reviews of our institutions including on-site visits, requiring our institutions to submit additional information and reports, or suspending or terminating our campuses' authority to operate. Any of the sanctions by the ED, SAs or ACs could materially adversely affect our financial condition, results of operations and cash flows, and impose significant operating restrictions on us.

***Action by the U.S. Congress to revise the laws governing the federal student financial aid programs or reduce funding for those programs could reduce our student population and increase our costs of operation.*** Political and budgetary concerns significantly affect Title IV Programs. The U.S. Congress ( Congress ) enacted the HEA to be reauthorized on a periodic basis, which most recently occurred in 2008. Congress has begun the legislative process for reauthorizing the HEA, but it is unclear at this time if the reauthorization will be completed in 2015, 2016, or later. Until the reauthorization process is completed, the current provisions of the HEA will remain in effect, unless Congress amends any specific provisions.

In addition, Congress can change the laws affecting Title IV Programs in the annual federal appropriations bills and other laws it enacts between the HEA reauthorizations. We cannot predict all of the changes that Congress will ultimately make. Since a significant percentage of our revenue is indirectly derived from Title IV Programs, any action by Congress that significantly reduces Title IV Program funding or the ability of our campuses or students to participate in Title IV Programs could have a material adverse effect on our financial condition, results of operations and cash flows.

If one or more of our ITT Technical Institute or DWC campuses lost its eligibility to participate in Title IV Programs, or if Congress significantly reduced the amount of available Title IV Program funding, we would try to arrange or provide alternative sources of financial aid for the students at the affected campuses. It is unlikely that private organizations would be willing to provide loans to students attending those campuses or that the interest rate and other terms of those loans would be as favorable as for Title IV Program loans. If all or substantially all of our campuses lost their eligibility to participate in Title IV Programs, we likely would not be able to continue to operate our business.

Legislative action may also increase our administrative costs and burden and require us to modify our practices in order for our campuses to comply fully with the legislative requirements, which could have a material adverse effect on our financial condition, results of operations and cash flows.

***One or more of our institutions may lose its eligibility to participate in Title IV Programs, if its federal student loan cohort default rates are too high.*** Under the HEA, an institution may lose its eligibility to participate in some or all Title IV Programs, if the rates at which the institution's students default on their federal student loans exceed specified percentages. The ED calculates these rates for each institution on an annual basis, based on the number of students who have defaulted, not the dollar amount of such defaults. Each institution that participated in the FFEL program and/or FDL program receives a FFEL/FDL cohort default rate for each federal fiscal year ( FFY ) based on defaulted FFEL and FDL program loans. A FFY is October 1 through September 30. The ED calculates an institution's annual cohort default rate as the rate at which borrowers scheduled to begin repayment on their loans in one FFY default on those loans by the end of the second succeeding FFY ( Three-Year CDR ).

The ED began calculating a Three-Year CDR for each institution for FFY 2009, and the ED issued those FFY 2009 Three-Year CDRs in 2012. If an institution's Three-Year CDR is:

30% or greater for three consecutive FFYs, the institution loses eligibility to participate in the FDL program and the Pell program for the remainder of the FFY in which the ED determines that the institution has lost its eligibility and for the two subsequent FFYs; or

greater than 40% for one FFY, the institution loses eligibility to participate in the FDL programs for the remainder of the FFY in which the ED determines that the institution has lost its eligibility and for the two subsequent FFYs.

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In addition, the ED may place an institution on provisional certification status, if the institution's official Three-Year CDR is 30% or greater for at least two of the three most recent FFYs. The ED may more closely review an institution that is provisionally certified, if it applies for approval to open a new location or offer a new program of study that requires approval, or makes some other significant change affecting its eligibility. See *Our institutions' failure to submit their 2013 audited financial statements and Compliance Audits to the ED by the due date resulted in sanctions imposed by the ED on our institutions that include, among other things, our institutions having to post a letter of credit, being placed on heightened cash monitoring and being provisionally certified*, for further information concerning the impact on an institution of being placed on provisional certification by the ED.

The following table sets forth the average of our institutions' Three-Year CDRs for the FFYs indicated, as reported by the ED:

| <b>FFY</b>          | <b>Three-Year<br/>CDR Average</b> |
|---------------------|-----------------------------------|
| 2012 <sup>(a)</sup> | 18.8%                             |
| 2011 <sup>(b)</sup> | 22.1%                             |
| 2010                | 28.5%                             |
| 2009                | 32.9% <sup>(c)</sup>              |

- (a) The most recent year for which the ED has issued preliminary Three-Year CDRs. The ED's regulations afford institutions the opportunity to challenge or correct their draft Three-Year CDRs before those rates are official.
- (b) The most recent year for which the ED has published official Three-Year CDRs.
- (c) Reduced by the ED from 34.2% as a result of an uncorrected data adjustment.

We believe that the higher Three-Year CDR average for FFY 2010 compared to the official Three-Year CDR average for FFY 2011 and the preliminary Three-Year CDR average for FFY 2012 was primarily due to the servicing on the FFEL program loans that were purchased by the ED from the lenders (the Purchased Loans) during 2009 and 2010. The Purchased Loans were initially serviced by the FFEL program lenders that made those loans, until the Purchased Loans were sold to the ED. Upon receipt of the Purchased Loans, the ED transferred the servicing of those loans to the servicer of the FDL program loans. Shortly thereafter, the ED replaced the servicer of the FDL program loans with four different servicers, and servicing of the Purchased Loans was distributed among the new servicers of the FDL program loans. We believe that the changes in the servicers of the Purchased Loans had a negative impact on the servicing of those loans, which could have resulted in a higher Three-Year CDR average with respect to those loans. We appealed the ITT Technical Institute institutions' official Three-Year CDRs for FFY 2009 on the basis that those Purchased Loans were improperly serviced. We have not yet received the ED's final determination of the ITT Technical Institute institutions' Three-Year CDRs for FFY 2009 in response to our loan servicing appeal, but we anticipate that the result of this appeal will not significantly change the average Three-Year CDR for FFY 2009 shown above. Further, because none of our institutions had a Three-Year CDR for FFY 2010 of 30% or greater, the fact that the Three-Year CDRs for FFY 2009 was greater than 30% does not impact our institutions' eligibility to participate in the FDL program or the Pell program. We did not appeal the ITT Technical Institute institutions' official Three-Year CDRs for FFYs 2010 or 2011, and do not intend to appeal for FFY 2012.

An institution can appeal its loss of eligibility that is based on exceeding one of the Three-Year CDR thresholds described above. During the pendency of any such appeal, the institution remains eligible to participate in the FDL and Pell programs. If an institution continues its participation in the FDL programs during the pendency of any such appeal and the appeal is unsuccessful, the institution must pay the ED the amount of interest, special allowance,

reinsurance and any related payments paid by the ED (or which the ED is obligated to pay) with respect to the FDL program loans made to the institution's students or their parents that would not have been made if the institution had not continued its participation (the Direct Costs). If a substantial number of our campuses were subject to losing their eligibility to participate in the FDL and Pell programs because of our institutions' high Three-Year CDRs, the potential amount of the Direct Costs for which we would be liable if our appeals were unsuccessful would prevent us from continuing some or all of the affected campuses' participation in the FDL program during the pendency of those appeals, which would have a material adverse effect on our financial condition, results of operations and cash flows.

Current and future economic conditions in the United States could also adversely affect our institutions' Three-Year CDRs. Increases in interest rates, declines in individuals' incomes and job losses for our students and graduates or their parents have contributed to, and could continue to contribute to, higher default rates on student loans.

The servicing and collection efforts of student loan servicers help to lower our institutions' Three-Year CDRs. We supplement their efforts by attempting to contact students to advise them of their responsibilities and any deferment, forbearance or alternative repayment plans for which they may qualify.

If any of our institutions lost its eligibility to participate in FDL and Pell programs and we could not arrange for alternative financing sources for the students attending the campuses in that institution, we would probably have to close those campuses, which would have a material adverse effect on our financial condition, results of operations and cash flows. If all or substantially all of our campuses lost their eligibility to participate in Title IV Programs, we likely would not be able to continue to operate our business.

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*If the ED's new gainful employment regulations withstand legal challenges in court, and if any of our programs of study fail to qualify as programs that lead to gainful employment in a recognized occupation under those regulations, students attending those programs of study will be unable to use Title IV Program funds to help pay their education costs.*

On October 31, 2014, the ED issued final regulations that will become effective on July 1, 2015, specifying requirements related to programs of study that are intended to lead to gainful employment in a recognized occupation (the New GE Rule). Those requirements include two debt-to-earnings rates (D/E Rates) to be calculated every year, consisting of a debt-to-annual earnings (aDTE) rate and a debt-to-discretionary income (dDTI) rate.

The aDTE rate is calculated by comparing (i) the annual loan payment required on the median student loan debt incurred by students receiving Title IV Program funds who completed a particular program and (ii) the higher of the mean or median of those graduates' annual earnings approximately two to four years after they graduate, to arrive at a percentage rate. The dDTI rate is calculated by comparing (i) the annual loan payment required on the median student loan debt incurred by students receiving Title IV Program funds who completed a particular program and (ii) the higher of the mean or median of those graduates' discretionary income approximately two to four years after they graduate to arrive at a percentage rate. The ED receives the earnings data used to calculate the aDTE and dDTI rates from the Social Security Administration (SSA). Institutions do not have access to the SSA earnings information.

A program must achieve an aDTE rate at or below 8%, or a dDTI rate at or below 20%, to be considered passing. A program that does not have a passing rate under either the aDTE or dDTI rates, but has an aDTE rate greater than 8% but less than or equal to 12%, or a dDTI rate greater than 20% but less than or equal to 30%, is considered in the zone. A program with an aDTE rate greater than 12% and a dDTI rate greater than 30%, is considered failing. A program will cease to be eligible for students to receive Title IV Program funds, if its aDTE rate and dDTI rate are failing in two out of any three consecutive award years or both of those rates are either failing or in the zone for four consecutive award years for which the ED calculates D/E Rates. An award year under the Title IV Programs begins on July 1<sup>st</sup> and ends on June 30<sup>th</sup> of the immediately succeeding calendar year.

If a program could become ineligible for students to use Title IV Program funds based on its D/E Rates for the next award year, which could occur based on the program's D/E Rates for a single year, the institution must:

deliver a warning to current and prospective students in that program at the prescribed time and by a prescribed method which, among other things, states that students may not be able to use Title IV Program funds to attend or continue to attend the program (Warning); and

not enroll, register or enter into a financial commitment with a prospective student in the program, until three business days after (a) a Warning is provided to the prospective student or (b) a subsequent Warning is provided to the prospective student, if more than 30 days have passed since the initial Warning was first provided to the prospective student.

The New GE Rule also requires institutions to make additional public disclosures and report additional information to the ED with respect to each program that leads to gainful employment in a recognized occupation. We believe that the additional disclosure and reporting requirements will be administratively burdensome, will increase our compliance costs, and could cause fewer students to enroll in our programs of study.



If a program becomes ineligible for students to use Title IV Program funds, or if the institution chooses to discontinue a program after it receives D/E Rates that are failing or in the zone for a single award year, the institution cannot seek to reestablish the eligibility of that program, or establish the eligibility of a similar program, based on having a classification of instructional program ( CIP ) code that has the same first four digits as the CIP code of the ineligible program, until three years following the date on which the program became ineligible or was discontinued.

We cannot predict with any certainty which or how many of our programs of study may become ineligible or subject to a Warning under the New GE Rule. While we are evaluating the potential impact of the New GE Rule, we cannot predict what the impact will be on our operations. Compliance with the New GE Rule could reduce our enrollments, increase our cost of doing business and have a material adverse effect on our business, financial condition, results of operations and cash flows.

In response to the predecessor of the New GE Rule that was issued in 2011, we made significant changes to the programs of study that we offer. This prior rule also put downward pressure on our tuition prices, to help prevent students from incurring debt that exceeded the levels required for a program to remain eligible for students to receive Title IV Program funds. This, in turn, increased the percentage of our revenue that is derived from Title IV Programs, which could adversely impact our compliance with other ED regulations. We have also limited enrollment in certain programs of study and substantially increased our efforts to promote student loan repayment. These pressures and other factors are likely to continue under the New GE Rule. Any or all of these factors could reduce our enrollment and/or increase our cost of doing business, perhaps materially, which could have a material adverse effect on our business, prospects, financial condition, results of operations, cash flows and stock price.

In November 2014, two organizations of schools filed separate lawsuits against the ED in federal courts seeking to have the New GE Rule invalidated. One lawsuit was filed by the Association of Private Sector Colleges and Universities, which represents more than 1,400 for-profit institutions nationwide, and the other lawsuit was filed by the Association of Proprietary Colleges, which

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represents more than 20 for-profit colleges in the state of New York. The lawsuits allege, among other things, that the New GE Rule exceeds the ED's statutory authority, violates institutions' constitutional rights, and is arbitrary and capricious. We cannot predict when or how the courts will rule on these lawsuits.

*We may be subject to sanctions, including, without limitation, an increase in the amount of the ED Letter of Credit, and other limitations in order to continue our campuses' participation in Title IV Programs, state authorization and accreditation, if we or our campuses do not meet the financial standards of the ED, SAs or ACs.* The ED, SAs and ACs prescribe specific financial standards that an institution must satisfy to participate in Title IV Programs, operate in a state and be accredited. The ED evaluates institutions for compliance with its financial responsibility standards each year, based on the institution's annual audited financial statements, as well as following any change of control of the institution and when the institution is reviewed for recertification by the ED. In evaluating an institution's compliance with the financial responsibility standards, the ED may examine the financial statements of the individual institution, the institution's parent company or any party related to the institution. Historically, the ED has evaluated the financial condition of our institutions on a consolidated basis, based on our financial statements at the parent company level.

The most significant ED financial responsibility measurement is the institution's composite score, which is calculated by the ED based on three ratios:

the equity ratio, which measures the institution's capital resources, ability to borrow and financial viability;

the primary reserve ratio, which measures the institution's ability to support current operations from expendable resources; and

the net income ratio, which measures the institution's ability to operate at a profit.

The ED assigns a strength factor to the results of each of these ratios on a scale from negative 1.0 to positive 3.0, with negative 1.0 reflecting financial weakness and positive 3.0 reflecting financial strength. The ED then assigns a weighting percentage to each ratio and adds the weighted scores for the three ratios together to produce a composite score for the institution (the Composite Score). The Composite Score must be at least 1.5 for the institution to be deemed financially responsible by the ED without the need for further oversight. Our institutions' Composite Score, based on our fiscal year consolidated financial statements at the parent company level, was 1.8 in 2012. In calculating our institutions' 2013 Composite Score, we believe that an exclusion for the effect of a change in accounting estimate related to the CUSO RSA should be available under the ED's regulations, which would cause our 2013 Composite Score to be higher than if that exclusion was not permitted.

On January 28, 2015, we received a letter from the ED stating that it does not agree with our position, resulting in a determination by the ED that our institutions' 2013 Composite Score was 0.9. As a result of this determination, the ED indicated that our institutions failed to comply with the ED's financial responsibility standards. Due to our failure to submit our 2013 audited consolidated financial statements and compliance audits to the ED by the ED's June 30, 2014 deadline, the ED had previously determined that we failed to comply with the ED's financial responsibility standards for that reason and imposed penalties on us including being placed on provisional certification, having to request Title IV funds from the ED under the Heightened Cash Monitoring 1 method of payment, and requiring us to post a letter of credit with the ED in the amount of \$79.7 million. We are already subject to the same sanctions and penalties that the

ED normally imposes on institutions that fail to have a Composite Score of at least 1.5, and the ED's determination that our institutions have a 2013 Composite Score of 0.9 did not result in additional sanctions or penalties from the ED against us or our institutions, but we cannot assure you that the ED will not impose additional sanctions or penalties. Based on our fiscal year consolidated financial statements at the parent company level, our institutions Composite Score was above 1.5 in 2014.

We disagree with the ED's determination regarding our institutions' 2013 Composite Score, and we believe that our institutions' 2013 Composite Score is above 1.5. We provided a written response to the ED requesting that the ED reconsider the composite score calculation for fiscal year ended December 31, 2013 and offered to meet with the ED to discuss this matter. The ED made a written request for additional information from us, to which we responded on March 25, 2015. On April 15, 2015, the ED reaffirmed its determination that our consolidated financial statements for the fiscal year ended December 31, 2013 yield a Composite Score of 0.9 out of a possible 3.0. On April 20, 2015, we provided the ED with a notice of our intent to appeal the April 15, 2015 letter from the ED addressing our institutions' 2013 Composite Score and reiterated our offer to meet with the ED to discuss the calculation. We cannot assure you that the ED will agree with our position on this matter.

The letter of credit that the ED has already required us to post might be accepted to satisfy any additional letter of credit requirement, but there can be no assurance that the ED would not require us to increase the amount of any then-existing letter of credit based on our institutions' 2013 Composite Scores. Any significant delay in our institutions' receipt of Title IV Program funds due to the penalties that the ED has imposed on us could adversely affect our financial condition, results of operations, liquidity and cash flows, could cause us to be in default of the Financing Agreement and could negatively impact our ability to satisfy our payment obligations under contractual arrangements, including the RSAs and the Financing Agreement. Depending on the length of the delay, we cannot assure you that we would be able to continue to operate our business in such an event. If the ED requires us to increase the amount of our letter of credit payable to the ED, we cannot assure you that we would be able to do so, or that we would be able to provide the cash collateral necessary to maintain any letter of credit.

The SA's financial standards include a variety of financial metrics and ratios, including, without limitation, positive net working capital, positive net worth, operating profit, one-to-one ratio of assets to liabilities and/or one-to-one ratio of current assets to

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current liabilities. In addition, some of the ACs and SAs to which we are subject could impose sanctions and penalties against us and our institutions as a result of a 2013 Composite Score below 1.5, including requiring us to post separate letters of credit for their benefit, or suspending or terminating our campuses' authority to operate. Any sanctions or penalties imposed by the ACs and SAs could have a material adverse effect on our financial condition, results of operations, and cash flows. Our institutions violated the financial standards of the SAs in Florida, Pennsylvania, Tennessee, Texas and West Virginia, due to:

the PEAKS Consolidation;

our institutions' failure to submit their 2013 audited consolidated financial statements to the SAs by the applicable due dates; and/or

other factors.

As a result of these violations, our:

Florida SA:

changed the authorization to operate for each of our 13 campuses in Florida from an annual license to a provisional license, through July 31, 2015;

told us that it would conduct an on-site visit of each of our Florida campuses to determine the campus' compliance with our Florida SA's regulations;

told us that it would require each of our Florida campuses to correct any deficiencies noted during our Florida SA's on-site visit of the campus;

required us to submit to our Florida SA any correspondence that we or any of our institutions have with the ED or the AC of our Florida campuses, within 15 days of the submission or receipt of that correspondence;

required each of our Florida campuses to submit a train-out plan to our Florida SA on or before September 4, 2014; and

required us to report to our Florida SA, at its September 2014 meeting, on the stability of our Florida campuses and any changes that may further affect our stability or operations;

Pennsylvania SA could:

place each of our seven campuses in Pennsylvania on quarterly financial reporting;

require each of our Pennsylvania campuses to submit to our Pennsylvania SA a teach-out plan with respect to all of the campus programs;

require each of our Pennsylvania campuses to submit to our Pennsylvania SA a business plan with respect to the campus operations;

raise the required amount of the surety bond that each of our Pennsylvania campuses are required to post for the benefit of our Pennsylvania SA; and/or

suspend or revoke each of our Pennsylvania campuses authorization to operate as an educational institution in Pennsylvania;

Tennessee SA could:

assess monetary fines against each of our five campuses in Tennessee;

require each of our Tennessee campuses to submit to our Tennessee SA an audit of the campus financial stability that is conducted in accordance with generally accepted auditing standards in the United States;

revoke or change each of our Tennessee campuses authorization to operate as an educational institution in Tennessee; and/or

suspend or terminate all or any portion of our Tennessee campuses operations in Tennessee, including, without limitation, new student enrollment, advertising and/or teaching specific programs;

Texas SA could:

assess an administrative penalty;

revoke our Texas campuses certificates of approval;

place conditions on our Texas campuses' certificates of approval;

suspend the admission of students to our Texas campuses or programs;

deny program approvals for our Texas campuses;

deny, suspend or revoke the registration of our Texas campuses' representatives;

apply for an injunction against our Texas campuses;

ask the attorney general to collect a civil penalty for violation of state law or regulations; and/or

order a peer review of our Texas campuses; and

West Virginia SA could:

raise the amount of the surety bond that our one campus in West Virginia needs is required to post for the benefit of our West Virginia SA;

call the surety bond that our West Virginia campus posted for the benefit of our West Virginia SA;

suspend, withdraw or revoke our West Virginia campus' authorization to operate or solicit students in West Virginia;

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change our West Virginia campus authorization to operate in West Virginia to a probationary authorization;

require our West Virginia campus to refund its students tuition and fees; and/or

take any other action against our West Virginia campus that our West Virginia SA deems appropriate.

If some or all of the sanctions described above were imposed on many of the affected campuses, those sanctions would have a material adverse effect on our financial condition, results of operations, liquidity and cash flows.

***One or more of our institutions may have to post a letter of credit or be subject to other sanctions if it does not correctly calculate and return within the required time frame Title IV Program funds for, or refund monies paid by or on behalf of, students who withdraw before completing their program of study.*** The HEA and its implementing regulations impose limits on the amount of Title IV Program funds withdrawing students can use to pay their education costs (the Return Policy ). The Return Policy permits a student to use only a pro rata portion of the Title IV Program funds that the student would otherwise be eligible to use, if the student withdraws during the first 60% of any period of enrollment. For the vast majority of our campuses, a period of enrollment is generally an academic quarter. The institution must calculate and return to the ED any Title IV Program funds that the institution receives on behalf of a withdrawing student in excess of the amount the student can use for such period of enrollment. The institution must return those unearned funds in a timely manner which is generally within 45 days of the date the institution determined that the student had withdrawn. If the unearned funds are not properly calculated and timely returned, we may have to post a letter of credit in favor of the ED or be otherwise sanctioned by the ED. An institution is required to post a letter of credit with the ED in an amount equal to 25% of the total dollar amount of unearned Title IV Program funds that the institution was required to return with respect to withdrawn students during its most recently completed fiscal year, if the institution is found in an audit or program review to have untimely returned unearned Title IV Program funds with respect to 5% or more of the students in the audit or program review sample of withdrawn students, in either of its two most recently completed fiscal years. As of December 31, 2014, no audit or program review had found that any of our institutions violated the ED's standard on the timely return of unearned Title IV Program funds. The requirement to post a letter of credit or other sanctions by the ED could increase our cost of regulatory compliance and adversely affect our results of operations. Further, we cannot assure you that our institutions would be able to submit a letter of credit payable to the ED in the amount required by the ED, or that we would be able to provide the cash collateral required to maintain any letter of credit.

The standards of most of the SAs and the ACs limit a student's obligation to an institution for tuition and fees, if a student withdraws from the institution (the Refund Policies ). The specific standards vary among the SAs. Depending on when, during an academic term, a student withdraws and the applicable Refund Policies, in many instances the student remains obligated to the institution for some or all of the student's education costs that were paid by the Title IV Program funds returned under the Return Policy. In these instances, many withdrawing students are unable to pay all of their education costs, unless the students have access to other sources of financial aid. Our experience has been that many of our affected students do not have access to other sources of financial aid and that we have been unable to collect a significant portion of many withdrawing students' education costs that would have been paid by Title IV Program funds that were returned, which, in the aggregate, have had and may continue to have a material adverse effect on our results of operations and cash flows.

***One or more of our institutions may lose its eligibility to participate in Title IV Programs, if the percentage of its revenue derived from those programs is too high.*** Under a provision of the HEA commonly referred to as the 90/10



Rule, a proprietary institution may be sanctioned if, on a cash accounting basis, the institution derives more than 90% of its applicable revenue in a fiscal year from Title IV Programs. If an institution exceeds the 90% threshold for any single fiscal year, the ED would place that institution on provisional certification status for the institution's following two fiscal years, unless the institution's participation in Title IV Programs ends sooner. In addition, if an institution exceeds the 90% threshold for two consecutive fiscal years, it would be ineligible to participate in Title IV Programs as of the first day of the following fiscal year and would be unable to apply to regain its eligibility until the end of the second subsequent fiscal year. Furthermore, if one of our institutions exceeded the 90% threshold for two consecutive fiscal years and became ineligible to participate in Title IV Programs but continued to disburse Title IV Program funds, the ED can require the institution to repay, with limited exceptions, all Title IV Program funds disbursed by the institution after the effective date of the loss of eligibility.

For our 2014 fiscal year, none of our institutions derived more than approximately 81% of its applicable revenue on a cash accounting basis from Title IV Programs under the 90/10 Rule calculation. Any changes in federal law that increase Title IV Program grant or loan limits, or that count funds other than Title IV Program funds toward the 90% limit, may result in an increase in the percentage of revenue that we indirectly derive from Title IV Programs, which could make it more difficult for us to satisfy the 90/10 Rule.

A significant portion of the veterans' educational benefits that our students receive from the VA and state agencies administering those funds is included in our non-Title IV revenue for purposes of the 90/10 Rule. If a portion of our veteran students' educational benefits that are included in our non-Title IV revenue for purposes of the 90/10 Rule is no longer available, the percentage of our revenue from Title IV sources could increase, and if a material amount of such VA funding is no longer available, the percentage of our revenue from Title IV sources could materially increase, which could make it more difficult for us to satisfy the 90/10 Rule. See *Our campuses' failure to comply with the requirements for receiving veterans' educational benefits or Department of Defense tuition assistance program funds could result in their loss of eligibility to receive such benefits and funds, which could materially and adversely affect our business.*

We regularly monitor compliance with the 90/10 Rule to minimize the risk that any of our institutions would derive more than the maximum allowable percentage of its applicable revenue from Title IV Programs for any fiscal year. If an institution appeared likely to approach the maximum percentage threshold, we would consider making changes in student financing to comply with the 90/10 Rule, but we cannot assure you that we would be able to do this in a timely manner or at all. If any of our institutions lost its eligibility to participate in Title IV Programs and we could not arrange for alternative financing sources for the students attending the campuses in that institution, we would probably have to close those campuses, which could have a material adverse effect on our financial condition, results of operations and cash flows. If all or substantially all of our campuses lost their eligibility to participate in Title IV Programs, we likely would not be able to continue to operate our business.

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*Failure by one or more of our institutions to satisfy the ED's administrative capability requirements could result in financial penalties, limitations on the institution's participation in Title IV Programs, or loss of the institution's eligibility to participate in Title IV Programs.* To participate in Title IV Programs, an institution must satisfy criteria of administrative capability prescribed by the ED. These criteria include requirements that the institution:

demonstrate a reasonable relationship between the length of its programs and the entry-level job requirements of the relevant fields of employment;

comply with all of the applicable Title IV Program regulations prescribed by the ED;

have capable and sufficient personnel to administer the institution's participation in Title IV Programs;

define and measure the satisfactory academic progress of its students within parameters specified by the ED;

provide adequate financial aid counseling to its students who receive Title IV Program funds; and

timely submit all required reports and financial statements to the ED.

If the ED determines that an institution is not capable of adequately administering its participation in any of the Title IV Programs, the ED could, among other things:

impose monetary fines or penalties on the institution;

require the institution to repay funds received under Title IV Programs;

transfer the institution from the advance method of payment of Title IV Program funds to the heightened cash monitoring or reimbursement system of payment; or

limit or terminate the institution's eligibility to participate in Title IV Programs.

Any of these sanctions could adversely affect our financial condition, results of operations and cash flows and impose significant operating restrictions on us. Further, the ED can disapprove new educational program applications for administrative capability reasons. For example, in December 2014, the ED disapproved our application to offer four new degree programs at the ITT Technical Institutes due to administrative capability issues reported in recent compliance audits and ED program reviews, and in March 2015, the ED disapproved two of eight new degree programs that we applied to offer at DWC also due to administrative capability issues.

In addition, for 2014 and subsequent years, an institution is deemed by the ED to lack administrative capability if its Three-Year CDR equals or exceeds 30% for at least two of the three most recent federal fiscal years for which such rates have been published. If an institution's administrative capability is impaired solely because its Three-Year CDRs equal or exceed the applicable percentage, the institution can continue to participate in Title IV Programs, but the ED may place the institution on provisional certification.

***We are subject to sanctions, if we pay impermissible commissions, bonuses or other incentive payments to individuals or entities involved in certain recruiting, admission or financial aid activities.*** The ED's regulations prohibit an institution participating in Title IV Programs from providing any commission, bonus or other incentive payment based directly or indirectly on success in securing enrollments or financial aid to any person or entity engaged in any student recruitment or admission activity or in making decisions regarding the awarding of Title IV Program funds (the Incentive Compensation Prohibition). We believe that the Incentive Compensation Prohibition:

does not establish clear criteria for compliance in all circumstances, and the ED will not entertain a request by an institution for the ED to review and assess its individual compensation plan;

may subject us to qui tam lawsuits for alleged violations of the False Claims Act, 31 U.S.C. § 3729 *et seq.* ( False Claims Act );

adversely affects our ability to compensate our employees based on their performance of their job responsibilities, which makes it more difficult to attract and retain highly-qualified employees; and

impairs our ability to sustain and grow our business.

We cannot be sure that the compensation that we have paid our employees will not be determined to violate the Incentive Compensation Prohibition. If the ED determines that our compensation practices violate the Incentive Compensation Prohibition, the ED could subject us to substantial monetary fines or penalties or other sanctions. We could also be subjected to qui tam lawsuits for alleged violations of the False Claims Act related to the Incentive Compensation Prohibition. Those sanctions and lawsuits could have a material adverse effect on our financial condition, results of operations, cash flows and future growth.

***We cannot operate new campuses or offer new programs, if they are not timely authorized by our regulators, and we may have to repay Title IV Program funds disbursed to students enrolled at any of those locations or in any of those programs, if we do not obtain prior authorization.*** Our expansion plans assume that we will be able to continue to obtain the necessary authorization from the ED, ACs and SAs to establish new campuses and expand or revise program offerings in a timely manner. If we are unable to obtain the required authorizations from the ED, ACs or SAs for any new campuses or any new or revised program offerings, or to obtain such authorizations in a timely manner, our ability to operate the new campuses or offer new or revised programs as planned would be impaired, which could have a material adverse effect on our expansion plans.

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The process of obtaining any required SA and AC authorizations can also delay our operating new campuses or offering new programs. The status of our institutions and the state laws and regulations in effect in the states where we are located or anticipate establishing a new location or the ACs standards may limit our ability to establish new campuses and expand the programs offered at a campus, which could have a material adverse effect on our expansion plans.

In addition, an institution that is eligible to participate in Title IV Programs may add a new location or education program without the ED's approval only if certain requirements are met. Otherwise, the institution must obtain the ED's approval before it may disburse Title IV Program funds to students in the new location or education program. If we were to erroneously determine that a new location or education program is eligible for Title IV Program funding, we would likely be liable for repayment of the Title IV Program funds provided to students in that location or program. See Business - Highly Regulated Industry.

Due to our institutions' failure to submit their 2013 audited consolidated financial statements and Compliance Audits to the ED by June 30, 2014, all of our institutions are provisionally certified to participate in Title IV Programs. See *Our institutions' failure to submit their 2013 audited consolidated financial statements and Compliance Audits to the ED by the due date resulted in sanctions imposed by the ED on our institutions that include, among other things, our institutions having to post a letter of credit, being placed on heightened cash monitoring and being provisionally certified.* Any institution provisionally certified by the ED must apply for and receive approval by the ED for any substantial change before the institution can award, disburse or distribute Title IV Program funds based on the substantial change. Substantial changes generally include, but are not limited to:

the establishment of an additional location;

an increase in the level of academic offering beyond those listed in the institution's Eligibility and Certification Approval Report with the ED;

an addition of any non-degree program or short-term training program; or

an addition of a degree program by a proprietary institution.

In December 2014, the ED informed us that it had disapproved our application to offer four new degree programs at the ITT Technical Institutes due to administrative capability issues reported in recent compliance audits and ED program reviews. The ED also told us that we could reapply for these programs when we demonstrated improved performance in those areas. Although we believe that we have made improvements in the areas identified by the ED and we intend to reapply to the ED for approval to offer these programs in the future, we cannot assure you that the ED will approve that re-application or that the ED will permit us to apply for a third time if the re-application is not approved. In addition, in March 2015, the ED approved six and disapproved two new degree programs that we had applied to offer at Daniel Webster College. The basis for disapproval was due to administrative capability issues reported in recent compliance audits and ED program reviews.

See Business - Highly Regulated Industry, for a further discussion of the ED's provisional certification of an institution to participate in Title IV Programs. See also *If the ED's new gainful employment regulations withstand legal challenges in court, and if any of our programs of study fail to qualify as programs that lead to gainful employment in*

*a recognized occupation under those regulations, students attending those programs of study will be unable to use Title IV Program funds to help pay their education costs,* regarding additional program approval requirements that are contained in the New GE Rule.

***Failure by any of our campuses or program offerings to satisfy the ACICS compliance standards with respect to Student Retention Rates, Graduate Placement Rates or Licensure Examination Pass Rates could cause us to close those campuses and reduce the offerings of those programs.*** Under the standards of the ACICS, if the Student Retention Rate or Graduate Placement Rate:

of a campus falls below the ACICS benchmark standards, the campus is required to develop and implement a campus improvement plan and periodically report its results to the ACICS;

of a campus falls below the ACICS compliance standards, the campus is required to develop and implement a campus improvement plan and come into compliance within a specified time period, or the ACICS may withdraw the campus inclusion in the institution's grant of accreditation;

of a program offering at a campus falls below the ACICS benchmark standards, the campus is required to develop and implement a program improvement plan for that program offering; or

of a program offering at a campus falls below the ACICS compliance standards, the program offering is required to develop and implement a campus improvement plan and come into compliance within a specified time period, or the ACICS may withdraw its authorization of that program offering.

The ACICS has also implemented standards related to Licensure Examination Pass Rates that apply to programs of study that have graduates who, if they seek employment, are required to have a certificate, licensure or registration based on an industry-sponsored examination in the applicable field. Under the ACICS standards, if the Licensure Examination Pass Rate:

of a program offering at a campus falls below the ACICS benchmark standards, the campus is required to develop and implement a program improvement plan for that program offering; or

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of a program offering at a campus falls below the ACICS compliance standards, the program offering is required to develop and implement a campus improvement plan and come into compliance within a specified time period, or the ACICS may withdraw its authorization of that program offering.

A campus that falls below the ACICS benchmark standards is not required to obtain permission from the ACICS prior to applying to add a new program offering, but a campus that falls below the ACICS compliance standards is required to obtain permission from the ACICS prior to applying to add a new program offering. See *Business Highly Regulated Industry Regulation by Accrediting Commissions* for a description of ACICS review of and actions related to our campuses and programs.

If any of our ITT Technical Institute locations and/or program offerings fall below the Student Retention Rate, Graduate Placement Rate or Licensure Examination Pass Rate compliance standards and we were unable to timely bring those locations and/or program offerings into compliance, we may have to close those locations and reduce the offerings of those programs, which could have a material adverse effect on our expansion plans, financial condition, results of operations and cash flows.

***The failure of our programs of study offered in any state to qualify as credit hour programs, as opposed to clock hour programs, under the ED s regulations would likely result in our students, who attend those programs, receiving less funds from Title IV Programs, may result in fewer students attending those programs and could result in financial penalties.*** The ED s regulations related to determining when a program of study is required to measure student progress in clock hours, as opposed to credit hours, are complex. Students attending credit hour programs of study that are required to be measured in clock hours for Title IV purposes may likely receive less funds from Title IV Programs to pay their cost of education with respect to those programs of study. Students interested in those programs of study may have to use more expensive private financing to pay their cost of education or may be unable to enroll in those programs of study. Students may determine that they do not qualify for private financing or that the private financing costs make borrowing too expensive, which may cause students to abandon or delay their education. Any or all of these factors could reduce our enrollment, which could have a material adverse effect on our business, financial condition, results of operations, cash flows and stock price. If we were to erroneously determine that a program of study is not required to measure student progress in clock hours, we would likely be liable for repayment of a portion of the Title IV Program funds provided to students in that program of study based on the difference between the amount of funds those students received and the amount they were eligible to receive.

***Government and regulatory agencies and third parties have brought, and may bring additional, investigations, claims or actions against us based on alleged violations of the extensive regulatory requirements applicable to us, which could require us to pay monetary damages, receive other sanctions and expend significant resources to defend those claims or actions.*** We are subject to investigations and claims of non-compliance with regulatory standards and other actions brought by regulatory agencies, students, shareholders and other parties. Some of the more significant pending investigations, claims and actions are described below. If the results of any investigations, claims and/or actions are unfavorable to us, we may be required to pay money damages or be subject to fines, penalties, injunctions, operational limitations, loss of eligibility to participate in federal or state financial aid programs, debarments, additional oversight and reporting, or other civil and criminal sanctions. Those sanctions could have a material adverse effect on our financial condition, results of operations and cash flows. In addition, we have incurred, and expect to continue to incur, significant legal and other expenses in connection with investigations, claims and actions, which could have a material adverse effect on our financial condition, results of operations and cash flows. Investigations, claims and actions have caused and will continue to cause a substantial diversion of our management s attention and resources from our ongoing business operations, which could have a material adverse effect on our business, financial condition, results of operations and cash flows. Adverse publicity regarding any investigations, claims and/or actions could also negatively affect our business and the market price of our common stock. Further, the fact that investigations, claims and actions are pending against us has resulted in, and could in the future result in,

increased scrutiny, the withholding of authorizations and/or the imposition of other sanctions by SAs, the ACs and other regulatory agencies governing us. See Business Highly Regulated Industry.

See Note 15 Commitments and Contingencies of the Notes to Consolidated Financial Statements, and the discussions under the sub-headings Government Investigations and Litigation, for information regarding certain lawsuits and investigations affecting us.

***Investigations, claims and actions against companies in our industry could adversely affect our business and stock price.*** The operations of a number of other companies in the postsecondary education industry have been subject to intense regulatory scrutiny. In some cases, allegations of wrongdoing have resulted in reviews or investigations by the U.S. Department of Justice, SEC, ED, CFPB, Government Accountability Office, Department of Veterans Affairs, Federal Trade Commission, Department of Defense, state education and professional licensing authorities, states attorney general offices or other state agencies. These investigations and actions have alleged, among other things, deceptive trade practices and noncompliance with applicable laws and regulations. These allegations have attracted adverse media coverage that may negatively affect public perceptions of proprietary education institutions, including the ITT Technical Institutes and Daniel Webster College. Adverse media coverage regarding other companies in the proprietary education sector or regarding us directly could damage our reputation, could result in lower enrollments, revenue and profit, and could have a negative impact on our stock price. These allegations, reviews, investigations and enforcement actions and the accompanying adverse publicity could also result in increased scrutiny of, and have a negative impact on, us and our industry.



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***Our campuses' failure to comply with the requirements for receiving veterans' educational benefits or Department of Defense tuition assistance program funds could result in their loss of eligibility to receive such benefits and funds, which could materially and adversely affect our business.*** Effective May 11, 2015, CSAAVE, a division of the California Department of Veterans Affairs, gave notice to all of our campuses in California, suspending the approval of their courses for receipt of veterans' educational program benefits under the GI Bill Programs. The basis for the suspension was CSAAVE's determination that the campuses did not fully comply with the financial stability standards for accreditation published by the ACICS. The notice of suspension precludes our California campuses from future enrollment or re-enrollment of veterans or their dependents intending to utilize the GI Bill Programs' education benefits to pay in whole or in part for their enrollment in the campus. We have been in contact with CSAAVE, which requested that we submit additional financial information, including a statement of determination from the ACICS that all of our California campuses fully comply with the ACICS financial stability standards and requirements for accreditation. We have submitted the requested information to CSAAVE. If CSAAVE does not lift the suspension order, CSAAVE says that the approval of our California campuses to train veterans will be withdrawn no later than July 13, 2015. If the suspension order is not lifted on a timely basis or if the approval to train veterans is withdrawn, our enrollments, results of operations and financial condition could be materially and adversely affected.

Effective May 18, 2015, NYSAA, a division of the New York Department of Veterans Affairs, gave notice to all of our campuses in the New York, suspending the approval of their courses for receipt of veterans' educational program benefits under the GI Bill Programs. The basis for the suspension was NYSAA's determination that the campuses did not fully comply with the financial stability standards for accreditation published by the ACICS. The notice of suspension precludes our New York campuses from future enrollment of veterans or their dependents intending to utilize the GI Bill Programs' education benefits to pay in whole or in part for their enrollment in the campus. The notice of suspension specifically allows certification of benefits for re-enrollments. NYSAA has directed that we submit, among other things, evidence of current financial stability, consistent with the ACICS standards, as well as documentation that the campuses in New York were not participating in practices claimed by the CFPB. We have submitted the requested information to NYSAA. If NYSAA does not lift the suspension order, NYSAA says that the approval of our New York campuses to train veterans will be withdrawn no later than July 17, 2015. If the suspension order is not lifted on a timely basis or if the approval to train veterans is withdrawn, our enrollments, results of operations and financial condition could be materially and adversely affected.

Our campuses in 36 states in addition to New York and California are approved to receive veterans' educational program benefits under the GI Bill Programs. Based on the recent actions by the state approving agencies in California and New York, we believe that state approving agencies in other states may take similar actions to suspend the approval of our courses in the campuses of those states for receipt of veterans' educational program benefits under the GI Bill Programs and require the submission of additional information and reports. Any of these actions by any state approving agency could materially and adversely affect our enrollments, results of operations and financial condition. If a material amount of the veterans' educational benefits funding that our students have historically received that is included in our non-Title IV revenue for purposes of the 90/10 Rule is no longer available, the percentage of our revenue from Title IV sources could materially increase, which could make it more difficult for us to satisfy the 90/10 Rule. See *One or more of our institutions may lose its eligibility to participate in Title IV Programs, if the percentage of its revenue derived from those programs is too high.*

***Changes in the amount or availability of veterans' educational benefits or Department of Defense tuition assistance programs could materially and adversely affect our business.*** Certain members of Congress and the Obama Administration have increased their focus on Department of Defense tuition assistance and veterans' educational benefits that are used for programs of study offered at proprietary education institutions, particularly distance education programs of study. EO 13607 requires an institution to agree to comply with the principles of

excellence described in the EO in order for the institution to participate in the Department of Defense tuition assistance and veterans education benefits programs, including the Post-9/11 GI Bill and the Tuition Assistance Program for active duty service members. Among other things, the principles of excellence include a requirement that institutions implement an institutional refund policy for veterans and service members that is aligned with the return of unearned student aid rules applicable to Title IV Programs when students withdraw prior to completing their programs. In addition, federal legislation has been introduced that would revise the 90/10 Rule to count Department of Defense tuition assistance and veterans educational benefits toward the 90% limit. To the extent that any laws, regulations or other requirements are adopted that limit or condition the amount of educational benefits that veterans and active duty service members can use toward their costs of education at proprietary education institutions or in distance education programs, or that limit or condition the participation of proprietary education institutions or distance education programs in veteran or military tuition assistance programs or in Title IV Programs with respect to veteran or military tuition assistance programs, our enrollments, results of operations and financial condition could be materially and adversely affected.

***If the graduates of some of our programs are unable to obtain licensure in their chosen professional fields of study, the enrollment in and the revenue derived from those programs could decrease and claims could be made against us that could be costly to defend.*** Graduates of certain of our programs of study offered through our Breckinridge School of Nursing and Health Sciences seek professional licensure in their chosen field following graduation. Their success in obtaining licensure depends on several factors, including:

the merits of the individual student;

whether the campus and the program were authorized by the appropriate SAs and/or approved by an accrediting commission and/or professional association; and

whether we complied with the requirements of those SAs, the accrediting commission or the professional association.

Certain SAs refuse to license students who graduate from programs that do not meet specific types of programmatic accreditation, residency or other state requirements. In the event that one or more SAs refuses to recognize our graduates for professional licensure in the future based on factors relating to our campuses or their programs, student enrollment in those programs would be negatively impacted which could have an adverse effect on our results of operations. In addition, we could be exposed to claims that would force us to incur legal and other expenses that could have a material adverse effect on our results of operations.

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***Laws and regulations relating to marketing practices could limit our marketing activities or cause us to discontinue the marketing activities that we currently use or plan to use, and failure to comply with such laws and regulations could result in statutory damages or lawsuits against us.*** We rely on a variety of direct-to-consumer marketing techniques, including telemarketing, email marketing and postal mailings, and we are subject to various laws and regulations which govern marketing and advertising practices. For example, the Telephone Consumer Protection Act of 1991, the Telemarketing Sales Rule, the CAN-SPAM Act of 2003 and various other federal and state laws and regulations impose requirements on the manner and extent to which we can market our programs to prospective students. A recent amendment to the Telephone Consumer Protection Act requires, among other things, that we receive prior express written consent from consumers in order to place telemarketing calls to wireless phones using certain technology. Efforts to comply with the new regulations may negatively affect our ability to contact prospective students and, therefore, our revenue and profitability. Newly-adopted or amended laws and regulations relating to telemarketing, and increased enforcement of such laws and regulations by governmental agencies or by private litigants, could adversely affect our business, operating results and financial condition. Our failure to comply with laws and regulations applicable to our marketing activities could also result in statutory damages and class action lawsuits or other lawsuits against us.

***The Early Career Academy is highly regulated, may require significant expenditures by us and may not be a successful business endeavor.*** To date, we have become the EMO for only one public charter high school. As such, the Early Career Academy is in the initial stages, and we cannot assure you that it will be a successful endeavor for us in the foreseeable future or at all. The Early Career Academy business is subject to extensive regulation, and we believe that it may require significant expenditures by us. Some of the factors that could have an adverse effect on the business of the Early Career Academy include, among others:

a reduction in government funding for, or a loss of tax-exempt status or funding eligibility by, public charter high schools;

the poor performance or misconduct by the Early Career Academy or operators of other public charter high schools;

legal claims challenging various aspects of public charter high schools; and

non-compliance with applicable regulations.

**Risks Related to Our Business**

***Our guarantee obligations under the private education loan programs have had, and could continue to have, a material adverse effect on us, our consolidated financial statements and our compliance with covenants and metrics to which we are subject.*** We have entered into risk sharing and guarantee agreements with entities related to private education loans provided to our students to help pay the students' cost of education that student financial aid from federal, state and other sources does not cover. Our obligations under the PEAKS Guarantee will remain in effect until the PEAKS Senior Debt and the PEAKS Trust's fees and expenses are paid in full. Our obligations under the CUSO RSA will remain in effect, until all private education loans made under the CUSO Program are paid in full. See Note 15 - Commitments and Contingencies of the Notes to Consolidated Financial Statements, for information regarding the guarantee payments, the payments on behalf of borrowers and the payments that we made related to the

RSAs in 2014.

The repayment performance of the private education loans under the RSAs has been significantly worse, and the charge-off rate on those loans has been significantly higher, than we originally projected when we entered into the RSAs and our subsequent projections. Further, under the PEAKS Guarantee, due to the PEAKS Consolidation and other factors, we were not in compliance with certain financial metrics under the PEAKS Program, which resulted in an increase in the required minimum Asset/Liability Ratio and a requirement that we make higher payments under the PEAKS Guarantee. As a result of the higher charge-off rates of the private education loans made under both the CUSO Program and PEAKS Program and the increased Asset/Liability Ratio, we have made payments related to the RSAs that have been significantly higher than we initially anticipated, and we currently estimate that we will be required to make payments in material amounts under the RSAs in 2015 and future years. See Note 15 Commitments and Contingencies of the Notes to Consolidated Financial Statements, for the amount of payments that we currently estimate we will be required to make through the remaining terms of the RSAs.

As a consequence of the restatement of our unaudited condensed consolidated financial statements in our Quarterly Reports on Form 10-Q for the fiscal quarters ended March 31, 2013, June 30, 2013 and September 30, 2013, certain quarterly reports that we were required to deliver to the indenture trustee of the PEAKS Trust under the PEAKS Guarantee were inaccurate. We delivered corrected quarterly reports to the indenture trustee on October 9, 2014. If we had delivered accurate quarterly reports, or with respect to periods in 2014 through June 30, 2014, delivered quarterly reports, to the indenture trustee of the PEAKS Trust, we believe the indenture trustee would have made payment demands beginning in April 2013, requiring us to make additional payments under the PEAKS Guarantee totaling approximately \$60.3 million in the aggregate, in order to maintain an Asset/Liability Ratio of 1.40/1.00. On October 9, 2014, we made a guarantee payment of \$50.0 million, which payment, along with other payments that we made to the PEAKS Trust in prior months, included amounts that would have become due between April 2013 and September 2014, had we delivered accurate quarterly reports. The delivery of inaccurate quarterly reports constituted a breach of the PEAKS Guarantee and an event of default under the PEAKS Indenture. In the event of a default under the PEAKS Indenture, the payment of the entire amount of the PEAKS Senior Debt could be accelerated, which would trigger our obligation to pay the full amount of the PEAKS

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Senior Debt pursuant to our obligations under the PEAKS Guarantee, additional remedies could be sought against us and there could be a cross-default under the Financing Agreement, any of which would have a material adverse effect on our results of operations, financial condition and cash flows. We believe that the delivery of the corrected quarterly reports and the payments we made under the PEAKS Guarantee through October 9, 2014 satisfied our obligations under the PEAKS Guarantee with respect to these matters and cured the breach of the PEAKS Guarantee and the event of default under the PEAKS Indenture. We cannot predict, however, whether the holders of the PEAKS Senior Debt will assert other breaches of the PEAKS Guarantee by us or assert that any breach of the PEAKS Guarantee or event of default under the PEAKS Indenture was not properly cured.

We have offset approximately \$8.5 million against amounts owed to us by the CUSO under a revolving note owed to us by the CUSO (the Revolving Note ), instead of making additional payments under the CUSO RSA in that amount. We understand the CUSO's position to be that the offset was improper and, as a result, we are in default under the CUSO RSA. In the event of a default by us under the CUSO RSA related to the offset, we may be required to pay to the CUSO approximately \$9.2 million, net of approximately \$1.0 million of recoveries from charged-off loans that are owed, but have not been paid, to us. If the CUSO instead were to withdraw cash collateral in that amount from the restricted bank account maintained to hold collateral to secure our obligations under the CUSO RSA, we would be required to deposit that amount of cash in the account to maintain the required level of collateral under the CUSO RSA.

In addition, as a result of the Consolidations, the liabilities of the PEAKS Trust and the CUSO are recorded on our consolidated balance sheet. See *As a result of the PEAKS Consolidation, our consolidated financial statements are materially different from those that we previously issued, which could have negative implications for our Financing Agreement and guarantee obligations and regulatory compliance* and *The CUSO Consolidation could have a material adverse effect on our consolidated financial statements and our compliance with covenants and metrics to which we are subject.*

Even if the charge-off rates of the private education loans made under the CUSO Program and PEAKS Program remain at levels similar to the charge-off rates that we are currently utilizing in our estimates of future payment amounts under the RSAs, those payment amounts could have a material adverse effect on our liquidity, cash flows and financial position, and could cause us to violate the requirements of the ED, SAs and the ACs and/or our compliance with the covenants under the Financing Agreement.

Our estimates of the future payment amounts under the CUSO RSA and the timing of those payments, assume, among other factors, that we make Discharge Payments (as defined below) to the fullest extent possible in 2018 and later years. If we do not make the Discharge Payments as assumed in 2018 and later years, due to an inability to make payments in those amounts or for any other reason, we estimate that we will have to pay significantly larger amounts under the CUSO RSA over the remaining term of that agreement.

Our estimates of the future charge-off rates of the private education loans made under the CUSO Program and PEAKS Program and of other factors that we utilize in our projections are based on numerous assumptions which may not prove to be correct and involve a number of risks and uncertainties. We would be required to pay additional material amounts under the RSAs and we could be required to make payments under the RSAs earlier than currently projected in the event that:

the charge-off rates on the private education loans are higher than we are currently estimating;

other factors utilized in our projections are worse than currently estimated; and/or

other factors negatively impact our compliance with the financial metrics to which we are subject under the RSAs.

Any of these events could have a material adverse effect on us, including, among others, on our:

results of operations, financial condition and cash flows;

liquidity and ability to pay our obligations as they become due;

ability to comply with the requirements of the ED, SAs and ACs to which we are subject, resulting in significant negative consequences;

ability to comply with our covenants under the Financing Agreement, resulting in a default thereunder, which could have a material adverse effect on our results of operations, financial condition, cash flows, liquidity and ability to comply with our other obligations; and

ability to make required payments under the RSAs, resulting in a default thereunder, which, in the case of a default under the PEAKS Guarantee, could result in an acceleration of the entire amount of the PEAKS Senior Debt and our obligations to pay the full amount of the PEAKS Senior Debt pursuant to the terms of the PEAKS Guarantee, additional remedies against us and there could be a cross-default under the Financing Agreement, any of which would have a material adverse effect on our results of operations, financial condition and cash flows.

***If we fail to effectively identify, establish and operate new campuses, our growth may be slowed.*** Part of our business strategy includes operating new campuses at locations throughout the United States. Establishing new campuses poses challenges and requires us to make investments in management and capital expenditures, incur marketing and advertising expenses and devote other resources that are different, and in some cases greater, than those required with respect to the operation of existing campuses. To operate a new campus, we would be required to obtain the appropriate authorizations from the applicable SAs and ACs, which may be conditioned or delayed in a manner that could significantly affect our growth plans. In addition, to be eligible to participate in Title IV Programs, a new campus must be certified by the ED, either before or after it starts disbursing Title IV

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Program funds to its students. See *We cannot operate new campuses or offer new programs, if they are not timely authorized by our regulators, and we may have to repay Title IV Program funds disbursed to students enrolled at any of those locations or in any of those programs, if we do not obtain prior authorization.* We cannot be sure that we will be able to identify suitable expansion opportunities or that we will be able to successfully integrate or profitably operate any new campuses. Any failure by us to effectively identify, establish and manage the operations of newly established campuses could slow our growth, make any newly established campuses more costly to operate than we had planned and have a material adverse effect on our expansion plans and results of operations.

***Our success depends, in part, on our ability to effectively identify, develop, obtain approval to offer and teach new programs at different levels in a cost-effective and timely manner.*** Part of our business strategy also includes increasing the number, levels, lengths and disciplines of programs offered at our campuses. Developing and offering new programs pose challenges and require us to make investments in research and development, management and capital expenditures, to incur marketing and advertising expenses and to devote other resources that are in addition to, and in some cases greater than, those associated with our current program offerings. In order to offer new programs at different levels at our campuses, we may be required to obtain the appropriate authorizations from the ED, SAs, ACs and, in certain circumstances, specialized programmatic accrediting commissions, which may be conditioned or delayed in a manner that could affect the programs offered at our campuses. We cannot be sure that we will be able to identify new programs, that we will be able to obtain the requisite authorizations to offer new programs at different levels at our campuses or that students will enroll in any new programs that we offer at our campuses. Any failure by us to effectively identify, develop, obtain authorization to offer and teach new programs at our campuses could have a material adverse effect on our expansion plans and results of operations. See Business Strategy Enhance Results at Each Institution, *If the ED's new gainful employment regulations withstand legal challenges in court, and if any of our programs of study fail to qualify as programs that lead to gainful employment in a recognized occupation under those regulations, students attending those programs of study will be unable to use Title IV Program funds to help pay their education costs*, *We cannot operate new campuses or offer new programs, if they are not timely authorized by our regulators, and we may have to repay Title IV Program funds disbursed to students enrolled at any of those locations or in any of those programs, if we do not obtain prior authorization* and *Failure by any of our campuses or program offerings to satisfy the ACICS compliance standards with respect to Student Retention Rates, Graduate Placement Rates or Licensure Examination Pass Rates could cause us to close those campuses and reduce the offerings of those programs.*

***Our success depends, in part, on our ability to keep pace with changing market needs and technology.*** Increasingly, prospective employers of our graduates demand that their entry-level employees possess appropriate technical skills and also appropriate soft skills, such as communication, critical thinking and teamwork skills. The skills that employees need may evolve rapidly in a changing economic and technological environment. Accordingly, it is important for our programs to evolve in response to those economic and technological changes. Any expansion of our existing programs and the development of new programs may not be accepted by prospective students or the employers of our graduates. Even if we are able to develop acceptable new programs, we may not be able to begin offering those new programs as quickly as required by the employers we serve or as quickly as our competitors offer similar programs. If we are unable to adequately respond to changes in market requirements due to regulatory or financial constraints, technological changes or other factors, our ability to attract and retain students could be impaired and the rates at which our graduates obtain jobs involving their fields of study could suffer.

***Our financial performance depends, in part, on our ability to continue to develop awareness and acceptance of our programs among working adults and, to a lesser extent, recent high school graduates.*** The awareness of our programs among working adults and, to a lesser extent, recent high school graduates is important to the success of our campuses. If we were unable to successfully market or advertise our programs, our ability to attract and enroll prospective students in our programs would be adversely affected and, consequently, our ability to increase revenue or

maintain profitability would be impaired. The following are some of the factors that could prevent us from successfully marketing or advertising our programs:

adverse publicity regarding us, our competitors or proprietary education generally;

student dissatisfaction with our programs and services;

employer dissatisfaction with our programs and services;

high costs of certain types of advertising media; and

our failure to maintain or expand our brands or other factors related to our marketing or advertising practices.

***Increases in institutional scholarships and internal student financing could have a material adverse effect on our cash flows, revenue and student population.*** During the fourth quarter of 2012, we introduced an institutional scholarship program, called the Opportunity Scholarship, which is intended to help reduce the cost of an ITT Technical Institute education and increase student access to our programs of study. By June 30, 2013, the Opportunity Scholarship was being offered to students at all of the ITT Technical Institute campuses. We believe that the Opportunity Scholarship has, and will continue to, reduce our students' need and use of private education loans, as well as decrease the internal student financing that we provide to our students. As an institutional scholarship, our revenue is reduced by the amount of the Opportunity Scholarship awarded. In addition, no cash payments are received and students will not be obligated to make payments to us of the amounts awarded under the Opportunity Scholarship. Therefore, the amounts receivable from students to us, as well as our revenue, decreased in 2014 and, we believe, may continue to decrease in 2015.

The increased amount of internal student financing that we previously provided to our students has exposed us to greater credit risk. The internal student financing that we provide to our students consists of non-interest bearing, unsecured credit extended to our students. Internal student financing typically provides for payment to us by our



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students by the end of the student's academic year or enrollment, whichever occurs first, compared to payments from private education loan programs, which we typically received at the beginning of a student's academic year. This change in the timing of payments had a material adverse effect on our cash flows from operations in 2012 and 2013. In addition, we have the risk of collection with respect to our internal student financing, which caused us to increase our allowance for doubtful accounts in 2013 and 2014 and resulted in an increase in our bad debt expense as a percentage of revenue in 2013 and 2014. We plan to continue to offer the Opportunity Scholarship and other scholarships to eligible students which we believe will continue to reduce the amount of internal student financing that we provide to our students. The increased use of institutional scholarships and awards by our students and any additional internal student financing provided to our students could result in a continuation of the adverse factors that are described above, including a material adverse effect on our financial condition and cash flows.

***We have a significant amount of cash held as collateral for outstanding letters of credit, which has a continuing material adverse effect on our cash flows and liquidity.*** We were required to deposit \$89.3 million to be held as cash collateral for outstanding letters of credit for our account. Our collateralization of the letters of credit had, and continues to have, a material adverse effect on our liquidity, and significantly reduced the amount of cash that we have available for other purposes, including to satisfy our future payment obligations under the RSAs. The funds held as cash collateral are not available for use by us, and could be paid to the issuing bank for the letters of credit if the letters of credit are drawn upon. The fact that a significant amount of our cash is held in connection with the letters of credit could also negatively affect our ability to satisfy the financial metrics of the ED, SAs and ACs to which we are subject. We cannot assure you that we will not have to deposit additional amounts to be held as cash collateral as a result of an increase in required amounts of the letters of credit or a requirement for an additional letter of credit, which deposit could have a material adverse effect on our cash flows and liquidity.

***If we experience losses in excess of the amounts that we have accrued with respect to the significant amount of internal student financing that we have provided to our students, it could have a material adverse effect on our financial condition, results of operations and cash flows.*** We offer internal student financing to help students pay the portion of their cost of education that is not covered by financial aid or other funds. These balances are unsecured and not typically guaranteed. These balances have increased significantly in the last few years as a result of the number of our students who did not qualify for private education loans from third parties due to their prior credit history and the limited funding available under private education loan programs for which those students could qualify. The introduction of the Opportunity Scholarship has reduced, and will continue to reduce, our students' need for internal student financing. Internal student financing adversely affects our cash flows and exposes us to greater credit risk. Although we have accrued for estimated losses related to unpaid student balances, losses in excess of the amount we have accrued for bad debts could have a material adverse effect on our financial condition and results of operations.

***If we are unable to successfully conclude litigation against us, our business, financial condition and results of operations could be materially adversely affected.*** We are subject to various lawsuits, investigations and claims, covering a wide range of matters, including, but not limited to, alleged violations of federal and state laws, claims involving students or graduates and routine employment matters. We cannot predict the ultimate outcome of these matters and have incurred, and expect to incur, significant defense costs and other expenses in connection with these matters. Those costs and expenses have had, and could continue to have, a material adverse effect on our business, financial condition, results of operations and cash flows and the market price of our common stock. These matters have and will continue to cause substantial diversion of our management's attention and resources from our ongoing business operations, which could have a material adverse effect on our business, financial condition, results of operations and cash flows. We may be required to pay substantial damages or settlement costs in excess of our insurance coverage related to these matters, or may be required to pay substantial fines or penalties, any of which could have a further material adverse effect on our business, financial condition, results of operations and cash flows. An adverse outcome in any of these matters could also materially and adversely affect our authorizations, licenses,

accreditations and eligibility to participate in Title IV programs. See Legal Proceedings.

***High interest rates and tightening of the credit markets could adversely affect our ability to attract and retain students and could increase our risk exposure.*** Since much of the financing our students receive is tied to floating interest rates, higher interest rates cause a corresponding increase in the cost to our existing and prospective students of financing their education, which could result in a reduction in the number of students attending our campuses and, consequently, in our revenue. Higher interest rates could also contribute to higher default rates with respect to our students' repayment of Title IV Program and private education loans. High default rates may, in turn, adversely impact our eligibility to participate in Title IV Programs, trigger our guarantee obligations with respect to private education loan programs and/or negatively affect the willingness of private lenders to make private education loan programs available to our students, which could result in a reduction in the number of students attending our campuses and could have a material adverse effect on our financial condition, results of operations and cash flows. As a result of those adverse effects on our students' ability to finance their cost of education, our receivables could increase and/or our student population could decrease, which could have a material adverse effect on our financial condition, results of operations and cash flows.

***The ability of the CPD to provide education-related services depends, in large part, on obtaining authorizations from vendors and trade associations to use their content in the CPD's education-related services.*** Part of our business strategy includes developing and providing education-related services to students and other constituencies. Through the CPD, we are developing and providing education-related services, including training programs, curricula, assessments and consulting. The majority of the content of the education-related services provided by the CPD is authorized under agreements between the CPD and vendors or trade

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associations (the Content Agreements ). We cannot be sure that we will be able to maintain or renew the existing Content Agreements or enter into new Content Agreements. Any failure by us to effectively identify or develop content for education-related services, or maintain, renew or obtain Content Agreements with respect to our education-related services, could have a material adverse effect on our expansion plans and results of operations.

***The search for, and transition of, a new chief executive officer and a new chief financial officer could adversely affect us, and our inability to attract, hire or retain key personnel could harm our business.*** Our success to date has depended, and will continue to depend, largely on the skills, efforts and motivation of our executive officers. As previously disclosed, on August 4, 2014, in connection with the notification by Kevin M. Modany, our Chief Executive Officer, to our Board of Directors of his intention to resign as our Chief Executive Officer, we entered into a letter agreement with Mr. Modany (the Modany Letter Agreement ), pursuant to which Mr. Modany agreed to remain our Chief Executive Officer for a period ending on February 4, 2015, which period has been extended to August 31, 2015 (as so extended, the Applicable Period ), most recently pursuant to a second amendment to the Modany Letter Agreement entered into on May 26, 2015. Also as previously disclosed, on April 27, 2015, Daniel M. Fitzpatrick, our Chief Financial Officer, notified us of his plan to retire, and on April 29, 2015, we entered into a letter agreement with Mr. Fitzpatrick (the Fitzpatrick Letter Agreement ), pursuant to which he will remain our Chief Financial Officer for a period ending on October 29, 2015, as extended by us for up to four months (as so extended or earlier terminated, the Transition Period ).

The planned resignations of Messrs. Modany and Fitzpatrick may cause disruption in our business, strategic and employee relationships, which may significantly delay or prevent the achievement of our business objectives, and may cause a loss of key employees or declines in the productivity of existing employees. The search for a permanent Chief Executive Officer and a permanent Chief Financial Officer may take many months or more, further exacerbating these factors. Competition for senior management personnel is intense and we cannot assure you that we will be able to select and employ a new Chief Executive Officer or a new Chief Financial Officer in a timely manner. Identifying and hiring an experienced and qualified Chief Executive Officer and Chief Financial Officer are typically difficult, and may be even more difficult under the circumstances affecting us at this time. Further, we may not be able to effectively compete with compensation packages offered by other companies that are recruiting senior executive officers, due to the limitations imposed on us by the Incentive Compensation Prohibition. We may be unable to attract a suitably qualified individual for either the Chief Executive Officer position or the Chief Financial Officer position, or we may be required to pay increased base salary compensation in order to do so. Any or all of these risks could adversely affect our business, operating results or financial condition.

Our search for a new Chief Executive Officer and a new Chief Financial Officer may also adversely affect our business or impose additional risks, such as the following:

disruption of our business or distraction of our employees and management;

difficulty recruiting, hiring, motivating and retaining other talented and skilled personnel;

increased stock price volatility; and

difficulty in establishing, maintaining or negotiating business or strategic relationships or transactions.

We cannot assure you that the transition to a new Chief Executive Officer or a new Chief Financial Officer will be smooth or successful. Leadership transitions can be inherently difficult to manage and may cause uncertainty or a disruption to our business or may increase the likelihood of turnover in other key officers and employees. Changes to strategic or operating goals with the appointment of new executives may, themselves, prove to be disruptive. Periods of transition in senior management leadership are often difficult as the new executives gain detailed knowledge of the company's operations and may result in cultural differences and friction due to changes in strategy and style. During the transition periods, there may be uncertainty among investors, employees, creditors and others concerning our future direction and performance. Any disruption or uncertainty could have a material adverse effect on our results of operations and financial condition and the market price of our common stock.

During our search for, and transition to, a new Chief Executive Officer and a new Chief Financial Officer, it is important that we retain key personnel. All of our officers and other employees are at-will employees, which means they can terminate their employment relationship with us at any time, and their knowledge of our business and industry would be difficult to replace. If we lose the services of key personnel, especially during this period of leadership transition, or do not hire or retain other personnel for key positions, including the Chief Executive Officer or Chief Financial Officer positions, our business, results of operations and stock price could be adversely affected.

Our success also depends in large part on our ability to attract and retain highly qualified faculty, school administrators and corporate management. We face competition in the attraction and retention of personnel who possess the skill sets that we seek. In addition, key personnel may leave us and subsequently compete against us. Furthermore, we do not currently carry key man life insurance. The loss of the services of any of our key personnel, especially during this period of leadership transition, or our failure to attract and retain other qualified and experienced personnel on acceptable terms, could impair our ability to successfully manage our business.

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In order to support revenue growth, we need to hire, retain, develop and train employees who are responsible for student recruiting, financial aid, registration, teaching and career services. Our ability to develop a strong team of employees with these responsibilities may be affected by a number of factors, including:

our ability to timely and effectively train and motivate our employees in order for them to become productive;

restrictions imposed by regulatory bodies on the method of compensating employees, such as the Incentive Compensation Prohibition;

our ability to attract enough prospective students to our program offerings; and

our ability to effectively manage a multi-institutional and multi-location educational organization.

If we are unable to hire, retain, develop and train employees who are responsible for student recruiting, financial aid, registration, teaching and career services, our operations would be adversely affected.

Recent and ongoing adverse matters affecting us and our industry, including, without limitation, investigations, claims and lawsuits, and the negative publicity associated with those matters, may make it significantly more difficult for us to attract, motivate and retain employees at all levels of our organization. In addition, volatility or lack of performance in our stock price may also affect our ability to attract and retain key employees, including a new Chief Executive Officer or a new Chief Financial Officer. Our key executives may be more inclined to leave us, because the exercise prices of their stock options are significantly below the market price of our common stock or the perceived value of their restricted stock units continues to decline.

***Competition could decrease our market share or force us to increase spending.*** The postsecondary education market in the United States is highly fragmented and competitive, with no single private or public institution enjoying a significant market share. Our campuses compete for students with degree- and non-degree-granting institutions, which include public and private nonprofit colleges and proprietary institutions, as well as with alternatives to higher education, such as military service or immediate employment. Certain public and private colleges offer programs similar to those offered by our campuses at a lower tuition cost due in part to government subsidies, foundation grants, tax deductible contributions or other financial resources not available to proprietary institutions. Other proprietary institutions offer programs that compete with those of our campuses. Certain of our competitors in both the public and private sectors have greater financial and other resources than we do. In addition, recent and ongoing adverse matters affecting us and our industry, including, without limitation, investigations, claims and lawsuits, have resulted in negative publicity related to us and our industry. All of these factors could affect the success of our marketing efforts and enable our competitors to recruit prospective students more effectively.

We may be required to increase spending in response to competition in order to retain or attract students or pursue new market opportunities. As a result, our financial condition, results of operations and cash flows may be negatively affected. We cannot be sure that we will be able to compete successfully against current or future competitors or that competitive pressures faced by us will not adversely affect our business, financial condition, results of operations or cash flows.

***We may be unable to successfully complete or integrate acquisitions.*** In August 2013, we acquired Cable Holdings, and in January 2014, we acquired Great Equalizer, Inc. and CompetenC Solutions, Inc. We may consider additional selective acquisitions of schools or education-related businesses in the future. We may not be able to complete acquisitions on favorable terms or, even if we do, we may not be able to successfully integrate the acquired businesses into our business. Acquisition challenges include, among others:

regulatory approvals;

significant capital expenditures;

assumption of known and unknown liabilities;

our ability to control costs; and

our ability to integrate new personnel.

The successful integration of acquisitions may also require substantial attention from our senior management and the senior management of the acquired business, which could decrease the time that they devote to the day-to-day management of our business. If we do not successfully address risks and challenges associated with acquisitions, including integration, acquisitions could harm, rather than enhance, our operating performance.

In addition, if we consummate an acquisition, our capitalization and results of operations may change significantly. An acquisition could result in:

the incurrence of debt and contingent liabilities;

an increase in interest expense, amortization expenses, goodwill and other intangible assets;

charges relating to integration costs; and

an increase in the number of shares outstanding.

These results could have a material adverse effect on our results of operations or financial condition or result in dilution to current stockholders.

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***Terrorist attacks and other acts of violence or war could have an adverse effect on our operations.*** Terrorist attacks and other acts of violence or war could disrupt our operations. Attacks or armed conflicts that directly impact our physical facilities or ability to recruit and retain students and employees could adversely affect our ability to deliver our programs of study to our students and, thereby, impair our ability to achieve our financial and operational goals. Furthermore, violent acts and threats of future attacks could adversely affect the U.S. and world economies. Finally, future terrorist acts could cause the United States to enter into a wider armed conflict that could further impact our operations and result in prospective students, as well as our current students and employees, entering military service. These factors could cause significant declines in the number of students who attend our campuses and have a material adverse effect on our results of operations.

***Natural disasters and other acts of God could have an adverse effect on our operations.*** Hurricanes, earthquakes, floods, tornados and other natural disasters and acts of God could disrupt our operations. Natural disasters and other acts of God that directly impact our physical facilities or ability to recruit and retain students and employees could adversely affect our ability to deliver our programs of study to our students and, thereby, impair our ability to achieve our financial and operational goals. Furthermore, natural disasters could adversely affect the economy and demographics of the affected region, which could cause significant declines in the number of students who attend our campuses in that region and have a material adverse effect on our results of operations.

***A breach of the physical security at any of our locations could harm our business.*** There have been a number of shooting and other incidents involving violence at post-secondary and other school locations over the last several years. An incident involving violence resulting from a breach of the physical security or otherwise at any of our locations and/or harm to any of our students or employees could expose us to adverse publicity, as well as significant litigation and claims from third parties, which could have a material adverse effect on our reputation, business, prospects, results of operations, financial condition or cash flows.

***Anti-takeover provisions in our charter documents and under Delaware law, as well as required approvals by the ED, the ACs and most of the SAs, could make an acquisition of us more difficult.*** Certain provisions of Delaware law, our Restated Certificate of Incorporation and our By-Laws could have the effect of making it more difficult for a third party to acquire, or discouraging a third party from attempting to acquire, control of us. Those provisions could:

limit the price that certain investors might be willing to pay in the future for shares of our common stock;

discourage or prevent certain types of transactions involving an actual or threatened change in control of us (including unsolicited takeover attempts), even though such a transaction may offer our stockholders the opportunity to sell their stock at a price above the prevailing market price;

make it more difficult for stockholders to take certain corporate actions; and

have the effect of delaying or preventing a change in control of us.

Certain of those provisions authorize us to:

issue blank check preferred stock;

divide our Board of Directors into three classes expiring in rotation;

require advance notice for stockholder proposals and nominations;

prohibit stockholders from calling a special meeting; and

prohibit stockholder action by written consent.

In addition, the ED, the ACs and most of the SAs have requirements pertaining to the change in ownership and/or control (collectively change in control ) of institutions, but these requirements do not uniformly define what constitutes a change in control and are subject to varying interpretations as to whether a particular transaction constitutes a change in control. If we or any of our campuses experience a change in control under the standards of the ED, the ACs or the SAs, we or the affected campuses must seek the approval of the relevant regulatory agencies. Transactions or events that constitute a change in control for one or more of our regulatory agencies include:

the acquisition of a school from another entity;

significant acquisitions or dispositions of our common stock; and

significant changes to the composition of our, or any campus, Board of Directors.

Some of these transactions or events may be beyond our control. Our failure to obtain, or a delay in obtaining, a required approval of any change in control from the relevant regulatory agencies could impair our ability or the ability of the affected campuses to participate in Title IV Programs, or could require us to suspend our recruitment of students in one or more states until we receive the required approval. A material adverse effect on our financial condition, results of operations and cash flows would result if we had a change in control and a material number of our campuses:

failed to timely obtain the approvals of the SAs required prior to or following a change in control;

failed to timely regain approval by the ACs for inclusion in their institution's grant of accreditation or have their inclusion in that accreditation temporarily continued or reinstated by the ACs;

failed to timely regain eligibility to participate in Title IV Programs from the ED or receive temporary certification to continue to participate in Title IV Programs pending further review by the ED; or



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were subjected by the ED to restrictions that severely limited for a substantial period of time the number of new additional locations and/or new programs of study that are eligible to participate in Title IV Programs.

The fact that a change in control would require approval of the relevant regulatory agencies, and the uncertainty and potential delay related to obtaining such approvals, could have the effect of making it more difficult for a third party to acquire, or discouraging a third party from attempting to acquire, control of us.

***The personal information that we collect may be vulnerable to breach, theft or loss that could adversely affect our reputation and operations.*** Possession and use of personal information in our operations subjects us to risks and costs that could harm our business. In the ordinary course of our business, we collect, use and retain large amounts of personal information regarding prospective students, students, their families and employees. Some of this personal information is held and managed by certain of our vendors. Although we use security and business controls to limit access and use of personal information, a third party may be able to circumvent those security and business controls, which could result in a breach of student or employee privacy. In addition, errors in the storage, use or transmission of personal information could result in a breach of student or employee privacy. Possession and use of personal information in our operations also subjects us to legislative and regulatory burdens that could require notification of data breaches and restrict our use of personal information. We cannot assure you that a breach, loss or theft of personal information will not occur. A major breach, theft or loss of personal information regarding our students and their families or our employees that is held by us or our vendors could subject us to costly claims or litigation, have a material adverse effect on our reputation and results of operations and result in further regulation and oversight by federal and state authorities and increased costs of compliance. Potential new federal or state laws and regulations also may increase our costs of compliance or limit our ability to use personal information to recruit students.

***Security breaches or system interruptions or delays involving our computer networks could disrupt our operations, damage our reputation, limit our ability to attract and retain students and require us to expend significant resources.*** The performance and reliability of our computer systems are critical to our information management, reputation and ability to attract and retain students. Any system error or failure, or a sudden and significant increase in traffic, could disrupt the provision of education to students attending our campuses. We cannot assure you that we will be able to expand the infrastructure of our computer systems on a timely basis sufficient to meet demand. Our computer systems and operations could be vulnerable to interruption or malfunction due to events beyond our control, including natural disasters and telecommunications failures. Any interruption to our computer systems could have a material adverse effect on our operations and ability to attract and retain students. These factors could affect the number of students who attend our campuses and have a material adverse effect on our results of operations.

Our computer systems may be vulnerable to unauthorized access, computer hackers, computer viruses and other security problems. A user who circumvents security measures could misappropriate proprietary information or cause interruptions or malfunctions in operations. As a result, we may be required to expend significant resources to protect against the threat of those security breaches or to alleviate problems caused by those breaches. These factors could affect the number of students who attend our campuses and have a material adverse effect on our results of operations.

***We rely on exclusive proprietary rights and intellectual property that may not be adequately protected under current laws, and we may encounter disputes from time to time relating to our use of intellectual property of third parties.*** Our success depends in part on our ability to protect our proprietary rights. We rely on a combination of copyrights, trademarks, service marks, trade secrets, domain names and agreements to protect our proprietary rights. We rely on service mark and trademark protection in the United States to protect our rights to distinctive marks associated with our services. We rely on agreements under which we obtain rights to use the ITT and related marks and course content developed by our faculty, our other employees and third party content experts. We cannot assure you that those measures will be adequate, that we have secured, or will be able to secure, appropriate protections for

all of our proprietary rights, or that third parties will not infringe upon or violate our proprietary rights. Despite our efforts to protect those rights, unauthorized third parties may attempt to duplicate or copy the proprietary aspects of our names, curricula and other content. Our management's attention may be diverted by those attempts and we may need to use funds in litigation to protect our proprietary rights against any infringement or violation.

We may encounter disputes from time to time over rights and obligations concerning intellectual property, and we may not prevail in those disputes. In certain instances, we may not have obtained sufficient rights in the content or mode of delivery of a course or a program of study. Third parties may raise a claim against us alleging an infringement or violation of the intellectual property of that third party. Some third party intellectual property rights, such as certain patent rights, may be extremely broad, and it may not be possible for us to conduct our operations in such a way as to avoid infringing upon those intellectual property rights. Any such intellectual property claim could subject us to costly litigation, regardless of whether the claim has merit. Our insurance coverage may not cover potential claims of this type adequately or at all, and we may be required to alter the content or mode of delivery of our courses or programs of study, or pay significant monetary damages, any of which could have a material adverse effect on our results of operations.

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**Risk Related to Our Common Stock**

*The trading price of our common stock may fluctuate and decline substantially in the future.* The trading price of our common stock has fluctuated and declined, and may continue to fluctuate and decline, substantially as a result of a number of factors, some of which are not within our control. Those factors include, among others:

our ability to meet or exceed our own forecasts or expectations of analysts or investors;

quarterly variations in our operating results;

changes in federal and state laws and regulations and accreditation standards, or changes in the way that laws, regulations and accreditation standards are interpreted and applied;

the initiation, pendency or outcome of litigation, regulatory reviews and investigations, and any adverse publicity related thereto;

the effects of financial reporting matters, such as material weaknesses in internal control over financial reporting, restatements and the Consolidations;

actions by the NYSE, or uncertainty related to possible actions by the NYSE, related to the continued listing of our common stock;

negative media reports with respect to us and/or our industry;

changes in our own forecasts or earnings estimates by analysts;

price and volume fluctuations in the overall stock market, which have affected the market prices of many companies in the proprietary, postsecondary education industry in recent periods;

the amount and availability of financing and grant programs for our students;

the short interest in our stock at any point in time;

the loss of key personnel; and

general economic conditions.

Those factors could adversely affect the trading price of our common stock and could prevent an investor from selling shares of our common stock at or above the price at which those shares were purchased.

**Item 1B. Unresolved Staff Comments.**

Not applicable.

**Item 2. Properties.**

As of December 31, 2014, we:

leased 114 facilities used by our campuses;

owned 42 facilities used by our campuses;

leased one facility that is intended to be used by a new campus in the future; and

leased nine facilities that are not expected to be used as a campus or learning site, four of which have leases that expire in 2015.

Thirteen of the owned facilities and three of the leased facilities are used by DWC. We also own our headquarters building in Carmel, Indiana, which represents approximately 43,000 square feet of office space. Our facilities are located in 39 states.

Our obligations under the Financing Agreement are secured by mortgages on 31 separate properties owned by us and DWC, including all of the improvements thereto and fixtures thereon. These properties consist of all of the real property owned by us and DWC. See Note 12 Debt of the Notes to Consolidated Financial Statements, for a further discussion of the Financing Agreement.

We generally locate our campuses in suburban areas near major population centers. We generally house our campus facilities in modern, air conditioned buildings, which include classrooms, laboratories, student break areas and administrative offices. Our campuses typically have accessible parking facilities and are generally near a major highway. The facilities at our locations range in size from approximately 10,000 to 58,000 square feet. The initial lease terms of our leased facilities range from two to 15 years. The average remaining lease term of our leased facilities is approximately three years. If desirable or necessary, a campus may be relocated to a new facility reasonably near the existing facility at the end of the lease term.

**Item 3. Legal Proceedings.**

We are subject to various claims and contingencies, including those related to litigation, government investigations, business transactions, employee-related matters and taxes, among others. We cannot assure you of the ultimate outcome of any litigation or investigations involving us. Any litigation alleging violations of education or consumer protection laws and/or regulations, misrepresentation, fraud or deceptive practices may also subject our affected

campuses to additional regulatory scrutiny.

See Note 15 Commitments and Contingencies of the Notes to Consolidated Financial Statements, and the discussions under the sub-headings Litigation and Government Investigations, for information regarding certain lawsuits and investigations affecting us.

**Table of Contents****Item 4. Mine Safety Disclosures.**

Not Applicable.

**PART II****Item 5. Market For Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

Our common stock is listed on the NYSE under the ESI trading symbol. The prices set forth below are the high and low sale prices of our common stock on the NYSE during the periods indicated.

| Fiscal Quarter Ended | 2014     |          | 2013     |          |
|----------------------|----------|----------|----------|----------|
|                      | High     | Low      | High     | Low      |
| March 31             | \$ 45.80 | \$ 26.73 | \$ 19.49 | \$ 11.69 |
| June 30              | \$ 29.89 | \$ 16.20 | \$ 28.52 | \$ 11.95 |
| September 30         | \$ 17.17 | \$ 4.07  | \$ 31.85 | \$ 23.82 |
| December 31          | \$ 14.10 | \$ 3.66  | \$ 42.80 | \$ 27.97 |

There were 82 holders of record of our common stock on May 22, 2015.

We did not pay a cash dividend in 2014 or 2013. We do not anticipate paying any cash dividends on our common stock in the foreseeable future. The declaration and payment of dividends on our common stock are subject to the discretion of our Board of Directors and compliance with applicable law, as well as the limitations contained in our Financing Agreement. The Financing Agreement generally prohibits us from paying dividends; accordingly, we do not anticipate paying dividends while the Financing Agreement is outstanding. Any decision thereafter to pay dividends will depend on general business conditions, the effect of such payment on our financial condition and other factors our Board of Directors may in the future consider to be relevant.

We did not sell any of our securities during the three months ended December 31, 2014 that were not registered under the Securities Act.

In the three months ended December 31, 2014, we did not repurchase any shares of our common stock. Our Board of Directors has authorized us to repurchase shares of our common stock in the open market or through privately negotiated transactions in accordance with Rule 10b-18 of the Exchange Act (the Repurchase Program). The shares that remained available for repurchase under the Repurchase Program were 7,771,025 as of December 31, 2014. Unless earlier terminated by our Board of Directors, the Repurchase Program will expire when we repurchase all shares authorized for repurchase thereunder.

The performance graph set forth below compares the cumulative total shareholder return on our common stock with the S&P 500 Index, a Peer Issuer Group Index and a former peer issuer index for the period from December 31, 2009 through December 31, 2014. The peer issuer group consists of the following companies selected on the basis of the similar nature of their business: American Public Education, Inc., Apollo Education Group, Inc., Bridgepoint Education, Inc., Capella Education Company, Career Education Corp., Corinthian Colleges, Inc., DeVry Education Group, Inc., Grand Canyon Education, Inc., K12 Inc., Lincoln Educational Services Corporation, Strayer Education, Inc. and Universal Technical Institute, Inc. (the Peer Issuer Group). We believe that, including us, the Peer Issuer Group represents a significant portion of the market value of publicly traded companies whose primary business is

postsecondary education. The Peer Issuer Group differs from the former peer issuer group in that Education Management Corporation was included in the former peer issuer group, but was removed from the Peer Issuer Group due to its common stock being delisted and deregistered in 2014.

**Table of Contents****Cumulative Total Return**

(Based on \$100 invested on December 31, 2009 and assumes  
the reinvestment of all dividends)

|                                | 12/31/09 | 12/31/10 | 12/31/11 | 12/31/12 | 12/31/13 | 12/31/14 |
|--------------------------------|----------|----------|----------|----------|----------|----------|
| ITT Educational Services, Inc. | 100.00   | 66.37    | 59.29    | 18.04    | 34.99    | 10.01    |
| Peer Issuer Group Index        | 100.00   | 78.52    | 71.54    | 42.02    | 58.39    | 64.48    |
| Former Peer Issuer Group Index | 100.00   | 78.94    | 77.94    | 39.55    | 57.10    | 57.12    |
| S&P 500 Index                  | 100.00   | 115.06   | 117.49   | 136.30   | 180.44   | 205.14   |

The preceding stock price performance graph and related information shall not be deemed soliciting material or to be filed with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act or the Exchange Act, except to the extent that we specifically incorporate it by reference into such filing.

**Item 6. Selected Financial Data.**

The following selected financial data are qualified by reference to and should be read with our Consolidated Financial Statements and Notes to Consolidated Financial Statements and other financial data included elsewhere in this report. See also Management's Discussion and Analysis of Financial Condition and Results of Operations, for additional discussion of the selected financial data and the impact of the Consolidations.

|  | Year Ended December 31,                       |              |              |              |              |
|--|---|--------------|--------------|--------------|--------------|
|  | 2014 (a)                                      | 2013 (a)     | 2012         | 2011         | 2010         |
|  | (Dollars in thousands, except per share data) |              |              |              |              |
| <b>Statement of Operations Data:</b>   |   |              |              |              |              |
| Revenue  | \$ 961,783                                    | \$ 1,072,311 | \$ 1,286,633 | \$ 1,499,977 | \$ 1,573,123 |
| Cost of educational services   | 460,782                                       | 486,353      | 538,350      | 553,065      | 537,855      |
| Student services and administrative expenses   | 389,116                                       | 397,541      | 400,856      | 414,156      | 415,189      |
| Goodwill and asset impairment  | 2,454   | 0            | 15,166       | 0            | 0            |
| Legal and professional fees related to certain lawsuits, investigations and accounting matters (b) | 32,008  | 6,923        | 873          | 0            | 0            |
| Loss related to loan program guarantees (c)  | 2,019   | 90,964       | 101,025      | 23,500       | 5,650        |
| Provision for private education loan losses  | 14,150  | 29,349       | 0            | 0            | 0            |
| Total costs and expenses   | 900,529                                       | 1,011,130    | 1,056,270    | 990,721      | 958,694      |
| Operating income   | 61,254  | 61,181       | 230,363      | 509,256      | 614,429      |



|  |        |          |   |   |   |
|--|--------|----------|---|---|---|
| Gain (loss) on consolidation of variable interest entities | 16,631 | (73,248) | 0 | 0 | 0 |
|--|--------|----------|---|---|---|

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|   |           |             |            |            |            |
|---|-----------|-------------|------------|------------|------------|
| Interest income (expense), net                  | (28,235)  | (25,169)    | (2,375)    | 1,077      | 586        |
| Income (loss) before provision for income taxes | 49,650    | (37,236)    | 227,988    | 510,333    | 615,015    |
| Provision (benefit) for income taxes            | 20,397    | (10,212)    | 89,018     | 201,247    | 240,314    |
| Net income (loss)                               | \$ 29,253 | \$ (27,024) | \$ 138,970 | \$ 309,086 | \$ 374,701 |

**Earnings (loss) per share: (d)**

|         |         |           |         |          |          |
|---------|---------|-----------|---------|----------|----------|
| Basic   | \$ 1.25 | \$ (1.15) | \$ 5.82 | \$ 11.27 | \$ 11.30 |
| Diluted | \$ 1.23 | \$ (1.15) | \$ 5.79 | \$ 11.18 | \$ 11.18 |

**Other Operating Data (e):**

|   |          |          |           |           |           |
|---|----------|----------|-----------|-----------|-----------|
| Capital expenditures, net (f)             | \$ 6,092 | \$ 5,147 | \$ 18,250 | \$ 30,900 | \$ 32,989 |
| Number of students at end of period       | 53,646   | 57,542   | 61,059    | 73,255    | 84,686    |
| Number of campuses at end of period       | 144      | 147      | 147       | 141       | 130       |
| Number of learning sites at end of period | 0        | 2        | 2         | 3         | 4         |

**As of December 31,**  
**2014 (a)    2013 (a)    2012    2011    2010**  
**(Dollars in thousands)**

**Balance Sheet Data:**

|  |            |            |            |            |            |
|--|------------|------------|------------|------------|------------|
| Cash and cash equivalents and investments                    | \$ 135,937 | \$ 215,771 | \$ 243,465 | \$ 379,609 | \$ 313,194 |
| Total current assets   | \$ 291,414 | \$ 434,616 | \$ 386,580 | \$ 456,790 | \$ 412,419 |
| Property and equipment, less accumulated depreciation        | \$ 157,072 | \$ 168,509 | \$ 189,890 | \$ 201,257 | \$ 198,213 |
| Total assets   | \$ 749,160 | \$ 806,851 | \$ 675,204 | \$ 729,320 | \$ 673,102 |
| Total current liabilities                                    | \$ 322,630 | \$ 473,777 | \$ 327,023 | \$ 345,243 | \$ 355,501 |
| Total long-term debt (g)                                     | \$ 125,372 | \$ 71,341  | \$ 140,000 | \$ 150,000 | \$ 150,000 |
| CUSO secured borrowing obligation, excluding current portion | \$ 100,194 | \$ 0       | \$ 0       | \$ 0       | \$ 0       |
| Total liabilities  | \$ 601,155 | \$ 691,205 | \$ 549,439 | \$ 560,215 | \$ 546,060 |
| Shareholders' equity   | \$ 148,005 | \$ 115,646 | \$ 125,765 | \$ 169,105 | \$ 127,042 |

- (a) Beginning on February 28, 2013, we consolidated the PEAKS Trust in our consolidated financial statements. Beginning on September 30, 2014, we consolidated the CUSO in our consolidated financial statements. See Note 8 Variable Interest Entities of the Notes to Consolidated Financial Statements, for a further discussion of the Consolidations.
- (b) Legal and professional fees related to certain lawsuits, investigations and accounting matters represent the expenses that we believe are not representative of those normally incurred in the ordinary course of business, including, with respect to accounting matters, accounting for and audit expenses specifically related to the PEAKS Consolidation and the restatement of our 2013 quarterly consolidated financial statements. See Note 8 Variable Interest Entities of the Notes to Consolidated Financial Statements for a further discussion of the PEAKS Consolidation and Note 15 Commitments and Contingencies of the Notes to Consolidated Financial Statements, for a further discussion of the Consolidations, lawsuits and investigations.
- (c) Loss related to loan program guarantees represents the additional contingent liability accruals recorded for the RSAs and the 2007 RSA, which includes the accrual that we recorded in 2012 for the settlement related to the 2007 RSA.

- (d) Earnings (loss) per share for all periods have been calculated in conformity with Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC or Codification ) 260, Earnings Per Share. Earnings (loss) per share data are based on historical net income and the weighted average number of shares of our common stock outstanding during each period. The number of shares used to calculate basic earnings per share differs from the number of shares used to calculate diluted earnings per share. The number of shares used to calculate basic earnings per share was the weighted average number of common shares outstanding. The number of shares used to calculate diluted earnings per share was the weighted average number of common shares outstanding, plus the average number of shares that could be issued under our stock-based compensation plans and less the number of shares assumed to be purchased with any proceeds received from the exercise of awards under those plans.
- (e) We did not pay any cash dividends in any of the periods presented.

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- (f) The amounts included in the line items Capital expenditures, net and Facility expenditures and land purchases reported in our Consolidated Statements of Cash Flows in our Annual Reports on Form 10-K for our fiscal years ended December 31, 2013, 2012, 2011 and 2010, have been combined and are shown as Capital expenditures, net in this table.
- (g) Total long-term debt for the years ended December 31, 2014 and 2013 represent the amounts shown on our Consolidated Balance Sheet under the line items related to long-term debt and the PEAKS Senior Debt.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*The following discussion should be read with the Selected Financial Data and the Consolidated Financial Statements and Notes to Consolidated Financial Statements included elsewhere in this report.*

This management's discussion and analysis of financial condition and results of operations is based on our consolidated financial statements, which have been prepared in conformity with generally accepted accounting principles in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets, liabilities, revenue, expenses and contingent assets and liabilities. Actual results may differ from those estimates and judgments under different assumptions or conditions.

In this management's discussion and analysis of financial condition and results of operations, when we discuss factors that contributed to a change in our financial condition or results of operations, we disclose the primary factors that materially contributed to that change in the order of significance.

**Executive Summary**

In 2014, a number of events and factors impacted our results of operations, financial position, cash flows and liquidity, the most significant of which included the following:

we made payments aggregating \$170.3 million related to the PEAKS Program and the CUSO Program;

the ED Letter of Credit was issued for our account, and we provided approximately \$89.3 million in cash collateral for the ED Letter of Credit and other outstanding letters of credit, which funds are not available for use by us and could be paid to the issuing bank for the letters of credit if the letters of credit are drawn upon;

we borrowed \$100.0 million under the new Financing Agreement, and utilized all of the funds from that borrowing to repay outstanding borrowings under the Amended Credit Agreement, to provide a portion of the cash collateral required related to the letters of credit and to pay fees in connection with the Financing Agreement;

the amount of institutional scholarships and awards provided to our students increased significantly, and new and total student enrollment in education programs decreased, in each case, compared to the prior year; and

the PEAKS Trust was consolidated in our consolidated financial statements for the entire year, and the CUSO was consolidated in our consolidated financial statements beginning on September 30, 2014. These events and factors are described further in this management's discussion and analysis of financial condition and results of operations and in the Notes to Consolidated Financial Statements contained in this Annual Report on Form 10-K.

We continue to have significant cash payment obligations in connection with the PEAKS Program and the CUSO Program. Based on various assumptions, including the historical and projected performance and collection of the PEAKS Trust Student Loans, we believe that we will make payments under the PEAKS Guarantee of approximately:

\$29.8 million in 2015;

\$4.3 million in 2016; and

\$15.3 million in 2020.

Based on various assumptions, including the historical and projected performance and collections of the CUSO Student Loans, the following table sets forth, in the periods indicated, our projections of the estimated amount of Regular Payments and Discharge Payments that we expect to pay (or that we expect will be owed by us, which amounts could be reduced prior to payment thereof by the amount of recoveries from charged-off loans owed to us) and the estimated amount of recoveries from charged-off loans that we expect to be paid to us by the CUSO (or that we may utilize to offset a portion of the amounts of Regular Payments or Discharge Payments owed by us):

| Year           | Estimated Regular Payments    | Estimated Discharge Payments | Estimated Total Payments | Estimated Recoveries |
|----------------|-------------------------------|------------------------------|--------------------------|----------------------|
|                | (Dollar amounts in thousands) |                              |                          |                      |
| 2015           | \$ 11,723                     | \$ 2,709 <sup>(1)</sup>      | \$ 14,432                | \$ (1,393)           |
| 2016           | 15,895                        | 0                            | 15,895                   | (1,479)              |
| 2017           | 17,615                        | 0                            | 17,615                   | (1,545)              |
| 2018 and later | 0                             | 78,747                       | 78,747                   | (1,580)              |
|                | \$ 45,233                     | \$ 81,456                    | \$ 126,689               | \$ (5,997)           |

- (1) Represents the Discharge Payment of \$2.7 million that we made on March 19, 2015 pursuant to the terms of the Fifth Amendment to CUSO RSA.

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We believe that the vast majority of the \$78.7 million of estimated payments projected to be paid after 2017 will be made by us in 2018. The estimated future payment amounts and timing related to the CUSO RSA assume, among other factors, that we do not make any Discharge Payments in 2015, 2016 or 2017 (other than the Discharge Payment made in March 2015 pursuant to the terms of the Fifth Amendment to CUSO RSA) and do make Discharge Payments to the fullest extent possible in 2018 and later years. If we do not make the Discharge Payments as assumed in 2018 and later years, we estimate that we would make approximately \$100.3 million of Regular Payments in 2018 through approximately 2026. Of this amount, approximately \$18.6 million to \$20.0 million would be paid annually in each of 2018 through 2021, and approximately \$22.7 million in the aggregate, would be paid in 2022 through 2026.

We also have debt service and principal repayment obligations under the Financing Agreement. We estimate that in 2015, the amount of those cash payment obligations will be approximately \$19.3 million. In the event of a default by us under the Financing Agreement, the lenders could declare the full amount of the Term Loans then outstanding to be immediately due and payable in full. Our obligations under the Financing Agreement are secured by a security interest in substantially all of our and our subsidiaries' assets, including a mortgage on all of our and our subsidiaries' owned real estate. The covenants under the Financing Agreement could have a material adverse effect on our business by limiting our ability to take advantage of financing, merger and acquisition or other corporate opportunities and/or to make certain payments under the RSAs.

Continued enrollment declines and/or continued increases in use of institutional scholarships and awards would have a negative impact on our revenue, cash flows and financial condition.

Based on our current projections, we believe that cash generated from operations will be sufficient for us to satisfy our CUSO RSA and PEAKS Guarantee payments, working capital, loan repayment and capital expenditure requirements over the 12-month period following the date that this Annual Report on Form 10-K was filed with the SEC. We also believe that any reduction in cash and cash equivalents that may result from their use to make payments under the CUSO RSA and PEAKS Guarantee or repay loans will not have a material adverse effect on our planned capital expenditures, ability to meet any applicable regulatory financial responsibility standards, ability to satisfy the financial covenants under the Financing Agreement or ability to conduct normal operations over the 12-month period following the date that this Annual Report on Form 10-K was filed with the SEC. Our projections, however, are estimates, which are based on numerous assumptions and, therefore, may not prove to be accurate or reliable and involve a number of risks and uncertainties. See Part I, Item 1, Risk Factors and Note 16 Risks and Uncertainties of the Notes to Consolidated Financial Statements for a further discussion of those risks and uncertainties.

**Consolidations and Core Operations**

Our consolidated financial statements as of and for the fiscal year ended December 31, 2014 include the results of operations, financial condition and cash flows of the CUSO and the PEAKS Trust, two variable interest entities that we were required to consolidate in our consolidated financial statements. Beginning on September 30, 2014, our consolidated financial statements include the CUSO, and beginning on February 28, 2013, our consolidated financial statements include the PEAKS Trust.

We included the CUSO in our consolidated financial statements beginning on September 30, 2014, because we were considered to have the power to direct the activities that most significantly impact the economic performance of the CUSO under ASC 810, Consolidation (ASC 810), on that date. We determined that the activities that most significantly impact the economic performance of the CUSO involve the servicing (which includes the collection) of the private education loans made under the CUSO Program (the CUSO Student Loans). We were considered to have the power to direct the servicing activities of the CUSO Student Loans as a result of our substantive ability to terminate the servicing agreement that governs the servicing activities of the CUSO Student Loans (the CUSO

Servicing Agreement ). Pursuant to the CUSO Servicing Agreement, if the entity that performs the servicing activities on behalf of the CUSO (the CUSO Program Servicer ) fails to meet certain performance criteria specified in the CUSO Servicing Agreement, and the CUSO Program Servicer does not affect a cure of that failure during a specified cure period, we would have the right to terminate the CUSO Servicing Agreement.

We believe that the CUSO Program Servicer failed to meet the performance criteria specified in the CUSO Servicing Agreement on September 30, 2014, and that it was not reasonably possible that the CUSO Program Servicer would be able to affect a cure during the 90-day cure period. Because we believe that the cure period was not substantive, we were deemed, for accounting purposes, to have the right to terminate the CUSO Servicing Agreement as of September 30, 2014. As a result, we effectively had the power to direct the servicing activities of the CUSO as of September 30, 2014 and, therefore, were required to consolidate the CUSO in our consolidated financial statements as of that date. While our consolidated financial statements for periods after September 30, 2014 reflect the results of operations, financial condition and cash flows of the CUSO, we do not actively manage the operations of the CUSO, and the assets of the consolidated CUSO can only be used to satisfy the obligations of the CUSO. Our obligations under the CUSO RSA remain in effect, until all CUSO Student Loans are paid in full, as discussed further in Note 15 Commitments and Contingencies of the Notes to Consolidated Financial Statements.

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In accordance with ASC 810, we included the PEAKS Trust in our consolidated financial statements beginning on February 28, 2013, because we determined that was the first date that we had the power to direct the activities of the PEAKS Trust that most significantly impact the economic performance of the PEAKS Trust. We determined that the activities that most significantly impact the economic performance of the PEAKS Trust involve the servicing (which includes the collection) of the private education loans made under the PEAKS Program (the PEAKS Trust Student Loans ) and believe that February 28, 2013 was the first date that we could have exercised our right to terminate the servicing agreement that governs the servicing activities of the PEAKS Trust Student Loans (the PEAKS Servicing Agreement ) due to the failure of the entity that performs those servicing activities for the PEAKS Trust Student Loans on behalf of the PEAKS Trust to meet certain performance criteria specified in the PEAKS Servicing Agreement.

While our consolidated financial statements for periods after February 28, 2013 reflect the results of operations, financial condition and cash flows of the PEAKS Trust, we do not actively manage the operations of the PEAKS Trust, and the assets of the consolidated PEAKS Trust can only be used to satisfy the obligations of the PEAKS Trust. Our obligations under the PEAKS Guarantee remain in effect, until the PEAKS Senior Debt and the PEAKS Trust's fees and expenses are paid in full, as discussed further in Note 15 Commitments and Contingencies of the Notes to Consolidated Financial Statements.

In periods prior to the respective dates of the Consolidations, we concluded that we were not required to consolidate the CUSO and PEAKS Trust in our consolidated financial statements, because we believed we did not have the power to direct the activities that most significantly impacted the economic performance of the CUSO and the PEAKS Trust and, therefore, we were not the primary beneficiary of the CUSO and the PEAKS Trust. See Note 8 Variable Interest Entities of the Notes to Consolidated Financial Statements, for a further discussion of the PEAKS Consolidation and the CUSO Consolidation.

Unless otherwise noted, the information in this management's discussion and analysis of financial condition and results of operations is presented and discussed on a consolidated basis, including the CUSO and the PEAKS Trust as of and following the applicable consolidation dates. Certain information is also provided, however, regarding our results of operations, financial condition and cash flows on a basis that excludes the impact of the CUSO and the PEAKS Trust. We identify and describe our education programs and education-related services on this basis as our core operations ( Core Operations ). The presentation of the Core Operations financial measures differs from the presentation of our consolidated financial measures determined in accordance with generally accepted accounting principles in the United States ( GAAP ). We believe that the presentation of the Core Operations information assists investors in comparing current period information against prior periods during which the CUSO and the PEAKS Trust were not consolidated. In addition, our management believes that the Core Operations information provides useful information to investors, because it:

allows more meaningful information about our ongoing operating results, financial condition and cash flows;

helps in performing trend analyses and identifying trends that may otherwise be masked or distorted by items that are not part of the Core Operations; and

provides a higher degree of transparency of our core results of operations, financial condition and cash flows.



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The following tables set forth selected data from our balance sheets, statements of operations and statements of cash flows as of and for the years ended:

December 31, 2014, regarding:

the Core Operations on a stand-alone basis;

the PEAKS Trust on a stand-alone basis;

the CUSO on a stand-alone basis;

the elimination of transactions between the PEAKS Trust and Core Operations, and the elimination of transactions between the CUSO and Core Operations, in each case as a result of the applicable Consolidation; and

the Core Operations, the CUSO and the PEAKS Trust consolidated in accordance with GAAP; and

December 31, 2013, regarding:

the Core Operations on a stand-alone basis;

the PEAKS Trust on a stand-alone basis;

the elimination of transactions between the PEAKS Trust and Core Operations, as a result of the PEAKS Consolidation; and

the Core Operations and the PEAKS Trust consolidated in accordance with GAAP; and

December 31, 2012.

The information presented related to 2014 and 2013 also constitutes the reconciliation of our non-GAAP Core Operations, PEAKS Trust and CUSO data to the related GAAP consolidated financial measures. Following the tables, we describe the effect of the PEAKS Consolidation and the CUSO Consolidation, as applicable, on the financial statement information presented, including the components attributable to the Core Operations, the PEAKS Trust and the CUSO. Certain reclassifications have been made to the presentation of the selected data in the following tables for the year ended December 31, 2013 to conform to the current year presentation. For the years ended December 31, 2014 and 2013, all income tax amounts related to the PEAKS Trust and CUSO have been included in Core Operations.



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|  | As of December 31, 2014 |                  |                  |                   | GAAP<br>Consolidated |
|--|-------------------------|------------------|------------------|-------------------|----------------------|
|  | Core<br>Operations      | PEAKS<br>Trust   | CUSO             | Eliminations      |                      |
| <b>(Dollar amounts in thousands)</b>   |                         |                  |                  |                   |                      |
| <b>Balance Sheet Data:</b>   |                         |                  |                  |                   |                      |
| Cash and cash equivalents  | \$ 135,937              | \$ 0             | \$ 0             | \$ 0              | \$ 135,937           |
| Restricted cash  | 1,967                   | 1,556            | 2,517            | 0                 | 6,040                |
| Accounts receivable, net   | 46,383                  | 0                | 0                | 0                 | 46,383               |
| Private education loans, current portion, less allowance for loan losses of \$0                | 0                       | 7,169            | 3,415            | 0                 | 10,584               |
| Deferred income taxes  | 34,547                  | 0                | 0                | 0                 | 34,547               |
| Prepaid expenses and other current assets  | 61,096                  | 0                | 0                | (3,173)           | 57,923               |
| <b>Total current assets</b>  | <b>279,930</b>          | <b>8,725</b>     | <b>5,932</b>     | <b>(3,173)</b>    | <b>291,414</b>       |
| Property and equipment, net  | 157,072                 | 0                | 0                | 0                 | 157,072              |
| Private education loans, excluding current portion, less allowance for loan losses of \$44,392 | 0                       | 59,902           | 20,390           | 0                 | 80,292               |
| Deferred income taxes  | 68,041                  | 0                | 0                | 0                 | 68,041               |
| Collateral deposits  | 97,932                  | 0                | 0                | 0                 | 97,932               |
| Other assets   | 54,125                  | 0                | 284              | 0                 | 54,409               |
| <b>Total assets</b>  | <b>\$ 657,100</b>       | <b>\$ 68,627</b> | <b>\$ 26,606</b> | <b>\$ (3,173)</b> | <b>\$ 749,160</b>    |
| Current portion of long-term debt  | \$ 9,635                | \$ 0             | \$ 0             | \$ 0              | \$ 9,635             |
| Current portion of PEAKS Trust senior debt   | 0                       | 37,545           | 0                | 0                 | 37,545               |
| Current portion of CUSO secured borrowing obligation   | 0                       | 0                | 20,813           | 0                 | 20,813               |
| Accounts payable   | 67,848                  | 0                | 0                | 0                 | 67,848               |
| Accrued compensation and benefits  | 12,264                  | 0                | 0                | 0                 | 12,264               |
| Other current liabilities  | 37,034                  | 199              | 179              | (10,362)          | 27,050               |
| Deferred revenue   | 147,475                 | 0                | 0                | 0                 | 147,475              |
| <b>Total current liabilities</b>   | <b>274,256</b>          | <b>37,744</b>    | <b>20,992</b>    | <b>(10,362)</b>   | <b>322,630</b>       |
| Long-term debt, excluding current portion  | 86,714                  | 0                | 0                | 0                 | 86,714               |
| PEAKS Trust senior debt, excluding current portion   | 0                       | 38,658           | 0                | 0                 | 38,658               |
| CUSO secured borrowing obligation, excluding current portion                                   | 0                       | 0                | 100,194          | 0                 | 100,194              |
| Other liabilities  | 152,049                 | 0                | 1,073            | (100,163)         | 52,959               |
| <b>Total liabilities</b>   | <b>513,019</b>          | <b>76,402</b>    | <b>122,259</b>   | <b>(110,525)</b>  | <b>601,155</b>       |
| Total shareholders equity  | 144,081                 | (7,775)          | (95,653)         | 107,352           | 148,005              |
| <b>Total liabilities and shareholders equity</b>   | <b>\$ 657,100</b>       | <b>\$ 68,627</b> | <b>\$ 26,606</b> | <b>\$ (3,173)</b> | <b>\$ 749,160</b>    |



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|   | As of December 31, 2013       |                    |                  |                   |                      |
|---|-------------------------------|--------------------|------------------|-------------------|----------------------|
|   | As of<br>December 31,<br>2012 | Core<br>Operations | PEAKS<br>Trust   | Eliminations      | GAAP<br>Consolidated |
|   | (Dollar amounts in thousands) |                    |                  |                   |                      |
| <b>Balance Sheet Data:</b>                                |                               |                    |                  |                   |                      |
| Cash and cash equivalents                                 | \$ 243,465                    | \$ 215,771         | \$ 0             | \$ 0              | \$ 215,771           |
| Restricted cash   | 3,478                         | 3,043              | 2,593            | 0                 | 5,636                |
| Accounts receivable, net                                  | 78,928                        | 99,530             | 0                | 0                 | 99,530               |
| PEAKS Trust student loans, current portion, net           | 0                             | 0                  | 7,730            | 0                 | 7,730                |
| Deferred income taxes                                     | 44,547                        | 77,549             | 0                | 0                 | 77,549               |
| Prepaid expenses and other current assets                 | 16,162                        | 27,827             | 573              | 0                 | 28,400               |
| <b>Total current assets</b>                               | <b>386,580</b>                | <b>423,720</b>     | <b>10,896</b>    | <b>0</b>          | <b>434,616</b>       |
| Property and equipment, net                               | 189,890                       | 168,509            | 0                | 0                 | 168,509              |
| PEAKS Trust student loans, excluding current portion, net | 0                             | 0                  | 76,479           | 0                 | 76,479               |
| Deferred income taxes                                     | 57,471                        | 68,324             | 0                | 0                 | 68,324               |
| Other assets  | 41,263                        | 67,354             | 0                | (8,431)           | 58,923               |
| <b>Total assets</b>                                       | <b>\$ 675,204</b>             | <b>\$ 727,907</b>  | <b>\$ 87,375</b> | <b>\$ (8,431)</b> | <b>\$ 806,851</b>    |
| Current portion of long-term debt                         | \$ 0                          | \$ 50,000          | \$ 0             | \$ 0              | \$ 50,000            |
| Current portion of PEAKS Trust senior debt                | 0                             | 0                  | 157,883          | 0                 | 157,883              |
| Accounts payable  | 63,304                        | 58,021             | 0                | 0                 | 58,021               |
| Accrued compensation and benefits                         | 21,023                        | 18,107             | 0                | 0                 | 18,107               |
| Other current liabilities                                 | 106,796                       | 33,366             | 11,830           | (3,060)           | 42,136               |
| Deferred revenue  | 135,900                       | 147,630            | 0                | 0                 | 147,630              |
| <b>Total current liabilities</b>                          | <b>327,023</b>                | <b>307,124</b>     | <b>169,713</b>   | <b>(3,060)</b>    | <b>473,777</b>       |
| Long-term debt, excluding current portion                 | 140,000                       | 0                  | 0                | 0                 | 0                    |
| PEAKS Trust senior debt, excluding current portion        | 0                             | 0                  | 71,341           | 0                 | 71,341               |
| Other liabilities   | 82,416                        | 213,343            | 1,684            | (68,940)          | 146,087              |
| <b>Total liabilities</b>                                  | <b>549,439</b>                | <b>520,467</b>     | <b>242,738</b>   | <b>(72,000)</b>   | <b>691,205</b>       |
| <b>Total shareholders equity</b>                          | <b>125,765</b>                | <b>207,440</b>     | <b>(155,363)</b> | <b>63,569</b>     | <b>115,646</b>       |
| <b>Total liabilities and shareholders equity</b>          | <b>\$ 675,204</b>             | <b>\$ 727,907</b>  | <b>\$ 87,375</b> | <b>\$ (8,431)</b> | <b>\$ 806,851</b>    |

In accordance with ASC 810, the assets and liabilities of the CUSO were treated as having been acquired by us at their fair values as of September 30, 2014. The carrying values of the assets and liabilities of the CUSO are included on our Consolidated Balance Sheet as of December 31, 2014. The assets of the CUSO consist primarily of cash and the CUSO Student Loans. The liabilities of the CUSO consist primarily of the CUSO secured borrowing obligation, which is discussed further below under Critical Accounting Policies and Estimates *CUSO Secured Borrowing Obligation*. The carrying values of the assets and liabilities related to the CUSO Program that had been included as

balance sheet items related to our Core Operations and consisted of the Revolving Note, other receivables (which consisted of recoveries from charged-off CUSO Student Loans that were owed to us, but were not paid to or offset by us) and the contingent liability, were eliminated from our Consolidated Balance Sheet as of December 31, 2014.

Although the assets and liabilities of the CUSO are presented on our Consolidated Balance Sheets following the CUSO Consolidation, the assets of the CUSO can only be used to satisfy the obligations of the CUSO.

In accordance with ASC 810, the assets and liabilities of the PEAKS Trust were treated as having been acquired by us at their fair values as of February 28, 2013. The carrying values of the assets and liabilities of the PEAKS Trust are included on our Consolidated Balance Sheets as of December 31, 2014 and 2013. The assets of the PEAKS Trust consist primarily of cash and the PEAKS Trust Student Loans. The liabilities of the PEAKS Trust consist primarily of the PEAKS Senior Debt. The assets of the

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PEAKS Trust serve as collateral for, and are intended to be the principal source of, the repayment of the PEAKS Senior Debt. The carrying values of the assets and liabilities related to the PEAKS Program that had been included as balance sheet items related to our Core Operations and consisted of the Subordinated Note, a guarantee receivable and a contingent liability, were eliminated from our Consolidated Balance Sheets as of December 31, 2014 and 2013.

Although the assets and liabilities of the PEAKS Trust are presented on our Consolidated Balance Sheets following the PEAKS Consolidation, the assets of the PEAKS Trust can only be used to satisfy the obligations of the PEAKS Trust.

In estimating the carrying value of the PEAKS Trust Student Loans and the CUSO Student Loans, we made various assumptions, including, but not limited to, the amount of recoveries that would be realized from loans that had defaulted. The recovery assumption used in determining the carrying value of the PEAKS Trust Student Loans and the CUSO Student Loans as of December 31, 2014 was approximately 2%, which was based on the information and collections on the PEAKS Trust Student Loans and CUSO Student Loans that had defaulted prior to that date. If the actual recoveries from the Private Education Loans are more or less than the assumption utilized, a resulting adjustment will be reflected in earnings. Each 1% change in the recovery assumption would have resulted in a change in the carrying value of the Private Education Loans of approximately \$2.0 million as of December 31, 2014.

|  | <b>Year Ended December 31, 2014</b>  |                        |             |                     |                              |
|--|--------------------------------------|------------------------|-------------|---------------------|------------------------------|
|  | <b>Core<br/>Operations</b>           | <b>PEAKS<br/>Trust</b> | <b>CUSO</b> | <b>Eliminations</b> | <b>GAAP<br/>Consolidated</b> |
|  | <b>(Dollar amounts in thousands)</b> |                        |             |                     |                              |
| <b>Statement of Operations Data:</b>   |                                      |                        |             |                     |                              |
| Revenue  | \$ 949,176                           | \$ 11,471              | \$ 1,136    | \$ 0                | \$ 961,783                   |
| Costs and expenses:  |                                      |                        |             |                     |                              |
| Cost of educational services   | 460,782                              | 0                      | 0           | 0                   | 460,782                      |
| Student services and administrative expenses   | 384,200                              | 4,479                  | 437         | 0                   | 389,116                      |
| Goodwill and asset impairment  | 2,454                                | 0                      | 0           | 0                   | 2,454                        |
| Legal and professional fees related to certain lawsuits, investigations and accounting matters | 32,008                               | 0                      | 0           | 0                   | 32,008                       |
| Loss related to loan program guarantees  | 2,019                                | 0                      | 0           | 0                   | 2,019                        |
| Provision for private education loan losses  | 0                                    | 12,111                 | 2,039       | 0                   | 14,150                       |
| Total costs and expenses   | 881,463                              | 16,590                 | 2,476       | 0                   | 900,529                      |
| Operating income (loss)  | 67,713                               | (5,119)                | (1,340)     | 0                   | 61,254                       |
| Gain on consolidation of variable interest entities  | 0                                    | 0                      | (94,970)    | 111,601             | 16,631                       |
| Interest income  | 65                                   | 0                      | 0           | 0                   | 65                           |
| Interest (expense)   | (3,761)                              | (20,814)               | (3,725)     | 0                   | (28,300)                     |
| Income (loss) before provision for income taxes  | 64,017                               | (25,933)               | (100,035)   | 111,601             | 49,650                       |
| Provision for income taxes   | 20,397                               | 0                      | 0           | 0                   | 20,397                       |

|                   |           |             |              |            |           |
|-------------------|-----------|-------------|--------------|------------|-----------|
| Net income (loss) | \$ 43,620 | \$ (25,933) | \$ (100,035) | \$ 111,601 | \$ 29,253 |
|-------------------|-----------|-------------|--------------|------------|-----------|

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|  | <b>Year Ended December 31, 2013</b>             |                            |                        |                     |                              |
|--|---|----------------------------|------------------------|---------------------|------------------------------|
|  | <b>Year<br/>Ended<br/>December 31,<br/>2012</b> | <b>Core<br/>Operations</b> | <b>PEAKS<br/>Trust</b> | <b>Eliminations</b> | <b>GAAP<br/>Consolidated</b> |
|  | <b>(Dollar amounts in thousands)</b>            |                            |                        |                     |                              |
| <b>Statement of Operations Data:</b>   |   |                            |                        |                     |                              |
| Revenue  | \$ 1,286,633                                    | \$ 1,059,315               | \$ 12,996              | \$ 0                | \$ 1,072,311                 |
| Costs and expenses:  |   |                            |                        |                     |                              |
| Cost of educational services   | 538,350   | 486,353                    | 0                      | 0                   | 486,353                      |
| Student services and administrative expenses   | 400,856   | 392,253                    | 5,288                  | 0                   | 397,541                      |
| Goodwill and asset impairment  | 15,166  | 0                          | 0                      | 0                   | 0                            |
| Legal and professional fees related to certain lawsuits, investigations and accounting matters | 873   | 6,923                      | 0                      | 0                   | 6,923                        |
| Loss related to loan program guarantees  | 101,025   | 115,503                    | 0                      | (24,539)            | 90,964                       |
| Provision for private education loan losses  | 0   | 0                          | 29,349                 | 0                   | 29,349                       |
| <b>Total costs and expenses</b>  | <b>1,056,270</b>                                | <b>1,001,032</b>           | <b>34,637</b>          | <b>(24,539)</b>     | <b>1,011,130</b>             |
| Operating income (loss)  | 230,363   | 58,283                     | (21,641)               | 24,539              | 61,181                       |
| (Loss) on consolidation of variable interest entities  | 0   | 0                          | (112,748)              | 39,500              | (73,248)                     |
| Interest income  | 1,348   | 578                        | 0                      | (470)               | 108                          |
| Interest (expense)   | (3,723)   | (3,989)                    | (21,288)               | 0                   | (25,277)                     |
| Income (loss) before provision for income taxes  | 227,988   | 54,872                     | (155,677)              | 63,569              | (37,236)                     |
| Provision (benefit) for income taxes   | 89,018  | (10,212)                   | 0                      | 0                   | (10,212)                     |
| <b>Net income (loss)</b>   | <b>\$ 138,970</b>                               | <b>\$ 65,084</b>           | <b>\$ (155,677)</b>    | <b>\$ 63,569</b>    | <b>\$ (27,024)</b>           |

The PEAKS Consolidation and the CUSO Consolidation impact the presentation of our Statements of Operations in a number of ways. Following the applicable Consolidation, our revenue consists of:

revenue from the Core Operations, primarily from tuition, tool kit sales and student fees;

student loan interest income on the PEAKS Trust Student Loans and the CUSO Student Loans (collectively, the Private Education Loans ), which is the accretion of the accretable yield on the Private Education Loans; and

administrative fees earned by the CUSO.

Following the applicable Consolidation, our student services and administrative expenses are comprised of:

expenses related to the Core Operations, including marketing expenses, an expense for uncollectible accounts and administrative expenses incurred primarily at our corporate headquarters; and

expenses incurred by the PEAKS Trust and the CUSO, primarily related to fees for servicing the Private Education Loans and various other administrative fees and expenses of the PEAKS Trust and the CUSO.

The loss related to loan program guarantees represents:

in 2012, the contingent liability accruals that we recorded related to the PEAKS Guarantee and the CUSO RSA;

in 2013, the contingent liability accruals that we recorded related to the CUSO RSA, because the contingent liability related to the PEAKS Guarantee was eliminated from our consolidated financial statements as a result of the PEAKS Consolidation (though our obligations under the PEAKS Guarantee remain in effect); and

in 2014, the contingent liability accruals that we recorded related to the CUSO RSA prior to September 30, 2014, because after that date, the contingent liability related to the CUSO RSA was eliminated from our consolidated financial statements as a result of the CUSO Consolidation (though our obligations under the CUSO RSA remain in effect).

Following the applicable Consolidation, our provision for private education loan losses in a reporting period represents the increase in the allowance for loan losses that occurred during that period. The allowance for loan losses is the difference between the carrying value and the total present value of the expected principal and interest collections of each loan pool of the Private Education Loans, discounted by the loan pool's effective interest rate as of December 31, 2014 or 2013, as applicable.

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In the year ended December 31, 2014, we recognized a gain upon the CUSO Consolidation that represented the difference between (i) the fair value of the net liabilities of the CUSO that we recorded upon the CUSO Consolidation, and (ii) the carrying value of the net liabilities related to the CUSO Program that had been recorded in our consolidated financial statements and were eliminated upon the CUSO Consolidation, in each case as of September 30, 2014. In the year ended December 31, 2013, we recognized a loss upon the PEAKS Consolidation that represented the amount by which the fair value of the PEAKS Trust's liabilities exceeded the fair value of the PEAKS Trust's assets as of February 28, 2013, partially reduced by the net amount of the carrying value of the assets and liabilities related to the PEAKS Program that had been recorded in our consolidated financial statements as of February 28, 2013 and were eliminated upon the PEAKS Consolidation.

Following the applicable Consolidation, our interest expense includes:

interest expense from matters related to the Core Operations, primarily the interest expense on the outstanding balance under the Amended Credit Agreement (prior to December 4, 2014) and the Financing Agreement (on and after December 4, 2014);

interest expense on the PEAKS Senior Debt, which includes the contractual interest obligation and the accretion of the discount on the PEAKS Senior Debt; and

interest expense on the CUSO Secured Borrowing Obligation, which includes the amount of interest expense on the CUSO Student Loans that is accrued for payment to the owners of the CUSO and the accretion of the discount of the adjustment associated with accounting for the CUSO Secured Borrowing Obligation at fair value upon the CUSO Consolidation.

Since the inception of the PEAKS Program, we have guaranteed, and continue to guarantee the payment of the principal and interest owed on the PEAKS Senior Debt, the administrative fees and expenses of the PEAKS Trust and the minimum required Asset/Liability Ratio, pursuant to the terms of the PEAKS Guarantee. Our obligations under the PEAKS Guarantee remain in effect until the PEAKS Senior Debt and the PEAKS Trust's fees and expenses are paid in full.

Since the inception of the CUSO Program, under the CUSO RSA, we have guaranteed, and continue to guarantee, the repayment of any CUSO Student Loans that are charged off above a certain percentage of the CUSO Student Loans made under the CUSO Program, based on the annual dollar volume. Our obligations under the CUSO RSA remain in effect until all CUSO Student Loans are paid in full. Under the CUSO RSA, we have an obligation to make the monthly payments due and unpaid on those private education loans that have been charged off above a certain percentage ( Regular Payments ). Instead of making Regular Payments, however, we may elect to discharge our obligations to make Regular Payments on specified charged-off private education loans by:

paying the then outstanding balance (plus accrued and unpaid interest) of those private education loans that have been charged off above a certain percentage and, with respect to which, an amount equal to at least ten monthly payments has been paid; or

paying the then outstanding balance (plus accrued and unpaid interest) of those private education loans that have been charged off above a certain percentage and, with respect to which, an amount equal to at least ten monthly payments has not been paid, plus any interest that would otherwise have been payable until ten monthly payments had been made, discounted at the rate of 10% per annum (collectively, Discharge Payments ).

The revenue and expenses of the PEAKS Trust are presented in our Consolidated Statements of Operations following the PEAKS Consolidation. The cash received by the PEAKS Trust, which is derived from its revenue, however, is considered restricted and can only be used to satisfy the obligations of the PEAKS Trust. The revenue and expenses of the CUSO are presented in our Consolidated Statements of Operations following the CUSO Consolidation. The cash received by the CUSO, which is derived from its revenue, however, is considered restricted and can only be used to satisfy the obligations of the CUSO.

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Year Ended December 31, 2014

|  | Core Operations  | PEAKS<br>Trust | CUSO         | Eliminations | GAAP<br>Consolidated |
|--|------------------|----------------|--------------|--------------|----------------------|
| <b>(Dollar amounts in thousands)</b>   |                  |                |              |              |                      |
| <b>Statement of Cash Flows Data:</b>   |                  |                |              |              |                      |
| <b>Cash flows from operating activities:</b>                                     |                  |                |              |              |                      |
| Net income (loss)  | \$ 43,620        | \$ (25,933)    | \$ (100,035) | \$ 111,601   | \$ 29,253            |
| Adjustments to reconcile net income to net cash flows from operating activities: |                  |                |              |              |                      |
| Depreciation and amortization  | 26,456           | 0              | 0            | 0            | 26,456               |
| Provision for doubtful accounts  | 63,928           | 0              | 0            | 0            | 63,928               |
| Deferred income taxes  | 41,969           | 0              | 0            | 0            | 41,969               |
| Stock-based compensation expense   | 10,336           | 0              | 0            | 0            | 10,336               |
| Goodwill and asset impairment  | 2,454            | 0              | 0            | 0            | 2,454                |
| Accretion of discount on private education loans                                 | 0                | (11,471)       | (699)        | 0            | (12,170)             |
| Accretion of discount on long-term debt  | 118              | 0              | 0            | 0            | 118                  |
| Accretion of discount on PEAKS Trust senior debt                                 | 0                | 6,712          | 0            | 0            | 6,712                |
| Accretion of discount on CUSO secured borrowing obligation                       | 0                | 0              | 231          | 0            | 231                  |
| Provision for private education loan losses                                      | 0                | 12,111         | 2,039        | 0            | 14,150               |
| (Gain) on consolidation of variable interest entities                            | 0                | 0              | 94,970       | (111,601)    | (16,631)             |
| Other  | (613)            | 0              | 0            | 0            | (613)                |
| Changes in operating assets and liabilities:                                     |                  |                |              |              |                      |
| Restricted cash  | 1,076            | 1,037          | 221          | 0            | 2,334                |
| Accounts receivable  | (10,010)         | 0              | 0            | 0            | (10,010)             |
| Private education loans  | 0                | 16,499         | 2,053        | 0            | 18,552               |
| Accounts payable   | 9,591            | 0              | 0            | 0            | 9,591                |
| Other operating assets and liabilities   | (211,426)        | 159,713        | 2,986        | 0            | (48,727)             |
| Deferred revenue   | (1,156)          | 0              | 0            | 0            | (1,156)              |
| <b>Net cash flows from operating activities</b>                                  | <b>(23,657)</b>  | <b>158,668</b> | <b>1,766</b> | <b>0</b>     | <b>136,777</b>       |
| <b>Net cash flows from investing activities</b>                                  | <b>(100,325)</b> | <b>0</b>       | <b>0</b>     | <b>0</b>     | <b>(100,325)</b>     |
| <b>Cash flows from financing activities:</b>                                     |                  |                |              |              |                      |
| Debt issue costs   | (4,938)          | 0              | 0            | 0            | (4,938)              |
| Proceeds from term borrowings  | 100,000          | 0              | 0            | 0            | 100,000              |
| Repayment of revolving borrowings  | (50,000)         | 0              | 0            | 0            | (50,000)             |
| Repayment of PEAKS Trust senior debt   | 0                | (158,668)      | 0            | 0            | (158,668)            |
| Repayment of CUSO secured borrowing obligation                                   | 0                | 0              | (1,766)      | 0            | (1,766)              |
|  | (914)            | 0              | 0            | 0            | (914)                |

Repurchase of common stock and shares  
tendered for taxes

|   |            |           |         |      |            |
|---|------------|-----------|---------|------|------------|
| <b>Net cash flows from financing activities</b>   | 44,148     | (158,668) | (1,766) | 0    | (116,286)  |
| Net change in cash and cash equivalents           | (79,834)   | 0         | 0       | 0    | (79,834)   |
| Cash and cash equivalents at beginning of period  | 215,771    | 0         | 0       | 0    | 215,771    |
| <b>Cash and cash equivalents at end of period</b> | \$ 135,937 | \$ 0      | \$ 0    | \$ 0 | \$ 135,937 |

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|  | Year Ended December 31, 2013          |                    |                |              |                      |
|--|---------------------------------------|--------------------|----------------|--------------|----------------------|
|  | Year<br>Ended<br>December 31,<br>2012 | Core<br>Operations | PEAKS<br>Trust | Eliminations | GAAP<br>Consolidated |
|  | (Dollar amounts in thousands)         |                    |                |              |                      |
| <b>Statement of Cash Flows Data:</b>   |                                       |                    |                |              |                      |
| <b>Cash flows from operating activities:</b>                                     |                                       |                    |                |              |                      |
| Net income (loss)  | \$ 138,970                            | \$ 65,084          | \$ (155,677)   | \$ 63,569    | \$ (27,024)          |
| Adjustments to reconcile net income to net cash flows from operating activities: |                                       |                    |                |              |                      |
| Depreciation and amortization  | 29,350                                | 27,252             | 0              | 0            | 27,252               |
| Provision for doubtful accounts  | 56,818                                | 67,640             | 0              | 0            | 67,640               |
| Deferred income taxes  | (59,571)                              | (54,102)           | 0              | 0            | (54,102)             |
| Excess tax benefit from stock option exercises                                   | (1,382)                               | 0                  | 0              | 0            | 0                    |
| Stock-based compensation expense   | 16,658                                | 11,638             | 0              | 0            | 11,638               |
| Settlement cost  | 21,750                                | (46,000)           | 0              | 0            | (46,000)             |
| Goodwill and asset impairment  | 15,166                                | 0                  | 0              | 0            | 0                    |
| Accretion of discount on private education loans                                 | 0                                     | 0                  | (12,996)       | 0            | (12,996)             |
| Accretion of discount on PEAKS Trust senior debt                                 | 0                                     | 0                  | 4,926          | 0            | 4,926                |
| Provision for private education loan losses                                      | 0                                     | 0                  | 29,349         | 0            | 29,349               |
| Loss on consolidation of variable interest entities                              | 0                                     | 0                  | 112,748        | (39,500)     | 73,248               |
| Other  | 6,992                                 | 315                | 0              | 0            | 315                  |
| Changes in operating assets and liabilities:                                     |                                       |                    |                |              |                      |
| Restricted cash  | 3,794                                 | 435                | (890)          | 0            | (455)                |
| Accounts receivable  | (87,138)                              | (87,225)           | 0              | 0            | (87,225)             |
| Private education loans  | 0                                     | 0                  | 11,554         | 0            | 11,554               |
| Accounts payable   | (15,572)                              | (5,574)            | 0              | 0            | (5,574)              |
| Other operating assets and liabilities   | 72,429                                | 85,017             | 12,932         | (24,069)     | 73,880               |
| Deferred revenue   | (90,643)                              | 11,299             | 0              | 0            | 11,299               |
| <b>Net cash flows from operating activities</b>                                  | <b>107,621</b>                        | <b>75,779</b>      | <b>1,946</b>   | <b>0</b>     | <b>77,725</b>        |
| <b>Net cash flows from investing activities</b>                                  | <b>123,164</b>                        | <b>(13,078)</b>    | <b>0</b>       | <b>0</b>     | <b>(13,078)</b>      |
| <b>Cash flows from financing activities:</b>                                     |                                       |                    |                |              |                      |
| Excess tax benefit from stock option exercises                                   | 1,382                                 | 0                  | 0              | 0            | 0                    |
| Proceeds from exercise of stock options  | 8,345                                 | 0                  | 0              | 0            | 0                    |
| Debt issue costs   | (1,525)                               | 0                  | 0              | 0            | 0                    |
| Proceeds from revolving borrowings   | 175,000                               | 0                  | 0              | 0            | 0                    |
| Repayment of revolving borrowings  | (185,000)                             | (90,000)           | 0              | 0            | (90,000)             |
| Repayment of PEAKS Trust senior debt   | 0                                     | 0                  | (1,946)        | 0            | (1,946)              |
| Repurchase of common stock and shares tendered for taxes                         | (209,371)                             | (395)              | 0              | 0            | (395)                |

|   |                   |                   |             |             |                   |
|---|-------------------|-------------------|-------------|-------------|-------------------|
| <b>Net cash flows from financing activities</b>   | (211,169)         | (90,395)          | (1,946)     | 0           | (92,341)          |
| Net change in cash and cash equivalents           | 19,616            | (27,694)          | 0           | 0           | (27,694)          |
| Cash and cash equivalents at beginning of period  | 223,849           | 243,465           | 0           | 0           | 243,465           |
| <b>Cash and cash equivalents at end of period</b> | <b>\$ 243,465</b> | <b>\$ 215,771</b> | <b>\$ 0</b> | <b>\$ 0</b> | <b>\$ 215,771</b> |

Although the cash flows of the PEAKS Trust are presented in our Consolidated Statements of Cash Flows following the PEAKS Consolidation, the cash resulting from the cash flows from operations and financing activities of the PEAKS Trust can only be used to satisfy the obligations of the PEAKS Trust. Although the cash flows of the CUSO are presented in our Consolidated Statements of Cash Flows following the CUSO Consolidation, the cash resulting from the cash flows from operations and financing activities of the CUSO can only be used to satisfy the obligations of the CUSO.



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### General

As of December 31, 2014, we had 144 college locations in 39 states, which were providing education programs to approximately 53,000 students. In 2014, we derived approximately 97% of our revenue from the Core Operations from tuition and approximately 3% from the sale of tool kits and fees, charged to and paid by, or on behalf of, our students. Most students enrolled in our education programs at our institutions pay a substantial portion of their tuition and other education-related expenses with funds received under various government-sponsored student financial aid programs, especially Title IV Programs.

Our revenue from the Core Operations varies based primarily on the following factors:

the aggregate student population, which is influenced by the number of students attending our institutions at the beginning of a fiscal period and student retention rates;

the amount of tuition charged to our students; and

the levels of availability and utilization of institutional scholarships, grants and awards.

New students generally enter our education programs at the beginning of an academic term that typically begins for most education programs in early March, mid-June, early September and late November or early December. We believe that the changes to our institutions' aggregate student population in recent years was primarily due to:

our prospective students' greater sensitivity to the cost of a postsecondary education;

our prospective students' uncertainty about the value of a postsecondary education due to the prolonged economic and labor market disruptions;

changes that we made to education program offerings at select campuses, which resulted in a more significant decline in new student enrollment in the criminal justice programs of study compared to our institutions' other curricula; and

the discontinuation or suspension of new student enrollments at select locations.

In order to participate in Title IV Programs, a new campus must be authorized by the state in which it will operate, accredited by an accrediting commission recognized by the ED, and certified by the ED to participate in Title IV Programs. The ED's certification process cannot commence until the location receives its state authorization and accreditation.

We generally earn tuition revenue on a straight-line basis over the length of each of four, 12-week academic quarters in each fiscal year. State regulations, accrediting commission criteria and our policies generally require us to refund a portion of the tuition and fee payments received from a student who withdraws from one of our institutions during an

academic term. We recognize immediately the amount of tuition and fees, if any, that we may retain after payment of any refund. Revenue that we recognize after each Consolidation also includes student loan interest income on the related Private Education Loans, which is the accretion of the accretable yield on those Private Education Loans.

We incur expenses throughout a fiscal period in connection with the operation of our institutions. The cost of educational services includes salaries of faculty and institution administrators, cost of course materials, occupancy costs, depreciation and amortization of equipment costs, facilities and leasehold improvements, and other miscellaneous costs incurred by our institutions.

Student services and administrative expenses from the Core Operations include marketing expenses, an expense for uncollectible accounts and administrative expenses incurred primarily at our corporate headquarters. Marketing expenses include advertising expenses and salaries and employee benefits for recruiting representatives. After each Consolidation, student services and administrative expenses also include expenses incurred by the PEAKS Trust and the CUSO, as applicable, primarily related to fees for servicing the Private Education Loans held by that entity and various other administrative fees and expenses of that entity.

In 2014, we continued to add education program offerings among existing campuses. We also continued our efforts to diversify our education program offerings by developing education programs at different degree levels in both technology and non-technology fields of study that we intend to offer at our campuses and deliver entirely in residence, entirely online over the Internet or partially in residence and partially online. In 2014, we did not begin operations at any new ITT Technical Institute campuses or learning sites. As part of our efforts to maximize the efficiency and effectiveness of our current campus locations, during 2014, we:

relocated three of our campuses into existing facilities of other ITT Technical Institute campuses;

converted one of our learning sites into an ITT Technical Institute campus;

closed one of our learning sites;

closed four of our ITT Technical Institute campuses; and

decreased the number of our campuses that offer bachelor degree programs from 134 to 130.

The following table sets forth select operating statistics for the periods indicated:

|   | <b>Year Ended December 31,</b> |             |             |
|---|--------------------------------|-------------|-------------|
|   | <b>2014</b>                    | <b>2013</b> | <b>2012</b> |
| Additional education program offerings                          | 146                            | 348         | 272         |
| Additional training program offerings                           | 2,397                          | 293         | N/A         |
| Number of locations with additional education program offerings | 84                             | 104         | 62          |
| Began operations at new campuses                                | 0                              | 0           | 6           |
| Campuses offering bachelor degree programs                      | 130                            | 134         | 133         |



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In 2015, we intend to add more of our current education program offerings among most of our institutions' locations. We also plan to continue developing new education programs in both technology and non-technology fields, but primarily in technology-and healthcare-related disciplines. We believe that those programs of study will be at different education levels and delivered in a variety of formats, including entirely in residence, entirely online or partially in residence and partially online. In December 2014, the ED did not approve our application to offer four new degree programs at the ITT Technical Institutes due to administrative capability issues reported in recent compliance audits and ED program reviews. In March 2015, the ED approved six and denied two new degree programs that we had applied to offer at Daniel Webster College. The basis for disapproval was due to administrative capability issues reported in recent compliance audits and ED program reviews. While our growth strategy continues to include opening new campuses, we do not expect to begin operations at any new campuses in 2015. We plan to continue to evaluate the performance of the current ITT Technical Institute campuses in order to maximize the efficiency and effectiveness of our national network of campuses. As part of this effort, we may suspend enrollments at, and/or relocate and close, additional campuses. We also plan to continue to develop and offer training programs to career advancers and other professionals through the CPD.

**Variations in Quarterly Results of Operations**

Our quarterly results of operations have tended to fluctuate within a fiscal year due to the timing of student matriculations. Each of our four fiscal quarters has 12 weeks of earned tuition revenue. The academic schedule generally does not affect our incurrence of most of our costs, however, and costs do not fluctuate significantly on a quarterly basis.

The revenue recognized in our fiscal quarters has been impacted by fluctuations in our institutions' total student enrollment. These fluctuations were primarily due to changing patterns of student matriculations and variations in student persistence, which were primarily attributable to the number of graduates in the fiscal quarter and student retention in certain courses. These factors are discussed in greater detail below under Results of Operations. In addition, the increased amount of our institutional scholarships and awards, primarily the Opportunity Scholarship, has reduced revenue per student in the various periods compared to the same prior year periods.

The following table sets forth the Core Operations revenue per student for the periods indicated:

|                    | Core Operations Revenue per Student |   |           |   |           |   |
|--------------------|-------------------------------------|---|-----------|---|-----------|---|
|                    | 2014                                |   | 2013      |   | 2012      |   |
|                    | Amount                              | Increase<br>(Decrease)<br>to<br>Prior<br>Year | Amount    | Increase<br>(Decrease)<br>to<br>Prior<br>Year | Amount    | Increase<br>(Decrease)<br>to<br>Prior<br>Year |
| Three Months Ended |                                     |   |           |   |           |   |
| March 31           | \$ 4,080                            | (12.2)%                                       | \$ 4,646  | 0.3%  | \$ 4,631  | 1.7%  |
| June 30            | 4,111                               | (2.1)%  | 4,200     | (8.9)%  | 4,613     | 0.4%  |
| September 30       | 4,323                               | (0.9)%  | 4,360     | (7.7)%  | 4,726     | 2.6%  |
| December 31        | 4,198                               | (2.9)%  | 4,323     | (7.1)%  | 4,654     | (0.8)%  |
| Total for Year     | \$ 16,712                           | (4.7)%  | \$ 17,529 | (5.9)%  | \$ 18,624 | 1.4%  |

Core Operations revenue per student is calculated by dividing all revenue from Core Operations by the total student enrollment in education programs as of the beginning of the applicable fiscal period.

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The following table sets forth the percentage relationship of certain statement of operations data to revenue for the periods indicated:

|  | <b>Year Ended December 31,</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2014</b>                    | <b>2013</b> | <b>2012</b> |
| Revenue  | 100.0%                         | 100.0%      | 100.0%      |
| Cost of educational services   | 47.9%                          | 45.4%       | 41.8%       |
| Student services and administrative expenses   | 40.5%                          | 37.1%       | 31.2%       |
| Goodwill and asset impairment  | 0.3%                           | 0.0%        | 1.1%        |
| Legal and professional fees related to certain lawsuits, investigations and accounting matters | 3.3%                           | 0.6%        | 0.1%        |
| Loss related to loan program guarantees  | 0.2%                           | 8.5%        | 7.9%        |
| Provision for private education loan losses  | 1.5%                           | 2.7%        | 0.0%        |
| Operating income   | 6.4%                           | 5.7%        | 17.9%       |
| Gain (loss) on consolidation of variable interest entities                                     | 1.7%                           | (6.8)%      | 0.0%        |
| Interest income (expense), net   | (2.9)%                         | (2.3)%      | (0.2)%      |
| Income (loss) before income taxes  | 5.2%                           | (3.5)%      | 17.7%       |

The following table sets forth our total student enrollment in education programs as of the dates indicated:

| <b>As of December 31,</b> | <b>Total Student Enrollment in Education Programs</b> | <b>(Decrease) to Prior Year</b> |
|---------------------------|---|---------------------------------|
| 2014                      | 53,646  | (6.8)%                          |
| 2013                      | 57,542  | (5.8)%                          |
| 2012                      | 61,059  | (16.6)%                         |

Total student enrollment in education programs as of March 31, 2015 was 51,201, a decrease of 10.4% as compared to 57,125 as of March 31, 2014.

Total student enrollment in education programs includes all new and continuing students. A continuing student is any student who, in the academic term being measured, is enrolled in an education program at one of our campuses and was enrolled in the same program at any of our campuses at the end of the immediately preceding academic term. A new student is any student who, in the academic term being measured, enrolls in and begins attending any education program at one of our campuses:

for the first time at that campus;

after graduating in a prior academic term from a different education program at that campus; or

after having withdrawn or been terminated from an education program at that campus.

The following table sets forth our new student enrollment in education programs in the periods indicated:

|  | 2014                   |                                   | 2013                   |                                   | 2012                   |                                   |
|--|------------------------|-----------------------------------|------------------------|-----------------------------------|------------------------|-----------------------------------|
|  | New Student Enrollment | Increase (Decrease) to Prior Year | New Student Enrollment | Increase (Decrease) to Prior Year | New Student Enrollment | Increase (Decrease) to Prior Year |
| <b>New Student Enrollment in Education Programs in the Three Months Ended:</b> |                        |                                   |                        |                                   |                        |                                   |
| March 31   | 16,746                 | (3.8%)                            | 17,412                 | (3.6%)                            | 18,067                 | (17.0%)                           |
| June 30  | 15,523                 | (8.1%)                            | 16,883                 | 7.5%                              | 15,698                 | (9.5%)                            |
| September 30   | 18,317                 | (9.8%)                            | 20,307                 | 5.2%                              | 19,298                 | (15.8%)                           |
| December 31  | 12,639                 | (9.7%)                            | 13,995                 | 4.5%                              | 13,398                 | (11.4%)                           |
| <b>Total for the year</b>  | <b>63,225</b>          | <b>(7.8%)</b>                     | <b>68,597</b>          | <b>3.2%</b>                       | <b>66,461</b>          | <b>(13.9%)</b>                    |

New student enrollment in education programs in the three months ended March 31, 2015 was 14,104, a decrease of 15.8% as compared to the same prior year period.

We believe that the 9.7% decrease in new student enrollment in education programs in the three months ended December 31, 2014 compared to the three months ended December 31, 2013 was primarily due to:

a decrease in the rate at which prospective students who inquired about our education programs actually applied for enrollment in the three months ended December 31, 2014 compared to the same prior year period; and

a decrease in the number of admissions representatives in the three months ended December 31, 2014 compared to the same prior year period, which were partially offset by an increase in the rate at which prospective students who applied for enrollment actually began attending classes in their education programs.

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We believe that the 9.8% decrease in new student enrollment in education programs in the three months ended September 30, 2014 compared to the three months ended September 30, 2013 was primarily due to:

a decrease in the rate at which prospective students who inquired about our education programs actually applied for enrollment in the three months ended September 30, 2014 compared to the same prior year period; and

a decrease in the number of admissions representatives in the three months ended September 30, 2014 compared to the same prior year period,  
which were partially offset by an increase in the rate at which prospective students who applied for enrollment actually began attending classes in their education programs.

We believe that the 8.1% decrease in new student enrollment in education programs in the three months ended June 30, 2014 compared to the three months ended June 30, 2013, and the 3.8% decrease in new student enrollment in education programs in the three months ended March 31, 2014 compared to the three months ended March 31, 2013 were primarily due to a decrease in the number of prospective students who inquired about our education programs in each of those periods, which was partially offset by:

an increase in the rate at which prospective students who applied for enrollment actually began attending classes in their education programs; and

increased availability to and use by our students of institutional scholarships and awards, which have the effect of reducing the students' cost of our education programs.

We believe that the decreases in new student enrollment in education programs in the three months ended December 31, 2014, September 30, 2014, June 30, 2014 and March 31, 2014, compared to the same prior year periods were also due to our prospective students :

greater sensitivity to the cost of postsecondary education; and

uncertainty about the value of a postsecondary education due to the prolonged economic and labor market disruptions.

A continued decline in new and total student enrollment in education programs could have a material adverse effect on our business, financial condition, revenue and other results of operations and cash flows. We have taken a number of steps in an attempt to reverse the declines in total and new student enrollment in education programs, including, without limitation:



increasing the availability of institutional scholarships, primarily the Opportunity Scholarship, which are intended to help reduce the cost of an ITT Technical Institute education and increase student access to our education programs; and

refining our marketing, advertising and communications to focus more on the student value proposition and outcomes of an ITT Technical Institute education.

At the vast majority of our campuses, we generally organize the academic schedule for education programs offered on the basis of four 12-week academic quarters in a calendar year. The academic quarters typically begin in early March, mid-June, early September and late November or early December. To measure the persistence of our students, the number of continuing students in any academic term is divided by the total student enrollment in education programs in the immediately preceding academic term.

The following table sets forth the rates of our students' persistence as of the dates indicated:

| Year | Student Persistence as of: |         |              |             |
|------|----------------------------|---------|--------------|-------------|
|      | March 31                   | June 30 | September 30 | December 31 |
| 2014 | 70.2%                      | 70.0%   | 69.9%        | 71.8%       |
| 2013 | 71.5%                      | 68.4%   | 69.4%        | 71.4%       |
| 2012 | 72.4%                      | 71.3%   | 69.8%        | 72.6%       |

Student persistence was 69.2% as of March 31, 2015, a decrease of 100 basis points compared to March 31, 2014.

We believe that the increase in student persistence as of each of December 31, September 30 and June 30, 2014 compared to the same date in the prior year was primarily due to a decrease in graduates in each of the three months ended December 31, September 30 and June 30, 2014 compared to the same prior year period. We believe that the decrease in student persistence as of March 31, 2014 compared to March 31, 2013 was primarily due to a decrease in student retention in the three months ended March 31, 2014 compared to the same prior year period, primarily attributed to lower student retention in a few courses that are delivered in the early portions of certain associate degree programs of study.

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***Year Ended December 31, 2014 Compared with Year Ended December 31, 2013.*** Revenue decreased \$110.5 million, or 10.3%, to \$961.8 million in the year ended December 31, 2014 compared to \$1,072.3 million in the year ended December 31, 2013. The primary factors that contributed to this decrease were:

an increase in institutional scholarships and awards provided to our students, which reduced revenue by \$90.6 million in the year ended December 31, 2014 compared to the prior year; and

an average 6.2% decrease in total student enrollment in education programs as of the end of each fiscal quarter in 2014 compared to 2013.

The increase in institutional scholarships and awards was primarily due to the introduction of the Opportunity Scholarship at the vast majority of the ITT Technical Institute campuses in the academic quarter that began in March 2013 and the expanded availability and increased utilization of the Opportunity Scholarship since its introduction.

Revenue of the PEAKS Trust is comprised of interest income on the PEAKS Trust Student Loans, which is the accretion of the accretable yield on the PEAKS Trust Student Loans. Revenue of the PEAKS Trust decreased \$1.5 million, or 11.7%, to \$11.5 million in the year ended December 31, 2014 compared to \$13.0 million in the year ended December 31, 2013.

Revenue of the CUSO is comprised of (i) interest income on the CUSO Student Loans, which is the accretion of the accretable yield on the CUSO Student Loans, and (ii) an administrative fee paid by the owners of the CUSO (the CUSO Participants ) to the CUSO on a monthly basis ( Administrative Fee ). Revenue attributable to the interest income on the CUSO Student Loans was approximately \$0.7 million and revenue attributable to the Administrative Fee was approximately \$0.4 million in the year ended December 31, 2014. No interest income on the CUSO Student Loans or revenue attributable to the Administrative Fee was included in revenue in the year ended December 31, 2013, because the CUSO Consolidation was effective September 30, 2014.

Cost of educational services decreased \$25.6 million, or 5.3%, to \$460.8 million in the year ended December 31, 2014 compared to \$486.4 million in the year ended December 31, 2013. The primary factors that contributed to this decrease included:

decreases in compensation costs and benefit costs resulting from fewer employees; and

a decrease in occupancy costs as a result of fewer physical locations and reduced square footage. These decreases were partially offset by an increase in the cost of electronic devices issued to students as part of a transition from physical to electronic books.

Cost of educational services as a percentage of revenue increased 250 basis points to 47.9% in the year ended December 31, 2014 compared to 45.4% in the year ended December 31, 2013. The primary factors that contributed to this increase was a decline in revenue and an increase in the cost of electronic devices issued to students, which was partially offset by decreases in compensation costs and benefit costs and a decrease in occupancy costs.

Student services and administrative expenses decreased \$8.4 million, or 2.1%, to \$389.1 million in the year ended December 31, 2014 compared to \$397.5 million in the year ended December 31, 2013. The principal causes of this decrease were decreases in compensation costs, benefit costs and bad debt expense. Approximately \$4.5 million of expenses of the PEAKS Trust and \$0.4 million of expenses of the CUSO were included in student services and administrative expenses in the year ended December 31, 2014. Those expenses primarily represented fees for servicing the Private Education Loans and various other administrative fees and expenses of the PEAKS Trust and the CUSO. In the year ended December 31, 2013, \$5.3 million of expenses of the PEAKS Trust were included in student services and administrative expenses, which primarily represented fees for servicing the PEAKS Trust Student Loans and various other administrative fees and expenses of the PEAKS Trust. The amount of the fees for servicing the PEAKS Trust Student Loans are based on the outstanding balance of non-defaulted PEAKS Trust Student Loans, and the amount of the other administrative fees and expenses of the PEAKS Trust are based on the outstanding principal balance of the PEAKS Senior Debt. The amount of the fees for servicing the CUSO Student Loans is based on the number of loans that have not defaulted and the payment status of the loans.

Student services and administrative expenses increased to 40.5% of revenue in the year ended December 31, 2014 compared to 37.1 % of revenue in the year ended December 31, 2013. The principal cause of this increase was the decline in revenue, which was partially offset by decreases in compensation costs and benefit costs and bad debt expense. Bad debt expense as a percentage of revenue increased to 6.6% in the year ended December 31, 2014 compared to 6.3% in the year ended December 31, 2013, primarily as a result of a decrease in collections on accounts receivable balances of students no longer enrolled in a program of study.

In the year ended December 31, 2014, we recorded an impairment charge of \$2.0 million for the impairment of goodwill associated with the acquisitions of Cable Holdings and the Ascolta business, and an impairment charge of \$0.4 million for the impairment of the trademark associated with the acquisition of Daniel Webster College. The amount of each impairment charge equaled the difference between the estimated fair value of the goodwill or trademark and its carrying value as of the impairment testing date. The determination of the estimated fair value requires the use of assumptions, which may change in future periods. See Note 11 Goodwill and Other Intangibles of the Notes to Consolidated Financial Statements. We did not record an impairment charge in the year ended December 31, 2013 for goodwill or other intangible assets.

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Legal and professional fees related to certain lawsuits, investigations and accounting matters increased \$25.1 million, or 362.3%, to \$32.0 million in the year ended December 31, 2014 compared to \$6.9 million in the year ended December 31, 2013. In the year ended December 31, 2014, these expenses related primarily to legal and professional fees associated with:

the investigation of us by the SEC;

the lawsuit filed against us by the CFPB;

the investigation of us by various state Attorneys General;

the lawsuit filed against us by the New Mexico Attorney General;

the securities class action lawsuits filed against us;

legal and professional fees related to certain lawsuits, investigations and accounting matters;

a letter agreement, dated as of March 17, 2014, that we entered into with the trustee under the PEAKS Program and the holders of the PEAKS Senior Debt (the PEAKS Letter Agreement), in order to resolve differing interpretations of the permissibility of payments on behalf of borrowers that we made; and

certain other legal and regulatory matters.

In the year ended December 31, 2013, these expenses related primarily to legal fees associated with the SEC investigation of us, the CFPB investigation of us and the securities class action lawsuits filed against us. See Note 15 Commitments and Contingencies of the Notes to Consolidated Financial Statements, for further information about those matters.

In the year ended December 31, 2014, we recorded a loss related to loan program guarantees of \$2.0 million for the CUSO RSA compared to \$91.0 million in the year ended December 31, 2013 for the CUSO RSA. The entire amount of the loss recorded in the year ended December 31, 2013 related to a change in our accounting estimate for the amount of our guarantee obligations under the CUSO RSA. We revised our estimate for the CUSO RSA based on our enhanced default rate methodology and more recent performance data that we obtained in the three months ended December 31, 2013. The primary enhancements and performance data included:

an adjustment to the default estimates for student borrowers as a result of recently obtained actual default data for similarly-situated student borrowers;

an adjustment to the default rate expectations, due to declines in repayment performance;

our ability to make Discharge Payments; and

a lower expectation for collections on defaulted loans as a result of the performance to date of collections.

See Note 8 Variable Interest Entities and Note 15 Commitments and Contingencies of the Notes to Consolidated Financial Statements.

The provision for private education loan losses of approximately \$14.2 million in the year ended December 31, 2014 represented the increase in the allowance for loan losses on the PEAKS Trust Student Loans that occurred from January 1, 2014 through December 31, 2014 and the increase in the allowance for loan losses on the CUSO Student Loans that occurred from September 30, 2014 through December 31, 2014. The provision for private education loan losses of approximately \$29.3 million in the year ended December 31, 2013 represented the increase in the allowance for loan losses on the PEAKS Trust Student Loans that occurred from February 28, 2013 through December 31, 2013. We did not consolidate the CUSO in our consolidated financial statements in the year ended December 31, 2013, and, therefore, we did not include the CUSO Student Loans in our consolidated financial statements or recognize any provision for CUSO Student Loan losses in that year.

Operating income increased \$0.1 million, or 0.1%, to \$61.3 million in the year ended December 31, 2014 compared to \$61.2 million in the year ended December 31, 2013, primarily as a result of the impact of the factors discussed above in connection with revenue, cost of educational services, student services and administrative expenses, goodwill impairment, legal and professional fees related to certain lawsuits, investigations and accounting matters, loss related to loan program guarantees and provision for private education loan losses. Our operating margin increased to 6.4% in the year ended December 31, 2014 compared to 5.7% in the year ended December 31, 2013, primarily due to the impact of the factors discussed above.

In the year ended December 31, 2014, we recorded a gain upon the consolidation of a variable interest entity (the CUSO) of \$16.6 million, compared to a loss upon the consolidation of a variable interest entity (the PEAKS Trust) of \$73.2 million in the year ended December 31, 2013. Upon the CUSO Consolidation, we recorded the CUSO's assets and liabilities at their fair value in our consolidated financial statements and we eliminated the carrying value of the assets and liabilities related to the CUSO Program that had been recorded in our consolidated financial statements as of September 30, 2014. The fair value of the CUSO's liabilities exceeded the fair value of the CUSO's assets as of September 30, 2014 by approximately \$95.0 million. As of September 30, 2014, the carrying value of the liabilities related to the CUSO Program that had been recorded in our consolidated financial statements exceeded the carrying value of the assets related to the CUSO Program that had been recorded in our consolidated financial statements by approximately \$111.6 million. As a result, we recognized a total gain of approximately \$16.6 million in our consolidated financial statements for the year ended December 31, 2014, which represented the difference between (i) the fair value of the net liabilities of the CUSO that we recorded upon the CUSO Consolidation, and (ii) the carrying value of the net liabilities related to the CUSO Program that had been recorded in our consolidated financial statements and were eliminated upon the CUSO Consolidation, in each case, as of September 30, 2014. In the year ended December 31, 2013, the loss upon the PEAKS Trust Consolidation of \$73.2 million represented the amount by which the fair value of the PEAKS Trust's liabilities exceeded the fair value of the PEAKS Trust's assets as of February 28, 2013 upon the PEAKS Consolidation, partially reduced by the net amount of the carrying value of the assets and liabilities related to the PEAKS Program that had been recorded in our consolidated financial statements as of February 28, 2013 and were eliminated upon the PEAKS Consolidation. See Note 8 Variable Interest Entities of the Notes to Consolidated Financial Statements, for a further discussion of the Consolidations.



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Interest income was less than \$0.1 million in the year ended December 31, 2014 and approximately \$0.1 million in December 31, 2013.

Interest expense increased \$3.0 million, or 12.0%, to \$28.3 million in the year ended December 31, 2014 compared to \$25.3 million in the year ended December 31, 2013, primarily due to:

interest expense of approximately \$20.8 million on the PEAKS Senior Debt , which includes the contractual interest obligation and the accretion of the discount on the PEAKS Senior Debt in the year ended December 31, 2014, compared to \$21.3 million in the year ended December 31, 2013;

interest expense of approximately \$3.7 million related to the CUSO Secured Borrowing Obligation in the year ended December 31, 2014, compared to none in the year ended December 31, 2013; and

an increase in the effective interest rate under the Amended Credit Agreement, which was partially offset by a decrease in our weighted average outstanding borrowings under the Amended Credit Agreement.

Our combined federal and state effective income tax rate was 41.1% in the year ended December 31, 2014 compared to 27.4% in the year ended December 31, 2013. We recorded pretax consolidated income in the year ended December 31, 2014 compared to a pretax consolidated loss in the year ended December 31, 2013. Our effective income tax rate was lower in the year ended December 31, 2013 compared to the year ended December 31, 2014 primarily due to certain losses related to the PEAKS Trust that were included in our consolidated pretax loss for which an income tax benefit was not recognized.

***Year Ended December 31, 2013 Compared with Year Ended December 31, 2012.*** Revenue decreased \$214.3 million, or 16.7%, to \$1,072.3 million in the year ended December 31, 2013 compared to \$1,286.6 million in the year ended December 31, 2012. The primary factors that contributed to this decrease were:

an increase in institutional scholarships and awards provided to our students, which reduced revenue by \$108.3 million in the year ended December 31, 2013; and

an average 9.9% decrease in total student enrollment.

Revenue of the PEAKS Trust is comprised of interest income on the PEAKS Trust Student Loans, which is the accretion of the accretable yield on the PEAKS Trust Student Loans. Revenue attributable to the interest income on the PEAKS Trust Student Loans was approximately \$13.0 million in the year ended December 31, 2013. No interest income on the PEAKS Trust Student Loans was included in revenue in the year ended December 31, 2012, because the PEAKS Consolidation was effective February 28, 2013. See Note 8 Variable Interest Entities of the Notes to Consolidated Financial Statements, for a discussion of the PEAKS Consolidation.

Cost of educational services decreased \$52.0 million, or 9.7%, to \$486.4 million in the year ended December 31, 2013 compared to \$538.4 million in the year ended December 31, 2012. The primary factors that contributed to this decrease included:

a decrease in compensation costs and benefit costs resulting from fewer employees; and

a decrease in course supply expenses, due to lower student enrollments in education programs.

Cost of educational services as a percentage of revenue increased 360 basis points to 45.4% in the year ended December 31, 2013 compared to 41.8% in the year ended December 31, 2012. The primary factor that contributed to this increase was a decline in revenue, which was partially offset by decreases in compensation costs and benefit costs and course supply expenses.

Student services and administrative expenses decreased \$3.3 million, or 0.8%, to \$397.5 million in the year ended December 31, 2013 compared to \$400.9 million in the year ended December 31, 2012. The principal causes of this decrease were decreases in compensation and benefit costs and expenses related to student scholarships, which were partially offset by increases in media advertising expenses and bad debt expense. Approximately \$5.3 million of expenses of the PEAKS Trust were included in student services and administrative expenses in the year ended December 31, 2013. Those expenses primarily represented fees for servicing the PEAKS Trust Student Loans and various other administrative fees and expenses of the PEAKS Trust. The amount of the fees for servicing the PEAKS Trust Student Loans are based on the outstanding balance of non-defaulted PEAKS Trust Student Loans, and the amount of the other administrative fees and expenses are based on the outstanding principal balance of the PEAKS Senior Debt.

Student services and administrative expenses increased to 37.1% of revenue in the year ended December 31, 2013 compared to 31.2% of revenue in the year ended December 31, 2012. The principal cause of this increase was the decline in revenue, which was partially offset by decreases in compensation costs and benefit costs and expenses related to student scholarships. Bad debt expense as a percentage of revenue increased to 6.3% in the year ended December 31, 2013 compared to 4.4% in the year ended December 31, 2012, primarily as a result of an increase in student account balances that were determined to be uncollectible.

We recorded an expense of \$15.2 million in the year ended December 31, 2012 related to the impairment of the Subordinated Note and Revolving Note. See Note 8 Variable Interest Entities of the Notes to Consolidated Financial Statements, for a more detailed discussion of the impairment of the notes. No impairment of those notes was recorded in the year ended December 31, 2013.



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Legal and other professional fees related to certain lawsuits, investigations and accounting matters increased \$6.1 million, or 693.0%, to \$6.9 million in the year ended December 31, 2013, compared to \$0.9 million in the year ended December 31, 2012. These expenses related primarily to legal fees associated with the investigation of us by the SEC, the CFPB investigation of us and the securities class action lawsuits filed against us. See [Legal Proceedings](#) and [Note 15 Commitments and Contingencies of the Notes to Consolidated Financial Statements](#), for further information about these matters.

In the year ended December 31, 2013, we recorded a loss related to loan program guarantees of \$91.0 million for the CUSO RSA compared to \$101.0 million in the year ended December 31, 2012 for the RSAs. The entire amount of the loss recorded in the year ended December 31, 2013 related to a change in our accounting estimate for the amount of our guarantee obligations under the CUSO RSA. We revised our estimate for the CUSO RSA based on an enhanced default rate methodology and more recent performance data that we obtained in the three months ended December 21, 2013. The primary enhancements and performance data included:

an adjustment to the default estimates for student borrowers, as a result of recently obtained actual default data for similarly-situated student borrowers;

an adjustment to the default rate expectations, due to declines in repayment performance;

our ability to make Discharge Payments; and

a lower expectation for collections on defaulted loans as a result of the performance to date of collections.

The loss recorded in the year ended December 31, 2012 included \$79.2 million for additional contingent liabilities related to our guarantee obligations related to our guarantee obligations under the CUSO RSA and PEAKS Guarantee and \$21.8 million related to the settlement of litigation and the resolution of our guarantee obligations under the 2007 RSA. See [Note 8 Variable Interest Entities](#) and [Note 15 Commitments and Contingencies of the Notes to Consolidated Financial Statements](#).

The provision for private education loan losses of approximately \$29.3 million in the year ended December 31, 2013 represented the increase in the allowance for loan losses on the PEAKS Trust Student Loans that occurred from February 28, 2013 through December 31, 2013. We did not consolidate the PEAKS Trust in our consolidated financial statements in the year ended December 31, 2012, and, therefore, we did not include the PEAKS Trust Student Loans in our consolidated financial statements or recognize any provision for private education loan losses in that year.

Operating income decreased \$169.2 million, or 73.4%, to \$61.2 million in the year ended December 31, 2013 compared to \$230.4 million in the year ended December 31, 2012, primarily as a result of the impact of the factors discussed above in connection with revenue, cost of educational services, student services and administrative expenses, legal and professional fees related to certain lawsuits, investigations and accounting matters, loss related to loan program guarantees and provision for private education loan losses. Our operating margin decreased to 5.7% in the year ended December 31, 2013 compared to 17.9% in the year ended December 31, 2012, primarily due to the impact of the factors discussed above.

In the year ended December 31, 2013, we recorded a loss upon the PEAKS Consolidation of \$73.2 million. This loss represented the amount by which the fair value of the PEAKS Trust's liabilities exceeded the fair value of the PEAKS Trust's assets as of February 28, 2013 upon the PEAKS Consolidation, partially reduced by the net amount of the carrying value of the assets and liabilities related to the PEAKS Program that had been recorded in our consolidated financial statements as of February 28, 2013 and were eliminated upon the PEAKS Consolidation. See Note 8 Variable Interest Entities of the Notes to Consolidated Financial Statements, for a further discussion of the PEAKS Consolidation.

Interest income decreased \$1.2 million, or 92.0%, to \$0.1 million in the year ended December 31, 2013 compared to \$1.3 million in the year ended December 31, 2012, primarily due to discontinuing the amortization of the discount on the Subordinated Note. See Note 8 Variable Interest Entities of the Notes to Consolidated Financial Statements, for a discussion of the Subordinated Note.

Interest expense increased \$21.6 million, or 578.9%, to \$25.3 million in the year ended December 31, 2013 compared to \$3.7 million in the year ended December 31, 2012, primarily due to:

interest expense of approximately \$21.3 million on the PEAKS Senior Debt, which includes the contractual interest obligation and the accretion of the discount on the PEAKS Senior Debt, in the year ended December 31, 2013 as a result of the PEAKS Consolidation, during which the effective interest rate was 9.9%; and

an increase in the effective interest rate under the Amended Credit Agreement, which was partially offset by a decrease in our weighted average outstanding borrowings under the revolving credit facility.

Our combined federal and state effective income tax rate was 27.4% in the year ended December 31, 2013 compared to 39.0% in the year ended December 31, 2012. The primary factor that contributed to the decrease in the effective income tax rate in the year ended December 31, 2013 compared to the year ended December 31, 2012 was the recognition of certain losses related to the PEAKS Trust in our consolidated financial results for which an income tax benefit was not recognized.

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**Financial Condition, Liquidity and Capital Resources**

Cash and cash equivalents were \$135.9 million as of December 31, 2014 compared to \$215.8 million as of December 31, 2013. The \$79.8 million decrease in cash and cash equivalents as of December 31, 2014 compared to December 31, 2013 was primarily due to:

payments totaling approximately \$170.3 million related to our obligations under the PEAKS Guarantee and CUSO RSA, which included:

the \$40.0 million payment we made in March 2014 pursuant to the PEAKS Letter Agreement, which is considered to be a payment under the PEAKS Guarantee and reduced the outstanding balance of the PEAKS Senior Debt;

payments of approximately \$116.6 million that we made to satisfy our obligations under the PEAKS Guarantee with respect to the minimum required Asset/Liability Ratio, which reduced the outstanding balance of the PEAKS Senior Debt;

payments of approximately \$2.7 million that we made to satisfy our obligations under the PEAKS Guarantee with respect to interest owed on the PEAKS Senior Debt and administrative fees and expenses of the PEAKS Trust;

payments of approximately \$1.8 million that we made on behalf of borrowers related to the PEAKS Program;

Regular Payments under the CUSO RSA, net of amounts recovered from charged-off loans that were owed to us, of approximately \$6.6 million; and

Discharge Payments under the CUSO RSA of approximately \$2.6 million.

providing cash collateral of \$89.3 million related to outstanding letters of credit issued for our account;  
and

the repayment of \$50.0 million of outstanding borrowings under the Amended Credit Agreement. The reduction in cash and cash equivalents was partially offset by:

proceeds from borrowings under the Financing Agreement of \$100.0 million, excluding \$3.0 million of commitment fees paid to the lender; and

net cash flows generated from operating activities of \$136.8 million.

See Note 12 Debt and Note 15 Commitments and Contingencies of the Notes to Consolidated Financial Statements, for a further discussion of the payments we made related to the Amended Credit Agreement and the RSAs.

Our Consolidated Balance Sheet as of December 31, 2014 included the assets and liabilities of the PEAKS Trust and the CUSO. As of December 31, 2013, our Consolidated Balance Sheet included the assets and liabilities of the PEAKS Trust. The assets and liabilities of the CUSO were not included on our Consolidated Balance Sheet as of December 31, 2013 because we did not consolidate the CUSO in our consolidated financial statements until September 30, 2014. The assets of the PEAKS Trust can only be used to satisfy the obligations of the PEAKS Trust and the assets of the CUSO can only be used to satisfy the obligations of the CUSO.

Restricted cash of \$6.0 million as of December 31, 2014 included approximately \$1.6 million of funds held by the PEAKS Trust and \$2.5 million of funds held by the CUSO. Funds held by the PEAKS Trust shown as restricted cash on our Consolidated Balance Sheet as of December 31, 2013 were \$2.6 million. Although the funds held by the PEAKS Trust and the CUSO are included on our Consolidated Balance Sheet after the related Consolidation, those funds can only be used to satisfy the obligations of the PEAKS Trust and the CUSO, as applicable. See Note 8 Variable Interest Entities of the Notes to Consolidated Financial Statements, for a further discussion of the Consolidations.

The PEAKS Trust's ability to satisfy its obligations is based on payments received from borrowers on the PEAKS Trust Student Loans and collections on the PEAKS Trust Student Loans that have defaulted. To the extent that those payments and collections from borrowers on the PEAKS Trust Student Loans are not sufficient to satisfy the obligations of the PEAKS Trust, including the PEAKS Senior Debt, we are required to make payments under the PEAKS Guarantee.

We have significant payment obligations under the PEAKS Guarantee and the CUSO RSA. Under the PEAKS Guarantee, we guarantee payment of the principal and interest owed on the PEAKS Senior Debt, the administrative fees and expenses of the PEAKS Trust and a minimum required ratio of assets of the PEAKS Trust to outstanding PEAKS Senior Debt ( Asset/Liability Ratio ). Our guarantee obligations under the PEAKS Program remain in effect until the PEAKS Senior Debt and the PEAKS Trust's fees and expenses are paid in full. Under the CUSO RSA, we guarantee the repayment of any CUSO Student Loans that are charged off above a certain percentage of the CUSO Student Loans made under the CUSO Program, based on the annual dollar volume. Our obligations under the CUSO RSA remain in effect until all CUSO Student Loans are paid in full. See Note 15 Commitments and contingencies of the Notes to Consolidated Financial Statements for a further discussion of the PEAKS Guarantee and CUSO RSA.

We believe that we will make payments in 2015 of approximately \$29.8 million under the PEAKS Guarantee and approximately \$13.0 million, net of \$1.4 million in recoveries, under the CUSO RSA. As revised pursuant to Amendment No. 2, the Financing Agreement limits the aggregate amount of payments that we can make related to the PEAKS Guarantee and the CUSO RSA to \$45.0 million under both programs in 2015, and to \$35.0 million under both programs in any year after 2015 that the Financing Agreement is in effect. We expect to make significant payments after 2015 under the PEAKS Guarantee and the CUSO RSA. For a detailed description of our obligations under the PEAKS Guarantee and the CUSO RSA, the amounts that we estimate we may have to pay

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pursuant to those obligations in the future and certain disputes and other matters relating to the RSAs, see Note 15 Commitments and Contingencies of the Notes to Consolidated Financial Statements. If we are required to pay amounts that exceed the amounts that we estimated could be due under the RSAs, we may not have cash and other sources of funds sufficient to make those payments. Failure to make required payments:

would constitute a default under the applicable program documents;

could result in cross-defaults under the Financing Agreement; and

could have a material adverse effect on our compliance with the regulations of the ED, state education and professional licensing authorities, the accrediting commissions that accredit our institutions and other agencies that regulate us.

In addition, payments that we do make under the RSAs will reduce the cash we have available to use for other purposes, including to make required payments under the Financing Agreement, and will reduce our cash balance, which could negatively impact our ability to satisfy the ED's financial responsibility measurements, the financial requirements of the SAs or the financial metrics to which we are subject under the RSAs. Failure to satisfy those other obligations or standards could have a material adverse effect on our financial condition, results of operations and cash flows.

On October 31, 2014, the ED Letter of Credit in the amount of \$79.7 million was issued for our account. We also have other letters of credit outstanding for our account in the amount of \$2.4 million. Pursuant to the Amended Credit Agreement, we were required to provide cash collateral in an amount equal to 109% of the face amount of the ED Letter of Credit and 103% of the face amount of all other letters of credit. We satisfied that collateral obligation by providing approximately \$89.3 million in cash collateral utilizing proceeds from the Term Loans and other funds in 2014. That amount is included in the line item Collateral deposits on our Consolidated Balance Sheet as of December 31, 2014. The funds held as cash collateral related to the letters of credit are not available for use by us, and could be paid to the issuing bank for the letters of credit if the letters of credit are drawn upon. The fact that a significant amount of our cash is held in connection with the letters of credit could also negatively affect our ability to satisfy the financial metrics of the ED, SAs and ACs to which we are subject.

Pursuant to the CUSO RSA, we are required to maintain collateral to secure our guarantee obligation in an amount equal to a percentage of the outstanding balance of the private education loans disbursed to our students under the CUSO Program. As of December 31, 2014 and 2013, the total amount of this collateral was approximately \$8.6 million, and was included in the line item Collateral deposits on our Consolidated Balance Sheets. The funds held as cash collateral related to the CUSO RSA are not available for use by us, and could be withdrawn by the CUSO, in which case we would be required to deposit that amount of cash in the account to maintain the required level of collateral. The CUSO has notified us that it had taken control of the restricted account containing the cash collateral, as described further in Note 15 Commitments and Contingences of the Notes to Consolidated Financial Statements.

We also utilized a portion of the proceeds of the Term Loans and other funds to repay \$50.0 million of outstanding loans under the Amended Credit Agreement. See Note 12 Debt of the Notes to Consolidated Financial Statements, for a further discussion of the Term Loans and our use of those proceeds.

We are required to recognize the funded status of our defined benefit postretirement plans on our balance sheet. We recorded an asset of \$29.0 million for the ESI Pension Plan, a non-contributory defined benefit pension plan commonly referred to as a cash balance plan, and a liability of \$0.3 million for the ESI Excess Pension Plan, a nonqualified, unfunded retirement plan, on our Consolidated Balance Sheet as of December 31, 2014. In order to determine those amounts, we performed an actuarial valuation of the ESI Pension Plan and ESI Excess Pension Plan (the Pension Plans), and reviewed and updated our key assumptions as part of each valuation, including the discount rate and expected long-term rate of return on the investments.

Effective March 31, 2006, the benefit accruals under the Pension Plans were frozen, such that no further benefits accrue under those plans after March 31, 2006. Participants in the Pension Plans, however, continue to be credited with vesting service and interest according to the terms of the Pension Plans. Total net pension benefit in the year ended December 31, 2014 was \$4.6 million, compared to \$2.1 million in the year ended December 31, 2013 and \$0.2 million in the year ended December 31, 2012. In 2015, we do not expect that our total net pension benefit will be material.

We did not make any contributions to the Pension Plans in 2014 or 2013. We do not expect to make any material contributions to either of the Pension Plans in 2015.

See Note 14 Employee Benefit Plans of the Notes to Consolidated Financial Statements, for a more detailed discussion of the Pension Plans.

**Capital Resources.** Our cash flows are highly dependent upon the receipt of Title IV Program funds. The primary Title IV Programs from which the students at our campuses receive grants, loans and other aid to fund the cost of their education include:

the FDL program, which represented, in aggregate, approximately 57% of our cash receipts in 2014 and 58% of our cash receipts in 2013; and

the Pell program, which represented, in aggregate, approximately 24% of our cash receipts in 2014 and 24% of our cash receipts in 2013.

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We also receive funds on behalf of our students from state financial aid programs, veterans and military service member benefit programs and other sources, which represented, in aggregate, approximately 14% of our cash receipts in 2014 and approximately 13% in 2013.

Under a provision of the HEA commonly referred to as the 90/10 Rule, a proprietary institution, such as each of our institutions, must not derive more than 90% of its applicable revenue in a fiscal year, on a cash accounting basis, from Title IV Programs. If an institution exceeds the 90% threshold for any single fiscal year, that institution would be placed on provisional certification status for the institution's following two fiscal years. In addition, if an institution exceeds the 90% threshold for two consecutive fiscal years, it would be ineligible to participate in Title IV Programs as of the first day of the following fiscal year and would be unable to apply to regain its eligibility until the end of the second subsequent fiscal year. Payments that we made under the 2007 RSA impact the 90/10 Rule calculation by reducing the amount of cash receipts from sources other than Title IV Programs and total cash receipts. As a result of the PEAKS Consolidation and CUSO Consolidation, disbursements of the private education loans that we received under the PEAKS Program and CUSO Program are no longer considered cash proceeds from external sources for purposes of determining total cash receipts in the 90/10 Rule calculation. The amount of payments received by the PEAKS Trust and CUSO from borrowers is included, however, in both the total receipts component and the cash receipts from sources other than Title IV Programs component of the 90/10 Rule calculation.

In our 2014 and 2013 fiscal years, none of our institutions derived more than approximately 81% of its revenue from Title IV Programs under the 90/10 Rule calculation. In the aggregate, we derived approximately 80% of our revenue in 2014 and 82% of our revenue in 2013 from Title IV Programs under the 90/10 Rule calculation.

Federal regulations affect the timing of our receipt and disbursements of Title IV Program funds. These regulations require institutions to disburse all Title IV Program funds by payment period. For most of our campuses, the payment period is an academic term. Our campuses generally disburse the first installment of an FDL program loan to a first-year undergraduate student who was a first-time borrower 30 or more days after the student begins his or her education program. We disburse Title IV Program funds to other students enrolled in education programs ten days before the start of each academic term.

During the fourth quarter of 2012, we introduced an institutional scholarship program, called the Opportunity Scholarship, which is intended to help reduce the cost of an ITT Technical Institute education and increase student access to our programs of study. Beginning with the June 2013 academic quarter, the Opportunity Scholarship was being offered to students at all of the ITT Technical Institute campuses. As a result of our institutional scholarships and awards granted in 2014 and 2013, we received minimal cash payments from private education loan lenders related to our students' cost of education in 2014 and 2013.

As an institutional scholarship, in addition to us not receiving any cash payment when amounts are awarded under the Opportunity Scholarship, students are not obligated to make payments to us of amounts awarded under the Opportunity Scholarship and, therefore, the accounts receivable from students to us, as well as revenue, decreased in 2014 and 2013, as we began awarding the Opportunity Scholarship at all of our ITT Technical Institute campuses. The Opportunity Scholarships awarded in 2014 and 2013 and, to a lesser extent, other factors had the effect of reducing our Core Operations revenue per student by approximately 4.7% in 2014 compared to 2013.

**Operations.** Net cash flows from operating activities increased \$59.1 million to \$136.8 million in the year ended December 31, 2014 compared to \$77.7 million in the year ended December 31, 2013. The increase in net cash flows from operating activities was primarily due to the \$46.0 million payment that we made to settle the litigation and absolve us from any further obligations under the 2007 RSA in the year ended December 31, 2013 and lower income tax payments made during the year ended December 31, 2014 compared to the year ended December 31, 2013. The

increase was partially offset by a decrease in funds received as a result of lower total student enrollment.

Accounts receivable less allowance for doubtful accounts was \$46.4 million as of December 31, 2014 compared to \$99.5 million as of December 31, 2013. Days sales outstanding decreased 16.8 days to 17.5 days at December 31, 2014 compared to 34.3 days at December 31, 2013. Our accounts receivable balance and days sales outstanding at December 31, 2014 decreased primarily due to, in order of significance:

a decrease in internal student financing caused by an increase in the utilization of the Opportunity Scholarship by our students; and

a decrease in total student enrollment.

The amount of institutional scholarships and awards provided to our students increased 52.6% to \$261.2 million in 2014 compared to \$171.1 million in 2013.

In the year ended December 31, 2013, net cash flows from operating activities decreased \$29.9 million to \$77.7 million compared to \$107.6 million in the year ended December 31, 2012. The decrease in net cash flows from operating activities was primarily due to a decrease in funds received as a result of lower student enrollments and the \$46.0 million payment that we made to settle the litigation and absolve us from any further obligations under the 2007 RSA. The decrease was partially offset by lower income tax and compensation-related payments.



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**Investing.** Capital expenditures, including expenditures for facility renovation, expansion and construction, totaled \$6.1 million in 2014, \$5.2 million in 2013 and \$18.2 million in 2012. These expenditures consisted primarily of classroom and laboratory equipment (such as computers and electronic equipment), classroom and office furniture, software and leasehold improvements.

We also spent:

\$5.2 million to acquire certain assets of Ascolta in the year ended December 31, 2014; and

\$7.2 million to acquire Cable Holdings in the year ended December 31, 2013.

See Note 3 Acquisitions of the Notes to Consolidated Financial Statements, for a more detailed discussion of the Ascolta acquisition.

Cash generated from operations is expected to be sufficient to fund our capital expenditure requirements.

**Financing.** On December 4, 2014, we and certain of our subsidiaries entered into the Financing Agreement. Under the Financing Agreement, we received an aggregate principal amount of \$100.0 million under the Term Loans. A portion of the proceeds of the Term Loans and other funds were used by us on December 4, 2014 to provide approximately \$89.2 million in cash collateral for letters of credit outstanding for our account, which was in addition to the approximately \$0.1 million of cash collateral we had previously provided related to a letter of credit in September 2014. We also used a portion of the proceeds of the Term Loans and other funds to repay all outstanding borrowings, plus accrued interest and fees, owed by us under the Amended Credit Agreement in the amount of approximately \$50.4 million on December 4, 2014. A portion of the proceeds of the Term Loans, as well as other funds, were also used for payment of fees in connection with the Financing Agreement.

On March 21, 2012, we entered into the Amended Credit Agreement that provided for a \$325.0 million senior revolving credit facility. A portion of the borrowings under the Amended Credit Agreement was used to prepay the entire outstanding indebtedness under a prior credit agreement which was terminated on March 21, 2012. In addition to the prepayment of the outstanding indebtedness under the prior credit agreement, borrowings under the Amended Credit Agreement were used for general corporate purposes. The commitments of the lenders under the Amended Credit Agreement to make revolving loans, issue or participate in new letters of credit and to amend, renew or extend letters of credit outstanding were terminated effective December 4, 2014.

See Note 12 Debt of the Notes to Consolidated Financial Statements, for additional information regarding the Financing Agreement and the Amended Credit Agreement.

In January 2010, the PEAKS Trust issued PEAKS Senior Debt in the aggregate principal amount of \$300.0 million to investors. The PEAKS Trust utilized the proceeds from the issuance of the PEAKS Senior Debt and the Subordinated Note to purchase student loans from the lender. Beginning on February 28, 2013, we consolidated the PEAKS Trust in our consolidated financial statements. As a result, among other things, the PEAKS Senior Debt is recorded on our Consolidated Balance Sheets following that date.

See Note 8 Variable Interest Entities of the Notes to Consolidated Financial Statements, for a further discussion of the PEAKS Consolidation. See Note 12 Debt of the Notes to Consolidated Financial Statements, for a further discussion of the PEAKS Senior Debt.

Beginning on September 30, 2014, we consolidated the CUSO in our consolidated financial statements. As a result, among other things, the CUSO Secured Borrowing Obligation is recorded on our Consolidated Balance Sheets following that date. See Note 8 Variable Interest Entities of the Notes to Condensed Consolidated Financial Statements, for a further discussion of the CUSO Consolidation.

Based on our current projections, we believe that cash generated from operations will be sufficient for us to satisfy our CUSO RSA and PEAKS Guarantee payments, working capital, loan repayment and capital expenditure requirements over the 12-month period following the date that this Annual Report on Form 10-K was filed with the SEC. We also believe that any reduction in cash and cash equivalents that may result from their use to make payments under the CUSO RSA and PEAKS Guarantee or repay loans will not have a material adverse effect on our planned capital expenditures, ability to meet any applicable regulatory financial responsibility standards, ability to satisfy the financial covenants under the Financing Agreement or ability to conduct normal operations over the 12-month period following the date that this Annual Report on Form 10-K was filed with the SEC. Our projections, however, are estimates, which are based on numerous assumptions and, therefore, may not prove to be accurate or reliable and involve a number of risks and uncertainties.

***Student Financing Update.*** During the fourth quarter of 2012, we introduced an institutional scholarship program, called the Opportunity Scholarship, which is intended to help reduce the cost of an ITT Technical Institute education and increase student access to our programs of study. As of June 30, 2013, the Opportunity Scholarship was being offered to students at all of the ITT Technical Institute campuses. We believe that the Opportunity Scholarship has and will continue to reduce our students' need and use of private education loans, as well as decrease the internal student financing that we provide to our students. As an institutional scholarship, our revenue is reduced by the amount of the Opportunity Scholarship awarded. In addition, no cash payments are received and students will not be obligated to make payments to us of the amounts awarded under the Opportunity Scholarship. We believe that the amounts receivable from students to us has decreased, and will continue to decrease in future periods, as more students utilize the Opportunity Scholarship, instead of internal student financing.

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Our revenue decreased in the year ended December 31, 2014 compared to the prior year, primarily as a result of the increase in institutional scholarships and awards provided to our students. As a result of the increase in institutional scholarships and awards, our revenue decreased \$90.6 million in the year ended December 31, 2014 compared to the year ended December 31, 2013 and \$108.3 million in the year ended December 31, 2013 compared to the year ended December 31, 2012. We believe that the reduction in our Core Operations revenue per student in 2014 compared to 2013 was primarily attributable to the amount of institutional scholarships that we awarded in 2014 compared to 2013. The increase in institutional scholarships and awards in the year ended December 31, 2014 was primarily due to the introduction of the Opportunity Scholarship at the vast majority of the ITT Technical Institute campuses in the academic quarter that began in March 2013, and the expanded availability and increased utilization of the Opportunity Scholarship since its introduction.

In 2013 and 2012, we increased the amount of internal student financing that we provided to our students. The internal student financing that we provide to our students consists of non-interest bearing, unsecured credit extended to our students and is included in Accounts receivable, net on our Consolidated Balance Sheets. The increased amount of internal student financing that we previously provided to our students has also exposed us to greater credit risk. In addition, we have the risk of collection with respect to our internal student financing which contributed to an increase in our bad debt expense as a percentage of revenue. Bad debt expense as a percentage of revenue increased to 6.6% in the year ended December 31, 2014 compared to 6.3% in the year ended December 31, 2013.

The introduction and increased utilization of the Opportunity Scholarship has significantly decreased the need for us to provide internal student financing to our students. Days sales outstanding decreased 16.8 days to 17.5 days as of December 31, 2014, compared to 34.3 days at December 31, 2013. As of December 31, 2014, our accounts receivable less allowance for doubtful accounts decreased \$53.1 million, or 53.4%, to \$46.4 million compared to \$99.5 million as of December 31, 2013, primarily due to:

a decrease in internal student financing caused by an increase in the utilization of the Opportunity Scholarship by our students; and

a decrease in total student enrollment.

We plan to continue offering the Opportunity Scholarship and other scholarships which we believe will continue to reduce the amount of internal student financing that we provide to our students. The increased use of institutional scholarships and awards by our students and any additional internal student financing provided to our students could result in a continuation of the adverse factors that are described above, including a material adverse effect on our financial condition and cash flows.

**Contractual Obligations and Other Commercial Commitments**

The following table sets forth the specified contractual obligations and other commitments as of December 31, 2014:

|                                | Total | Payments Due by Period |           |           | More than 5 Years |
|--------------------------------|-------|------------------------|-----------|-----------|-------------------|
|                                |       | Less than 1 Year       | 1-3 Years | 3-5 Years |                   |
| <b>Contractual Obligations</b> |       |                        |           |           |                   |

|  | (In thousands)    |                   |                   |                   |                   |
|--|-------------------|-------------------|-------------------|-------------------|-------------------|
| Operating lease obligations                      | \$ 149,958        | \$ 41,207         | \$ 63,843         | \$ 36,764         | \$ 8,144          |
| Term Loans <sup>(a)</sup>                        | 123,178           | 19,291            | 103,887           | 0                 | 0                 |
| PEAKS Senior Debt <sup>(b)</sup>                 | 114,702           | 43,299            | 28,401            | 24,816            | 18,186            |
| CUSO Secured Borrowing Obligation <sup>(c)</sup> | 192,670           | 20,813            | 46,129            | 48,028            | 77,700            |
| <b>Total</b>                                     | <b>\$ 580,508</b> | <b>\$ 124,610</b> | <b>\$ 242,260</b> | <b>\$ 109,608</b> | <b>\$ 104,030</b> |
| <b>Other Commitments</b>                         |                   |                   |                   |                   |                   |
| Letters of credit fees <sup>(d)</sup>            | \$ 21,203         | \$ 2,815          | \$ 8,063          | \$ 10,325         | \$ 0              |

- (a) The Term Loans are our borrowings under the Financing Agreement. The amounts shown consist of the required quarterly principal payment amounts and quarterly administrative fees, as well as the required monthly interest payment amounts. It does not include any amounts that we may have to pay pursuant to the mandatory prepayment provision based on excess cash flow, as described in the Financing Agreement, because of the uncertainty of the amount of any excess cash flow. Interest payment amounts have been calculated based on their scheduled payment dates using the interest rate charged on our borrowings as of December 31, 2014. See Note 12 Debt of the Notes to Consolidated Financial Statements, for a further discussion of the Financing Agreement.
- (b) The PEAKS Senior Debt represents the PEAKS Senior Debt issued by the PEAKS Trust. Beginning on February 28, 2013, the PEAKS Trust was consolidated in our consolidated financial statements, and the PEAKS Senior Debt was included on our Consolidated Balance Sheet as of December 31, 2014. There is no separate liability recorded on our Consolidated Balance Sheet as of December 31, 2014 for the PEAKS Guarantee, because this liability was eliminated upon the PEAKS

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Consolidation. We do, however, have significant payment obligations under the PEAKS Guarantee, as further discussed in Note 15 Commitments and Contingencies of the Notes to Consolidated Financial Statements. The assets of the PEAKS Trust serve as collateral for, and are intended to be the principal source of, the repayment of the PEAKS Senior Debt. There are no scheduled principal repayment requirements for the PEAKS Senior Debt prior to the January 2020 maturity date. The amounts shown in the above table represent our estimate of the total PEAKS Senior Debt interest and principal payments that may be made by the PEAKS Trust in the periods indicated. We estimated the interest due on the PEAKS Senior Debt in each of the periods based on our estimate of the outstanding balance of the PEAKS Senior Debt during those periods. Interest payments have been calculated using the interest rate charged on the PEAKS Senior Debt as of December 31, 2014. We estimated the amount of PEAKS Senior Debt principal payments in each of the periods based on an estimate of the excess cash flows generated by the PEAKS Trust. Cash flows generated by the PEAKS Trust in any month that exceed the amounts needed to pay various administrative fees and expenses and the interest due on the PEAKS Senior Debt for the month must be applied to reduce the outstanding balance on the PEAKS Senior Debt. We also considered whether any payments would be required to be made under the PEAKS Guarantee in order to maintain the required Asset/Liability Ratio. Payments made under the PEAKS Guarantee to maintain the required Asset/Liability Ratio reduce the amount of the outstanding PEAKS Senior Debt and have been included as principal payments in the above table. In order to estimate the PEAKS Senior Debt interest and principal payments shown above, we made certain assumptions regarding the timing and amount of the cash flows generated by the PEAKS Trust. The cash flows of the PEAKS Trust are dependent on the performance of the PEAKS Trust Student Loans and, therefore, are subject to change. See Note 8 Variable Interest Entities, Note 12 Debt and Note 15 Commitments and Contingencies of the Notes to Consolidated Financial Statements, for a further discussion of the PEAKS Senior Debt and PEAKS Guarantee.

- (c) The CUSO Secured Borrowing Obligation represents the estimated amount owed by the CUSO to the CUSO Participants related to their participation interests in the CUSO Student Loans, which amount is expected to be paid to the CUSO Participants by the CUSO from payments received by the CUSO related to the CUSO Student Loans, whether from the borrower or from us under the CUSO RSA. Beginning on September 30, 2014, the CUSO was consolidated in our consolidated financial statements, and the CUSO Secured Borrowing Obligation was included on our Consolidated Balance Sheet as of December 31, 2014. There is no separate liability recorded on our Consolidated Balance Sheet as of December 31, 2014 for the CUSO RSA, because this liability was eliminated upon the CUSO Consolidation. The amounts shown in the table represent our estimate of the amount of the payments to be made to the CUSO Participants in the periods indicated. In order to estimate these payments, we made certain assumptions regarding the timing and amount of the repayment of the CUSO Student Loans and, therefore, are subject to change. See Note 8 Variable Interest Entities of the Notes to Consolidated Financial Statements, for a further discussion of the CUSO Secured Borrowing Obligation.
- (d) Represents the estimated amount of fees that we believe we will be required to pay in each of the periods shown related to the letters of credit issued for our account that were outstanding as of December 31, 2014. We estimated the amount of fees due on the letters of credit in each of the periods assuming that the letters of credit that were outstanding as of December 31, 2014 will remain outstanding in the same amount over the next five years, except for the ED Letter of Credit, which we assumed would remain outstanding until November 4, 2019. The estimated fee amounts have been calculated using the rates specified in the Amended Credit Agreement under which they were issued. See Note 12 Debt of the Notes to Consolidated Financial Statements, for a further discussion of these fees. As of December 31, 2014, the amount of the letters of credit that we had caused to be issued was \$82.1 million. The face amounts of the letters of credit are not included in the amounts shown in the table because they do not constitute a type of contractual obligation that is required to be disclosed in the table, and we cannot reasonably predict if or when the letters of credit may be drawn upon. In addition, we have provided cash collateral in the amount of approximately \$89.3 million related to the letters of credit. In the event that any of the letters of credit are drawn upon, the issuing bank would be able to access the related cash collateral to satisfy such draw. See Off-Balance Sheet Arrangements , below, for further discussion of the letters

of credit.

The table above does not reflect unrecognized tax benefits of \$24.9 million and accrued interest related to unrecognized tax benefits of \$6.1 million, because we cannot reasonably predict the timing of the resolution of the related tax positions. We believe it is reasonably possible that we could pay approximately \$1.0 million within the 12 months following December 31, 2014 to resolve certain income tax audits for which we have recorded an unrecognized tax benefit. See Note 13 Income Taxes of the Notes to Consolidated Financial Statements, for additional information on the unrecognized tax benefits as of December 31, 2014.

### **Off-Balance Sheet Arrangements**

As of December 31, 2014, we leased our non-owned facilities under operating lease agreements. A majority of the operating leases contain renewal options that can be exercised after the initial lease term. Renewal options are generally for periods of one to five years. All operating leases will expire over the next nine years and management believes that:

those leases will be renewed or replaced by other leases in the normal course of business;

we may purchase the facilities represented by those leases; or

we may purchase or build other replacement facilities.

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There are no material restrictions imposed by the lease agreements, and we have not entered into any significant guarantees related to the leases. We are required to make additional payments under the terms of certain operating leases for taxes, insurance and other operating expenses incurred during the operating lease period.

As part of our normal course of operations, one of our insurers issues surety bonds for us that are required by various education authorities that regulate us. We are obligated to reimburse our insurer for any of those surety bonds that are paid by the insurer. As of December 31, 2014, the total face amount of those surety bonds was approximately \$19.0 million.

We caused the ED Letter of Credit in the amount of \$79.7 million to be issued on October 31, 2014. As of December 31, 2014, the amount of the outstanding letters of credit that we have caused to be issued to the ED, our workers' compensation insurers and one of our state regulatory agencies was \$82.1 million. Pursuant to the Amended Credit Agreement, we were required to provide cash collateral in an amount equal to 109% of the face amount of the ED Letter of Credit and 103% of the face amount of all other letters of credit. As of December 31, 2014, approximately \$89.3 million of cash is maintained in a restricted bank account to satisfy those cash collateral requirements. This amount is included in the line item Collateral deposits on our Consolidated Balance Sheet as of December 31, 2014. See Note 12 Debt and Note 15 Commitments and Contingencies of the Notes to Consolidated Financial Statements, for a further discussion of the ED Letter of Credit.

Beginning on September 30, 2014, our consolidated financial statements include the CUSO. As a result, the assets and liabilities of the CUSO have been included on, and all intercompany transactions have been eliminated from, our Consolidated Balance Sheet as of December 31, 2014. While we no longer record a contingent liability for the CUSO RSA on our Consolidated Balance Sheet beginning September 30, 2014, our obligations under the CUSO RSA remain in effect. See Note 8 Variable Interest Entities and Note 15 Commitments and Contingencies of the Notes to Consolidated Financial Statements, for a further discussion of the CUSO Consolidation. See also Part I, Item 1A Risk Factors Risks Related to Recent Developments *The CUSO Consolidation could have a material adverse effect on our consolidated financial statements and our compliance with covenants and metrics to which we are subject.*

## **Critical Accounting Policies and Estimates**

We believe the following critical accounting policies affect our more significant estimates and judgments used in the preparation of our consolidated financial statements. These policies should be read in conjunction with Note 1 Business and Significant Accounting Policies of the Notes to Consolidated Financial Statements.

**Recognition of Revenue.** Tuition revenue is recorded on a straight-line basis over the length of the applicable course to the extent that we consider the collectability of that revenue to be reasonably assured. If a student withdraws from an institution, the standards of most SAs that regulate our institutions, the ACs and our own internal policy limit a student's obligation for tuition and fees to the institution depending on when a student withdraws during an academic term. The terms of the Refund Policies vary by state, and the limitations imposed by the Refund Policies are generally based on the portion of the academic term that has elapsed at the time the student withdraws. Generally, the greater the portion of the academic term that has elapsed at the time the student withdraws, the greater the student's obligation is to the institution for the tuition and fees related to that academic term. We record revenue net of any refunds that result from any applicable Refund Policy. On an individual student basis, tuition earned in excess of cash received is recorded as accounts receivable, and cash received in excess of tuition earned is recorded as deferred revenue.

We do not charge a separate fee for textbooks and certain equipment that students use in their education programs. We record the cost of these textbooks and equipment in prepaid expenses and other current assets and amortize the cost on a straight-line basis over the applicable course length. Tool kit sales, and the related cost, are recognized when the

student receives the tool kit. Academic fees (which are charged only one time to students on their first day of class attendance) are recognized as revenue on a straight-line basis over the average education program length. If a student withdraws from an institution, all unrecognized revenue relating to his or her fees, net of any refunds that result from any applicable Refund Policy, is recognized upon the student's departure. An administrative fee is charged to a student and recognized as revenue when the student withdraws or graduates from an education program at an institution. We reassess the collectability of tuition revenue on a student-by-student basis throughout our revenue recognition period. We reassess the collectability of tuition revenue that we may earn based on new information and changes in the facts and circumstances relevant to a student's ability to pay, which primarily include when a student withdraws from a program of study.

We derived approximately 97% of our revenue from tuition and approximately 3% from tool kit sales and student fees in the year ended December 31, 2014, and approximately 98% from tuition and approximately 2% from tool kit sales and student fees in each of the years ended December 31, 2013 and 2012. The amount of tuition earned depends on:

the cost per credit hour of the courses in our education programs;

the length of a student's enrollment;

the number of courses a student takes during each period of enrollment; and

the total number of students enrolled in our education programs.

Each of these factors is known at the time our tuition revenue is calculated.



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Since the academic quarter that began in March 2013, we have significantly increased the amount of institutional scholarships and awards that we offer to our institutions' students and which those students use to help reduce their educational expenses. Institutional scholarships and awards reduce the students' tuition charges and are recorded as offsets to revenue. In the year ended December 31, 2014, institutional scholarships and awards amounted to, in aggregate, approximately \$261.2 million, compared to approximately \$171.1 million in the year ended December 31, 2013.

Interest income on the Private Education Loans, which is the accretion of the accretable yield on the Private Education Loans, is included in revenue in our Consolidated Statements of Operations and recognized based on the effective interest method, as described in Note 9 Private Education Loans of the Notes to Consolidated Financial Statements.

**Equity-Based Compensation.** In accordance with ASC 718, Compensation Stock Compensation ( ASC 718 ), the value of our equity instruments exchanged for employee and director services is measured at the date of grant, based on the calculated fair value of the grant, and is recognized as an expense over the period of time that the grantee must provide services to us before the stock-based compensation is fully vested. The vesting period is generally the period set forth in the agreement granting the stock-based compensation. Under the terms of our stock-based compensation plans, some grants immediately vest in full when the grantee's employment or service terminates for death or disability. As a result, in certain circumstances, the period of time that the grantee provides services to us in order for that stock-based compensation to fully vest may be less than the vesting period set forth in the agreement granting the stock-based compensation. In these instances, compensation expense will be recognized over this shorter period. We recognize stock-based compensation expense on a straight-line basis over the service period applicable to the grantee.

We use a binomial option pricing model to determine the fair value of stock options granted, and we use the market price of our common stock to determine the fair value of restricted stock units ( RSUs ) granted. Various assumptions are used in the binomial option pricing model to determine the fair value of the stock options. These assumptions are discussed in Note 1 Business and Significant Accounting Policies of the Notes to Consolidated Financial Statements.

The following table sets forth the stock-based compensation expense, including its components, and related income tax benefit recognized in our Consolidated Statements of Operations in the periods indicated:

|   | <b>Year Ended December 31,</b> |                  |                  |
|---|--------------------------------|------------------|------------------|
|   | <b>2014</b>                    | <b>2013</b>      | <b>2012</b>      |
|   | <b>(In thousands)</b>          |                  |                  |
| Cost of education services                    | \$ 4,790                       | \$ 4,799         | \$ 6,084         |
| Student services and administrative expense   | 5,546                          | 6,839            | 10,574           |
| <b>Total stock-based compensation expense</b> | <b>\$ 10,336</b>               | <b>\$ 11,638</b> | <b>\$ 16,658</b> |
| Income tax (benefit)                          | (3,980)                        | (4,481)          | (6,414)          |
|   | <b>\$ 6,356</b>                | <b>\$ 7,157</b>  | <b>\$ 10,244</b> |

As of December 31, 2014, we estimated that pre-tax compensation expense for unvested stock-based compensation grants in the amount of approximately \$9.0 million, net of estimated forfeitures, will be recognized in future periods. We expect to recognize this expense over the remaining service period applicable to the grantees which, on a weighted average basis, is approximately two years.

See also Note 1 Business and Significant Accounting Policies and Note 6 Equity Compensation Plans of the Notes to Consolidated Financial Statements, for a discussion of stock-based compensation.

**Income Taxes.** We follow ASC 740, Income Taxes (ASC 740), which prescribes a single, comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. This guidance requires us to evaluate whether it is more likely than not, based on the technical merits of a tax position, that the benefits resulting from the position will be realized by us.

**Accounts Receivable and Allowance for Doubtful Accounts.** We extend unsecured credit to our institutions' students for tuition and fees, and we record a receivable for the tuition and fees earned in excess of the payment received from or on behalf of a student. The individual student balances of these receivables are insignificant. We record an allowance for doubtful accounts with respect to accounts receivable based on the students' credit profiles and our historical collection experience related to amounts owed by our students with similar credit profiles. If our collection trends were to differ significantly from our historical collection experience, we would make a corresponding adjustment to our allowance for doubtful accounts.

When a student is no longer enrolled in an education program at one of our campuses, we increase the allowance for doubtful accounts related to the former student's receivable balance to reflect the amount we estimate will not be collected. The amount that we estimate will not be collected is based on a review of the historical collection experience for each campus, adjusted as needed to reflect other facts and circumstances. We review the collection activity after a student withdraws or graduates from an education program and will write off the accounts receivable, if we conclude that collection of the balance is not probable.

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**Private Education Loans.** We consolidate two VIEs that purchased, own and collect private education loans made to our students in our consolidated financial statements. Beginning on February 28, 2013, we consolidated the PEAKS Trust in our consolidated financial statements, and beginning on September 30, 2014, we consolidated the CUSO in our consolidated financial statements.

Certain of the Private Education Loans had evidence of credit deterioration since the date those loans were originated and, therefore, we determined that, at the date of the PEAKS Consolidation and the CUSO Consolidation, it was probable that all contractually required payments under the applicable loans would not be collected. We recorded those loans at fair value at the date of the PEAKS Consolidation and the CUSO Consolidation, as applicable. We also recorded at fair value the Private Education Loans that did not individually have evidence of deteriorated credit quality at the date of the PEAKS Consolidation and the CUSO Consolidation, because we determined that the application of an expected cash flow model provided the most reasonable presentation and this accounting treatment was consistent with the American Institute of Certified Public Accountants (the AICPA) December 18, 2009 Confirmation Letter (the Confirmation Letter). No allowance for loan losses was recorded at the date of the PEAKS Consolidation or the CUSO Consolidation, because all of the Private Education Loans were recorded at fair value and future credit losses are considered in the estimate of fair value. Cash flows from the Private Education Loans expected to be collected within the 12 month period after December 31, 2014 have been classified as current on our Consolidated Balance Sheet. The remaining balance is classified as non-current.

As of the date of the applicable Consolidation, we aggregated the PEAKS Trust Student Loans into 24 separate pools of loans and the CUSO Student Loans into 48 separate pools of loans, based on common risk characteristics of the loans, which included:

the fiscal quarter in which the Private Education Loan was purchased by the PEAKS Trust or the CUSO; and

the consumer credit score of the borrower.

Loans that did not have evidence of deteriorated credit quality were not aggregated in the same pools with loans that had evidence of deteriorated credit quality. The same aggregation criteria, however, were used to determine those loan pools. Each loan pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows.

On a quarterly basis subsequent to the PEAKS Consolidation and the CUSO Consolidation, as applicable, we estimate the total principal and interest expected to be collected over the remaining life of each loan pool. These estimates include assumptions regarding default rates, forbearances and other factors that reflect then-current market conditions. Prepayments of loans were not considered when estimating the expected cash flows, because, historically, few Private Education Loans have been prepaid.

If a decrease in the expected cash flows of a loan pool is probable and would cause the expected cash flows to be less than the expected cash flows at the end of the previous fiscal quarter, we would record the impairment as:

a provision for private education loan losses in our Consolidated Statement of Operations; and

an increase in the allowance for loan losses on our Consolidated Balance Sheet.

The provision for private education loan losses represents the increase in the allowance for loan losses that occurred during the period. The allowance for loan losses is the difference between the carrying value and the total present value of the expected principal and interest collections of each loan pool, discounted by the loan pool's effective interest rate at the end of the previous fiscal quarter. If a significant increase in the expected cash flows of a loan pool is probable and would cause the expected cash flows to be greater than the expected cash flows at the end of the previous fiscal quarter, we would:

first reverse any allowance for loan losses with respect to that loan pool that was previously recorded on our Consolidated Balance Sheet, up to the amount of that allowance; and

record any remaining increase prospectively as a yield adjustment over the remaining estimated lives of the loans in the loan pool.

The impact of prepayments, changes in variable interest rates and any other changes in the timing of the expected cash flows of a loan pool are recognized prospectively as adjustments to interest income.

The impact of modifications made to loans in a loan pool is incorporated into our quarterly assessment of whether a significant change in the expected cash flows of the loan pool is probable or has occurred. We consider the historical loss experience associated with the Private Education Loans in estimating the future probabilities of default for all of the outstanding Private Education Loans.

The excess of any cash flows expected to be collected with respect to a loan pool of the Private Education Loans over the carrying value of the loan pool is referred to as the accretable yield. The accretable yield is not reported on our Consolidated Balance Sheets, but it is accreted and included as interest income at a level rate of return over the remaining estimated life of the loan pool. If we determine that the timing and/or amounts of expected cash flows with respect to a loan pool are not reasonably estimable, no interest income would be accreted and the loans in that loan pool would be reported as nonaccrual loans. We recognize the accretable yield of the Private Education Loans as interest income, because the timing and the amounts of the expected cash flows are reasonably estimable.

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If a Private Education Loan is paid in full or charged-off, that loan is removed from the loan pool. If the amount of the proceeds received for that loan, if any, is less than the unpaid principal balance of the loan, the difference is first applied against the loan pool's nonaccretable difference for principal losses (i.e., the lifetime credit loss estimate established at the date of the related Consolidation). If the nonaccretable difference for principal losses with respect to a loan pool has been fully depleted, any unpaid loan principal balance in excess of the proceeds received for the loan is charged-off against the loan pool's allowance for loan losses. We do not recognize charge-offs of individual Private Education Loans when those loans reach certain stages of delinquency, because those loans are accounted for at a loan pool level.

If any portion of a Private Education Loan that had previously been charged-off is recovered, the amount collected increases the applicable loan pool's nonaccretable difference. If the nonaccretable difference with respect to the applicable loan pool has been fully depleted, the amount collected increases that loan pool's allowance for loan losses.

**Fair Value.** ASC 820, Fair Value Measurements (ASC 820), defines fair value for financial reporting as the price that would be received upon the sale of an asset or paid upon the transfer of a liability in an orderly transaction between market participants at the measurement date. The fair value measurement of our financial assets utilized assumptions categorized as observable inputs under ASC 820. Observable inputs are assumptions based on independent market data sources.

The following table sets forth information regarding the recurring fair value measurement of our financial assets as of December 31, 2014:

| Description          | Fair Value Measurements at Reporting Date Using |   |  |  |
|----------------------|---|---|--|--|
|                      | As of December 31, 2014                         | (Level 1)<br>Quoted Prices in Active Markets for Identical Assets | (Level 2)<br>Significant Other Observable Inputs | (Level 3)<br>Significant Unobservable Inputs |
|                      | (In thousands)                                  |   |  |  |
| Cash equivalents:    |   |   |  |  |
| Money market fund    | \$ 60,960                                       | \$ 60,960   | \$ 0   | \$ 0   |
| Restricted cash:     |   |   |  |  |
| Money market fund    | 1,967   | 1,967   | 0  | 0  |
| Collateral deposits: |   |   |  |  |
| Money market fund    | 8,628   | 8,628   | 0  | 0  |
|                      | \$ 71,555                                       | \$ 71,555   | \$ 0   | \$ 0   |

We used quoted prices in active markets for identical assets as of the measurement date to value our financial assets that were categorized as Level 1.

**Property and Equipment.** We include all property and equipment in the financial statements at cost and make provisions for depreciation of property and equipment using the straight-line method. The following table sets forth the general ranges of the estimated useful lives of our property and equipment:

| <b>Type of Property and Equipment</b>     | <b>Estimated Useful Life</b> |
|---|------------------------------|
| Furniture and equipment                   | 3 to 10 years                |
| Leasehold, building and land improvements | 3 to 14 years                |
| Buildings                                 | 20 to 40 years               |

Changes in circumstances, such as changes in our curricula and technological advances, may result in the actual useful lives of our property and equipment differing from our estimates. We regularly review and evaluate the estimated useful lives of our property and equipment. Although we believe that our assumptions and estimates are reasonable, deviations from our assumptions and estimates could produce a materially different result.

**Long-Lived Assets.** We regularly review our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable. If we determine that the carrying value of the long-lived asset exceeds its fair market value, we recognize an impairment loss equal to the difference. We base our impairment analyses of long-lived assets on our current business strategy, expected growth rates and estimates of future economic and regulatory conditions. We evaluate each note receivable individually for impairment. We consider a note receivable to be impaired when it is probable that we will be unable to collect all amounts of principal and interest owed to us under the terms of the underlying note. If the present value of the expected future cash flows from the note receivable is less than the carrying value of the note receivable, we recognize an impairment loss in the amount of the difference.

**Goodwill and Other Indefinite-Lived Intangible Assets.** Goodwill and certain other intangible assets (primarily trademarks) are not amortized, because there are no legal, regulatory, contractual, economic or other factors that limit the useful life of those intangible assets. Intangible assets that are not amortized (indefinite-lived intangible assets) are subject to evaluation for impairment.

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We perform this evaluation annually, during the fourth quarter, or more frequently if facts and circumstances warrant. These facts and circumstances may include a significant long-term decrease in our market capitalization based on events specific to our operations, as well as deteriorating operating results and current period and projected future operating results that negatively differ from the operating plans used in the most recent impairment analysis. We also consider changes in the accreditation, regulatory or legal environment, increased competition; innovation changes and changes in the market acceptance of our educational programs and the graduates of those programs, among other factors, when determining whether an interim impairment analysis is warranted.

We assess whether goodwill or other indefinite-lived intangible assets may be impaired by determining the estimated fair value of the reporting unit and comparing that value to the carrying value of the reporting unit. If the carrying value of the reporting unit exceeds the estimated fair value of the reporting unit, we allocate the estimated fair value of the reporting unit to the assets (including intangible assets) and liabilities of the reporting unit, with the residual representing the implied fair value of goodwill. We recognize an impairment loss if, and to the extent that, the carrying value of the goodwill or other indefinite-lived intangible asset exceeds its estimated fair value.

***Contingent Liabilities.*** We are subject to various claims and contingencies, including those related to litigation, government investigations, business transactions, guarantee obligations and employee-related matters, among others. When we are aware of a claim or potential claim, we assess the likelihood of any loss or exposure. If it is probable that a loss will result and the amount of the loss can be reasonably estimated, we record a liability for the loss. The liability recorded includes probable and estimable legal costs associated with the claim or potential claim. If the loss is not probable or the amount of the loss cannot be reasonably estimated, we disclose the claim if the likelihood of a potential loss is reasonably possible and the amount involved is material.

Prior to the CUSO Consolidation, we determined the amount of our contingent liability for our guarantee obligations related to the CUSO Program by estimating the expected payments to be made by us under the guarantee and the amount that we expected to be repaid to us. We also considered the payment options available to us. To the extent that we projected that we would have sufficient funds available to pay the full amount of the outstanding balance of those private education loans that have been charged off at the time that they default to satisfy our guarantee obligations, we incorporated that assumption into our estimate of the contingent liability. If we did not believe that we would have sufficient funds available, we assumed that we would make monthly payments to satisfy our guarantee obligations related to the CUSO Program. We discounted the amount of those expected future monthly payments at a risk-free rate of interest. Making payments for the full amount of the charged-off loans at the time that they default results in us paying a lesser amount than we otherwise would have been required to pay under our guarantee obligations in future periods and, therefore, results in an estimated contingent liability that is less than if we had assumed we would make monthly payments in the future.

The difference between the amount of the guarantee payments that we expected to make and the amount that we expected would be repaid to us, each discounted at a risk-free rate of interest, as applicable, was included in our estimate of the amount of our contingent liability related to our guarantee obligations under the CUSO Program prior to the date of the CUSO Consolidation. Beginning on September 30, 2014, we no longer record a contingent liability related to the CUSO Program on our Consolidated Balance Sheet because the contingent liability was eliminated upon the CUSO Consolidation.

***PEAKS Senior Debt.*** In accordance with ASC 810, we included the PEAKS Senior Debt on our consolidated balance sheet at its fair value as of February 28, 2013, the date of the PEAKS Consolidation. The difference between the fair value of the PEAKS Senior Debt and its outstanding aggregate principal balance at the date of the PEAKS Consolidation was recorded as an accrued discount on our consolidated balance sheet at the date of the PEAKS Consolidation. The accrued discount is being recognized in interest expense at a level rate of return over the life of the

PEAKS Senior Debt.

**CUSO Secured Borrowing Obligation.** The CUSO Participants purchased participation interests in the CUSO Student Loans from the CUSO. The terms of the agreements between the CUSO Participants and the CUSO did not meet the requirements under ASC 860, Transfers and Servicing (ASC 860), to be considered a sale. As a result, the CUSO was required to record a liability (the CUSO Secured Borrowing Obligation) on its balance sheet for the cash received from the CUSO Participants. The CUSO Secured Borrowing Obligation represents the estimated amount that the CUSO owes to the CUSO Participants related to their participation interests in the CUSO Student Loans, which amount is expected to be paid to the CUSO Participants by the CUSO from payments received by the CUSO related to the CUSO Student Loans, whether from the borrower or from us under the CUSO RSA.

In accordance with ASC 810, we included the CUSO Secured Borrowing Obligation on our consolidated balance sheet at its fair value as of September 30, 2014, the date of the CUSO Consolidation. The difference between the estimated fair value of the CUSO Secured Borrowing Obligation and the amount expected to be paid by the CUSO to the CUSO Participants was recorded as an accrued discount on our consolidated balance sheet at the date of the CUSO Consolidation. The accrued discount is being recognized in interest expense at a level rate of return over the expected life of the CUSO Secured Borrowing Obligation.

The expected life of the CUSO Secured Borrowing Obligation is an estimate of the period of time over which payments are expected to be made by the CUSO to the CUSO Participants related to their participation interests in the CUSO Student Loans. The period of time over which payments are expected to be made by the CUSO to the CUSO Participants is based on when the CUSO Student Loans enter a repayment status and the period of time they remain in a repayment status. Since all of the CUSO Student Loans have not entered repayment, and those loans that have entered repayment may be granted forbearances or deferments, the



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period of time over which payments are expected to be made to the CUSO Participants is an estimate. The assumptions used to estimate the expected life of the CUSO Secured Borrowing Obligation are reviewed periodically and updated accordingly, which may result in an adjustment to the expected life of the CUSO Secured Borrowing Obligation and the related recognized interest expense.

## **New Accounting Guidance**

For a discussion of applicable new accounting guidance, see Note 2 New Accounting Guidance of the Notes to Consolidated Financial Statements.

## **Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

In the normal course of our business, we are subject to fluctuations in interest rates that could impact the cost of our financing activities and guarantee obligations. Our primary interest rate risk exposure results from changes in short-term interest rates, the LIBOR and the U.S. prime rate.

Changes in the LIBOR would affect the borrowing costs associated with the Amended Credit Agreement, Financing Agreement and the PEAKS Senior Debt. Changes in the U.S. prime rate would affect the interest cost of the Private Education Loans. We estimate that the market risk can best be measured by a hypothetical 100 basis point increase in the LIBOR or U.S. prime rate. If such a hypothetical increase in the LIBOR or U.S. prime rate were to occur, the effect on our results from operations and cash flows would not have been material for the year ended December 31, 2014.

## **Item 8. Financial Statements and Supplementary Data.**

The information required by this Item appears on pages F-1 through F-62 of this Annual Report.

## **Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.**

Not applicable

## **Item 9A. Controls and Procedures.**

### ***Evaluation of Disclosure Controls and Procedures***

We are responsible for establishing and maintaining disclosure controls and procedures ( DCP ) that are designed to ensure that information required to be disclosed by us in the reports filed by us under the Exchange Act is: (a) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms; and (b) accumulated and communicated to our management, including our principal executive and principal financial officers, to allow timely decisions regarding required disclosures. In designing and evaluating our DCP, we recognize that any controls and procedures, no matter how well designed and implemented, can provide only reasonable assurance of achieving the desired control objectives.

We conducted an evaluation pursuant to Rule 13a-15 of the Exchange Act of the effectiveness of the design and operation of our DCP as of December 31, 2014. This evaluation was conducted under the supervision (and with the participation) of our management, including our Chief Executive Officer and Chief Financial Officer. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our DCP were not effective at the reasonable assurance level as of December 31, 2014, because of material weaknesses (collectively, the Material Weaknesses ) in our ICFR described in Management's Report on Internal Control Over Financial Reporting included in this filing. Notwithstanding the Material Weaknesses, our management, based on the substantial work performed, concluded that our consolidated financial statements for the periods covered by and included in this Annual Report on Form 10-K are fairly stated in all material respects in accordance with GAAP for each of the periods presented in this Annual Report on Form 10-K.

### ***Management's Plan for Remediation***

Our management and Board of Directors are committed to the remediation of the Material Weaknesses, as well as the continued improvement of our overall system of ICFR. We are in the process of implementing measures to remediate the underlying causes of the control deficiencies that gave rise to the Material Weaknesses, which primarily include:

engaging a third-party consultant to assist us in our review and testing of the private education loan data that we receive from the servicer;

separating responsibilities related to information system access;

enhancing the level of the precision of the review controls related to our financial close and reporting process, our income tax reporting process, and our accounting for leasehold improvements; and

engaging supplemental internal and external resources.

We believe these measures will remediate the control deficiencies. While we have completed some of these measures as of the date of this report, we have not completed all of the corrective processes, procedures and related evaluation or remediation that we believe are necessary to determine whether the Material Weaknesses have been remediated. Therefore, the Material Weaknesses have not been remediated as of the date of this report. As we continue to evaluate and work to remediate the control deficiencies that gave rise to the Material Weaknesses, we may determine that additional measures are required to address the control deficiencies.

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We are committed to maintaining a strong internal control environment, and believe that these remediation actions will represent improvements in our ICFR when they are fully implemented. Certain remediation steps, however, have not been implemented or have not had sufficient time to be fully integrated in the operations of our ICFR. As a result, the identified Material Weaknesses will not be considered remediated, until controls have been designed and/or controls are in operation for a sufficient period of time for our management to conclude that the control environment is operating effectively. Additional remediation measures may be required, which may require additional implementation time. We will continue to assess the effectiveness of our remediation efforts in connection with our evaluation of our ICFR and DCP.

As we continue to evaluate and work to remediate the Material Weaknesses and enhance our ICFR and DCP, we may determine that we need to modify or otherwise adjust the remediation measures described above. As a result, we cannot assure you that our remediation efforts will be successful or that our ICFR or DCP will be effective as a result of those efforts.

### ***Prior Material Weaknesses and Remediation Measures***

We disclosed in Management's Report on Internal Control Over Financial Reporting of our Annual Report on Form 10-K for the fiscal year ended December 31, 2013, that there were matters that constituted material weaknesses in our ICFR (the 2013 Material Weaknesses). Specifically, we did not maintain effective internal controls related to:

the assessment of events that could affect the determination of whether we are the primary beneficiary of VIEs in which we hold a variable interest;

the assessment of the completeness and accuracy of the data maintained by the servicer of the private education loans that are owned by a variable interest entity that we were required to consolidate;

the review of assumptions and methodologies developed by third-party consultants to project guarantee obligations under the CUSO RSA; and

the timely identification and communication of information relevant to the private education loan programs to those members of our management who are responsible for our financial reporting processes.

We committed to remediating the control deficiencies that constituted the 2013 Material Weaknesses by implementing changes to our ICFR. In 2014, we implemented measures to remediate the underlying causes of the control deficiencies that gave rise to the 2013 Material Weaknesses, including, without limitation:

establishing new roles in executive management and financial reporting;

implementing additional oversight and review;

engaging additional third-party consultants to assist with assessing the data received from the servicer of private education loans for the purpose of valuation of the loans and related obligations;

engaging a third-party consultant to assist us in compiling and reviewing the financial reporting related to the VIEs that we consolidate; and

establishing more formalized communications for matters related to the private education loan programs.

Our management concluded that the remedial measures were sufficient to remediate all but the deficiency related to the data maintained by the servicer of the private education loans. Because certain of the corrective actions specific to this deficiency have not been fully implemented as of the date of this report, this deficiency was not considered to be fully remediated as of December 31, 2014.

We continue to maintain appropriate focus on these critical accounting areas and believe that the measures that we have implemented have remediated the identified control deficiencies that constituted three of the four 2013 Material Weaknesses and have strengthened our ICFR.

***Changes in Internal Control Over Financial Reporting***

In addition to the changes noted above, we have evaluated the changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2014, and have concluded that the following changes to our ICFR that occurred during the quarter ended December 31, 2014 have materially affected, or are reasonably likely to materially affect, our ICFR:

establishing new roles in executive management and financial reporting;

implementing additional oversight and review;

engaging additional third-party consultants to assist with assessing the data received from the servicer of private education loans for the purpose of valuation of the loans and related obligations;

engaging a third-party consultant to assist us in compiling and reviewing the financial reporting related to the VIEs that we consolidate; and

establishing more formalized communications for matters related to the private education loan programs.

***Management's Annual Report on Internal Control over Financial Reporting.*** Our management's report on internal control over financial reporting appears on page F-1 of this Annual Report and is incorporated herein by reference.

The effectiveness of our ICFR as of December 31, 2014 has been audited by Deloitte & Touche LLP ( *Deloitte* ), our independent registered public accounting firm, based on the criteria established in the *Internal Control Integrated Framework* (1992) issued by The Committee of Sponsoring Organizations of the Treadway Commission, as stated in its report dated May 29, 2015, which appears on page F-3 of this Annual Report and is incorporated herein by reference.

**Item 9B. Other Information.**

***Impairment Charge***

In the year ended December 31, 2014, we recorded an impairment charge of \$2.0 million for the impairment of goodwill associated with the acquisitions of Cable Holdings and the Ascolta business, and an impairment charge of \$0.4 million for the impairment of the trademark associated with the acquisition of Daniel Webster College. See Note 11 Goodwill and Other Intangibles to our Notes to Consolidated Financial Statements, for a further discussion of the impairment charges.

***Amendment to Financing Agreement***

On May 26, 2015, we entered into the FA Consent with Cerberus, as collateral agent and administrative agent, and the lenders party thereto. Pursuant to the FA Consent, Cerberus and the lenders under the Financing Agreement consent to an extension to June 15, 2015 of the deadline by which we are required to deliver to them the financial statements, projections and compliance certificate required under Sections 7.01(a)(ii) and 7.02(a)(iv) of the Financing Agreement

for our fiscal quarter ended March 31, 2015. The foregoing description of the FA Consent is qualified in its entirety by reference to the FA Consent, a copy of which is filed herewith as Exhibit 10.46 and is incorporated herein by reference.

*Amendment to CEO Letter Agreement*

On May 26, 2015, we and Kevin M. Modany, our Chief Executive Officer, entered into a second amendment (the Second Amendment ) to the letter agreement between Mr. Modany and us dated August 4, 2014 (as amended, the Modany Letter Agreement ). Pursuant to the Second Amendment, the parties agreed to extend the Applicable Period (as provided for and defined in the Modany Letter Agreement) to August 31, 2015. The foregoing description of the Second Amendment is qualified in its entirety by reference to the Second Amendment, a copy of which is filed herewith Exhibit 10.69 and is incorporated herein by reference.

*2015 Annual Meeting of Shareholders*

Our Board of Directors has established July 27, 2015 as the new date of our 2015 Annual Meeting of Shareholders (the 2015 Annual Meeting ). Because the date of the 2015 Annual Meeting has been changed by more than 30 days from the anniversary of the 2014 Annual Meeting of Shareholders, a different deadline applies for submission of proposals by shareholders intended to be included in our 2015 proxy statement and form of proxy. Shareholders who wish to have a proposal considered for inclusion in our proxy materials for the 2015 Annual Meeting pursuant to Rule 14a-8 under the Exchange Act, must ensure that such proposal is received by our Secretary, Ryan L. Roney, at 13000 N. Meridian Street, Carmel, Indiana 46032 on or before the close of business on June 8, 2015, which we have determined to be a reasonable time before we expect to begin to print and send our proxy materials. Any such proposal must also meet the requirements set forth in the rules and regulations of the SEC in order to be eligible for inclusion in the proxy materials for the 2015 Annual Meeting. The June 8, 2015 deadline will also apply in determining whether notice of a shareholder proposal is timely for purposes of exercising discretionary voting authority with respect to proxies under Rule 14a-4(c) of the Exchange Act.

In addition, in accordance with the requirements contained in our By-Laws, shareholders who wish to bring business before the 2015 Annual Meeting outside of Rule 14a-8 of the Exchange Act or to nominate a person for election as a director must ensure that written notice of such proposal (including all of the information specified in our By-Laws) is received by our Secretary, Ryan L. Roney, at the address specified above no later than the close of business on June 8, 2015. Any such proposal must meet the requirements set forth in our By-Laws in order to be brought before the 2015 Annual Meeting.

### **PART III**

#### **Item 10. Directors, Executive Officers and Corporate Governance.**

##### **Directors and Executive Officers**

The following is the biographical information with respect to our directors and our executive officers as of May 20, 2015. Unless otherwise specified, the occupation of each individual has been the same for the past five years.

C. David Brown, age 63, has been Chairman of Broad and Cassel, a law firm based in Florida, since March 2000. From 1989 until March 2000, he was Managing Partner of the Orlando office of the firm. Mr. Brown joined the firm in 1980. Mr. Brown is the immediate past Chairman of the Board of Trustees for the University of Florida. Mr. Brown is also a member of the board of directors of CVS Health Corporation, Rayonier Advanced Materials Inc., a leading specialty cellulose production company, and Orlando Health, a major health care provider serving Florida. During the past five years, he was also a director of Rayonier, Inc. Mr. Brown has been a director of ours since April 2015.

Jerry M. Cohen, age 63, retired as a senior partner of Deloitte in June 2014. Mr. Cohen joined Deloitte in 1973, and served for over 40 years with that firm, providing business advisory and audit services to a wide range of global organizations, including small,

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mid and large cap multinational public companies. Mr. Cohen worked with corporate boards of directors to develop, enhance and support corporate strategy and functioned as an advisor to senior executives and members of boards of directors. During his career, Mr. Cohen also served in a wide variety of strategic and leadership roles at Deloitte, including: managing partner, Philadelphia office; member of the Mid-Atlantic Executive Committee; regional managing partner Assurance and Advisory Operations, Midwest; member of the Assurance and Advisory Management Committee; and member of the Assurance and Advisory Partner Evaluation and Compensation Committee. Mr. Cohen has been a Director of ours since September 2014.

John F. Cozzi, age 53, has served as a partner of AEA Investors LP, a private equity firm, since January 2004. Mr. Cozzi has been a Director of ours since October 2003.

John E. Dean, age 64, has served as our Executive Chairman since August 4, 2014. Mr. Dean is an attorney who has specialized in higher education law since April 1985. Mr. Dean has been a partner at the Law Offices of John E. Dean since June 2005. Mr. Dean has also served as a principal of Washington Partners, LLC, a public affairs firm, since June 2002. Mr. Dean has been a Director of ours since December 1994.

James D. Fowler, Jr., age 71, served as senior vice president and director, human resources of ITT Industries, Inc., an industrial, commercial machinery and equipment company, from November 2000 until his retirement in October 2002. Mr. Fowler has been a Director of ours since April 1994.

Joanna T. Lau, age 56, has served as chairperson and chief executive officer of Lau Acquisition Corporation (doing business as LAU Technologies), a management consulting and investment firm, since March 1990. She is also a director of DSW Inc. Ms. Lau has been a Director of ours since October 2003.

Thomas I. Morgan, age 61, served as chairman of Baker & Taylor, Inc. ( B&T ), a distributor of physical and digital books, entertainment products and value-added services, from July 2008 until January 2014. He served as chief executive officer of B&T from July 2008 through January 2013. Prior to that, Mr. Morgan served as chief executive officer of Hughes Supply, Inc., a diversified wholesale distributor of construction, repair and maintenance-related products, from May 2003 until his retirement in March 2006. Mr. Morgan is also a director of Rayonier Advanced Materials, Inc. and Tech Data Corporation. During the past five years, Mr. Morgan was also a director of Rayonier, Inc. Mr. Morgan previously served as a Director of ours from May 2006 to June 2008, and currently has served as a Director of ours since January 2013.

Samuel L. Odle, age 65, has been a senior policy advisor for Bose Public Affairs Group, a public affairs consulting firm, since October 2012. He has also acted as a consultant, primarily in the healthcare and life sciences fields, since July 2012. Prior to that, he served as president and chief executive officer of Methodist Hospital ( MH ) and Indiana University Hospital ( IUH ) and executive vice president of Indiana University Health (formerly Clarian Health Partners) ( IU Health ), an Indianapolis-based private, non-profit healthcare organization comprised of MH, IUH and Riley Hospital for Children, since July 2004. Mr. Odle has been a Director of ours since January 2006.

Vin Weber, age 62, has served as co-chairman and partner of Mercury Public Affairs LLC (doing business as Mercury), a public affairs and lobbying firm, since October 2011. Mr. Weber was a partner at Clark & Weinstock Inc. ( C&W ) from 1994 until October 2011 and was the chief executive officer of C&W from 2007 until October 2011. During the past five years, he was also a director of Lenox Group, Inc. Mr. Weber has been a Director of ours since December 1994.

John A. Yena, age 74, has served as chairman of the board, emeritus of Johnson & Wales University ( J&W ), a postsecondary educational institution, since November 2011. Mr. Yena served as chairman of the board of J&W from



June 2004 until November 2011. During the past five years, he was also a director of Bancorp Rhode Island, Inc. Mr. Yena has been a Director of ours since May 2006.

Kevin M. Modany, age 48, has served as our Chief Executive Officer since April 2007. In August 2014, Mr. Modany notified our Board of Directors that he intended to resign as our Chief Executive Officer. Following Mr. Modany's notice, we entered into the Modany Letter Agreement, pursuant to which he would remain Chief Executive Officer during the Applicable Period. Mr. Modany will resign his position as our Chief Executive Officer on the last day of the Applicable Period. Mr. Modany served as a Director of ours from July 2006 until August 4, 2014 and as our Chairman from February 2008 until August 4, 2014. He also served as our President from April 2005 through March 2009.

Eugene W. Feichtner, age 59, has served as our President and Chief Operating Officer since August 2014. Mr. Feichtner served as an Executive Vice President and as President, ITT Technical Institute Division from April 2009 until August 2014. He served as our Senior Vice President, Operations from March 2004 through March 2009.

Daniel M. Fitzpatrick, age 55, has served as our Executive Vice President, Chief Financial Officer since April 2009. In April 2015, Mr. Fitzpatrick notified us of his plan to retire as our Chief Financial Officer. Following Mr. Fitzpatrick's notice, we entered into the Fitzpatrick Letter Agreement, pursuant to which he would remain Chief Financial Officer during the Transition Period. Mr. Fitzpatrick will resign his positions with us on the last day of the Transition Period. Mr. Fitzpatrick served as our Senior Vice President, Chief Financial Officer from June 2005 through March 2009.

Gerald T. Hope, age 52, has served as our Executive Vice President, Chief Information Officer since September 2013. Mr.

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Hope served as global head, chief information officer of corporate systems of Thomson Reuters Corporation (Thomson Reuters), a leading source of intelligent information for the world's businesses and professionals, from February 2009 until September 2013. Prior to that, Mr. Hope served as general manager and vice president of operations of Thomson Reuters from May 2005 until November 2007.

Angela K. Knowlton, age 52, has served as our Senior Vice President, Controller and Treasurer since March 2010 and was designated as our principal accounting officer in November 2014. She served as our Vice President, Controller and Treasurer from February 2006 to March 2010.

June M. McCormack, age 67, has served as an Executive Vice President since April 2009 and as our President, Online Division since May 2008. Ms. McCormack also served as our Interim Chief Information Officer from May 2012 through November 2012 and from June 2013 through September 2013.

Ryan L. Roney, age 42, has served as our Executive Vice President, Chief Administrative and Legal Officer and Secretary since July 2014. Mr. Roney served as the chief legal officer, executive vice president of business development and corporate secretary of Vistage International, Inc., a chief executive membership organization, from December 2012 until July 2014. Prior to that, he served as the chief ethics and compliance officer of Powerwave Technologies, Inc., a global supplier of end-to-end wireless solutions for wireless communications networks from June 2011 until November 2012. From October 2000 until March 2011, Mr. Roney served in various roles with Smiths Group, PLC, most recently as general counsel of Smiths Detection, a provider of regulated technology products and advanced services from August 2002 through March 2011.

Glenn E. Tanner, age 67, has served as our Executive Vice President, Chief Marketing Officer since April 2009. He served as our Senior Vice President, Marketing from April 2007 through March 2009.

Rocco F. Tarasi, III, age 43, has served as Senior Vice President, President The Center for Professional Development since January 2013. He served as our Vice President, Finance Corporate Strategy and Development from October 2011 through January 2013. Mr. Tarasi was the co-founder of BrainCredits Corporation, an education start-up, from August 2010 through October 2011, and served as managing director, policyIQ for Resources Global Professionals, a multinational professional services firm, from July 2003 through August 2010.

## **Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Exchange Act requires our executive officers and Directors, and persons who own more than 10% of our common stock, to file reports of ownership with the SEC. These persons also are required to furnish us with copies of all

Section 16(a) forms they file. Based solely on our review of copies of such forms received by us, or written representations from certain reporting persons that no Forms 5 were required for those persons, we believe that, during 2014, all of our executive officers, Directors and greater than 10% shareholders complied with all applicable filing requirements.

## **Code of Ethics**

We have adopted a written Code of Business Conduct and Ethics (the Code) in accordance with Item 406 of Regulation S-K under the Exchange Act that is applicable to our Directors and employees, including our principal executive officer, principal financial officer and principal accounting officer or controller, or persons performing similar functions. The Code is posted on our website at [www.ittesi.com](http://www.ittesi.com).

We also intend to promptly disclose on our website any amendments that we make to the Code. To the extent that our Board of Directors grants any waiver of the Code for any of our Directors or executive officers, we intend to disclose the waiver on our website within four business days following the grant of the waiver.

### **Audit Committee**

Our Audit Committee was established in accordance with Section 3(a)(58)(A) of the Exchange Act. Our Board of Directors has adopted a written charter for the Audit Committee, a current copy of which may be obtained from our website at [www.ittesi.com](http://www.ittesi.com). The functions of the Audit Committee are to assist the Board of Directors in its oversight of:

the integrity of our financial statements and other financial information provided by us to any governmental body or the public;

our compliance with legal and regulatory requirements;

our systems of internal controls regarding finance, accounting, legal compliance and ethics that our management and the Board of Directors establish;

our auditing, accounting and financial reporting processes generally;

the qualifications, independence and performance of our independent registered public accounting firm; and

the performance of our compliance and internal audit functions.

The Audit Committee also performs other functions as detailed in the Audit Committee's charter, including, without limitation, appointing, compensating, retaining and overseeing our independent registered public accounting firm and pre-approving all services to be provided to us by our independent registered public accounting firm.

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The Audit Committee held 11 meetings during 2014. The members of the Audit Committee in 2014 until August 4, 2014, were John F. Cozzi, John E. Dean (Chairperson), Joanna T. Lau and Thomas I. Morgan. From August 4, 2014 until October 6, 2014, the members of the Audit Committee were John F. Cozzi, Joanna T. Lau and Thomas I. Morgan (Chairperson). The current members of the Audit Committee are, and since October 6, 2014 have been, Jerry M. Cohen (Chairperson), John F. Cozzi, Joanna T. Lau and Thomas I. Morgan. Our Board of Directors has determined that Jerry M. Cohen is an audit committee financial expert, as that term is defined in Item 407(d)(5) of Regulation S-K under the Exchange Act, and is independent pursuant to our categorical standards of independence, Section 303A.02 of the NYSE Listed Company Manual and Rule 10A-3 of the Exchange Act. Each of the current members of the Audit Committee is independent and each of the members of the Audit Committee in 2014 while serving as such was independent, pursuant to our categorical standards of independence, Section 303A.02 of the NYSE Listed Company Manual and Rule 10A-3 of the Exchange Act.

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**Item 11. Executive Compensation.  
Compensation Discussion and Analysis**

This discussion explains the compensation program for our executives, including the Named Executive Officers. The individuals included as Named Executive Officers in this document are:

Kevin M. Modany, who served as our Chief Executive Officer during all of 2014;

Daniel M. Fitzpatrick, who served as our Chief Financial Officer during all of 2014; and

John E. Dean, Eugene W. Feichtner and Ronald F. Hamm, who were our three other most highly compensated executive officers during 2014.

Mr. Dean has been a Director of ours since 1994, and in August 2014, he became our Executive Chairman of the Board upon the resignation of Mr. Modany as Chairman and a Director, and Mr. Modany's notification of his intent to resign as our Chief Executive Officer in 2015. As Executive Chairman, Mr. Dean is an employee and executive officer of ours, and therefore he was considered along with our other executive officers in the determination of the Named Executive Officers for 2014. Mr. Dean's compensation as Executive Chairman was determined by the Compensation Committee separately from the compensation of the other Named Executive Officers, and he is not a participant in the short-term compensation element of our executive compensation program, he is not eligible for perquisites from us, and he is not a participant in any of our employee benefit programs or plans, other than the ESI 401(k) Plan and statutorily-mandated employee benefits (such as worker's compensation coverage). As a result, in this discussion, Mr. Dean's compensation is described separately from the descriptions of the compensation programs and determinations applicable to our other executive officers, including the other Named Executive Officers.

Mr. Hamm resigned from our company effective May 15, 2015. This discussion provides information regarding Mr. Hamm to the extent it applies based on his status with our company at the applicable time.

This discussion describes the following:

the objectives of our compensation program;

what our compensation program is designed to reward;

each element of compensation;

why we choose to pay each compensation element;

how we determine the amount to pay and, where applicable, the formula with respect to each compensation element;

how each compensation element and our decisions regarding that element relate to our overall compensation objectives and affect our decisions regarding other compensation elements; and

our consideration of the results of the most recent shareholder advisory vote on the compensation of our Named Executive Officers and any related effect on our executive compensation policies and decisions.

**Executive Summary.** Our executive compensation program is designed to attract, retain and motivate skilled executives. Based on its review of all of the elements of our executive officers' compensation, the Compensation Committee found that the compensation paid to our executive officers in 2014 was reasonable in light of market practices and effective in fulfilling the Committee's compensation objectives, as described below. See *Compensation Objectives*.

In 2011, the Compensation Committee was required to make changes to our executive compensation program as a result of the Incentive Compensation Prohibition affecting our industry that severely limits the types of, and bases for awarding, compensation to employees of postsecondary education institutions, like us. The ED has defined this prohibition on incentive compensation to include anything of value for services rendered (other than a fixed salary or wage) that is:

based in any part, directly or indirectly, on activities engaged in at any point in time through the completion of an educational program for the purpose of enrollment of students for any period of time or the award of financial aid to students; and

provided to any employee who undertakes recruiting or admitting of students, makes decisions about and awards federal student financial aid, or has responsibility for any such activities.

The limiting language of the Incentive Compensation Prohibition is very broad and the ED has not provided sufficient guidance on the breadth or scope of the regulations. As a result, we believe that the Incentive Compensation Prohibition can be interpreted to cover all of our employees (including our executive officers) and to prohibit the payment of compensation based on any performance-related metric, including common performance metrics such as earnings, earnings per share and total shareholder return since such metrics are driven by student enrollment and amounts received from financial aid. We reached this conclusion after consulting with regulatory counsel and considering that any alternative conclusion would involve a high level of risk for our company. An institution that is found to be in noncompliance with the Incentive Compensation Prohibition could face significant monetary penalties, limitations on its operations and/or termination of its eligibility to participate in all federal student financial aid programs.

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The Compensation Committee determined that, while it would prefer to continue to base executive compensation on performance-related metrics, the risk of violating the Incentive Compensation Prohibition prevented, and will prevent, the Committee from basing compensation amounts or adjustments on individual or company performance after the July 1, 2011 effective date of the Incentive Compensation Prohibition. The Compensation Committee recognized that, while the short- and long-term performance of both the individual executive officers and our company will no longer be used in compensation decisions, such performance will be reviewed by the full Board of Directors when evaluating the continued employment of each executive officer. The Compensation Committee determined that it would continue to be guided by the following objectives in determining the compensation of our executives:

competition;

alignment with shareholder interests; and

focus.

As a result of the prohibition on basing any portion of the executives' compensation on performance, the Compensation Committee did not establish an annual bonus program for 2014, but it did establish a short-term compensation element based on certain management objectives in 2014. As a result, in order to achieve the objectives noted above, the Compensation Committee used the following compensation elements as part of the 2014 executive compensation program, as described in more detail below under *Compensation Elements* :

base salary;

short-term compensation;

an annual grant of equity compensation;

employee benefits;

perquisites; and

qualified retirement savings.

***Compensation Objectives.*** The Compensation Committee is guided by the following objectives in determining the compensation of our executives:

***Competition.*** The Committee believes that compensation should reflect the competitive marketplace in order for us to attract, retain and motivate talented executives.

***Alignment with Shareholder Interests.*** Compensation should include equity-based compensation awards in order to align the executives' interests with those of our shareholders.

***Focus.*** The Committee believes that certain elements of compensation should provide some security to our executives to allow them to continue to focus on our financial and operating results, their individual performance and their job responsibilities.

***Compensation Elements.*** The elements of our compensation program, a description of the purpose of each element and the objectives that each element supports are shown in the table below. See *Compensation Objectives*.

| <b>Compensation Element</b>  | <b>Purpose</b>  | <b>Link to Compensation Objectives</b>                       |
|--|---|--|
| Base Salary  | Fixed cash component used to help us attract, motivate and retain our executives.   | Competition<br>Focus   |
| Short-Term Compensation  | Variable cash component used to help us motivate and retain our executives.   | Competition<br>Focus   |
| Equity-Based Compensation (e.g., Time-Based Stock Options and/or Restricted Stock Unit Awards) | Used to promote equity ownership by our executives.<br><br>Aligns the executives' interests with those of our shareholders. | Competition<br>Alignment with Shareholder Interests<br>Focus |



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|  |   |  |
|--|---|--|
| Qualified Retirement Savings (i.e., 401(k) Plan Contributions)                 | Used to help us provide stable compensation and some security to our executives, in order to help them save for retirement on a tax-deferred basis.   | Competition<br><br>Focus   |
| Nonqualified Deferred Compensation   | Provided some security to our executives and helped them save a portion of their compensation for retirement on a tax-deferred basis.   | Deferrals and contributions are no longer made under these plans.          |
| Pension Benefits (i.e., Qualified and Nonqualified Retirement Plan Earnings)   | Allowed executives to focus on their job responsibilities while employed and provided some security upon retirement.  | Benefit accruals under our pension plans were frozen as of March 31, 2006. |
| Employee Benefits  | Provides stable compensation and some security to our executives, in order to allow them to focus on their job responsibilities.  | Competition<br><br>Focus   |
| Perquisites  | Used to recognize our executives based on their responsibilities and to help us attract, motivate and retain our executives.  | Competition  |
| Potential Payments Upon Termination of Employment or a Change in Control of Us | Provides for payments in connection with a change in control and/or involuntary termination of employment.<br><br>Provides some security to our executives to help them focus on their job responsibilities and to encourage them to remain employed with us during a critical time of a potential change in control. | Competition<br><br>Alignment with Shareholder Interests<br><br>Focus       |

**2014 Compensation**

**Base Salary.** Salaries provide a necessary element of stability in the total compensation program and, as such, are not subject to variability. Salaries are set and administered to reflect the value of the job in the marketplace. In January 2014, the Compensation Committee established the salary levels for the Named Executive Officers (other than Mr. Dean), that became effective on February 10, 2014, based on a review of:

the base salaries of executives in the same or similar positions at the comparator companies that the Committee uses for benchmarking as described under *Process for Establishing Compensation*

Benchmarking ;

the area and level of job responsibilities of each executive;

inflationary factors; and

tenure and industry knowledge and experience.

The following table sets forth the annualized base salary information for each of the Named Executive Officers other than Mr. Dean as of February 10, 2014.

| <b>Named Executive Officer</b> | <b>2014 Annualized<br/>Base Salary</b> | <b>Dollar<br/>Increase<br/>Over<br/>Prior Year</b> | <b>Percentage<br/>Increase Over<br/>Prior<br/>Year</b> |
|--------------------------------|--|--|--|
| Kevin M. Modany                | \$ 824,076                             | \$ 24,002  | 3.0%   |
| Daniel M. Fitzpatrick          | \$ 412,000                             | \$ 12,000  | 3.0%   |
| Eugene W. Feichtner            | \$ 319,411                             | \$ 9,303   | 3.0%   |
| Ronald F. Hamm                 | \$ 334,750                             | \$ 9,750   | 3.0%   |

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In connection with his appointment as Executive Chairman in August 2014, the Compensation Committee approved an annual base salary for Mr. Dean of \$575,000. At the request of the Compensation Committee, Towers Watson & Co. ( Towers Watson ) conducted a market comparison review of the base salary amounts for similar executive chairman positions. Towers Watson advised the Compensation Committee that the base salary amount for Mr. Dean was reasonable and within the range of market comparisons.

**Short-Term Compensation.** In March 2014, the Compensation Committee established a short-term compensation element for our executive officers that would be payable in early 2015, if certain management objectives (the 2014 Management Objectives ) were accomplished during 2014. The 2014 Management Objectives were not in any way related to the enrollment of students or the award of financial aid to avoid violating the Incentive Compensation Prohibition. Instead, the 2014 Management Objectives consisted of various business objectives that relate to certain initiatives that are part of our strategic plan. The 2014 Management Objectives and their relative weightings are as follows:

|    | <b>Management Objectives</b>   | <b>Weight</b> |
|----|--|---------------|
| 1. | Obtain requisite state and accrediting commission authorizations for corporate training, continuing education and/or test preparation programs.  | 20%           |
| 2. | Design and implement an operational optimization plan to increase ITT/ESI s operational efficiencies for the corporation.  | 20%           |
| 3. | Obtain requisite federal, state and accrediting commission authorizations for additional health science, technology and/or engineering programs at the ITT Technical Institutes at both the associate degree and diploma levels. | 20%           |
| 4. | Improve the 2014 ITT Technical Institute quarterly student evaluation average score.   | 10%           |
| 5. | Revise and begin teaching the six identified high volume, high-impact program courses at the majority of ITT Technical Institute campuses.   | 10%           |
| 6. | Acquire a training company to support strategic initiatives associated with The Center for Professional Development.   | 10%           |
| 7. | Obtain requisite federal, state and accrediting commission authorizations for a dual high school diploma and associate degree program at an ITT Technical Institute.   | 5%            |
| 8. | Obtain requisite federal, state and accrediting commission authorizations for additional nursing programs at the ITT Technical Institutes at both the associate and bachelor degree levels                                       | 5%            |

On January 26, 2015, the Compensation Committee reviewed the results of the 2014 Management Objectives and determined the extent to which each of the 2014 Management Objectives was accomplished by our executive officers in 2014. The Committee assigned one to five points to each 2014 Management Objective, based on its determination of the extent to which the objective was accomplished. The number of points assigned to each 2014 Management Objective was multiplied by the weight associated with that 2014 Management Objective, resulting in a weighted number of points for that 2014 Management Objective. The weighted number of points for all of the 2014 Management Objectives were added together, resulting in a total number of weighted points. The following table sets forth the maximum short-term compensation percentage associated with each range of the total number of weighted points that could be assigned to the 2014 Management Objectives by the Compensation Committee:

| <b>Total Weighted Points</b> | <b>Maximum<br/>Short-Term<br/>Compensation Percentage</b> |
|------------------------------|---|
| 4.76 - 5.00                  | 200.0%  |
| 4.51 - 4.75                  | 187.5%  |
| 4.26 - 4.50                  | 175.0%  |
| 4.01 - 4.25                  | 162.5%  |
| 3.76 - 4.00                  | 150.0%  |
| 3.51 - 3.75                  | 137.5%  |
| 3.26 - 3.50                  | 125.0%  |
| 3.01 - 3.25                  | 112.5%  |
| 2.76 - 3.00                  | 100.0%  |
| 2.51 - 2.75                  | 87.5%   |
| 2.26 - 2.50                  | 75.0%   |
| 2.01 - 2.25                  | 62.5%   |
| 1.76 - 2.00                  | 50.0%   |

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| <b>Total Weighted Points</b> | <b>Maximum Short-Term Compensation Percentage</b> |
|------------------------------|---|
| 1.51 - 1.75                  | 41.7%   |
| 1.26 - 1.50                  | 33.3%   |
| 1.00 - 1.25                  | 25.0%   |

Based on the Committee's determination of the extent to which each of the 2014 Management Objectives was accomplished, the total number of weighted points for the 2014 Management Objectives was 2.60. That total number of weighted points corresponds to a maximum short-term compensation percentage of 87.5%, based on the above table.

To determine the maximum short-term compensation amount that an officer could receive, the Committee multiplied the maximum short-term compensation percentage (determined as described above) by a standard short-term compensation percentage of annualized base salary, ranging from 32% to 100%, with the percentage depending on the officer's position, and then multiplied that result by the officer's annualized base salary. The Committee utilized the annualized base salary as of December 31, 2014 for Messrs. Modany, Fitzpatrick and Hamm, and as of February 9, 2015 for Mr. Feichtner. The Committee used Mr. Feichtner's base salary rate as of that date, because it reflected the increase in his base salary related to the increased duties and responsibilities assumed by him in connection with his appointment as our President and Chief Operating Officer in August 2014. The following table sets forth the 2014 standard short-term compensation percentage of annualized base salary, for Messrs. Modany, Fitzpatrick and Hamm, as of December 31, 2014, and for Mr. Feichtner, as of February 9, 2015:

| <b>Named Executive Officer</b> | <b>2014 Standard Short-Term Compensation Percentage of Annualized Base Salary</b> |
|--------------------------------|---|
| Kevin M. Modany                | 100%  |
| Daniel M. Fitzpatrick          | 65%   |
| Eugene W. Feichtner            | 60%   |
| Ronald F. Hamm                 | 55% <sup>(1)</sup>  |

(1) During 2014, the Compensation Committee reduced the 2014 standard short-term compensation percentage for Mr. Hamm from 60% to 55% in connection with the Committee's approval of the reimbursement of up to \$30,000 in commuting expenses incurred by Mr. Hamm in 2014.

An executive officer's actual short-term compensation payment, however, could be more or less than the officer's potential short-term compensation amount as calculated as described above. An executive officer's actual short-term compensation amount also took into consideration the Compensation Committee's discretionary assessment of the officer's individual contribution toward accomplishing each 2014 Management Objective. The Committee did not make any further adjustments to any of the Named Executive Officers' 2014 short-term compensation from the amounts calculated as described above.

On January 26, 2015, the Compensation Committee approved the payment of the 2014 short-term compensation amount in cash to each of the Named Executive Officers, other than Mr. Dean, as follows:

| Named Executive Officer | 2014 Short-Term Compensation         |  |
|-------------------------|--------------------------------------|--|
|                         | 2014 Short-Term Compensation Payment | Payment as a Percentage of 2014 Annualized Base Salary |
| Kevin M. Modany         | \$ 721,067                           | 87.5%  |
| Daniel M. Fitzpatrick   | \$ 234,325                           | 56.9%  |
| Eugene W. Feichtner     | \$ 245,000                           | 61.3% <sup>(1)</sup>                                   |
| Ronald F. Hamm          | \$ 161,098                           | 48.1%  |

(1) Represents the percentage of Mr. Feichtner's 2015 annualized base salary.

On January 26, 2015, the Compensation Committee also approved an additional bonus payment of \$100,000 to Mr. Fitzpatrick in recognition of his significant efforts and time spent on company matters in 2014. That additional bonus payment amount is not included in the amount of Mr. Fitzpatrick's 2014 short-term compensation payment shown in the table above, because it was a discretionary payment that was not part of the 2014 short-term compensation element. Mr. Dean was not a participant in the 2014 short-term compensation element, and he did not receive any discretionary or other bonus payments from us related to 2014.

Equity-Based Compensation. The Compensation Committee believes that equity-based compensation should be a major component of the total compensation for executives. The Committee believes that the use of equity in the payment of compensation enhances our

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executives' commitment to our company over the long-term, because the value of equity-based compensation awards, such as time-based stock options, restricted stock and RSUs, helps align the executives' interests with those of our shareholders. The type and value of the equity-based compensation awards vary based on the executive's level and type of responsibilities.

In January 2014, the Compensation Committee reviewed market information regarding the form and grant value of equity awards granted at comparator companies and companies in the survey data provided by Towers Watson. Although the Committee did not change its philosophy regarding targeting the upper quarter of the range of equity-based compensation at comparator companies, in 2014 the Committee determined to grant the same number of shares to each executive that it had granted in the prior year, despite the decline in our stock price, knowing that it resulted in a grant value that was lower than in the prior year.

The following table sets forth information about the stock options and RSUs that were granted under the ITT Educational Services, Inc. Amended and Restated 2006 Equity Compensation Plan (the "Amended 2006 Plan") effective February 4, 2014 to each Named Executive Officer, other than Mr. Dean, as described above.

| Named Executive Officer | Stock Options                                  |                |                 | RSUs                  |                           | Date Compensation Committee Took Action <sup>(2)</sup> |
|-------------------------|--|----------------|-----------------|-----------------------|---------------------------|--|
|                         | Number of Securities Underlying Option Granted | Exercise Price | Expiration Date | Number of RSUs        | Grant Date <sup>(1)</sup> |  |
| Kevin M. Modany         | 62,500 <sup>(3)</sup>                          | \$ 27.94       | 02/04/21        | 28,125 <sup>(4)</sup> | 02/04/14                  | 01/20/14   |
| Daniel M. Fitzpatrick   | 15,000 <sup>(3)</sup>                          | \$ 27.94       | 02/04/21        | 6,750 <sup>(4)</sup>  | 02/04/14                  | 01/20/14   |
| Eugene W. Feichtner     | 10,000 <sup>(3)</sup>                          | \$ 27.94       | 02/04/21        | 4,500 <sup>(4)</sup>  | 02/04/14                  | 01/20/14   |
| Ronald F. Hamm          | 10,000 <sup>(3)</sup>                          | \$ 27.94       | 02/04/21        | 4,500 <sup>(4)</sup>  | 02/04/14                  | 01/20/14   |

- (1) The effective date of the stock option and RSU grants.
- (2) The stock option and RSU grants were approved by the Compensation Committee during a Committee meeting on January 20, 2014, and had an effective grant date of February 4, 2014.
- (3) Nonqualified stock option granted at 100% of the closing market price of a share of our common stock on February 4, 2014, the effective date of the grant. One-third of the option is exercisable on the anniversary date of the grant in each of the years 2015, 2016 and 2017.
- (4) The period of restriction for this RSU grant lapses in thirds on the anniversary date of the grant in each of the years 2015, 2016 and 2017.

In connection with his appointment as Executive Chairman, the Compensation Committee approved a grant of RSUs to Mr. Dean on August 4, 2014. The RSUs had a value of \$1,000,000, based on the closing price of the Company's common stock on the date of grant, which resulted in a grant of 129,534 RSUs to Mr. Dean. The value of the RSUs granted to Mr. Dean was included as part of the Towers Watson market comparison review of the compensation for similar executive chairman positions, and Towers Watson advised the Compensation Committee that the value of Mr. Dean's RSU award was reasonable and within the range of market comparisons. The RSUs will vest, subject to Mr. Dean's continued service as an employee and/or a member of our Board of Directors, on August 4, 2015 or, if earlier, upon his termination of employment due to death or disability. Mr. Dean will continue to vest in the equity-based awards granted to him in connection with his service as a non-employee Director of ours.

2015 Compensation

**Base Salary.** In January 2015, the Compensation Committee determined not to make any changes to the annual base salaries for any of the Named Executive Officers (other than Mr. Feichtner) based on the current market and business conditions and inflationary considerations. The Committee did not utilize or review specific peer group comparator information. As previously disclosed, the Compensation Committee had approved an increase in Mr. Feichtner's base salary from \$319,411 in 2014 to \$400,000 in 2015, to be effective as of February 9, 2015 (the date in 2015 that other employees at our headquarters received compensation adjustments), as a result of the increased duties and responsibilities assumed by Mr. Feichtner in connection with his appointment as our President and Chief Operating Officer in August 2014.

**Short-Term Compensation.** In January 2015, the Compensation Committee established a short-term compensation element for our executive officers (other than Mr. Modany, due to his previously-announced intention to resign from the company, and Mr. Dean) that will be payable in early 2016, if certain management objectives (the 2015 Management Objectives ) are accomplished during 2015. As with the 2014 Management Objectives, the 2015 Management Objectives are not in any way related to the enrollment of students or the award of financial aid to avoid violating the Incentive Compensation Prohibition. Instead, the 2015 Management Objectives consist of various business objectives that relate to certain initiatives that are part of our strategic plan. The 2015 Management Objectives and their relative weightings are as follows:

|    | <b>Management Objectives</b>  | <b>Weight</b> |
|----|---|---------------|
| 1. | Resolve certain outstanding legal and regulatory matters involving the company. | 20%           |



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|  |     |
|--|-----|
| 2. Optimize the total number of contact hours in the first academic quarter of the ITT Technical Institutes program offerings.   | 20% |
| 3. Effect matters relating to the third-party loan servicing organizations for the private education loan programs.  | 15% |
| 4. Improve the 2015 ITT Technical Institute quarterly student evaluation average score.  | 15% |
| 5. Reduce the current and future carrying cost and collateralization of the letter of credit that the company is required to post for the benefit of the U.S. Department of Education. | 10% |
| 6. Improve the average NCLEX score of the 2015 graduates of the Breckinridge School of Nursing and Health Sciences nursing program.  | 10% |
| 7. Acquire a training company to support strategic initiatives associated with The Center for Professional Development at ITT Technical Institute.                                     | 5%  |
| 8. Obtain requisite federal, state and accrediting commission authorizations for the ITT Technical Institutes to offer a dual high school diploma and associate degree program.        | 5%  |

The determination of the extent to which the 2015 Management Objectives are accomplished by our executive officers will be made by the Compensation Committee in early 2016. The Committee intends to assign zero to five points to each 2015 Management Objective, based on the extent to which the Committee determines the objective was accomplished. The number of points assigned to each 2015 Management Objective will be multiplied by the weight associated with that 2015 Management Objective, resulting in a weighted number of points for that 2015 Management Objective. The weighted number of points for all of the 2015 Management Objectives will be added together, resulting in a total number of weighted points. The following table sets forth the maximum short-term compensation percentage that is associated with each range of the total number of weighted points that are assigned to the 2015 Management Objectives by the Compensation Committee:

| <b>Total Weighted Points</b> | <b>Maximum Short-Term Compensation Percentage</b> |
|------------------------------|---|
| 4.76 - 5.00                  | 200.0%  |
| 4.51 - 4.75                  | 187.5%  |
| 4.26 - 4.50                  | 175.0%  |
| 4.01 - 4.25                  | 162.5%  |
| 3.76 - 4.00                  | 150.0%  |
| 3.51 - 3.75                  | 137.5%  |
| 3.26 - 3.50                  | 125.0%  |
| 3.01 - 3.25                  | 112.5%  |
| 2.76 - 3.00                  | 100.0%  |
| 2.51 - 2.75                  | 87.5%   |
| 2.26 - 2.50                  | 75.0%   |
| 2.01 - 2.25                  | 62.5%   |
| 1.76 - 2.00                  | 50.0%   |
| 1.51 - 1.75                  | 41.7%   |
| 1.26 - 1.50                  | 33.3%   |
| 1.00 - 1.25                  | 25.0%   |

To determine the maximum short-term compensation amount that an officer may receive, the maximum short-term compensation percentage (determined as described above) will be multiplied by a standard short-term compensation percentage of annualized base salary as of December 31, 2015, ranging from 32% to 100%, with the percentage depending on the officer's position, and the result will be multiplied by the officer's annualized base salary. The

following table sets forth the 2015 standard short-term compensation percentage of annualized base salary as of December 31, 2015 for each of the Named Executive Officers who currently are participants in the 2015 short-term compensation element:

| <b>Named Executive Officer</b> | <b>2015 Standard Short-Term Compensation Percentage of Annualized Base Salary</b> |
|--------------------------------|---|
| Daniel M. Fitzpatrick          | 65%   |
| Eugene W. Feichtner            | 70% <sup>(1)</sup>  |

(1) Reflects an increase from the prior year, due to Mr. Feichtner's appointment as our President and Chief Operating Officer in August 2014.

An executive officer's actual short-term compensation payment, however, may be more or less than the officer's potential short-term compensation amount as calculated as described above. An executive officer's actual short-term compensation amount will be based

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on the Compensation Committee's discretionary assessment of the officer's individual contribution toward accomplishing each 2015 Management Objective. Any 2015 short-term compensation payment will be made in cash. The Compensation Committee may, in its sole discretion, modify the terms of the short-term compensation element at any time before it is paid.

**Equity-Based Compensation.** In January 2015, the Compensation Committee approved an award of the same number of shares subject to equity awards to each executive that it had awarded in the prior year, except in the cases of: (i) Mr. Modany, who did not receive a 2015 equity grant due to his previously-announced intention to resign from the company; (ii) Mr. Feichtner, whose 2015 equity grant was increased due to the increased duties and responsibilities assumed by him in connection with his appointment as our President and Chief Operating Officer in August 2014; and (iii) Mr. Dean, who did not receive a 2015 equity award in connection with his service as our Executive Chairman. Due to the fact that we were not current in our filings with the SEC at the time of the Committee's approval, the Committee determined that the effective grant date of the equity awards will be the third trading day following the date that we become current in our filings with the SEC (unless within that three trading day period, we again become no longer current in our filings with the SEC). Pursuant to the Committee's approval, the following equity awards will be granted to Messrs. Fitzpatrick and Feichtner:

Mr. Fitzpatrick 15,000 stock options and 6,750 RSUs;

Mr. Feichtner 17,500 stock options and 7,875 RSUs;

the stock option awards will have a per share exercise price equal to the per share closing sale price of our common stock on the NYSE on the effective grant date, will have a term of seven years from the effective grant date and will vest in thirds on February 9, 2016, February 9, 2017 and February 9, 2018; and

the RSUs will vest in thirds on February 9, 2016, February 9, 2017 and February 9, 2018.

**Other Elements of Compensation****Retirement Plans**

**Qualified Retirement Savings.** Our executives participate in our ESI 401(k) Plan, a qualified defined contribution plan, that is designed to provide substantially all of our employees with a tax-deferred, long-term savings vehicle. See Equity Compensation and Qualified Savings Plans *ESI 401(k) Plan*.

**Nonqualified Deferred Compensation.** Due to federal limitations that preclude our highly-compensated employees from fully participating in the ESI 401(k) Plan, we established the ESI Excess Savings Plan, an unfunded, nonqualified deferred compensation plan for a select group of our management, including executive officers. We froze the ESI Excess Savings Plan, effective for plan years beginning on and after January 1, 2008, such that executives may no longer make elective deferrals and we no longer make contributions under the ESI Excess Savings Plan. Amounts previously credited to an executive under the ESI Excess Savings Plan, however, continue to accrue interest in accordance with the terms of the ESI Excess Savings Plan until those amounts are distributed pursuant to the plan's terms. See Nonqualified Deferred Compensation Plans *ESI Excess Savings Plan*.

In addition, we established the ESI Executive Deferred Bonus Compensation Plan (the *Deferred Bonus Plan*), an unfunded, nonqualified deferred compensation plan, for a select group of our management and highly-compensated employees, including the Named Executive Officers. The *Deferred Bonus Plan* allows eligible employees to defer payment of all or a portion of his or her annual bonus compensation and to earn interest on any annual bonus compensation payable in the form of cash and deferred under the plan. Since the Committee did not establish an annual bonus award component of executive compensation for 2014, executives did not receive any compensation that they could elect to defer under the *Deferred Bonus Plan* with respect to 2014. See *Nonqualified Deferred Compensation Plans* *Deferred Bonus Plan*.

The terms of the ESI Excess Savings Plan and the *Deferred Bonus Plan*, including the interest rate on the earnings on the Named Executive Officers' account balances under each plan, are based on common and typical terms and types of nonqualified deferred compensation plans that had been adopted by other publicly traded companies at the time that we adopted those plans.

*Pension Benefits.* Pension benefits provide retirement compensation that is based on the salary and bonus compensation paid to the employee during his or her employment. We froze the benefit accruals under the ESI Pension Plan and ESI Excess Pension Plan for all participants in the plans on March 31, 2006, such that no further benefits accrue under those plans after March 31, 2006. Participants do, however, continue to be credited with vesting service and interest credits according to the terms of those plans. See *Pension Plans* *ESI Pension Plan* and *ESI Excess Pension Plan*.

#### Employee Benefits and Perquisites

*Employee Benefits.* All of our executives, other than Mr. Dean, are eligible to participate in our employee benefits, which include medical and dental benefits, vision insurance, life insurance, flexible spending account, tuition reimbursement, disability insurance, vacation leave, sick leave, bereavement leave, ITT Technical Institute tuition discounts and an employee assistance program that can help employees find answers to various kinds of personal concerns by offering consultation, support, information, planning and referrals. The employee benefits are generally available on a non-discriminatory basis to all full-time and part-time regular employees.

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*Perquisites.* We also provide limited perquisites to our executives, including the Named Executive Officers, other than Mr. Dean, that vary based on the executive's level. The perquisites include use of a company car for Mr. Modany only, a tax return preparation and financial planning allowance, tickets to sporting, theater and other events, enhanced disability benefits, an annual physical examination and relocation assistance for newly-hired executive officers from outside the Indianapolis metropolitan area whom we ask to relocate. With respect to Mr. Hamm, in each of 2014 and 2015, the Compensation Committee approved the reimbursement of commuting expenses incurred by Mr. Hamm in each of those years, up to \$30,000 per year. In connection with that approval, the Committee eliminated Mr. Hamm's perquisite related to tickets to sporting, theater and other events in each year, and reduced his standard short-term compensation percentage of annualized base salary from 60% to 55% under the short-term compensation element in each year.

The value and type of perquisites made available to our executives are based on the value and type of perquisites that had been made available to executives at other publicly-traded companies at the time that we began making those perquisites available, and at the time of each subsequent annual review by the Compensation Committee of those perquisites. The Compensation Committee believes that the limited perquisites assist in furthering the objectives of attracting, retaining and motivating executives, as well as helping our executives focus on their job responsibilities. The Compensation Committee also believes that our executives value the perquisites provided to them and, given that the cost to us of the perquisites is not significant, the Committee has determined to continue providing these perquisites to our executives.

The perquisites that we provided to our Named Executive Officers in 2014 are disclosed in the Summary Compensation Table and footnotes thereto. See Summary Compensation Table. In January 2015, the Compensation Committee approved the value and type of perquisites to be provided in 2015 to the Named Executive Officers, which are generally consistent with the value and type of perquisites provided to them in 2014. The aggregate incremental cost to us in 2015 for providing all of the 2015 perquisites to the Named Executive Officers is not expected to exceed \$150,000.

**Potential Payments Upon Termination of Employment or a Change In Control of Us**

*Modany Letter Agreement.* On August 4, 2014, in connection with Mr. Modany's notification to our Board of Directors of his intention to resign as our Chief Executive Officer, we entered into the Modany Letter Agreement, pursuant to which Mr. Modany agreed to remain our Chief Executive Officer (or Special Advisor) through the Applicable Period, which subsequently has been extended to August 31, 2015. The Modany Letter Agreement provides that, subject to Mr. Modany's compliance with the release requirement and the restrictive covenants and cooperation provisions, Mr. Modany will provide consulting services to us during the 18 months following his resignation as Chief Executive Officer, and we will pay Mr. Modany a monthly fee equivalent to his current monthly base salary (which is \$68,673) and there will be continued vesting of his equity-based awards. Mr. Modany will have continued use of the company-provided automobile during the consulting period. Further, we will pay Mr. Modany a lump sum of \$20,598, which is equal to the cost of 18 months of coverage under the Consolidated Omnibus Budget Reconciliation Act of 1984, as amended (COBRA), for continued health, dental and vision coverage.

At the request of the Compensation Committee, Towers Watson conducted a market comparison review of the terms of the Modany Letter Agreement. Towers Watson advised the Compensation Committee that the terms of the Modany Letter Agreement were reasonable and within the range of market comparisons. The Compensation Committee also approved the payment by us of the fees and expenses of Mr. Modany's counsel incurred in connection with the negotiation of the Modany Letter Agreement.

*Fitzpatrick Letter Agreement.* On April 29, 2015, in connection with Mr. Fitzpatrick's notification to us of his plan to retire as our Chief Financial Officer, we entered into the Fitzpatrick Letter Agreement, pursuant to which Mr. Fitzpatrick agreed to remain our Chief Financial Officer (or Special Advisor) through the Transition Period. The Fitzpatrick Letter Agreement provides that subject to Mr. Fitzpatrick's compliance with the release requirement and the restrictive covenants and cooperation provisions, he will provide consulting services to us during the 18 months following his resignation as Chief Financial Officer, and we will pay Mr. Fitzpatrick a monthly fee equivalent to his current monthly base salary (which is \$34,333) and there will be continued vesting of his equity-based awards. Further, we will pay Mr. Fitzpatrick a lump sum of \$20,598, which is equal to the cost of 18 months of coverage under COBRA for continued medical, prescription drug, dental and vision coverage. The Compensation Committee also approved the payment by us of the fees and expenses of Mr. Fitzpatrick's counsel incurred in connection with the negotiation of the Fitzpatrick Letter Agreement.

*Senior Executive Severance Plan.* Our executive officers, including the Named Executive Officers (other than Mr. Dean), participate in the ITT Educational Services, Inc. Senior Executive Severance Plan (the "Senior Executive Severance Plan"), which provides for severance benefits if:

we terminate the executive's employment, other than for cause, or when the executive terminates his or her employment for good reason, in each case within two years after the occurrence of a change in control of us; or

we terminate the executive's employment, other than for cause, if a change in control of us is imminent. The benefits vary depending on the executive's level and include, among other things, two or three times the executive's base salary and bonus and a stipend equal to two or three times the annual cost of certain employee benefits. See "Potential Payments Upon Termination or Change in Control" *Senior Executive Severance Plan*.

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The Compensation Committee believes that a change in control transaction, or potential change in control transaction, would create uncertainty regarding the continued employment of our executives. This is because many change in control transactions result in significant organizational changes, particularly at the senior executive level. In order to encourage our executives to remain employed with us during an important time when their continued employment in connection with or following a transaction is often uncertain and to help keep our executives focused on our business rather than on their personal financial security, we believe that providing certain of our executives with severance benefits upon the specified terminations of employment is in the best interests of our company and our shareholders.

The benefits under the Senior Executive Severance Plan are not payable merely because a change in control transaction occurs or is imminent. Instead, payment of the severance benefits is only triggered if a change in control has occurred or is imminent and certain types of termination of employment occur within certain limited time periods. The Compensation Committee has determined that this double trigger requirement is appropriate and reasonable.

If benefits are triggered under the Senior Executive Severance Plan, our Chief Executive Officer would be entitled to payments under the three times multiplier and the other covered executives would be entitled to payments under the two times multiplier. Our Chief Executive Officer would also be entitled to certain benefits that would not be available to the other covered executives, including that our Chief Executive Officer would receive a tax gross-up payment on any excise taxes and that his severance benefits would not be limited in the event of the imposition of an excise tax. The Compensation Committee believes that our Chief Executive Officer should receive the higher multiplier and the enhanced benefits given his high level of responsibility and the substantial duties that he has with us, as well as the fact that it is common market practice for a chief executive officer to receive a higher level of severance benefits than other executive officers.

The amount and type of severance pay made available to our executive officers are based on common and typical amounts and types of severance pay that were made available to executives by other publicly-traded companies at the time that these benefits were determined.

*Other Plans.* In addition, awards granted under our equity compensation plans and all or a portion of the contributions, benefits and earnings under our qualified savings plan, nonqualified deferred compensation plans and pension plans may vest and/or become payable to the participating employees, including the Named Executive Officers, if the participating employee's employment terminates in certain situations or we undergo a change in control. See Potential Payments Upon Termination or Change In Control. The accelerated vesting and payments are useful in providing security to our executives and helps them to focus on their job responsibilities, instead of the safety of compensation that they have previously been awarded or paid. Further, the accelerated vesting of equity compensation awards upon a change in control:

provides employees with the same opportunities as shareholders, who are free to sell their equity at the time of the change in control event and thereby realize the value created at the time of the transaction;

ensures that employees do not have the fate of their outstanding equity tied to the future success of the new and different company that results from the change in control;

can be a strong retention device during change in control discussions, particularly for those employees whose equity represents a significant portion of their total pay package; and

treats all employees the same regardless of their employment status after the transaction.

***Process for Establishing Compensation.*** The Compensation Committee of our Board of Directors has overall responsibility and authority for approving and evaluating the compensation programs and policies pertaining to our executives and Directors. Each year, the Compensation Committee reviews all elements of all of our executive officers' compensation and the internal pay equity of our Chief Executive Officer's compensation compared to our other executive officers' compensation. The Compensation Committee also annually reviews the tally of total compensation of our executives in order to determine that the amount of compensation is within appropriate competitive parameters. The tally information is not, however, a key factor in the Committee's current compensation decisions, because the tally information is reflective of past competitive market practice.

The Compensation Committee has met, and will continue to meet, in executive sessions which are not attended by any of our employees. The Committee regularly reports its activities to our Board of Directors.

When making executive compensation decisions, the Compensation Committee also considers, for all executives other than our Chief Executive Officer, the recommendation of our Chief Executive Officer. Our Chief Executive Officer recommends salary levels, short-term compensation amounts, equity-based compensation awards and perquisites for our other executives based on their salary grade level. Our Chief Executive Officer's compensation is determined solely by the Compensation Committee with the assistance of the Committee's independent compensation consultant. The Compensation Committee applies the same principles for executive compensation in determining our Chief Executive Officer's compensation that it applies in determining the compensation of our other executive officers. The Compensation Committee has established a higher level of compensation for our Chief Executive Officer than the levels for our other executive officers, due to:

the high level of responsibility that he has with us;

the substantial duties and responsibilities that he has to us; and

the fact that the market and comparator compensation information demonstrates higher levels of compensation for chief executive officers both within and outside of our industry.



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*Independent Compensation Consultant.* The Compensation Committee directly retains a consultant from an independent compensation consulting firm to provide advice on aspects of our executive and Director compensation programs. The Committee requests written reports and holds meetings with the consultant, which are not attended by any of our employees, in order to obtain independent opinions on compensation proposals. The independent compensation consultant helps the Committee determine the amount and, where applicable, the formula for each element of the compensation program for each executive. The independent compensation consultant also assists the Committee in selecting the companies used for benchmarking and comparison purposes in certain years. The Compensation Committee retained the independent compensation consulting firm Towers Watson to advise it on 2014 and 2015 compensation determinations.

*Determinations.* In determining and recommending the compensation of our executives, the Compensation Committee consults with its independent compensation consulting firm and, along with our Chief Executive Officer, makes assessments after deliberate and thorough review and consideration of various factors. In 2014 and 2015, these factors included:

the level and area of job responsibilities of the executive;

inflationary factors; and

tenure and industry knowledge and experience.

In 2014, these factors also included the competitive marketplace and, in particular, how the level of an executive's compensation compares with the compensation paid to executives in the same or similar positions and with similar responsibilities at comparator companies. In 2015, the Compensation Committee did not review a detailed analysis of compensation paid to executives at comparator companies, but it did review a report from Towers Watson regarding executive compensation pay level trends, short- and long-term incentive plan design trends and other trends in executive compensation.

In January 2014, the Compensation Committee met in executive session to review a tally of the total compensation received by each of the executive officers in 2013 and information provided by Towers Watson. The Committee noted that there had not been any clarification by the ED regarding the types of compensation that are prohibited and which activities and employees are covered by the Incentive Compensation Prohibition and, therefore, it would continue to avoid basing executive compensation on performance-related metrics. In January 2014, the Committee determined to continue the short-term compensation element of executive compensation, and it established the management objectives for 2014 under such element. See *Compensation Elements 2014 Compensation Short-Term Compensation.*

In January 2015, the Compensation Committee met in executive session to review a tally of the total compensation received by each of the executive officers in 2014 and information provided by Towers Watson. The Committee noted that there still had not been any clarification regarding the types of compensation that are prohibited and which activities and employees are covered by the Incentive Compensation Prohibition and, therefore, it would continue to avoid basing executive compensation on performance-related metrics. In January 2015, the Committee determined to continue the short-term compensation element of executive compensation, and it established the management objectives for 2015 under such element. See *Compensation Elements 2015 Compensation Short-Term Compensation.*

*Shareholder Feedback.* In January 2015, the Compensation Committee considered the fact that, at the 2014 Annual Meeting of Shareholders, our shareholders approved the compensation paid to our Named Executive Officers as disclosed in the Proxy Statement for our 2014 Annual Meeting, and that the votes cast for that advisory proposal totaled approximately 84% of the shares represented at the 2014 Annual Meeting and entitled to vote. The Committee noted that this level of support was significantly higher than the 54% level of support for the same proposal at the 2013 Annual Meeting Shareholders. As a result of the higher level of support at the 2014 Annual Meeting of Shareholders, the Committee believes that, overall, our shareholders are not dissatisfied with our executive compensation program in light of the limitations imposed by the Incentive Compensation Regulations. The Committee also considered discussions that our Chief Executive Officer and Chief Administrative and Legal Officer had prior to the 2014 Annual Meeting with certain of our shareholders that own a significant percentage of our common stock regarding our executive compensation program and any concerns that such shareholders had related to it. We were told by some of those shareholders that while they would prefer that we base executive compensation on performance-related metrics, as we did prior to 2011, they understand that we have concluded that to do so would present a significant risk of violating the Incentive Compensation Prohibition. Despite understanding these limitations on our executive compensation program, some of those shareholders may be required to follow formulaic internal or external voting guidelines and, therefore, may be forced to cast a vote against our executive compensation proposal when otherwise they may not have. In addition, some of the shareholders expressed their support for the Compensation Committee's objective that the compensation of executives be reflective of the competitive marketplace in an effort to attract, retain and motivate talented executives. The Compensation Committee evaluated the feedback received from these shareholders and reiterated that it too would prefer to include performance-based metrics in our executive compensation program, but that the risk of violating the Incentive Compensation Prohibition is too high. As a result, the Committee determined that it is not able to make changes to the program at this time to address concerns related to the lack of performance-based metrics. The Committee noted that it continues to monitor the ED for any guidance that might reduce the risk of certain types of performance-based compensation violating the Incentive Compensation Prohibition.

*Equity-Based Compensation.* The Compensation Committee is responsible for determining equity-based compensation paid to our executives. All equity-based compensation awards to our executives at the Senior Vice President level and above are granted exclusively by our Compensation Committee. The Compensation Committee has delegated limited authority to our Chief Executive Officer to grant equity-based compensation awards to our newly-hired executives below the Senior Vice President level and other key employees.

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Equity-based compensation is granted to our executives and other key employees under the following circumstances:

the Compensation Committee has typically made grants to our executives and other key employees annually during its first regularly scheduled meeting of the calendar year, which grants become effective prospectively;

the Compensation Committee has typically made grants to our newly-hired executives at the Senior Vice President level and above at a Committee meeting occurring either:

prior to the date that the executive's employment with us begins, in which case the effective date of the grant is typically the executive's first day of employment with us but, if the markets are closed on that day, is the next subsequent day that the markets are open; or

after the executive's employment with us begins, in which case the effective date of the grant is the date of the Committee meeting or a subsequent date specified by the Committee at its meeting; and

pursuant to authority delegated to him by the Compensation Committee, our Chief Executive Officer typically grants equity-based compensation to our newly-hired executives below the Senior Vice President level and other key employees on the newly-hired employee's first day of employment with us.

In each of the above circumstances, the exercise price of any stock option granted is the closing market price of a share of our common stock on the effective date of the stock option grant. In addition, the number of any RSUs is either determined prior to the effective date of grant or is based on the closing market price of a share of our common stock on the effective date of the RSU grant. The grants of equity-based compensation to newly-hired employees that otherwise would have occurred after April 30, 2014 were postponed due to our company not being current in its filings with the SEC. Those grants will be made following our company becoming current in its SEC filings.

We do not time our release of material non-public information for the purpose of affecting the value of our executives compensation, nor do we time our grants of equity-based compensation to take advantage of material non-public information. Nevertheless, our process for granting equity-based compensation (as described above) may result in equity-based compensation, including stock options, being granted to our executives and other key employees at times when our Board of Directors or the Compensation Committee is in possession of material non-public information about us. This possibility is not taken into account in determining whether to make the equity-based compensation awards or the amount or value of those awards.

***Benchmarking.*** The Compensation Committee believes that compensation decisions are complex and from time to time it reviews the compensation levels paid to executives in the same or similar positions at other comparator companies. Although the Compensation Committee does not rely solely on benchmarking to determine any element of compensation or overall compensation, the Compensation Committee has utilized compensation data in connection with decisions regarding the competitive positioning of the Company's compensation levels.

In setting and administering the compensation program and policies for our executives, the Committee attempts to target:

the cash portion of the compensation of our executives to the median of the range of the cash compensation provided to executives of comparator companies, based on the dollar amount of such compensation; and

the equity-based compensation of our executives not to exceed the upper quarter of the range of equity-based compensation provided to executives of comparator companies, based on the number of shares awarded as a percentage of the number of shares outstanding.

This is intended to result in targeting the overall total direct compensation of our executives to the upper third of the range of compensation provided to executives of comparator companies. The Committee targets the upper third of the range, because it believes that part of the range will help us attract and retain a higher than average level of executive.

The companies used for the comparisons vary from time to time. For 2014 compensation determinations, the Compensation Committee reviewed compensation information provided by Towers Watson and contained in the 2013/2014 Towers Watson Compensation DataBank ( Towers Watson Survey ) and the 2013/2014 Mercer Executive Compensation Database ( Mercer Survey ). The Towers Watson Survey consisted of 241 companies with less than \$3 billion in annual revenue. The Mercer Survey consisted of 445 companies. The Compensation Committee did not select specific companies from among the survey participants. Information from the surveys was adjusted to our company's size by using regression analysis to reflect each executive's scope of revenue responsibility.

Additionally, our Compensation Committee used information from proxy statements of a company-specific peer group as a supplement to the general industry published survey data, which remains a primary data source given the similarity in size to our company of the companies included. The proxy peer group data was primarily used for the Chief Executive Officer and Chief Financial Officer positions, because these positions are most directly comparable to the positions at our company. The proxy peer group companies were used for industry financial comparison purposes and as a source of data for compensation plan design characteristics. In consultation with Towers Watson, the Compensation Committee considered the following characteristics in choosing which companies to include in the peer group:

U.S.-based companies that either compete with our company for market share or operate in similar industries as our company;

competitors for senior executive talent;

revenue and market capitalization; and

the degree to which certain companies list our company as a compensation peer.

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As a result, the Compensation Committee reviewed proxy data obtained from proxy materials of the following 13 companies in our industry:

|                                     |   |
|-------------------------------------|---|
| American Public Education,<br>Inc.; | Education Management Corporation;         |
| Apollo Education Group, Inc.;       | Grand Canyon Education, Inc.;             |
| Bridgepoint Education, Inc.;        | K12 Inc.;                                 |
| Capella Education Company;          | Lincoln Educational Services Corporation; |
| Career Education Corp.;             | Strayer Education, Inc.; and              |
| Corinthian Colleges, Inc.;          | Universal Technical Institute, Inc.       |
| DeVry Education Group, Inc.;        |   |

For 2015 compensation determinations, the Compensation Committee did not utilize a company-specific peer group or other detailed comparator information. The Committee reviewed information from Towers Watson that reviewed trends in executive compensation pay levels, trends in short- and long-term incentive plan design and other executive compensation trends. That information contained data regarding the primary components of compensation from the 2014/2015 Towers Watson CDB General Industry Executive Compensation Survey for the chief executive officer position and aggregate top 20 highest paid executives. That survey consisted of 342 companies. Companies used in that analysis reflected the general industry, and the Compensation Committee did not select specific companies from among the survey participants. Data provided in the analysis reflected broad industry trends related to executive compensation. The information also included executive compensation trends in companies in the S&P 1500.

***Additional Compensation Matters.***

*Clawback, Stock Ownership and Hedging Policies.* We do not have any policies regarding automatic adjustment or recovery of compensation paid or awarded to our executives in the event any of the performance measures upon which that compensation was paid or awarded are restated or adjusted, such that the compensation paid or awarded would have been less under the restated or adjusted performance measures.

We do not impose any specific equity or security ownership requirements on our executives. We believe that the equity-based compensation paid to our executives serves to align their interests with those of our shareholders. We believe that it is improper and inappropriate for any employee or Director to engage in short-term or speculative transactions involving our securities. We have a policy that prohibits our officers and Directors from purchasing or selling any publicly-traded options for our securities. This includes the trading of any call or put, the writing of any call or put, hedging or the use of collars. Further, our officers and Directors are prohibited from purchasing any financial instruments (including without limitation prepaid variable forward contracts, equity swaps, collars and exchange funds) that are designed to hedge or offset any decrease in the market value of equity securities granted to or held by such person. In addition, our officers and Directors are prohibited from holding our securities in a margin account or otherwise pledging our securities as collateral for a loan.

*The Impact of Accounting and Tax Treatments on the Compensation.* Section 162(m) of the Internal Revenue Code of 1986, as amended (the IRC) limits the allowable deduction for compensation paid or accrued with respect to the chief executive officer and each of the three other most highly compensated executive officers (other than the chief financial officer) of a publicly held corporation to no more than \$1 million per year. This limitation does not apply to compensation that meets the requirements under Section 162(m) and the regulations promulgated thereunder for qualified performance-based compensation. Our equity-based compensation plans have been approved by our shareholders and include a fixed limit on the number of stock options that may be granted to any individual in any

given year, and the exercise price is based on the fair market value of our stock on the date of grant. As a result, any future gains that may be realized on the stock options granted under our equity-based compensation plans should be exempt from the \$1 million limit on deductible compensation under Section 162(m). RSUs granted under our equity compensation plans, however, are subject to the 162(m) deduction limitation because the vesting of those RSUs is based on the passage of time instead of performance conditions. Further, the Committee's ability to maximize the tax deductibility of other forms of compensation beginning July 1, 2011 is limited by the Incentive Compensation Prohibition, because those regulations can be reasonably interpreted to prohibit the payment of performance-based compensation.

Section 409A of the IRC provides certain requirements for deferred compensation arrangements. Those requirements, among other things, limit flexibility with respect to the time and form of payment of deferred compensation. If a payment or award constitutes deferred compensation subject to Section 409A and the applicable requirements are not satisfied, the recipient could be subject to tax on the award and all other deferred compensation of the same type, and an additional 20% tax and interest at the underpayment rate plus 1%, at the time the legally binding right to the payment or award arises or, if later, when that right ceases to be subject to a substantial risk of forfeiture. Payments or awards under our plans and arrangements either are intended to not constitute deferred compensation for Section 409A purposes (and will thereby be exempt from Section 409A's requirements) or, if they constitute deferred compensation, are intended to comply with the Section 409A statutory provisions and final regulations.

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**Compensation Committee Report**

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K under the Exchange Act with our management. Based on that review and discussions, the Compensation Committee recommended to our Board of Directors that the Compensation Discussion and Analysis be included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014 and in our Proxy Statement for our 2015 Annual Meeting of Shareholders for filing with the U.S. Securities and Exchange Commission.

**Compensation Committee**

**John F. Cozzi**

**James D. Fowler, Jr.**

**Thomas I. Morgan, Chair**

**Samuel L. Odle**

**John A. Yena**

**Compensation-Related Risk Assessment**

Our Compensation Committee conducted an assessment of the risks related to our compensation policies and practices in January 2015. In conducting this assessment, the Compensation Committee noted several features of our compensation programs that reduce the likelihood of excessive risk-taking, including the following:

We have established internal controls, enterprise risk management and a compliance program to discourage and identify any excessive risk-taking by our employees.

There is a balanced mix of cash, equity, annual and longer-term components in the compensation program for our executives.

Due to the Incentive Compensation Prohibition, our compensation programs are not based on the performance of our employees.

While our short-term compensation element is based on certain management objectives for a particular year:

the maximum short-term compensation percentage is capped at 200% of the standard short-term percentage of our executives' annualized base salary, to protect against disproportionately large shorter-term incentives;

the Compensation Committee has substantial discretion on which to base the actual amount of the short-term compensation payments, including the ability to consider and reduce a payment

amount if the Committee determines that an executive caused us to incur unnecessary or excessive risk;

the management objectives include many different business objectives that are company-wide objectives, as opposed to individual objectives, which encourage decision-making that is in the best long-term interests of our company and shareholders; and

the management objectives are not unreasonable or clearly unattainable without excessive risk-taking.

A significant portion of our executives' total compensation consists of equity-based long-term awards, most of which vest over a period of three years, which encourages our executives to focus on sustaining our long-term interests. The equity grants are also made annually, so executives always have unvested awards that could decrease in value if our business is not managed for the long term.

Some of our non-executive employees are eligible to receive equity awards. For those non-executive employees who are eligible to receive equity awards, the equity awards encourage those employees to focus on our long-term interests.

Based on these factors, the Compensation Committee believes that our compensation policies and practices encourage behaviors that are aligned with our long-term interests, and that numerous factors, such as the lack of performance-related incentives, dissuade our employees from taking risks for short-term gain. As a result, the Compensation Committee determined that any risks arising from our compensation policies and practices are not reasonably likely to have a material adverse effect on us.



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The following table sets forth information regarding the compensation of the Named Executive Officers for each of our last three completed fiscal years.

**Summary Compensation Table for Fiscal Years 2014, 2013 and 2012**

| Name and<br>Principal Position<br>(a)   | Year<br>(b) | Salary <sup>(1)</sup><br>(c) | Bonus <sup>(2)</sup><br>(d) | Stock<br>Awards <sup>(3)</sup><br>(e) | Option<br>Awards <sup>(4)</sup><br>(f) | Non-Equity<br>Plan<br>Compensation <sup>(5)</sup><br>(g) | Change in<br>Pension<br>Value and<br>Non-<br>qualified<br>Deferred<br>Earnings <sup>(6)</sup><br>(h) | All Other<br>Compensation <sup>(7)</sup><br>(i) | Total <sup>(8)</sup><br>(j) |
|---|-------------|------------------------------|-----------------------------|---------------------------------------|--|--|--|---|-----------------------------|
|   |             |                              |                             |                                       |  |  |  |   |                             |
| Kevin M. Modany<br>Chief Executive<br>Officer   | 2014        | \$ 821,380                   | \$ 0                        | \$ 785,813                            | \$ 788,750                             | \$ 721,067   | \$ 11,908  | \$ 77,406                                       | \$ 3,206,324                |
|   | 2013        | \$ 798,596                   |                             | \$ 543,094                            | \$ 572,500                             | \$ 1,000,093   | \$ 3,011   | \$ 55,333                                       | \$ 2,972,627                |
|   | 2012        | \$ 788,250                   | \$ 0<br>\$ 985,313          | \$ 4,962,439                          | \$ 1,960,000                           | \$ 0   | \$ 10,857  | \$ 56,525                                       | \$ 8,763,384                |
| Daniel M.<br>Fitzpatrick<br>Executive Vice<br>President, Chief<br>Financial Officer                   | 2014        | \$ 410,652                   | \$ 100,000                  | \$ 188,595                            | \$ 189,300                             | \$ 234,325   | \$ 0   | \$ 13,792                                       | \$ 1,136,664                |
|   | 2013        | \$ 391,915                   | \$ 0                        | \$ 130,343                            | \$ 137,400                             | \$ 325,000   |  | \$ 19,468                                       | \$ 1,004,126                |
|   | 2012        | \$ 334,905                   | \$ 272,448                  | \$ 930,556                            | \$ 344,960                             |  | \$ 0   | \$ 15,722                                       | \$ 1,898,591                |
|   |             |                              |                             |                                       |  | \$ 0   | \$ 0   |   |                             |
| John E. Dean <sup>(9)</sup><br>Executive<br>Chairman  | 2014        | \$ 309,726                   | \$ 0                        | \$ 1,000,002                          | \$ 0                                   | \$ 0   | \$ 0   | \$ 221  | \$ 1,309,949                |
| Eugene W.<br>Feichtner<br>President and<br>Chief Operating<br>Officer                                 | 2014        | \$ 318,366                   | \$ 0                        | \$ 125,730                            | \$ 126,200                             | \$ 245,000   | \$ 93,530  | \$ 11,088                                       | \$ 919,914                  |
|   | 2013        | \$ 309,535                   |                             | \$ 86,895                             | \$ 91,600                              | \$ 232,581   | \$ 214   | \$ 10,949                                       | \$ 731,774                  |
|   | 2012        | \$ 305,147                   | \$ 0<br>\$ 229,144          | \$ 846,903                            | \$ 313,600                             |  | \$ 61,046  | \$ 11,454                                       | \$ 1,767,294                |
|   |             |                              |                             |                                       |  | \$ 0   |  |   |                             |
| Ronald F.<br>Hamm <sup>(10)</sup><br>Former Executive<br>Vice President,<br>President<br>Breckinridge | 2014        | \$ 333,655                   | \$ 0                        | \$ 125,730                            | \$ 126,200                             | \$ 161,098   | \$ 0   | \$ 37,701                                       | \$ 784,384                  |
|   | 2013        | \$ 243,750                   |                             | \$ 86,895                             | \$ 91,600                              | \$ 192,319   |  | \$ 23,451                                       | \$ 638,015                  |
|   |             |                              | \$ 0                        |                                       |  |  | \$ 0   |   |                             |

- (1) Amounts shown represent the dollar value of base salary earned during each of the years indicated. For Mr. Dean, the amount shown for 2014 consists of: (i) \$75,000, which is the dollar value of the annual retainer that he received in early 2014 as a non-employee Director of ours in 2014; and (ii) \$234,726, which is the base salary that he earned in 2014 following his appointment as the Executive Chairman of the Board on August 4, 2014. Mr. Dean elected to receive payment of his annual retainer in shares of our common stock, and to defer receipt of those shares, pursuant to the ESI Non-Employee Directors Deferred Compensation Plan (the Directors Deferred Compensation Plan ). See Director Compensation *Directors Deferred Compensation Plan*.
- (2) Amounts shown represent the dollar value of discretionary bonus amounts earned in the stated year. Under Item 402(a) of Regulation S-K under the Exchange Act, any bonus award that is paid above the amounts earned by the Named Executive Officer under, or that is otherwise paid to the Named Executive Officer without regard to, pre-established targets is to be reported in this column. The amounts earned under pre-established targets are reported in column (g), Non-Equity Incentive Plan Compensation, of the Summary Compensation Table. The amount shown for Mr. Fitzpatrick in 2014 represents a discretionary bonus payment made to him in recognition of his significant efforts and time spent on company matters in 2014, which was in addition to the amount paid to him under the short-term compensation element of the executive compensation program for 2014, shown in the Non-Equity Incentive Plan Compensation column. The amounts shown in this column for 2012 consist of amounts paid under the short-term compensation element of our executive compensation, based on certain management objectives for 2012 (the 2012 Management Objectives ). In December 2012, the Compensation Committee decided to assign zero to five points to each 2012 Management Objective based on the extent to which it was accomplished, instead of the previously-established determination to assign five points to each 2012 Management Objective only if it was fully accomplished. This change resulted in these payments being included in this column instead of in the Non-Equity Incentive Plan Compensation column of the Summary Compensation Table.
- (3) Amounts shown represent the aggregate grant date fair value, computed in accordance with ASC 718, of all awards of RSUs granted to the Named Executive Officer in the year indicated. To determine the grant date fair value of RSU awards, we use the closing market price of a share of our common stock on the effective date of the RSU award. The amounts ultimately realized by the Named Executive Officers from the RSU awards will depend on the price of our common stock in the future and may be quite different from the values shown. For Mr. Dean, the amount shown includes the aggregate grant date fair value of the award of RSUs granted to him on August 4, 2014, but does not include the amount of the 2014 Director annual retainer paid in early 2014 that Mr. Dean elected to receive in the form of shares of our common stock. That amount is included in column (c) of the table, and the fair value of such common stock was \$74,984.
- (4) Amounts shown represent the aggregate grant date fair value, computed in accordance with ASC 718, of all awards of stock options granted to the Named Executive Officer in the year indicated. The option awards relate solely to shares of our common stock. None of the Named Executive Officers has received any stock appreciation rights ( SARs ) from us. We did not adjust or amend the exercise price of any options previously awarded to any of the Named Executive Officers, whether through amendment, cancellation or replacement grants,

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or any other means (such as a repricing), or otherwise materially modify such awards, during any of the years indicated. We used a binomial option pricing model to determine the grant date fair value of the stock options granted in each of the years indicated, which takes into account the variables defined below:

**Volatility** is a statistical measure of the extent to which the stock price is expected to fluctuate during a period and combines our historical stock price volatility and the implied volatility as measured by actively traded stock options.

**Expected life** is the weighted average period that those stock options are expected to remain outstanding, based on the historical patterns of our stock option exercises, as adjusted to reflect the current position-level demographics of the stock option grantees.

**Risk-free interest rate** is based on interest rates for terms that are similar to the expected life of the stock options.

**Dividend yield** is based on our historical and expected future dividend payment practices.

The following table sets forth the assumptions supporting those variables that were used to determine the values reported with respect to the stock options granted to the Named Executive Officers in each of the years indicated:

|                          | <b>Assumptions Associated with<br/>Stock Options Granted In</b> |             |             |
|--------------------------|---|-------------|-------------|
|                          | <b>2014</b>   | <b>2013</b> | <b>2012</b> |
| Volatility               | 55%   | 60%         | 51%         |
| Expected life (in years) | 4.7   | 4.6         | 4.5         |
| Risk-free interest rate  | 1.3%  | 0.7%        | 0.7%        |
| Dividend yield           | None  | None        | None        |

The amounts ultimately realized by the Named Executive Officers from the option awards will depend on the price of our common stock in the future and may be quite different from the values shown.

- (5) Amounts shown represent the dollar value of all amounts earned for services performed during each of the years indicated pursuant to awards under non-equity incentive plans. There were no earnings on any outstanding non-equity incentive plan awards during any of the years indicated. The amounts reported in this column for 2014 and 2013 consist of amounts earned under the short-term compensation element of our executive compensation, based on the management objectives for that year, and paid in the following year. Under Item 402(a) of Regulation S-K under the Exchange Act, our short-term compensation element is defined to be non-equity incentive plan compensation, instead of bonus compensation, to the extent that the outcome with respect to the relevant targets under our management objectives was substantially uncertain at the time the targets were established by the Compensation Committee and communicated to the participants. As a result, our short-term compensation element is intended to serve as an incentive to obtain results over a specified fiscal year, which caused it to be reported in this column. As described further in Compensation Discussion and

*Analysis Compensation Elements 2014 Compensation* Short-Term Compensation, the amount shown in 2014 for Mr. Feichtner was based on his base salary rate as of February 9, 2015, instead of December 31, 2015 as initially contemplated, due to the fact that his base salary increase in connection with his appointment as our President and Chief Operating Officer in August 2014 was only delayed to February 2015 instead of being effective in August 2014 as a result of the Incentive Compensation Prohibition related to the number of permitted salary increases in a year. No changes were made to the 2014 Management Objectives applicable to Mr. Feichtner or any other Named Executive Officer. Amounts shown in this column include any portion of the award that may have been deferred by the Named Executive Officers under the Deferred Bonus Plan. See Nonqualified Deferred Compensation Plans *Deferred Bonus Plan*.

(6) Amounts shown consist of:

the aggregate change in actuarial present value of the Named Executive Officer's accumulated benefit on an annualized basis under all defined benefit and actuarial pension plans (including supplemental plans) from December 31 of the prior completed fiscal year to December 31 of the covered fiscal year, except that with respect to the 2013 aggregate change in actuarial present value for all Named Executive Officer participants, that aggregate change was a negative number (see table below), and therefore in accordance with the SEC rule, that negative change is not included in the amount reported in this column or in the Total column; and

the above-market or preferential earnings on compensation that is deferred on a basis that is not tax-qualified, including such earnings on nonqualified defined contribution plans.

The aggregate change in actuarial present value of the Named Executive Officer's accumulated benefit on an annualized basis under each of the following plans is presented in the table below:

the Retirement Plan for Salaried Employees of ITT Corporation (the Old Pension Plan), a non-contributory defined benefit pension plan;

the ESI Pension Plan, a cash balance defined benefit plan; and

the ESI Excess Pension Plan, an unfunded, nonqualified retirement plan.

See Pension Plans.

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| Named Executive Officer | ESI Excess Pension Plan  |  |  | Total       |
|-------------------------|--|--|--|-------------|
|                         | Old Pension Plan<br>Aggregate Change<br>in Present Value of<br>Accumulated Benefit | ESI Pension Plan<br>Aggregate Change<br>in Present Value of<br>Accumulated Benefit | Pension Plan<br>Aggregate Change<br>in Present Value of<br>Accumulated Benefit |             |
| Kevin M. Modany         |  |  |  |             |
| 2014                    | \$ 0   | \$ 4,024   | \$ 5,188   | \$ 9,212    |
| 2013                    | \$ 0   | \$ (1,612)   | \$ (2,078)   | \$ (3,690)  |
| 2012                    | \$ 0   | \$ 3,619   | \$ 4,667   | \$ 8,286    |
| Daniel M. Fitzpatrick   |  |  |  |             |
| 2014                    | \$ 0   | \$ 0   | \$ 0   | \$ 0        |
| 2013                    | \$ 0   | \$ 0   | \$ 0   | \$ 0        |
| 2012                    | \$ 0   | \$ 0   | \$ 0   | \$ 0        |
| John E. Dean            |  |  |  |             |
| 2014                    | \$ 0   | \$ 0   | \$ 0   | \$ 0        |
| Eugene W. Feichtner     |  |  |  |             |
| 2014                    | \$ 78,018  | \$ 12,312  | \$ 3,008   | \$ 93,338   |
| 2013                    | \$ (36,285)  | \$ 11,788  | \$ 2,893   | \$ (21,604) |
| 2012                    | \$ 46,795  | \$ 11,286  | \$ 2,782   | \$ 60,863   |
| Ronald F. Hamm          |  |  |  |             |
| 2014                    | \$ 0   | \$ 0   | \$ 0   | \$ 0        |
| 2013                    | \$ 0   | \$ 0   | \$ 0   | \$ 0        |

In addition, the above-market or preferential earnings on compensation that is deferred on a basis that is not tax-qualified for the benefit of the Named Executive Officers under the ESI Excess Savings Plan, an unfunded, nonqualified retirement plan are specified in the table below. There were no above-market or preferential earnings on compensation that is deferred on a basis that is not tax-qualified for the benefit of the Named Executive Officers under the Deferred Bonus Plan, an unfunded, nonqualified deferred compensation plan, in 2014, 2013 or 2012. See Nonqualified Deferred Compensation Plans.

| Named Executive Officer | ESI Excess Savings Plan<br>Above-Market or<br>Preferential Earnings on<br>Deferred Compensation <sup>(A)</sup> |       |
|-------------------------|--|-------|
|                         |  |       |
| Kevin M. Modany         |  |       |
| 2014                    | \$   | 2,696 |
| 2013                    | \$   | 3,011 |
| 2012                    | \$   | 2,571 |
| Daniel M. Fitzpatrick   |  |       |
| 2014                    | \$   | 0     |
| 2013                    | \$   | 0     |
| 2012                    | \$   | 0     |
| John E. Dean            |  |       |
| 2014                    | \$   | 0     |
| Eugene W. Feichtner     |  |       |
| 2014                    | \$   | 192   |
| 2013                    | \$   | 214   |

|                |    |     |
|----------------|----|-----|
| 2012           | \$ | 183 |
| Ronald F. Hamm |    |     |
| 2014           | \$ | 0   |
| 2013           | \$ | 0   |

- (A) Interest is above-market only if the rate of interest exceeds 120% of the applicable federal long-term rate, with compounding (as prescribed under Section 1274(d) of the IRC), at the rate that corresponds most closely to the rate under the applicable plan at the time the interest rate or formula is set. In the event of a discretionary reset of the interest rate, the requisite calculation is made on the basis of the interest rate at the time of such reset, rather than when originally established. Only the above-market portion of the interest is included.

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(7) Amounts shown represent all other compensation for each of the years indicated that could not properly be reported in columns (c) through (h) of the Summary Compensation Table, as follows:

| Named Executive Officer      | Perquisites <sup>(A)</sup>        |   |                              |   |  |                                      |                                   |                               |                   |
|------------------------------|-----------------------------------|---|------------------------------|---|--|--------------------------------------|-----------------------------------|-------------------------------|-------------------|
|                              | Use of Company Car <sup>(B)</sup> | and Financial Planning Allowance <sup>(C)</sup> | Event Tickets <sup>(D)</sup> | Enhanced Disability Benefits <sup>(E)</sup> | Annual Physical Examination <sup>(F)</sup> | Relocation Assistance <sup>(G)</sup> | Commuting Expenses <sup>(H)</sup> | Legal Expenses <sup>(I)</sup> | Perquisites Total |
| <b>Kevin M. Modany</b>       |                                   |   |                              |   |  |                                      |                                   |                               |                   |
| 2014                         | \$ 25,607                         | \$ 14,686                                       | \$ 3,511                     | \$ 6,593                                    | \$ 2,801                                   | \$ 0                                 | \$ 0                              | \$ 18,475                     | \$ 71,673         |
| 2013                         | \$ 25,261                         | \$ 6,331  | \$ 6,487                     | \$ 6,422                                    | \$ 3,182                                   | \$ 0                                 | \$ 0                              | \$ 0                          | \$ 47,683         |
| 2012                         | \$ 25,280                         | \$ 14,230                                       | \$ 2,334                     | \$ 6,503                                    | \$ 2,665                                   | \$ 0                                 | \$ 0                              | \$ 0                          | \$ 51,012         |
| <b>Daniel M. Fitzpatrick</b> |                                   |   |                              |   |  |                                      |                                   |                               |                   |
| 2014                         | \$ 0                              | \$ 4,120  | \$ 643                       | \$ 3,296                                    | \$ 0                                       | \$ 0                                 | \$ 0                              | \$ 0                          | \$ 8,059          |
| 2013                         | \$ 0                              | \$ 4,000  | \$ 2,056                     | \$ 3,222                                    | \$ 2,540                                   | \$ 0                                 | \$ 0                              | \$ 0                          | \$ 11,818         |
| 2012                         | \$ 0                              | \$ 3,353  | \$ 436                       | \$ 2,766                                    | \$ 1,667                                   | \$ 0                                 | \$ 0                              | \$ 0                          | \$ 8,222          |
| <b>John E. Dean</b>          |                                   |   |                              |   |  |                                      |                                   |                               |                   |
| 2014                         | \$ 0                              | \$ 0  | \$ 0                         | \$ 0  | \$ 0                                       | \$ 0                                 | \$ 0                              | \$ 0                          | \$ 0              |
| <b>Eugene W. Feichtner</b>   |                                   |   |                              |   |  |                                      |                                   |                               |                   |
| 2014                         | \$ 0                              | \$ 3,194  | \$ 0                         | \$ 2,555                                    | \$ 0                                       | \$ 0                                 | \$ 0                              | \$ 0                          | \$ 5,749          |
| 2013                         | \$ 0                              | \$ 3,101  | \$ 0                         | \$ 2,502                                    | \$ 0                                       | \$ 0                                 | \$ 0                              | \$ 0                          | \$ 5,603          |
| 2012                         | \$ 0                              | \$ 3,055  | \$ 604                       | \$ 2,521                                    | \$ 0                                       | \$ 0                                 | \$ 0                              | \$ 0                          | \$ 6,180          |
| <b>Ronald F. Hamm</b>        |                                   |   |                              |   |  |                                      |                                   |                               |                   |
| 2014                         | \$ 0                              | \$ 2,223  | \$ 0                         | \$ 2,678                                    | \$ 0                                       | \$ 9,145                             | \$ 16,005                         | \$ 0                          | \$ 30,051         |
| 2013                         | \$ 0                              | \$ 0  | \$ 69                        | \$ 2,622                                    | \$ 0                                       | \$ 19,072                            | \$ 0                              | \$ 0                          | \$ 21,763         |

| Named Executive Officer      | ITT/ESI Contributions            |                   |                                       |
|------------------------------|----------------------------------|-------------------|---------------------------------------|
|                              | Under 401(k) Plan <sup>(J)</sup> | Perquisites Total | All Other Compensation <sup>(K)</sup> |
| <b>Kevin M. Modany</b>       |                                  |                   |                                       |
| 2014                         | \$ 5,733                         | \$ 71,673         | \$ 77,406                             |
| 2013                         | \$ 7,650                         | \$ 47,683         | \$ 55,333                             |
| 2012                         | \$ 5,513                         | \$ 51,012         | \$ 56,525                             |
| <b>Daniel M. Fitzpatrick</b> |                                  |                   |                                       |
| 2014                         | \$ 5,733                         | \$ 8,059          | \$ 13,792                             |
| 2013                         | \$ 7,650                         | \$ 11,818         | \$ 19,468                             |
| 2012                         | \$ 7,500                         | \$ 8,222          | \$ 15,722                             |
| <b>John E. Dean</b>          |                                  |                   |                                       |
| 2014                         | \$ 221                           | \$ 0              | \$ 221                                |
| <b>Eugene W. Feichtner</b>   |                                  |                   |                                       |
| 2014                         | \$ 5,339                         | \$ 5,749          | \$ 11,088                             |
| 2013                         | \$ 5,346                         | \$ 5,603          | \$ 10,949                             |
| 2012                         | \$ 5,274                         | \$ 6,180          | \$ 11,454                             |
| <b>Ronald F. Hamm</b>        |                                  |                   |                                       |
| 2014                         | \$ 7,650                         | \$ 30,051         | \$ 37,701                             |

|      |    |       |    |        |    |        |
|------|----|-------|----|--------|----|--------|
| 2013 | \$ | 1,688 | \$ | 21,763 | \$ | 23,451 |
|------|----|-------|----|--------|----|--------|

- (A) Amounts shown represent the aggregate incremental cost to us for the perquisites provided to the Named Executive Officers in each of the years indicated.
- (B) The methodology for computing the aggregate incremental cost to us for providing use of a company car involves compiling the expenses that were paid by us or reimbursed to the Named Executive Officer for the Named Executive Officer's use of the vehicle. Those expenses include:

the amount of depreciation expense that we recognized on the company-owned car;

the cost of insurance premiums relating to the car that were paid by us;

the cost of gasoline used in the car that was paid or reimbursed by us; and

the cost of maintenance and repairs of the car that was paid or reimbursed by us.

- (C) The methodology for computing the aggregate incremental cost to us for providing a tax return and financial planning allowance involves determining the sum of all receipts for tax return and financial planning services that are submitted by and reimbursed to the Named Executive Officer up to the amount of the allowance authorized by the Compensation Committee (i.e., 2% of annualized base salary as of the effective date of any increase in base salary for that fiscal year for Mr. Modany, and 1% of annualized base salary as of the effective date of any increase in base salary for that fiscal year for each of the other Named Executive Officers).



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- (D) The methodology for computing the aggregate incremental cost to us for providing event tickets involves identifying the specific events that the Named Executive Officer and his or her guests attended during the year and attributing the actual costs paid by us or reimbursed to the Named Executive Officer for the Named Executive Officer and his or her guests to attend the event. Those costs include:

the portion of a license fee for a private suite and associated spectator seats used by the Named Executive Officer and his or her guests;

the cost of food and beverages consumed by the Named Executive Officer and his or her guests in connection with the event;

the cost of tickets used by the Named Executive Officer and his or her guests to attend the event; and

the cost of parking fees incurred by the Named Executive Officer and his or her guests to attend the event.

- (E) The methodology for computing the aggregate incremental cost to us for providing enhanced disability benefits involves:

multiplying the monthly charge to us per employee for the enhanced short-term disability benefits by the number of months;

multiplying the annual charge to us per \$100 of coverage for the enhanced long-term disability benefits by the number of \$100 increments in the coverage; and

adding together the sum of the amounts calculated in the prior two bullet points.

- (F) The methodology for computing the aggregate incremental cost to us for providing annual physical examinations involves determining the expenses for such examination that have been paid by us directly to the provider or reimbursed to the Named Executive Officer.
- (G) The methodology for computing the aggregate incremental cost to us for providing relocation assistance involves compiling all of the reimbursable expenses, as specified in our relocation assistance program, that have been paid by us or the Named Executive Officer with respect to the relocation.
- (H) The methodology for computing the aggregate incremental cost to us related to commuting expenses involves compiling the expenses that were paid by us or reimbursed to the Named Executive Officer for certain costs incurred in connection with commuting to our headquarters, including mileage, meals and lodging.
- (I) The methodology for computing the aggregate incremental cost to us related to legal expenses involves compiling the amounts paid or reimbursed by us related to the fees and expenses of Mr. Modany's counsel incurred in connection with the negotiation of the Modany Letter Agreement.

- (J) Amounts shown represent our contributions or other allocations made under the ESI 401(k) Plan, a defined contribution plan, for the benefit of the Named Executive Officers in each of the years indicated. See Equity Compensation and Qualified Savings Plans *ESI 401(k) Plan*.
- (K) Amounts shown do not include our cost for employee benefits that do not discriminate in scope, terms or operation in favor of our executive officers and that are available generally to all full-time and part-time regular employees, including, without limitation, medical and dental benefits, vision insurance, life insurance, flexible spending account, business travel and accident insurance, and disability insurance.
- (8) Amounts shown represent the sum of the dollar values for each compensation element in columns (c) through (i) in each of the years indicated.
- (9) On August 4, 2014, our Board of Directors appointed Mr. Dean as Executive Chairman of the Board, in connection with Mr. Modany's resignation as Chairman and a Director, and Mr. Modany's notification of his intent to resign as our Chief Executive Officer in 2015. Mr. Dean has been a Director of ours since 1994, but prior to 2014, he had not been an employee or executive officer of ours. As permitted by the SEC, because this is Mr. Dean's first year as a Named Executive Officer, the compensation paid to Mr. Dean in years prior to 2014 is not included in this table. Mr. Dean's compensation as a non-employee Director of ours in prior years, however, has been disclosed in proxy statements we previously filed with the SEC.
- (10) Mr. Hamm's employment with us began in March 2013 and ended on May 15, 2015.

**Amount of Salary and Bonus in Proportion to Total Compensation**

The salary, non-equity incentive plan and bonus compensation and salary, non-equity incentive plan and bonus compensation, as a percentage of each Named Executive Officer's total compensation, for the years indicated was as follows:

| Named Executive Officer | Salary     | Salary and Non-Equity Incentive Plan and Bonus |                                 | Total Compensation | Salary and Non-Equity Incentive Plan and Bonus Compensation as a Percentage of Total Compensation |            |            |
|-------------------------|------------|--|---------------------------------|--------------------|---|------------|------------|
|                         |            | Non-Equity Incentive Plan and Bonus            | Equity Incentive Plan and Bonus |                    | Percentage  | Percentage | Percentage |
| Kevin M. Modany         |            |  |                                 |                    |   |            |            |
| 2014                    | \$ 821,380 | \$ 721,067                                     | \$ 1,542,447                    | \$ 3,206,324       | 25.6%   | 22.5%      | 48.1%      |
| 2013                    | \$ 798,596 | \$ 1,000,093                                   | \$ 1,798,689                    | \$ 2,972,627       | 26.9%   | 33.6%      | 60.5%      |
| 2012                    | \$ 788,250 | \$ 985,313                                     | \$ 1,773,563                    | \$ 8,763,384       | 9.0%  | 11.2%      | 20.2%      |
| Daniel M. Fitzpatrick   |            |  |                                 |                    |   |            |            |
| 2014                    | \$ 410,652 | \$ 334,325                                     | \$ 744,977                      | \$ 1,136,664       | 36.1%   | 29.4%      | 65.5%      |
| 2013                    | \$ 391,915 | \$ 325,000                                     | \$ 716,915                      | \$ 1,004,126       | 39.0%   | 32.4%      | 71.4%      |
| 2012                    | \$ 334,905 | \$ 272,448                                     | \$ 607,353                      | \$ 1,898,591       | 17.6%   | 14.4%      | 32.0%      |
| John E. Dean            |            |  |                                 |                    |   |            |            |
| 2014                    | \$ 309,726 | \$ 0   | \$ 309,726                      | \$ 1,309,949       | 23.6%   | N/A        | 23.6%      |
| Eugene W. Feichtner     |            |  |                                 |                    |   |            |            |
| 2014                    | \$ 318,366 | \$ 245,000                                     | \$ 563,366                      | \$ 919,914         | 34.6%   | 26.6%      | 61.2%      |
| 2013                    | \$ 309,535 | \$ 232,581                                     | \$ 542,116                      | \$ 731,774         | 42.3%   | 31.8%      | 74.1%      |
| 2012                    | \$ 305,147 | \$ 229,144                                     | \$ 534,291                      | \$ 1,767,294       | 17.3%   | 13.0%      | 30.2%      |
| Ronald F. Hamm          |            |  |                                 |                    |   |            |            |

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|      |            |            |            |            |       |       |       |
|------|------------|------------|------------|------------|-------|-------|-------|
| 2014 | \$ 333,655 | \$ 161,098 | \$ 494,753 | \$ 784,384 | 42.5% | 20.5% | 63.1% |
| 2013 | \$ 243,750 | \$ 192,319 | \$ 436,069 | \$ 638,015 | 38.2% | 30.1% | 68.3% |

- (1) The amounts of non-equity incentive plan and bonus compensation reported in this table include the amounts of such compensation as reported in the Non-Equity Incentive Plan Compensation and Bonus columns of the Summary Compensation Table for each of the years indicated.
- (2) Amounts shown represent the sum of the dollar values for each compensation element that we are required to report in the Summary Compensation Table for each of the years indicated. See Summary Compensation Table.

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Generally in the years indicated, the amount of salary has represented less than 45%, and the amount of salary and non-equity incentive plan and bonus compensation combined has represented approximately 20% to 75%, of the Named Executive Officer's total compensation. In addition, depending on achievement of management objectives, the amount of non-equity incentive plan compensation in each year could have ranged from 15% to 200% of the Named Executive Officer's salary, depending on the Named Executive Officer's position. The increases in non-equity incentive plan and bonus compensation, and salary and non-equity incentive plan and bonus compensation, in each case as a percentage of total compensation, in 2013 compared to 2012 were primarily due to no supplemental equity awards being made in 2013.

**Form W-2, Wage and Tax Statement Compensation Table**

The Form W-2, Wage and Tax Statement Compensation Table below supplements the SEC-required disclosure in the Summary Compensation Table set forth above. The Form W-2, Wage and Tax Statement Compensation Table below sets forth the total taxable wages, tips and other compensation (collectively, "Wages") that we paid to the Named Executive Officers in each of the last five calendar years, as shown in Box 1 of the U.S. Internal Revenue Service's Form W-2, Wage and Tax Statement that we provided to the Named Executive Officers with respect to each of those calendar years. Total compensation as calculated under the SEC's rules and as shown in the Summary Compensation Table above and in prior year's Proxy Statements includes several items that are driven by accounting and actuarial assumptions, which are not necessarily reflective of the Wages that we paid to the Named Executive Officers in a particular calendar year.

Amounts shown in the Total Wages column below differ substantially from, and should not be considered a substitute for, the amounts shown in the Total column of the Summary Compensation Table. The Total Wages amounts in the table below represent:

amounts paid as salary to the Named Executive Officer in the applicable year, less any tax-qualified deductions such as contributions or premiums paid by the Named Executive Officer to the ESI 401(k) Plan, certain health and welfare benefit plans and health savings accounts;

amounts paid as bonus, non-equity incentive plan compensation and short-term compensation to the Named Executive Officer in the applicable year;

the value realized from the exercise of stock options by the Named Executive Officer in the applicable year, determined by subtracting the exercise price of the option from the market price of a share of our common stock at exercise, and then multiplying that amount by the total number of shares acquired on exercise at that exercise price;

the value realized from the vesting of RSUs held by the Named Executive Officer in the applicable year, determined, for stock-settled RSUs, by multiplying the number of RSUs vested by the market price of a share of our common stock on the vesting date, and for cash-settled RSUs, by multiplying the number of RSUs vested by the average of the closing market prices of our common stock over the 20 trading day period prior to the settlement date;

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the value of noncash payments, including certain fringe benefits, made to the Named Executive Officer in the applicable year;

the taxable cost of group-term life insurance in excess of \$50,000 for the Named Executive Officer in the applicable year; and

the taxable amount of all other compensation paid to the Named Executive Officer in the applicable year.

**Form W-2, Wage and Tax Statement Compensation Table**

| Name and Principal Position | Year | Total Wages <sup>(1)</sup> | Summary      | Difference <sup>(3)</sup> | Total Wages as a |
|-----------------------------|------|----------------------------|--------------|---------------------------|------------------|
|                             |      |                            | Compensation |                           | Percentage of    |
|                             |      |                            | Table Total  |                           | Summary          |
|                             |      |                            | Compensation |                           | Compensation     |
|                             |      |                            | Table Total  |                           | Table Total      |
|                             |      |                            |              |                           | Compensation     |
| Kevin M. Modany             |      |                            |              |                           |                  |
| Chief Executive Officer     | 2014 | \$ 2,120,860               | \$ 3,206,324 | \$ (1,085,464)            | 66.1%            |
|                             | 2013 | \$ 919,595                 | \$ 2,972,627 | \$ (2,053,032)            | 30.9%            |
|                             | 2012 | \$ 5,336,585               | \$ 8,763,384 | \$ (3,426,799)            | 60.9%            |
|                             | 2011 | \$ 2,419,077               | \$ 6,412,454 | \$ (3,993,377)            | 37.7%            |
|                             | 2010 | \$ 2,211,344               | \$ 6,745,967 | \$ (4,534,623)            | 32.8%            |

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| Name and Principal Position   | Year | Total Wages <sup>(1)</sup> | Summary Compensation Table Total |                             | Difference <sup>(3)</sup> | Total Wages as a Percentage of Summary Compensation Table Total |
|---|------|----------------------------|----------------------------------|-----------------------------|---------------------------|---|
|   |      |                            | Total Wages <sup>(1)</sup>       | Compensation <sup>(2)</sup> |                           | Compensation  |
| Daniel M. Fitzpatrick<br>Executive Vice President, Chief<br>Financial Officer   | 2014 | \$ 796,147                 | \$ 1,136,664                     | \$ (340,517)                | 70.0%                     |   |
|   | 2013 | \$ 400,468                 | \$ 1,004,126                     | \$ (603,658)                | 39.9%                     |   |
|   | 2012 | \$ 1,259,366               | \$ 1,898,591                     | \$ (639,225)                | 66.3%                     |   |
|   | 2011 | \$ 764,326                 | \$ 1,527,927                     | \$ (763,601)                | 50.0%                     |   |
|   | 2010 | \$ 698,426                 | \$ 1,429,072                     | \$ (730,646)                | 48.9%                     |   |
| John E. Dean<br>Executive Chairman  | 2014 | \$ 221,416                 | \$ 1,309,949                     | \$ (1,088,533)              | 16.9%                     |   |
| Eugene W. Feichtner<br>President and Chief Operating Officer  | 2014 | \$ 626,787                 | \$ 919,914                       | \$ (293,127)                | 68.1%                     |   |
|   | 2013 | \$ 323,208                 | \$ 731,774                       | \$ (408,566)                | 44.2%                     |   |
|   | 2012 | \$ 1,542,401               | \$ 1,767,294                     | \$ (224,893)                | 87.3%                     |   |
|   | 2011 | \$ 678,190                 | \$ 1,453,708                     | \$ (775,518)                | 46.7%                     |   |
|   | 2010 | \$ 1,409,800               | \$ 1,327,513                     | \$ 82,287                   | 106.2%                    |   |
| Ronald F. Hamm<br>Former Executive Vice President,<br>President Breckinridge School of<br>Nursing and Health Sciences | 2014 | \$ 523,626                 | \$ 784,384                       | \$ (260,758)                | 66.8%                     |   |
|   | 2013 | \$ 251,439                 | \$ 638,015                       | \$ (386,576)                | 39.4%                     |   |

(1) Amounts shown are described above the table.

(2) Amounts shown represent the amounts shown in, or calculated in accordance with the rules for, the Total column of the Summary Compensation Table.

(3) Amounts shown represent the difference between the Total Wages column and the Summary Compensation Table Total Compensation column.

**Grants of Plan-Based Awards Table**

The following table sets forth information regarding grants of plan-based awards in 2014 to each of our Named Executive Officers.

**Grants of Plan-Based Awards in Fiscal Year 2014**

| Date | Compensation | Estimated Possible Payouts | All Other            | All Other      | Exercise | Grant Date Fair Value of |
|------|--------------|----------------------------|----------------------|----------------|----------|--------------------------|
|      |              |                            | Stock Awards: Number | Option Awards: |          |                          |

| Named Executive Officer<br>(a)             | Grant Date <sup>(1)</sup><br>(b) | Committee Took Action to Grant Awards<br>(c) | Under Non-Equity Incentive Plan Awards <sup>(2)</sup> |                              |                               | of Shares of Stock or Units<br>(g) | Number of Securities Underlying Options<br>(h) | or Base Price of Option Awards (\$/sh) <sup>(6)</sup><br>(i) | Stock and Option Awards <sup>(7)</sup><br>(j) |
|--|----------------------------------|--|---|------------------------------|-------------------------------|------------------------------------|--|--|---|
|  |                                  |  | Threshold <sup>(3)</sup><br>(d)                       | Target <sup>(4)</sup><br>(e) | Maximum <sup>(5)</sup><br>(f) |                                    |  |  |   |
| Kevin M. Modany                            |                                  |  |   |                              |                               |                                    |  |  |   |
| Stock Option Award <sup>(8)</sup>          | 02/04/14                         | 01/20/14 <sup>(9)</sup>                      | N/A   | N/A                          | N/A                           | N/A                                | 62,500 <sup>(10)</sup>                         | \$ 27.94   | \$ 788,750                                    |
| RSU Award <sup>(11)</sup>                  | 02/04/14                         | 01/20/14 <sup>(9)</sup>                      | N/A   | N/A                          | N/A                           | 28,125 <sup>(12)</sup>             | N/A  | N/A  | \$ 785,813                                    |
| 2014 Management Objectives <sup>(13)</sup> | N/A                              | 01/20/14                                     | \$206,019   | \$824,076                    | \$1,648,152                   | N/A                                | N/A  | N/A  | N/A   |
| Daniel M. Fitzpatrick                      |                                  |  |   |                              |                               |                                    |  |  |   |
| Stock Option Award <sup>(8)</sup>          | 02/04/14                         | 01/20/14 <sup>(9)</sup>                      | N/A   | N/A                          | N/A                           | N/A                                | 15,000 <sup>(10)</sup>                         | \$ 27.94   | \$ 189,300                                    |
| RSU Award <sup>(11)</sup>                  | 02/04/14                         | 01/20/14 <sup>(9)</sup>                      | N/A   | N/A                          | N/A                           | 6,750 <sup>(12)</sup>              | N/A  | N/A  | \$ 188,595                                    |
| 2014 Management Objectives <sup>(13)</sup> | N/A                              | 01/20/14                                     | \$66,950  | \$267,800                    | \$535,600                     | N/A                                | N/A  | N/A  | N/A   |
| John E. Dean                               |                                  |  |   |                              |                               |                                    |  |  |   |
| Deferred Stock <sup>(14)</sup>             | 01/01/14                         | N/A  | N/A   | N/A                          | N/A                           | 2,233                              | N/A  | N/A  | \$ 74,984                                     |
| RSU Award <sup>(11)</sup>                  | 08/04/14                         | 08/04/14                                     | N/A   | N/A                          | N/A                           | 129,534 <sup>(15)</sup>            | N/A  | N/A  | \$ 1,000,002                                  |
| Eugene W. Feichtner                        |                                  |  |   |                              |                               |                                    |  |  |   |
| Stock Option Award <sup>(8)</sup>          | 02/04/14                         | 01/20/14 <sup>(9)</sup>                      | N/A   | N/A                          | N/A                           | N/A                                | 10,000 <sup>(10)</sup>                         | \$ 27.94   | \$ 126,200                                    |
| RSU Award <sup>(11)</sup>                  | 02/04/14                         | 01/20/14 <sup>(9)</sup>                      | N/A   | N/A                          | N/A                           | 4,500 <sup>(12)</sup>              | N/A  | N/A  | \$ 125,730                                    |

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| Named Executive Officer<br>(a)                         | Grant Date <sup>(1)</sup><br>(b) | Date<br>to Grant<br>Awards<br>(c) | Compensation<br>Committee<br>Took Action<br>(d) | Estimated Possible Payouts<br>Under Non-Equity<br>Incentive Plan Awards <sup>(2)</sup><br>(e) | Maximum <sup>(5)</sup><br>(f) | All<br>Other<br>Stock<br>Awards:<br>Number<br>of<br>Shares<br>of<br>Stock<br>or<br>Units<br>(g) | All<br>Other<br>Option<br>Awards:<br>Number<br>of<br>Securities<br>Underlying<br>Options<br>(h) | Exercise<br>or<br>Base<br>Price<br>of<br>Option<br>Awards<br>(\$/sh) <sup>(6)</sup><br>(i) | Grant<br>Date<br>Fair<br>Value of<br>Stock<br>and<br>Option<br>Awards <sup>(7)</sup><br>(j) |
|--|----------------------------------|-----------------------------------|---|---|-------------------------------|---|---|--|---|
|  |                                  |                                   |   |   |                               | 2014 Management Objectives <sup>(13)</sup>  | N/A   | 01/20/14   | \$ 47,912   |
| Ronald F. Hamm<br>Stock Option<br>Award <sup>(8)</sup> | 02/04/14                         | 01/20/14 <sup>(9)</sup>           | N/A   | N/A   | N/A                           | N/A   | 10,000 <sup>(10)</sup>  | \$ 27.94   | \$ 126,200  |
| RSU Award <sup>(11)</sup>                              | 02/04/14                         | 01/20/14 <sup>(9)</sup>           | N/A   | N/A   | N/A                           | 4,500 <sup>(12)</sup>   | N/A   | N/A  | \$ 125,730  |
| 2014 Management Objectives <sup>(13)</sup>             | N/A                              | 01/20/14                          | \$ 50,213                                       | \$ 200,850  | \$ 401,700                    | N/A   | N/A   | N/A  | N/A   |

N/A means not applicable.

- (1) Defined as the date of the grant for financial statement reporting purposes pursuant to ASC 718.
- (2) Amounts shown represent the dollar value of the estimated possible payout upon satisfaction of the conditions subject to the 2014 short-term compensation element.
- (3) Threshold refers to the minimum amount payable for a certain level of results under the plan.
- (4) Target refers to the amount payable, if the specified results target(s) are reached.
- (5) Maximum refers to the maximum payout possible under the plan.
- (6) Amounts shown represent the per-share exercise or base price of the options granted in the fiscal year.
- (7) Amounts shown represent the grant date fair value, computed in accordance with ASC 718, of each stock and option award granted to the Named Executive Officer in 2014. There were no adjustments or amendments made in 2014 to the exercise price of any option awards held by any of the Named Executive Officers, whether through amendment, cancellation or replacement grants, or any other means (such as a repricing), or that otherwise materially modified any option awards.
- (8) Represents a nonqualified stock option to purchase our common stock that was granted under the Amended 2006 Plan. See *Equity Compensation and Qualified Savings Plans Amended 2006 Plan*.
- (9) The awards were granted by the Compensation Committee during a Committee meeting on January 20, 2014 and had an effective grant date of February 4, 2014.
- (10) Nonqualified stock option granted at 100% of the closing market price of a share of our common stock on the effective date of the grant. One-third of the shares subject to each option granted is exercisable on the anniversary date of the grant in each of the years 2015, 2016 and 2017.
- (11) Represents a grant of RSUs that was made under the Amended 2006 Plan. See *Equity Compensation and Qualified Savings Plans Amended 2006 Plan*.



- (12) The period of restriction for this RSU grant lapses in thirds on the anniversary date of the grant in each of the years 2015, 2016 and 2017. These RSUs will be settled in shares of our common stock, one share for each RSU in the grant.
- (13) Represents awards that could be earned pursuant to the 2014 Management Objectives under the short-term compensation element that were approved by the Compensation Committee on January 20, 2014. Amounts actually earned in 2014 are reported in the Summary Compensation Table for that year in the Non-Equity Incentive Plan Compensation column. See Summary Compensation Table. The amounts shown for Mr. Feichtner reflect the threshold, target and maximum amounts that would have been payable to him based on his base salary at the time the Compensation Committee established the 2014 Management Objectives; the Committee subsequently based Mr. Feichtner's payment amount on his base salary as of February 9, 2015, as described in Compensation Discussion and Analysis *Compensation Elements 2014 Compensation Short-Term Compensation*. The amounts shown for Mr. Hamm reflect the threshold, target and maximum amounts that would have been payable to him based on the short-term compensation percentage applicable to Mr. Hamm at the time the Compensation Committee established the 2014 Management Objectives; the Committee subsequently reduced his short-term compensation percentage in connection with their approval of the reimbursement of his commuting expenses in 2014, as described in Compensation Discussion and Analysis *Compensation Elements 2014 Compensation Short-Term Compensation*.
- (14) Represents shares of our common stock not yet issued but credited to Mr. Dean's deferred share account under the Directors Deferred Compensation Plan. In early 2014, while still a non-employee Director, Mr. Dean elected to receive payment of his 2014 annual retainer in shares of our common stock, and to defer receipt of those shares, pursuant to the Directors Deferred Compensation Plan. See Director Compensation *Directors Deferred Compensation Plan*. The deferred shares of common stock will be paid to Mr. Dean following the termination of his services to us.
- (15) The period of restriction for this RSU grant lapses in full on August 4, 2015. These RSUs will be settled in shares of our common stock, one share for each RSU in the grant.

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### **Employment Contracts**

We have not entered into an employment contract, whether written or oral, with Mr. Feichtner or Mr. Hamm. We entered into the Modany Letter Agreement with Mr. Modany on August 4, 2014, pursuant to which Mr. Modany would remain our Chief Executive Officer (or, if so determined by us, Special Advisor) through the end of the Applicable Period. During the Applicable Period, Mr. Modany will continue to receive his current cash compensation and participate in our employee benefit plans, but will not receive any further grants of equity-based compensation. The Modany Letter Agreement provides that subject to Mr. Modany's compliance with the release requirement and the restrictive covenants and cooperation provisions, Mr. Modany will provide consulting services to us during the 18 months following the Applicable Period, and we will pay Mr. Modany a monthly fee equivalent to his current monthly base salary (which is \$68,673) and there will be continued vesting of his equity-based awards. The Modany Letter Agreement provides that Mr. Modany will not, during the 18-month period, compete with us or solicit our customers or employees. Mr. Modany will have continued use of the company-provided automobile during the consulting period. Further, we will pay Mr. Modany a lump sum of \$20,598 which equals the cost of 18 months of coverage under COBRA for continued health, dental and vision coverage.

We entered into the Fitzpatrick Letter Agreement with Mr. Fitzpatrick on April 29, 2015, pursuant to which Mr. Fitzpatrick agreed to remain our Chief Financial Officer (or Special Advisor) through the Transition Period. During the Transition Period, Mr. Fitzpatrick will continue to receive his current cash compensation and participate in our employee benefit plans. The only equity-based compensation Mr. Fitzpatrick will be entitled to receive during the Transition Period will be the awards previously approved by the Compensation Committee, which consist of a stock option grant to acquire 15,000 shares of our common stock and 6,750 RSUs, to be granted on the third trading day following the date that we become current in our filings with the SEC, unless within that three trading day period, we again become no longer current in our filings with the SEC.

The Fitzpatrick Letter Agreement provides that subject to Mr. Fitzpatrick's compliance with the release requirement and the restrictive covenants and cooperation provisions, he will provide consulting services to us during the 18 months following his resignation as Chief Financial Officer, and we will pay Mr. Fitzpatrick a monthly fee equivalent to his current monthly base salary (which is \$34,333) and there will be continued vesting of his equity-based awards. The Fitzpatrick Letter Agreement provides that Mr. Fitzpatrick will not, during the 18-month period, compete with us or solicit our customers or employees. Further, we will pay Mr. Fitzpatrick a lump sum of \$20,598, which is equal to the cost of 18 months of coverage under COBRA for continued medical, prescription drug, dental and vision coverage.

On August 4, 2014, John E. Dean was appointed our Executive Chairman and became an employee of ours. In connection with his appointment as Executive Chairman, we entered into a letter agreement with Mr. Dean which provides for him to receive an annual base salary of \$575,000 and a grant of RSUs on August 4, 2014 that had a value of \$1,000,000, based on the closing price of our common stock on the date of grant, which resulted in a grant of 129,534 RSUs to Mr. Dean on that date. The RSUs will vest, subject to Mr. Dean's continued service as Executive Chairman or as a member of the Board, on the first anniversary of the grant date or, if earlier, upon his termination of employment due to death or disability. Mr. Dean will receive no other compensation for his service as Executive Chairman, but will continue to vest in the equity-based awards granted to him in connection with his service as a non-employee Director.

### **Non-Equity Incentive Plan Awards and Bonuses**

The annual short-term compensation element for our executive officers relating to each of 2014 and 2013 was based on the 2014 Management Objectives and the 2013 Management Objectives, respectively. Pursuant to the SEC's

regulations, the amounts paid pursuant to this compensation element are classified in the tables in this document as non-equity incentive plan compensation, due to the fact that the awards were based on pre-established objectives. The annual short-term compensation element for our executive officers relating to 2012 also was based on management objectives, but because the Compensation Committee determined in late 2012 to assign zero to five points to each 2012 Management Objective based on the extent to which it was accomplished (instead of the previously-established determination to assign five points to each 2012 Management Objective only if it was fully accomplished), the amounts paid pursuant to this compensation element are classified in the tables in this document as bonus compensation, pursuant to the SEC's regulations.

Under the Deferred Bonus Plan, each eligible employee may elect to defer payment of all or a portion of his or her annual bonus award in the same form that the bonus is otherwise payable, either in cash or shares of our common stock. See *Nonqualified Deferred Compensation Plans - Deferred Bonus Plan*. None of the Named Executive Officers deferred any amounts under the Deferred Bonus Plan in 2012, 2013 or 2014.

### **Equity Compensation and Qualified Savings Plans**

***Amended 2006 Plan.*** On May 9, 2006, our shareholders approved the 2006 ITT Educational Services, Inc. Equity Compensation Plan (the "2006 Equity Compensation Plan"). On January 21, 2013, based on the recommendation of our Compensation Committee, our Board of Directors approved the Amended 2006 Plan and on May 7, 2013, our shareholders approved the Amended 2006 Plan. On October 20, 2014, based on the recommendation of our Compensation Committee, our Board of Directors approved a First Amendment to the Amended 2006, which provides that the Plan Committee (as defined below) may determine to provide for a time-based period of restriction for an award of RSUs that is less than one year.

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Eligibility to Receive Awards. The approximate number of persons eligible to participate in the Amended 2006 Plan is 825.

Types of Awards. The Amended 2006 Plan permits the grant of the following types of awards:

stock options (incentive and nonqualified);

SARs;

restricted stock;

RSUs;

performance shares;

performance units; and

other stock-based awards.

Duration of the Amended 2006 Plan. No award may be granted under the Amended 2006 Plan after May 7, 2023.

Administration. The Amended 2006 Plan is administered by a committee consisting of two or more members of our Board of Directors (the Plan Committee). It is intended that each member of the Plan Committee will be a non-employee director within the meaning of Rule 16b-3 of the Exchange Act, an outside director under regulations promulgated under Section 162(m) of the IRC, and an independent director under the NYSE listing standards. Our Board of Directors has currently designated the Compensation Committee as the Plan Committee for the Amended 2006 Plan; however, the entire Board will act as the Plan Committee with respect to awards to non-employee Directors. Subject to applicable law, the Plan Committee may delegate its authority under the Amended 2006 Plan.

Shares Subject to the Amended 2006 Plan. The total number of shares of our common stock available for awards under the Amended 2006 Plan is 7,350,000, subject to antidilution adjustments. Each share underlying stock options and SARs granted under the Amended 2006 Plan, and not forfeited or terminated, will reduce the number of shares available for future awards under the Amended 2006 Plan by one share. The delivery of a share in connection with a full-value award (i.e., an award of restricted stock, RSUs, performance shares, performance units or any other stock-based award with value denominated in shares) will reduce the number of shares remaining for other awards by two shares.

The source of shares for issuance under the Amended 2006 Plan may be authorized and unissued shares or treasury shares.

If an award under the Amended 2006 Plan is forfeited or terminated for any reason before being exercised, fully vested or settled, as the case may be, then the shares underlying that award will be added back to the remaining shares and will be available for future awards under the Amended 2006 Plan. The number of shares available for future awards under the Amended 2006 Plan, however, will be reduced by: (a) any shares subject to an award that are withheld or otherwise not issued upon the exercise of the award to satisfy the participant's tax withholding obligations or to pay the exercise price of the award; and (b) shares subject to an award that is settled in cash in lieu of shares. In addition, any shares tendered by a participant in payment of the exercise price of an option may not be re-issued under the Amended 2006 Plan.

Pursuant to the Amended 2006 Plan, subject to antidilution adjustments:

the maximum aggregate number of shares that may be delivered in connection with stock options intended to be incentive stock options under Section 422 of the IRC (incentive stock options) may not exceed 7,350,000 shares;

the maximum aggregate number of shares that may be granted to an individual participant during any calendar year pursuant to:

all forms of awards is 400,000 shares;

incentive stock options is 400,000 shares;

restricted stock and RSU awards is 250,000 shares; and

performance share awards is 250,000 shares;

the aggregate fair market value of shares that may be granted to a non-employee director during any calendar year may not exceed \$400,000; and

the maximum aggregate compensation that may be paid pursuant to performance units awarded in any one calendar year to an individual participant is \$2,000,000, or a number of shares having an aggregate fair market value not in excess of that amount.

Further, no incentive stock option will be granted to a participant if, as a result of such grant, the aggregate fair market value of shares with respect to which incentive stock options are exercisable for the first time in any calendar year would exceed \$100,000.

No Repricing. The Amended 2006 Plan prohibits repricing of stock options or SARs, including by way of an exchange for another award with a lower exercise price, unless shareholder approval is obtained.

Stock Options. Stock options granted under the Amended 2006 Plan may be either nonqualified or incentive stock options. Each option grant will be evidenced by an award agreement between the optionee and us setting forth the terms and conditions of the option. The Plan Committee will set the exercise price of each option, provided that the

exercise price may not be less than 100% of the fair market value of our common stock on the date the option is granted. The Amended 2006 Plan defines fair market value as the closing price of our common stock on the effective date of the option grant or, if that date is not a trading day, on the most recent trading day prior to the effective date of the option grant. In addition, in the case of an incentive stock option granted to a participant who, at the time the option is granted, owns stock representing more than 10% of the voting power of all classes of our stock, the exercise price of the incentive stock option will not be less than 110% of the fair market value of our common stock on the effective date of the option grant.

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The Plan Committee will determine the term of each stock option that it grants under the Amended 2006 Plan; however, the term may not exceed seven years from the date of grant. Moreover, in the case of an incentive stock option granted to a participant who, at the time the option is granted, owns stock representing more than 10% of the voting power of all classes of our stock, the term of the option may not exceed five years from the date of grant.

Unless otherwise provided with respect to an award by a participant's award agreement or by written contract of employment of service, if an optionee's employment or service terminates due to death or disability:

all of the optionee's stock options with time-based vesting provisions will become immediately exercisable and will remain exercisable until the earlier of:

the date three years after the date of the optionee's death or disability, or

the date the options expire in accordance with their terms; and

with respect to the optionee's options with performance-based vesting provisions:

the optionee will forfeit all such options that are not exercisable as of the date of death or disability; and

options that were exercisable as of the date of death or disability will remain exercisable until the earlier of (a) the date three years after such date, or (b) the date the options expire in accordance with their terms.

For stock options granted under the 2006 Equity Compensation Plan prior to November 24, 2010, termination of an optionee's employment or service due to retirement is treated in the same manner as termination of employment or service due to death or disability. In all cases, incentive stock options will not be exercisable for more than three months following an optionee's death or retirement or more than one year following the termination of an optionee's employment by reason of disability.

Unless otherwise provided with respect to an award by a participant's award agreement or by written contract of employment of service, upon termination by us of an optionee's employment or service without cause, or upon termination of employment or service by the optionee for a reason other than death or disability (or retirement for stock options granted prior to November 24, 2010):

an optionee will forfeit all of his or her options that had not yet become exercisable; and

options that were exercisable as of the date of the optionee's termination will remain exercisable until the earlier of (a) the date 90 days after the date of termination, or (b) the date the options expire in

accordance with their terms.

Unless otherwise provided with respect to an award by a participant's award agreement or by written contract of employment of service, upon termination of employment or service for cause, an optionee will immediately forfeit all of his or her outstanding options.

SARs. SAR grants may be either freestanding or tandem with option grants. Each SAR grant will be evidenced by an agreement that will specify the number of shares to which the SAR pertains, the grant price, the term of the SAR and such other provisions as the Plan Committee shall determine. The grant price of a freestanding SAR will not be less than 100% of the fair market value of our common stock on the effective date of the SAR grant, and the grant price of a tandem SAR will equal the exercise price of the related option. The Plan Committee will determine the term of each SAR that it grants under the Amended 2006 Plan; however, the term may not exceed seven years from the date of grant.

Upon exercise of a SAR, the holder will receive payment from us in an amount equal to the product of (a) the excess of the fair market value of our common stock on the date of exercise over the grant price and (b) the number of shares with respect to which the SAR is exercised. At the discretion of the Plan Committee, payment to the holder of a SAR may be in cash, shares of our common stock or a combination thereof.

If the employment or service of a holder of a SAR is terminated, the SAR will be treated in the same manner as options are treated.

Restricted Stock and Restricted Stock Units. Each restricted stock or RSU grant will be evidenced by an agreement that specifies the applicable period of restriction, the number of restricted shares or RSUs granted, the vesting or settlement date, and such other provisions as the Plan Committee determines.

The period of restriction applicable to an award of restricted stock or RSUs is at least one year for awards with a time-based period of restriction granted after November 24, 2010 (unless the Plan Committee determines otherwise with respect to an award of RSUs) and all awards with a performance-based period of restriction, and was at least three years for awards with a time-based period of restriction granted under the 2006 Equity Compensation Plan prior to November 24, 2010.

Participants holding restricted stock may exercise full voting rights and will receive all regular cash dividends paid with respect to those shares. Except as otherwise determined by the Plan Committee, all other distributions paid with respect to the restricted stock will be credited to the participant subject to the same restrictions on transferability and forfeitability as the underlying restricted stock.

When the applicable period of restriction on the restricted stock ends, the stock will become freely transferable, and the participant will receive those shares. When the applicable period of restriction ends, RSUs will be settled and paid. At the time of the grant, the Plan Committee shall determine whether the RSUs will be settled by delivery of shares, payment in cash of an amount equal to the fair market value of the shares on the settlement date or the average of the fair market value of the shares over a specified number of days prior to the settlement date, or a combination of shares and cash.



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With respect to restricted stock with a time-based period of restriction, unless otherwise provided with respect to an award by a participant's award agreement or by written contract of employment of service:

upon a participant's death or disability, the period of restriction will lapse immediately; and

upon termination of a participant's employment or service with us for any reason other than death or disability, the participant will forfeit all unvested restricted stock immediately after the termination of employment or service.

Unless otherwise provided with respect to an award by a participant's award agreement or by written contract of employment of service, with respect to restricted stock with a performance-based period of restriction, upon termination of a participant's employment or service with us for any reason, the participant will forfeit all unvested restricted stock immediately after the termination of employment or service.

With respect to RSUs with a time-based period of restriction, unless otherwise provided with respect to an award by a participant's award agreement or by written contract of employment of service:

upon a participant's death or disability, the period of restriction will lapse immediately, and the RSUs will be settled immediately thereafter; and

upon termination of a participant's employment or service with us for any reason other than death or disability, the participant will forfeit all of his or her unvested RSUs immediately after the termination of employment or service.

Unless otherwise provided with respect to an award by a participant's award agreement or by written contract of employment of service, with respect to RSUs with a performance-based period of restriction, upon termination of a participant's employment or service with us for any reason, the participant will forfeit all of his or her unvested RSUs immediately after the termination of employment or service.

*Performance Shares and Performance Units.* Each grant of performance shares and performance units will be evidenced by an agreement that specifies the number of shares or units granted, the applicable performance measures and performance periods, and such other provisions as the Plan Committee determines. Except as otherwise provided in the applicable award agreement, upon termination of employment or service or upon a change in control or subsidiary disposition, the performance period for performance shares and performance units must be at least one year.

A participant will not have voting rights or other rights as a shareholder with respect to the shares subject to an award of performance shares or performance units until the time, if at all, when shares are issued to the participant pursuant to the terms of the applicable award agreement.

As soon as practicable following the completion of the performance period applicable to outstanding performance shares or performance units, the Plan Committee will certify in writing the extent to which the applicable performance measures have been attained and the resulting final value of the award earned by the participant and to be paid upon its settlement. The Plan Committee, in its sole discretion as specified in the award agreement, may pay earned

performance shares or performance units by delivery of shares or by payment in cash or a combination thereof.

Unless otherwise provided with respect to an award by a participant's award agreement or by written contract of employment of service, if a participant terminates employment or service with us for any reason prior to the end of the performance period respecting an award of performance shares or performance units, the participant will forfeit any and all right to payment under the performance shares or performance units.

*Other Stock-Based Awards.* The Plan Committee has the right to grant other stock-based awards that may include, without limitation, grants of shares based on attainment of performance measures, payment of shares as a bonus or in lieu of cash based on attainment of performance measures, and the payment of shares in lieu of cash under other of our incentive or bonus programs.

The Plan Committee may determine to pay a non-employee Director's regular annual retainer, retainer for Board committee memberships, retainer for chairperson duties, fees for attendance at Board or Board committee meetings, or any other retainers or fees in the form of another stock-based award under the Amended 2006 Plan. The Plan Committee may also determine to permit the non-employee Directors to elect whether to receive all or a portion of such retainers and fees in the form of other stock-based award. Any such other stock-based awards would not be subject to any restrictions (other than restrictions applicable to our affiliates).

*Performance-Based Awards.* The Plan Committee may grant awards that are intended to qualify as performance-based compensation for purposes of deductibility under Section 162(m) of the IRC. For any such award, the Plan Committee will establish the goals to be used within 90 days after the commencement of the performance period, or, if the number of days in the performance period is less than 90, the number of days equal to 25% of the performance period applicable to such award. The Amended 2006 Plan sets forth certain performance measures from which the Plan Committee may select for these awards. The Plan Committee may establish performance measures, in its discretion, on a corporate-wide basis or with respect to one or more business units, divisions, subsidiaries, business segments, functions, salary grade levels, or positions, and in either absolute terms or relative to the performance of one or more comparable companies or an index covering multiple companies. In addition, unless otherwise determined by the Plan Committee, measurement of performance measures will exclude the impact of charges for restructurings, discontinued operations, extraordinary items, and other unusual or non-

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recurring items, as well as the cumulative effects of tax or accounting changes, each as determined in accordance with generally accepted accounting principles or identified in our financial statements, notes to the financial statements, management's discussion and analysis, or other filings with the SEC. As a result of the Incentive Compensation Prohibition and until there is further clarification of the scope and breadth of the Incentive Compensation Prohibition, the Plan Committee will not grant performance-based awards on or after July 1, 2011.

Change in Control, Cash-Out and Subsidiary Disposition. Except as otherwise provided in the applicable award agreement, if we experience a change in control:

any and all outstanding stock options and SARs granted under the Amended 2006 Plan with time-based vesting provisions will become immediately exercisable;

any restrictions imposed on restricted stock, RSUs and other stock-based awards granted under the Amended 2006 Plan with time-based vesting provisions will lapse; and

any and all performance shares, performance units and other awards (if performance-based) granted under the Amended 2006 Plan will vest on a pro rata monthly basis, including full credit for partial months elapsed, and will be paid (a) based on the level of performance achieved as of the date of the change in control, if determinable, or (b) at the target level, if not determinable.

In addition, the Plan Committee may, in its sole discretion, determine that: (a) all outstanding stock options and SARs will be terminated upon the occurrence of a change in control and that each participant will receive, with respect to each share subject to the options or SARs, an amount in cash equal to the excess of the consideration payable with respect to one share in connection with the change in control over the option's exercise price or the SAR's grant price; and (b) options and SARs outstanding as of the date of the change in control may be cancelled and terminated without payment, if the consideration payable in connection with the change in control is less than the option's exercise price or the SAR's grant price.

Further, the Plan Committee has the authority to provide for the automatic full vesting and exercisability of one or more outstanding unvested awards under the Amended 2006 Plan and the termination of restrictions on transfer and repurchase or forfeiture rights on the awards, in connection with a disposition of a subsidiary of ours, but only with respect to those participants who are at the time engaged primarily in service with the subsidiary involved in the subsidiary disposition.

A change in control means the occurrence of one or more of the following:

the acquisition by any person (within the meaning of Section 13(d) of the Exchange Act) or group (as used in Section 14(d)(2) of the Exchange Act), other than us, a subsidiary of ours or any employee benefit plan sponsored by us or a subsidiary of ours, of beneficial ownership (within the meaning of Section 13(d) of the Exchange Act) directly or indirectly of 25% or more of the outstanding shares of our common stock, provided that an increase in the percentage of the outstanding shares of our common stock beneficially owned by any person or group solely as a result of a reduction in the number of shares of our common stock then outstanding due to the repurchase by us of such common

stock shall not constitute a change in control, however any subsequent acquisition of shares of our common stock by any person or group resulting in such person or group beneficially owning 25% or more of the outstanding shares of our common stock shall constitute a change in control;

the consummation of any consolidation or merger of us or any sale, lease, exchange or other transfer of all or substantially all of our assets, unless, immediately following such consolidation, merger or sale,

all or substantially all the persons (within the meaning of Section 13(d) of the Exchange Act) who were the beneficial owners of the securities eligible to vote for the election of our Board of Directors ( company voting securities ) outstanding immediately prior to the consummation of such consolidation, merger or sale continue to beneficially own, directly or indirectly, more than 50% of the combined voting power of the then outstanding voting securities of the corporation or other entity resulting from such consolidation, merger or sale in substantially the same proportions as their ownership, immediately prior to the consummation of such consolidation, merger or sale, of the outstanding company voting securities, subject to certain exceptions, and

no person (within the meaning of Section 13(d) of the Exchange Act) (excluding any employee benefit plan or related trust sponsored or maintained by the continuing company or any entity controlled by the continuing company) beneficially owns, directly or indirectly, 25% or more of the combined voting power of the then outstanding voting securities of the continuing company, and

at least a majority of the members of the board of directors of the continuing company were incumbent directors of ours (as defined below) at the time of the execution of the definitive agreement providing for such consolidation, merger or sale or, in the absence of such an agreement, at the time at which approval of our Board of Directors was obtained for such transaction;

during any period of 12 consecutive calendar months, individuals who were directors of ours on the first day of such period ( incumbent directors ) cease for any reason to constitute a majority of our Board of Directors; provided, that any individual becoming a director after the first day of such period whose election or nomination by our shareholders was approved by a vote of at least a majority of the incumbent directors shall be deemed to be an incumbent director (unless such individual's initial assumption of office occurs as a result of an actual or threatened proxy contest with respect to election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of any person); or

the liquidation or dissolution of us.

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Notwithstanding any other provision of the Amended 2006 Plan, with respect to any provision or feature of the plan that constitutes or provides for a deferred compensation plan subject to IRC Section 409A, no event or transaction will constitute a change in control unless it is a change in control within the meaning of IRC Section 409A.

Adjustments of Awards Upon the Occurrence of Certain Unusual or Nonrecurring Events. The Plan Committee may make adjustments in the terms and conditions of, and the criteria included in, awards under the Amended 2006 Plan in recognition of unusual or nonrecurring events (including, without limitation, changes in capitalization) affecting us or our financial statements or of changes in applicable law, regulations, or accounting principles, whenever the Plan Committee determines that such adjustments are appropriate to prevent dilution or enlargement of the benefits or potential benefits intended to be made available under the Amended 2006 Plan. With respect to any awards intended to comply with the performance-based exception under the Amended 2006 Plan, unless otherwise determined by the Plan Committee, any such exception will be specified at such times and in such manner as will not cause such awards to fail to qualify under the performance-based exception.

Recoupment of Awards. All awards granted under the Amended 2006 Plan will be subject to any company policy on recoupment of awards, as in effect from time to time, and all laws relating to the recoupment of equity-based awards.

Amendment, Suspension and Termination of the Amended 2006 Plan. The Board of Directors may amend, suspend or terminate the Amended 2006 Plan at any time; provided, however, that shareholder approval is required for any amendment to the extent necessary to comply with the NYSE listing standards or applicable laws. In addition, no amendment, suspension or termination may adversely impact an award previously granted without the consent of the participant to whom such award was granted unless required by applicable law.

See Exhibit 10.1 to our Current Report on Form 8-K, filed on May 7, 2013 with the SEC for a copy of the Amended 2006 Plan and Exhibit 10.10 to our Quarterly Report on Form 10-Q, filed on April 29, 2015 with the SEC for a copy of the First Amendment.

2014 Awards. During 2014, the following equity-based compensation awards were granted under the Amended 2006 Plan:

nonqualified stock options to our key employees to purchase an aggregate of 168,500 shares of our common stock; and

an aggregate of 402,890 RSUs to our key employees, which RSUs settle in shares of our common stock.

**ESI 401(k) Plan.** On May 16, 1998, we established the ESI 401(k) Plan, a qualified defined contribution plan. The ESI 401(k) Plan is designed to provide substantially all of our employees with a tax-deferred, long-term savings vehicle. Prior to July 1, 2013, for each payroll period, we made matching cash contributions in an amount equal to (a) 100% of the first 1% of the employee's salary that the employee contributed to the plan and (b) 50% of the next 4% of the employee's salary that the employee contributed to the plan. Beginning on July 1, 2013, for each payroll period, we make matching cash contributions in an amount equal to 50% of the first 6% of the employee's salary that the employee contributes to the plan. Our matching contributions vest 100% upon completion of the third full year that the employee is employed by us. Employees can elect to contribute from 1% to the maximum amount of their salaries that is permitted by federal law, and they have a choice of 23 investment funds in which to invest their contributions.

After age 59  $\frac{1}{2}$ , employees may withdraw most of their and our vested contributions, including rollover, matching, employee pre-tax and predecessor plan contributions, and the earnings thereon. Regardless of the employee's age, our retirement contributions made before January 1, 2002 and the earnings thereon may not be withdrawn while the employee is still employed by us. Prior to age 59  $\frac{1}{2}$ , withdrawals by an employee are limited to rollover and predecessor plan contributions, unless the employee qualifies for a financial hardship withdrawal or a withdrawal in connection with a leave to perform qualifying military service. Upon termination of employment, the employee may withdraw all amounts attributable to the employee's contributions and our vested contributions. Payments are normally made in a single lump sum, but if the employee's balance is above a threshold amount, the employee may elect to receive payment in annual or monthly installments over a period not to exceed 20 years.

**Outstanding Equity Awards at Fiscal Year-End Table**

The following table sets forth information concerning the outstanding equity awards granted by us to the Named Executive Officers that were outstanding on December 31, 2014.

**Outstanding Equity Awards at Fiscal Year-End 2014**

| Named Executive Officer<br>(a)         | Option Awards  |                                |                       |                        | Stock Awards   |  |
|--|--|--------------------------------|-----------------------|------------------------|--|--|
|  | Number of Securities Underlying<br>Unexercised Options |                                | Option Exercise Price | Option Expiration Date | Number of Shares or Units of Stock that have Not Vested <sup>(3)</sup> | Market Value of Shares or Units of Stock that have Not Vested <sup>(4)</sup> |
|  | Exercisable <sup>(1)</sup>                             | Not Exercisable <sup>(2)</sup> | (d)                   | (e)                    | (f)  | (g)  |
| Kevin M. Modany                        |  |                                |                       |                        |  |  |
| 01/30/08 Award <sup>(5)</sup>          | 74,147   | 0                              | \$ 88.38              | 01/30/15               |  |  |
| 01/28/09 Award <sup>(6)</sup>          | 100,000  | 0                              | \$ 121.56             | 01/28/16               |  |  |
| 01/27/10 Award <sup>(7)</sup>          | 125,000  | 0                              | \$ 113.41             | 01/27/17               |  |  |
| 01/27/11 Award <sup>(8)</sup>          | 125,000  | 0                              | \$ 69.43              | 01/27/18               |  |  |
| 02/13/12 Award - Option <sup>(9)</sup> | 41,666   | 20,834                         | \$ 75.16              | 02/13/19               |  |  |

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| Named Executive Officer<br>(a)          | Option Awards  |                                     |                          | Option<br>Expiration<br>Date<br>(e) | Stock Awards<br>Market Value of<br>Shares or<br>Units   |  |
|---|--|-------------------------------------|--------------------------|-------------------------------------|---|--|
|   | Number of Securities Underlying<br>Option                |                                     | Exercise<br>Price<br>(d) |                                     | Number of Shares<br>or Units<br>of Stock<br>that<br>have<br>Not<br>Vested <sup>(3)</sup><br>(f) | Market Value of<br>Stock that<br>have<br>Not<br>Vested <sup>(4)</sup><br>(g) |
|   | Unexercised Options<br>Exercisable <sup>(1)</sup><br>(b) | Unexercisable <sup>(2)</sup><br>(c) |                          |                                     |   |  |
| 02/13/12 Award - RSUs <sup>(10)</sup>   |  |                                     |                          |                                     | 7,266   | \$ 69,826  |
| 02/13/12 Award - RSUs <sup>(11)</sup>   |  |                                     |                          |                                     | 44,229  | \$ 425,041   |
| 05/09/13 Award - Option <sup>(12)</sup> | 20,833   | 41,667                              | \$ 19.31                 | 05/09/20                            |   |  |
| 05/09/13 Award - RSUs <sup>(13)</sup>   |  |                                     |                          |                                     | 18,750  | \$ 180,183   |
| 02/04/14 Award - Option <sup>(14)</sup> | 0  | 62,500                              | \$ 27.94                 | 02/04/21                            |   |  |
| 02/04/14 Award - RSUs <sup>(15)</sup>   |  |                                     |                          |                                     | 28,125  | \$ 270,281   |
| <b>Daniel M. Fitzpatrick</b>            |  |                                     |                          |                                     |   |  |
| 01/30/08 Award <sup>(5)</sup>           | 15,508   | 0                                   | \$ 88.38                 | 01/30/15                            |   |  |
| 01/28/09 Award <sup>(6)</sup>           | 20,000   | 0                                   | \$ 121.56                | 01/28/16                            |   |  |
| 01/27/10 Award <sup>(7)</sup>           | 22,000   | 0                                   | \$ 113.41                | 01/27/17                            |   |  |
| 01/27/11 Award - Option <sup>(8)</sup>  | 16,500   | 0                                   | \$ 69.43                 | 01/27/18                            |   |  |
| 02/13/12 Award - Option <sup>(9)</sup>  | 7,333  | 3,667                               | \$ 75.16                 | 02/13/19                            |   |  |
| 02/13/12 Award - RSUs <sup>(10)</sup>   |  |                                     |                          |                                     | 1,279   | \$ 12,291  |
| 02/13/12 Award - RSUs <sup>(11)</sup>   |  |                                     |                          |                                     | 8,545   | \$ 82,117  |
| 05/09/13 Award - Option <sup>(12)</sup> | 5,000  | 10,000                              | \$ 19.31                 | 05/09/20                            |   |  |
| 05/09/13 Award - RSUs <sup>(13)</sup>   |  |                                     |                          |                                     | 4,500   | \$ 43,245  |
| 02/04/14 Award - Option <sup>(14)</sup> | 0  | 15,000                              | \$ 27.94                 | 02/04/21                            |   |  |
| 02/04/14 Award - RSUs <sup>(15)</sup>   |  |                                     |                          |                                     | 6,750   | \$ 64,868  |
| <b>John E. Dean</b>                     |  |                                     |                          |                                     |   |  |
| 05/22/12 Award - RSUs <sup>(16)</sup>   |  |                                     |                          |                                     | 1,722   | \$ 16,548  |
| 05/21/13 Award - RSUs <sup>(17)</sup>   |  |                                     |                          |                                     | 3,598   | \$ 34,577  |
| 08/04/14 Award - RSUs <sup>(18)</sup>   |  |                                     |                          |                                     | 129,534   | \$ 1,244,822   |
| <b>Eugene W. Feichtner</b>              |  |                                     |                          |                                     |   |  |
| 01/30/08 Award <sup>(5)</sup>           | 15,508   | 0                                   | \$ 88.38                 | 01/30/15                            |   |  |
| 01/28/09 Award <sup>(6)</sup>           | 17,500   | 0                                   | \$ 121.56                | 01/28/16                            |   |  |
| 01/27/10 Award <sup>(7)</sup>           | 20,000   | 0                                   | \$ 113.41                | 01/27/17                            |   |  |
| 01/27/11 Award - Option <sup>(8)</sup>  | 10,000   | 0                                   | \$ 69.43                 | 01/27/18                            |   |  |
| 02/13/12 Award - Option <sup>(9)</sup>  | 6,666  | 3,334                               | \$ 75.16                 | 02/13/19                            |   |  |
| 02/13/12 Award - RSUs <sup>(10)</sup>   |  |                                     |                          |                                     | 1,163   | \$ 11,176  |
| 02/13/12 Award - RSUs <sup>(11)</sup>   |  |                                     |                          |                                     | 7,780   | \$ 74,766  |
| 05/09/13 Award - Option <sup>(12)</sup> | 3,333  | 6,667                               | \$ 19.31                 | 05/09/20                            |   |  |
| 05/09/13 Award - RSUs <sup>(13)</sup>   |  |                                     |                          |                                     | 3,000   | \$ 28,830  |
| 02/04/14 Award - Option <sup>(14)</sup> | 0  | 10,000                              | \$ 27.94                 | 02/04/21                            |   |  |
| 02/04/14 Award - RSUs <sup>(15)</sup>   |  |                                     |                          |                                     | 4,500   | \$ 43,245  |
| <b>Ronald F. Hamm<sup>(19)</sup></b>    |  |                                     |                          |                                     |   |  |
| 05/09/13 Award - Option <sup>(12)</sup> | 3,333  | 6,667                               | \$ 19.31                 | 05/09/20                            |   |  |



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|   |   |        |          |          |  |       |    |        |
|---|---|--------|----------|----------|--|-------|----|--------|
| 05/09/13 Award - RSUs <sup>(13)</sup>   |   |        |          |          |  | 3,000 | \$ | 28,830 |
| 02/04/14 Award - Option <sup>(14)</sup> | 0 | 10,000 | \$ 27.94 | 02/04/21 |  |       |    |        |
| 02/04/14 Award - RSUs <sup>(15)</sup>   |   |        |          |          |  | 4,500 | \$ | 43,245 |

- (1) Amounts shown represent on an award-by-award basis, the number of securities underlying unexercised options that were exercisable as of December 31, 2014.
- (2) Amounts shown represent on an award-by-award basis, the number of securities underlying unexercised options that were unexercisable as of December 31, 2014. These options will become exercisable on their scheduled vesting dates as noted in the footnotes below, except that the options will become immediately exercisable upon the occurrence of an acceleration event or change in control, or upon termination of employment due to death, disability or, in the case of options granted prior to November 24, 2010, retirement.
- (3) Amounts shown represent on an award-by-award basis, the total number of shares of our common stock that had not vested as of December 31, 2014. These awards will vest on their scheduled vesting dates as noted in the footnotes below, except that the RSUs will immediately vest upon the occurrence of a change in control or upon termination of employment due to death or disability.
- (4) Amounts shown represent on an award-by-award basis, the aggregate market value of shares of our common stock that had not vested as of December 31, 2014. The aggregate market value is calculated by multiplying the number of shares or units by the closing market price of a share of our common stock on December 31, 2014.
- (5) This stock option award vested in three equal installments on January 30, 2009, 2010 and 2011.
- (6) This stock option award vested in three equal installments on January 28, 2010, 2011 and 2012.
- (7) This stock option award vested in three equal installments on January 27, 2011, 2012 and 2013.

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- (8) This stock option award vested in three equal installments on January 27, 2012, 2013 and 2014.
- (9) This stock option award vests in three equal installments on February 13, 2013, 2014 and 2015.
- (10) This RSU award vested in three equal installments on February 13, 2013, 2014 and 2015, and were settled in shares of our common stock.
- (11) This RSU award vests in full on February 13, 2015, and will be settled in shares of our common stock.
- (12) This stock option award vests in three equal installments on May 9, 2014, 2015 and 2016.
- (13) This RSU award vests in three equal installments on May 9, 2014, 2015 and 2016, and will be settled in shares of our common stock.
- (14) This stock option award vests in three equal installments on February 4, 2015, 2016 and 2017.
- (15) This RSU award vests in three equal installments on February 4, 2015, 2016 and 2017, and will be settled in shares of our common stock.
- (16) This RSU award vests in full on May 22, 2015.
- (17) This RSU award vests in full on May 21, 2016.
- (18) This RSU award vests in full on August 4, 2015.
- (19) The vesting schedules and expiration dates shown in the table and footnotes associated with Mr. Hamm's awards reflect the vesting schedules and expiration dates as of December 31, 2014, which have subsequently been impacted by his resignation. As a result of Mr. Hamm's resignation effective May 15, 2015, all RSUs held by him were forfeited, and all outstanding stock options held by him either have terminated or will terminate 90 days after his resignation date.

**Option Exercises and Stock Vested Table**

The following table sets forth, on an aggregated basis, information concerning the exercise of stock options to purchase common stock by, and the vesting of RSUs held by, the Named Executive Officers during 2014.

**Option Exercises and Stock Vested in Fiscal Year 2014**

| Named Executive Officer | Option Awards                         |                            | Stock Awards                         |                           |
|-------------------------|---------------------------------------|----------------------------|--------------------------------------|---------------------------|
|                         | Number of Shares Acquired on Exercise | Value Realized on Exercise | Number of Shares Acquired on Vesting | Value Realized on Vesting |
|                         |                                       |                            |                                      | (1) (2)                   |
| Kevin M. Modany         | 0                                     | \$ 0                       | 16,640                               | \$ 304,108                |
| Daniel M. Fitzpatrick   | 0                                     | \$ 0                       | 4,323                                | \$ 91,094                 |
| John E. Dean            | 0                                     | \$ 0                       | 1,412                                | \$ 11,762                 |
| Eugene W. Feichtner     | 0                                     | \$ 0                       | 4,106                                | \$ 107,853                |
| Ronald F. Hamm          | 0                                     | \$ 0                       | 1,500                                | \$ 12,495                 |

- (1) Amounts shown represent the number of shares of our common stock related to which RSUs vested during the fiscal year.
- (2) Amounts shown represent the aggregate dollar amount realized by the Named Executive Officer upon vesting of the RSUs. The dollar amount realized upon vesting of RSUs in 2014 was determined by multiplying the number of RSUs vested by the market price of a share of our common stock on the vesting date. The dollar amounts realized upon vesting of all RSUs in 2014 held by the Named Executive Officer are then added together to obtain the aggregate dollar amount shown in this column.

**Pension Benefits Table**

The following table sets forth information concerning the Named Executive Officers' pension benefits under each pension plan in which we participated.

### Pension Benefits

| Named Executive Officer | Plan Name <sup>(1)</sup> | Number of<br>Years<br>of<br>Credited<br>Service<br><sup>(2)</sup> | Present Value of Payments<br>Accumulated During Last<br>Fiscal Year <sup>(4)</sup> |        |      |
|-------------------------|--------------------------|---|--|--------|------|
|                         |                          |   | Benefit <sup>(3)</sup>   | \$     | \$   |
| Kevin M. Modany         | Old Pension Plan         | 0 <sup>(5)</sup>  | \$   | 0      | \$ 0 |
|                         | ESI Pension Plan         | 13 <sup>(6)</sup>   | \$   | 38,932 | \$ 0 |
|                         | ESI Excess Pension Plan  | 13 <sup>(6)</sup>   | \$   | 50,197 | \$ 0 |
| Daniel M. Fitzpatrick   | Old Pension Plan         | 0 <sup>(5)</sup>  | \$   | 0      | \$ 0 |
|                         | ESI Pension Plan         | 0 <sup>(5)</sup>  | \$   | 0      | \$ 0 |
|                         | ESI Excess Pension Plan  | 0 <sup>(5)</sup>  | \$   | 0      | \$ 0 |
| John E. Dean            | Old Pension Plan         | 0 <sup>(5)</sup>  | \$   | 0      | \$ 0 |
|                         | ESI Pension Plan         | 0 <sup>(5)</sup>  | \$   | 0      | \$ 0 |

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| <b>Named Executive Officer</b> | <b>Plan Name <sup>(1)</sup></b> | <b>Number of<br/>Years<br/>of<br/>Credited<br/>Service<br/><sup>(2)</sup></b> | <b>Present Value of<br/>Accumulated<br/>Benefit <sup>(3)</sup></b> | <b>Payments<br/>During Last<br/>Fiscal Year <sup>(4)</sup></b> |
|--------------------------------|---------------------------------|---|--|--|
| Eugene W. Feichtner            | ESI Excess Pension Plan         | 0 <sup>(5)</sup>  | \$ 0   | \$ 0   |
|                                | Old Pension Plan                | 20 <sup>(7)</sup>   | \$ 348,733   | \$ 0   |
|                                | ESI Pension Plan                | 36 <sup>(6)</sup>   | \$ 292,109   | \$ 0   |
|                                | ESI Excess Pension Plan         | 36 <sup>(6)</sup>   | \$ 78,226  | \$ 0   |
| Ronald F. Hamm                 | Old Pension Plan                | 0 <sup>(5)</sup>  | \$ 0   | \$ 0   |
|                                | ESI Pension Plan                | 0 <sup>(5)</sup>  | \$ 0   | \$ 0   |
|                                | ESI Excess Pension Plan         | 0 <sup>(5)</sup>  | \$ 0   | \$ 0   |
|                                |                                 |   |  |  |

- (1) Includes each plan that provides for specific retirement payments and benefits, or payments and benefits that will be provided primarily following retirement, including, without limitation, tax-qualified defined benefit plans and supplemental executive retirement plans, but excluding tax-qualified defined contribution plans and nonqualified defined contribution plans.
- (2) Computed as of December 31, 2014.
- (3) Amounts shown represent the actuarial present value of the Named Executive Officer's accumulated benefit under the plan, computed as of December 31, 2014. The estimated amounts assume that the Named Executive Officer's retirement age is the normal retirement age as defined in the plan or, if not so defined, the earliest time at which a participant may retire under the plan without any benefit reduction due to age. The estimated amounts are based on the Named Executive Officer's most current compensation subject to the plan and, as such, future levels of the Named Executive Officer's compensation are not estimated for purposes of the calculation. The estimated amounts used to quantify the present value of the accumulated benefit under the Old Pension Plan assume a normal retirement age of 65 using the RP-2000 mortality table and a 3.25% discount rate as of December 31, 2014 for each of the Named Executive Officers who participates in the plan. No mortality is assumed prior to age 65 for any of the Named Executive Officers in the estimated amounts shown for the Old Pension Plan. See Note 14 Employee Benefit Plans of the Notes to Consolidated Financial Statements, for a discussion of the valuation method and all material assumptions applied in quantifying the present value of the accumulated benefit under the ESI Pension Plan and ESI Excess Pension Plan.
- (4) Amounts shown represent the dollar amount of any payments and benefits paid to the Named Executive Officer under each plan identified during 2014.
- (5) The Named Executive Officer's employment with us began after participation in the plan by new eligible employees had ended.
- (6) The Named Executive Officer's number of years of credited service with respect to the ESI Pension Plan and the ESI Excess Pension Plan is different from the Named Executive Officer's number of actual years of service with us, because:

any benefit service with ITT Corporation or any of its affiliated companies that was credited to the participating employee under the Old Pension Plan or the Retirement Plan for Salaried Employees of ITT Nevada (the Nevada Pension Plan ), is treated as benefit service with us under the ESI Pension Plan and the ESI Excess Pension Plan;

the ESI Pension Plan covers only most of our eligible salaried employees who were employed by us prior to June 2, 2003; and

the ESI Excess Pension Plan covers only a select group of our management and highly-compensated employees who were employed by us prior to June 2, 2003.

The number of years of credited service attributed to each Named Executive Officer reflects the Named Executive Officer's actual service with us or an affiliated company under the ESI Pension Plan and the ESI Excess Pension Plan through the date that the plans were frozen. The number of years of actual service with us or an affiliated company by each Named Executive Officer who participates in the ESI Pension Plan or the ESI Excess Pension Plan and the difference between that Named Executive Officer's actual service and credited service under the ESI Pension Plan and the ESI Excess Pension Plan are as follows:

| <b>Named Executive Officer</b> | <b>Actual<br/>Years of<br/>Service With Us or<br/>an<br/>Affiliated<br/>Company<br/>(a)</b> | <b>Credit Years of<br/>Service Under the<br/>Plan<br/>(b)</b> | <b>Difference<br/>(b-a)</b> |
|--------------------------------|---|---|-----------------------------|
| Kevin M. Modany                | 12.5  | 13  | 0.5                         |
| Eugene W. Feichtner            | 35.6  | 36  | 0.4                         |

The number of actual years of service with us or an affiliated company under the ESI Pension Plan and the ESI Excess Pension Plan, rounded to the nearest whole year in accordance with each plan's terms, is the same as the number of credited years of

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service under the ESI Pension Plan and the ESI Excess Pension Plan and, therefore, no benefit augmentation resulted under the ESI Pension Plan or the ESI Excess Pension Plan to any of the Named Executive Officers as a result of the difference in the number of years of actual service from the number of years of credited service. The benefit accruals under the ESI Pension Plan and the ESI Excess Pension Plan for all participants in the plans were frozen on March 31, 2006, such that no further benefits accrue under those plans after March 31, 2006. See Pension Plans *ESI Pension Plan* and *ESI Excess Pension Plan*.

- (7) The Named Executive Officer's number of years of credited service under the Old Pension Plan is different from the Named Executive Officer's number of actual years of service with us, because our participation in the Old Pension Plan ended on December 19, 1995. The number of years of credited service attributed to each Named Executive Officer reflects the Named Executive Officer's actual service with a participating company under the Old Pension Plan through the end of our participation in the Old Pension Plan. See Pension Plans *Old Pension Plan*. The number of years of actual service with us or an affiliated company by each Named Executive Officer who participated in the Old Pension Plan and the difference between that Named Executive Officer's actual service and credited service under the Old Pension Plan are as follows:

| <b>Named Executive Officer</b> | <b>Actual<br/>Years of<br/>Service With Us<br/>or an<br/>Affiliated<br/>Company<br/>(a)</b> | <b>Credit<br/>Years of<br/>Service Under the<br/>Plan<br/>(b)</b> | <b>Difference<br/>(b-a)</b> |
|--------------------------------|---|---|-----------------------------|
| Eugene W. Feichtner            | 35.6  | 20  | (15.6)                      |

The number of actual years of service with us or an affiliated company is greater than the number of credited years of service under the Old Pension Plan and, therefore, no benefit augmentation resulted under the Old Pension Plan to any of the Named Executive Officers as a result of the difference in the number of years of actual service from the number of years of credited service.

**Pension Plans**

**Old Pension Plan.** Prior to December 19, 1995, we participated in the Old Pension Plan, a non-contributory defined benefit pension plan that covered substantially all of our eligible salaried employees, including our executive officers. We paid the entire cost of the Old Pension Plan with respect to our employees. Normal retirement age under the Old Pension Plan is 65.

The annual pension amounts to 2% of a participant's average final compensation (as defined below) for each of the first 25 years of benefit service, plus 1.5% of a participant's average final compensation for each of the next 15 years of benefit service prior to December 19, 1995, reduced by 1.25% of the participant's primary Social Security benefit for each year of benefit service to a maximum of 40 years; provided that no more than 50% of the participant's primary Social Security benefit is used for such reduction. A participant's average final compensation (including salary plus approved bonus payments) is defined under the Old Pension Plan as the total of (a) a participant's average annual base salary for the five calendar years of the last 120 consecutive calendar months of eligibility service affording the highest such average, plus (b) a participant's average annual compensation not including base salary (such as approved bonus compensation and overtime) for the five calendar years of the participant's last 120 consecutive calendar months

of eligibility service affording the highest such average. The dollar value of base salary and approved bonus (which may include non-equity incentive plan compensation under Item 402(a) of Regulation S-K under the Exchange Act), whether cash and/or non-cash, are the components of the compensation that are used for purposes of determining average final compensation under the Old Pension Plan, but annual compensation in excess of \$160,000 and compensation accrued after December 18, 1995 are not taken into account. The Old Pension Plan also provides for: (a) undiscounted early retirement pensions for participants who retire at or after age 60 and prior to normal retirement age following completion of 15 years of eligibility service; and (b) discounted early retirement pensions for participants who retire between ages 55 and 59 and whose age and years of eligibility service equate to at least 80. A participant is vested in benefits accrued under the Old Pension Plan upon completion of five years of eligibility service. A participant may receive a distribution in the form of a qualified joint and survivor annuity or a life annuity. The amount of the resulting monthly benefit under a joint and survivor annuity is typically less than a life annuity based solely on the participant's life expectancy. No extra years of credited service under the Old Pension Plan have been granted to any of the Named Executive Officers. As of December 31, 2014, Mr. Feichtner was the only Named Executive Officer participant who qualified for early retirement under the Old Pension Plan based on age and years of service, but he has not elected to receive the early retirement annual benefit under the Old Pension Plan. ITT Corporation is responsible for all benefits accrued under the Old Pension Plan and for administering those benefits with respect to its own employees as well as our retirees.

***ESI Pension Plan.*** On June 9, 1998, we established the ESI Pension Plan that, prior to June 2, 2003, covered most of our eligible salaried employees, including our executive officers. The purpose for establishing the ESI Pension Plan was to replace the Nevada Pension Plan. We participated in the Nevada Pension Plan, which covered substantially all of our eligible salaried employees, including our executive officers, from December 20, 1995 to June 9, 1998. The Nevada Pension Plan was terminated and liquidated in June 2000 and is no longer in existence. Effective June 2, 2003, the ESI Pension Plan was amended to cover only most of our eligible salaried employees, including our executive officers, who were employed by us prior to June 2, 2003. The benefit accruals under the ESI Pension Plan for all participants in the plan were frozen on March 31, 2006, such that no further benefits accrue under that plan after March 31, 2006, other than interest credits described below.

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The ESI Pension Plan is a cash balance defined benefit plan, which provides a set benefit to participating employees at their retirement that is not affected by the amount of our contributions to the ESI Pension Plan trust or the investment gains or losses with respect to such contributions. The ESI Pension Plan credited a bookkeeping account associated with each participating employee with:

an amount based on the employee's compensation, age and years of benefit service (the Pay Credit) at the end of each plan year (i.e., January 1 through December 31, except for the first plan year of June 9, 1998 through December 31, 1998) through March 31, 2006 of the 2006 plan year;

interest credits on the portion of the balance attributable to Pay Credits credited to the bookkeeping account for plan years prior to the 2002 plan year, calculated as of the end of each plan year at the fixed rate of 8% through December 31, 2010 and 5% beginning January 1, 2011, compounded annually; and

interest credits on the portion of the balance attributable to Pay Credits credited to the bookkeeping account for the 2002 and subsequent plan years, calculated as of the end of each plan year at a variable rate ranging from 6% to 12% through December 31, 2010 and 4% to 12% beginning January 1, 2011, compounded annually.

The variable rate for a plan year is the average of the 30-year U.S. Treasury Bond (or a comparable instrument) rates on each of March 31, June 30 and September 30 of the immediately preceding plan year. At retirement, the participating employee will receive a benefit equal to the value of the bookkeeping account associated with such employee. We pay the entire cost of the ESI Pension Plan. The Pay Credit equals a percentage of the participating employee's compensation (consisting of base salary, overtime pay and bonuses (which may include non-equity incentive plan compensation under Item 402(a) of Regulation S-K under the Exchange Act) whether cash and/or non-cash) for the plan year and is determined under the following schedule according to points based on the participating employee's age and years of benefit service:

| Points | Standard Schedule Allocation Percentage |                   |
|--------|---|-------------------|
|        | Prior to 2002                           | Beginning in 2002 |
| 1-29   | 2.0                                     | 2.5               |
| 30-34  | 2.5                                     | 2.5               |
| 35-39  | 3.0                                     | 3.0               |
| 40-44  | 3.5                                     | 3.5               |
| 45-49  | 4.0                                     | 4.0               |
| 50-54  | 4.5                                     | 4.5               |
| 55-59  | 5.5                                     | 5.5               |
| 60-64  | 6.5                                     | 6.5               |
| 65-69  | 7.5                                     | 7.5               |
| 70-74  | 9.0                                     | 9.0               |
| 75-79  | 10.5                                    | 10.5              |
| 80+    | 12.0                                    | 12.0              |



Participating employees who met certain age and service requirements received Pay Credits under the following Transition Schedule, which is more generous:

| Points | Transition Schedule Allocation Percentage |                   |
|--------|---|-------------------|
|        | Prior to 2002                             | Beginning in 2002 |
| 1-29   | 2.0                                       | 8.0               |
| 30-34  | 2.5                                       | 8.0               |
| 35-39  | 3.0                                       | 8.0               |
| 40-44  | 3.5                                       | 8.0               |
| 45-49  | 4.0                                       | 8.0               |
| 50-54  | 4.5                                       | 8.0               |
| 55-59  | 5.5                                       | 8.0               |
| 60-64  | 7.0                                       | 8.0               |
| 65-69  | 8.5                                       | 8.5               |
| 70-74  | 10.5                                      | 10.5              |
| 75-79  | 13.0                                      | 13.0              |
| 80+    | 16.0                                      | 16.0              |

Mr. Modany received Pay Credits under the Standard Schedule, Mr. Feichtner received Pay Credits under the Transition Schedule and Messrs. Fitzpatrick, Dean and Hamm were ineligible to participate in the ESI Pension Plan.

The participating employee's points for a plan year equal the sum of the employee's age and years of benefit service as of the last day of the plan year. Any benefit service and vesting service with ITT Corporation or any of its affiliated companies that were credited to the participating employee under the Old Pension Plan as of December 19, 1995 or under the Nevada Pension Plan from December 20, 1995 through June 9, 1998 are treated as benefit service and vesting service, respectively, with us under the ESI Pension Plan. A participating employee who has completed three or more years of vesting service (or his or her beneficiary) is eligible to

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receive a distribution from the ESI Pension Plan upon the participating employee's retirement on or after age 55, disability, death or after the employee has both terminated employment and reached age 55. The form and timing of the distribution may vary depending on the reason the participant's employment ends, the participant's marital status, the present value of the bookkeeping account associated with the employee and the employee's election. An employee may receive a distribution in the form of a lump sum, qualified joint and survivor annuity (for married participants) or life annuity (for unmarried participants). The amount of the resulting monthly benefit under a joint and survivor annuity is typically less than for a life annuity based solely on the participant's life expectancy. We do not have a policy with regard to crediting extra years of benefit service under our pension plans, but no extra years of benefit service under the ESI Pension Plan have been credited to any of the Named Executive Officers. As of December 31, 2014, Mr. Feichtner was the only Named Executive Officer participant who qualified for retirement under the ESI Pension Plan based on age and years of service. If Mr. Feichtner's employment with us terminated as of December 31, 2014, he would receive his accrued benefit under the ESI Pension Plan as of that date, which was \$292,109. An eligible employee's benefits under the ESI Pension Plan will be paid from the trust maintained for the ESI Pension Plan that has been funded by us.

***ESI Excess Pension Plan.*** On June 9, 1998, we established, and effective January 1, 2008, we restated, the ESI Excess Pension Plan, an unfunded, nonqualified retirement plan for a select group of our management and highly compensated employees. The benefit accruals under the ESI Excess Pension Plan for all participants in the plan were frozen on March 31, 2006, such that no further benefits accrue under that plan after March 31, 2006. The purpose of the ESI Excess Pension Plan was to restore benefits earned, but not available, to eligible employees under the ESI Pension Plan due to federal limitations on the amount of benefits that can be paid and compensation that may be recognized under a tax-qualified retirement plan. The practical effect of the ESI Excess Pension Plan was to continue the calculation of retirement benefits to all employees on a uniform basis. The eligible employee's compensation upon which the benefits under the ESI Excess Pension Plan are based is the same as for that eligible employee's benefits under the ESI Pension Plan (but without regard to the IRC limit on includible compensation for qualified plans).

An eligible employee will receive his or her benefit under the ESI Excess Pension Plan in a lump sum cash payment within 60 days following his or her termination of employment. If an eligible employee is a specified employee as defined in Section 409A of the IRC, however, then his or her benefit will be paid on the first day that is six months after the eligible employee's termination of employment. If an eligible employee dies before the benefit due to the employee under the ESI Excess Pension Plan has been paid, then the benefit will be paid to the employee's beneficiary within 60 days after the employee's death. We do not have a policy with regard to crediting extra years of benefit service under our pension plans, but no extra years of benefit service under the ESI Excess Pension Plan have been credited to any of the Named Executive Officers. As of December 31, 2014, Mr. Feichtner was the only Named Executive Officer participant who qualified for retirement under the ESI Excess Pension Plan based on age and years of service. If Mr. Feichtner's employment with us terminated as of December 31, 2014, he would receive his accrued benefit under the ESI Excess Pension Plan as of that date, which was \$78,226. An eligible employee's benefits under the ESI Excess Pension Plan will generally be paid directly by us. See *ESI Pension Plan*.

**Nonqualified Deferred Compensation Plan Table**

The following table sets forth information concerning the compensation of the Named Executive Officers in our 2014 fiscal year under the ESI Excess Savings Plan and the Directors Deferred Compensation Plan. None of the Named Executive Officers has deferred any bonus compensation under the Deferred Bonus Plan.

**Nonqualified Deferred Compensation in Fiscal Year 2014**

| Named Executive Officer                 | ITT/ESI<br>Executive Contributions   |                                       |  |  |
|---|--------------------------------------|---------------------------------------|--|--|
|   | Contributions in<br>Last Fiscal Year | in<br>Last Fiscal Year <sup>(4)</sup> | in<br>Aggregate Earnings<br>Last Fiscal Year | Aggregate Balance at<br>Last Fiscal Year-End |
| Kevin M. Modany                         |                                      |                                       |  |  |
| ESI Excess Savings Plan                 | \$ 0                                 | \$ 0                                  | \$ 4,542 <sup>(2)</sup>                      | \$ 59,279 <sup>(3)</sup>                     |
| Daniel M. Fitzpatrick                   |                                      |                                       |  |  |
| ESI Excess Savings Plan                 | \$ 0                                 | \$ 0                                  | \$ 0   | \$ 0   |
| John E. Dean                            |                                      |                                       |  |  |
| ESI Excess Savings Plan                 | \$ 0                                 | \$ 0                                  | \$ 0   | \$ 0   |
| Directors Deferred Compensation<br>Plan | \$ 74,984                            | \$ 0                                  | \$ (334,669) <sup>(4)</sup>                  | \$ 155,634 <sup>(5)</sup>                    |
| Eugene W. Feichtner                     |                                      |                                       |  |  |
| ESI Excess Savings Plan                 | \$ 0                                 | \$ 0                                  | \$ 321 <sup>(2)</sup>                        | \$ 4,192 <sup>(3)</sup>                      |
| Ronald F. Hamm                          |                                      |                                       |  |  |
| ESI Excess Savings Plan                 | \$ 0                                 | \$ 0                                  | \$ 0   | \$ 0   |

- (1) Effective for plan years beginning on and after January 1, 2008, we froze the ESI Excess Savings Plan, such that eligible employees may no longer make elective contributions and we no longer make contributions under the ESI Excess Savings Plan. See Nonqualified Deferred Compensation Plans *ESI Excess Savings Plan*. The amount shown for Mr. Dean

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related to the Directors Deferred Compensation Plan represents the fair value of the shares of common stock that Mr. Dean elected to receive and defer under the Directors Deferred Compensation Plan in connection with the 2014 annual retainer paid to non-employee Directors in January 2014, prior to his appointment as Executive Chairman in August 2014. See Director Compensation *Directors Deferred Compensation Plan*. The full amount shown for Mr. Dean in this column is reported as compensation to Mr. Dean in the Summary Compensation Table for 2014 in the Salary column. See Summary Compensation Table.

- (2) Represents the dollar amount of the aggregate interest or other earnings accrued during 2014 to the Named Executive Officer's account under the ESI Excess Savings Plan. The only portion of these amounts that is reported as compensation to the Named Executive Officer in the Summary Compensation Table for the 2014 year is the above-market or preferential earnings in 2014 on the balance of the Named Executive Officer's account under the ESI Excess Savings Plan which are included in the Change in Pension Value and Nonqualified Deferred Compensation Earnings column of the Summary Compensation Table. See Summary Compensation Table.
- (3) Represents the dollar amount of the total balance of the Named Executive Officer's account at the end of 2014 under the ESI Excess Savings Plan. The only portion of these amounts that is reported as compensation to the Named Executive Officer in the Summary Compensation Table for each of the 2013 and 2012 years is the above-market or preferential portion of aggregate earnings under the ESI Excess Savings Plan in 2013 and 2012, which contribute to the aggregate balance of the Named Executive Officer's ESI Excess Savings Plan account at year-end 2014. Those earnings are included in the amount of the Named Executive Officer's compensation for the particular year and are reported in the Change in Pension Value and Nonqualified Deferred Compensation Earnings column of the Summary Compensation Table for that particular year. The amount of those above-market or preferential earnings for each of the Named Executive Officers is specified in the table below.

| <b>Named Executive Officer</b> | <b>ESI Excess Savings Plan<br/>Above-Market<br/>Earnings in Fiscal<br/>Year</b> |             |
|--------------------------------|---|-------------|
|                                | <b>2013</b>   | <b>2012</b> |
| Kevin M. Modany                | \$ 3,011  | \$ 2,571    |
| Daniel M. Fitzpatrick          | \$ 0  | \$ 0        |
| John E. Dean                   | \$ 0  | \$ 0        |
| Eugene W. Feichtner            | \$ 214  | \$ 183      |
| Ronald F. Hamm                 | \$ 0  | \$ 0        |

- (4) Represents the dollar amount of the stock price depreciation during 2014 attributable to the deferred shares credited to Mr. Dean's deferred stock account under the Directors Deferred Compensation Plan. None of this amount is reported as compensation to Mr. Dean in the Summary Compensation Table.
- (5) Represents the fair value of the total balance of Mr. Dean's deferred stock account at the end of 2014 under the Directors Deferred Compensation Plan, calculated by multiplying the number of shares credited to Mr. Dean's deferred stock account by the closing price of a share of our common stock on December 31, 2014. The portion of this amount that relates to elections by Mr. Dean to receive and defer his annual retainer in shares of our common stock in prior years was reported in the Directors Compensation Table in prior years Proxy Statements.

**Nonqualified Deferred Compensation Plans**

**ESI Excess Savings Plan.** On June 9, 1998, we established, and effective January 1, 2008, we restated, the ESI Excess Savings Plan, an unfunded, nonqualified deferred compensation plan for a select group of our management

and highly compensated employees. Effective for plan years beginning on and after January 1, 2008, we froze the ESI Excess Savings Plan, such that eligible employees may no longer make elective deferrals and we will no longer make contributions under the ESI Excess Savings Plan. The ESI Excess Savings Plan offered eligible employees, who were precluded by federal limitations from fully participating in the ESI 401(k) Plan, a means for:

restoring their contributions lost under the ESI 401(k) Plan due to the federal limitations;

restoring our matching and non-matching contributions lost under the ESI 401(k) Plan due to the federal limitations; and

deferring a portion of their salaries equal to either 5% or the same deferral percentage that they elected under the ESI 401(k) Plan.

Any deferral of an eligible employee's salary under the ESI Excess Savings Plan applied only with respect to the salary that exceeded the federal limitations. See Equity Compensation and Qualified Savings Plans *ESI 401(k) Plan*.

Prior to the freeze of the ESI Excess Savings Plan, we made matching contributions under the ESI Excess Savings Plan equal to 100% of the first 1% and 50% of the next 4% of the eligible employee's salary that the employee deferred under the ESI Excess Savings Plan. Any amounts credited to an eligible employee under the ESI Excess Savings Plan will accrue interest at the rate of 8% compounded monthly. This rate is determined by the Compensation Committee and may be changed at any time by that Committee.

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Our matching contributions vest 100% upon completion of the third full year that the employee is employed by us. The payment of the eligible employee's salary deferrals, our vested matching contributions and the attributable interest accrued thereon will be made in a single lump sum cash payment within 60 days following a Change in Control (as defined in the ESI Excess Savings Plan and below) or the eligible employee's termination of employment. If an eligible employee is a specified employee as defined in Section 409A of the IRC, however, then his or her amounts will be paid on the first day that is six months after his or her termination of employment. If an eligible employee dies before the amounts due to the employee under the ESI Excess Savings Plan have been paid, then those amounts will be paid to the employee's beneficiary within 60 days after the employee's death.

A Change in Control under the ESI Excess Savings Plan means one of the following events:

the acquisition of ownership (other than by way of merger or consolidation with an entity that, immediately before the acquisition, was a Controlling Company (as defined in the ESI Excess Savings Plan and below)) during any 12 month period, by any one person or more than one person acting as a group, of all or substantially all of the assets of a Controlling Company;

the acquisition (other than by a Controlling Company) by any one person or more than one person acting as a group, of ownership of more than 50% of the total fair market value or total voting power of the ownership interests of stock of a Controlling Company;

the acquisition (other than by a Controlling Company) during any 12 month period, by any one person or more than one person acting as a group, of ownership of stock of a Controlling Company possessing 30% or more of the total voting power of stock of the Controlling Company; or

the replacement of a majority of members of the board of directors or comparable governing body of a Controlling Company, during any 12-month period, by members whose appointment or election is not endorsed by a majority of the members of the Controlling Company's board of directors or comparable governing body prior to the date of the appointment or election.

A Controlling Company means:

us;

a related company that participates in the ESI Excess Savings Plan and employs the eligible employee;

a related company that is the majority owner of us or a participating company that employs the eligible employee; or

any related company in an uninterrupted chain of majority ownership culminating in the ownership of us or a participating company that employs the eligible employee.

**Deferred Bonus Plan.** On March 15, 2000, we established, and effective January 1, 2008, we restated, the Deferred Bonus Plan, an unfunded, nonqualified deferred compensation plan for a select group of our management and highly compensated employees. The Deferred Bonus Plan provides that each eligible employee may elect to defer payment of all or a portion of his or her annual bonus compensation in the same form that the bonus is otherwise payable, either in cash or shares of our common stock. The deferral of payment of cash or shares of our common stock can only be made in increments of 25%. Any deferred cash amounts will accrue interest at the rate of 6% compounded annually. This rate is determined by the Compensation Committee and may be changed at any time by that Committee. Any deferred shares of our common stock will be credited with any cash dividends on those shares and, on a semi-annual basis, those cash dividends will be converted to shares of our common stock, based on the fair market value at the time of the conversion.

An eligible employee under the Deferred Bonus Plan may elect, as part of his or her deferral election, to receive payment of the deferred portion of his or her annual bonus compensation (a) within 60 days after termination of his or her employment with us or (b) in January of a designated calendar year that is no earlier than the second calendar year after the year in which the deferred bonus compensation was determined. If an eligible employee is a specified employee as defined in Section 409A of the IRC, then any amounts payable to the eligible employee under the Deferred Bonus Plan on account of his or her termination of employment with us will be paid on the first day that is six months after termination of his or her employment. If an eligible employee dies before all amounts due to the employee under the Deferred Bonus Plan have been paid, the unpaid balance will be paid in a lump sum within 60 days following the eligible employee's death, regardless of the employee's election. Payment of cash amounts deferred are made in the form of cash, and payment of shares of our common stock deferred are made in the form of shares of our common stock, except that any cash dividends that have not been converted to shares of our common stock will be paid in cash.

None of the Named Executive Officers deferred any amounts under the Deferred Bonus Plan in 2014.

**Directors Deferred Compensation Plan.** Mr. Dean is the only Named Executive Officer with amounts deferred under the Directors Deferred Compensation Plan, due to his prior status as a non-employee Director of ours. See Director Compensation *Directors Deferred Compensation Plan* for a description of the Directors Deferred Compensation Plan.

### **Potential Payments Upon Termination or Change In Control**

The amounts set forth or referenced in this section reflect amounts payable and the value of benefits under our plans and arrangements to each of the Named Executive Officers in the event of termination of such executive's employment and/or a change in control of us under various circumstances. The various types of circumstances that would trigger payments and benefits are specified in the discussion of each plan and arrangement under which benefits would be received. The following discussion is of plans and

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arrangements currently in effect, but it is always possible that different arrangements could be negotiated in connection with an actual termination of employment or change in control. Further, the amounts shown are estimates and are based on numerous assumptions, including that employment terminated or a change in control occurred on December 31, 2014, except as otherwise noted. Therefore, the actual amounts of the payments and benefits that would be received by the Named Executive Officers could be more or less than the amounts set forth below, and can only be determined at the time of an actual termination of employment or change in control event.

**Senior Executive Severance Plan.** On October 22, 2007, we established the Senior Executive Severance Plan, which provides severance benefits for a select group of our executives (including all of the Named Executive Officers other than Mr. Dean, due to his status as Executive Chairman, and Mr. Hamm, due to his resignation effective May 15, 2015) when:

the covered executive's employment is terminated, other than for cause, or when the covered executive terminates his or her employment for good reason, in each case within two years after the occurrence of an acceleration event, as described below; or

the covered executive's employment is terminated, other than for cause, during an imminent acceleration event period, as described below.

As a result, the benefits under the Senior Executive Severance Plan are not payable merely because a change in control transaction occurs or is imminent. Instead, payment of the severance benefits is only triggered if a change in control has occurred or is imminent and certain types of termination of employment occur. The Compensation Committee has determined that this double trigger requirement is in the best interests of our company and our shareholders.

The Senior Executive Severance Plan provides two levels of benefits for covered executives, based on the covered executive's position with us. Under the Senior Executive Severance Plan, Mr. Modany would receive the higher level of benefits and Messrs. Feichtner and Fitzpatrick would receive the lower level of benefits. If Mr. Modany's employment is terminated other than for cause during an imminent acceleration event period or within two years after an acceleration event, or if he resigns for good reason within two years after an acceleration event, he would be entitled to the following from us:

three times his highest annual base salary rate paid and his highest bonus paid or awarded any time during the three years immediately preceding the acceleration event (or in the case of a termination that occurs during an imminent acceleration event period, the three-year period immediately preceding the first day of the imminent acceleration event period);

a lump sum amount equal to three times the product of his highest annual base salary rate paid during the three years immediately preceding the acceleration event (or in the case of a termination that occurs during an imminent acceleration event period, the three-year period immediately preceding the first day of the imminent acceleration event period), multiplied by the highest percentage rate of our contributions with respect to him under the ESI 401(k) Plan at any time during that three year period;



a lump sum stipend equal to 36 times the monthly premium that, as of the date of Mr. Modany's termination of employment, is charged to qualified beneficiaries for health care continuation coverage under COBRA, for the same coverage options and levels of medical, prescription drug, dental and vision coverage that he had in effect under our welfare plans immediately prior to his termination of employment;

a lump sum stipend equal to 36 times the full monthly premium payable to our life insurance carrier for the type and level of life insurance coverage (including, if applicable, dependent life insurance coverage) in effect for him immediately prior to his termination of employment; and

a tax gross-up payment that covers any excise tax, interest and penalties under the IRC arising from the payment to him of any amount under the Senior Executive Severance Plan or otherwise as a result of an acceleration event.

If the employment of any of the other Named Executive Officers (other than Mr. Dean or Mr. Hamm) is terminated other than for cause during an imminent acceleration event period or within two years after an acceleration event, or if he resigns for good reason within two years after an acceleration event, he would be entitled to the following from us under the Senior Executive Severance Plan:

two times his highest annual base salary rate paid and his highest bonus paid or awarded any time during the three years immediately preceding the acceleration event (or in the case of a termination that occurs during an imminent acceleration event period, the three-year period immediately preceding the first day of the imminent acceleration event period);

a lump sum amount equal to two times the product of his highest annual base salary rate paid during the three years immediately preceding the acceleration event (or in the case of a termination that occurs during an imminent acceleration event period, the three-year period immediately preceding the first day of the imminent acceleration event period), multiplied by the highest percentage rate of our contributions with respect to that executive under the ESI 401(k) Plan at any time during that three year period;

a lump sum stipend equal to 24 times the monthly premium that, as of the date of the executive's termination of employment, is charged to qualified beneficiaries for COBRA continuation coverage for the same coverage options and levels of medical, prescription drug, dental and vision coverage that the executive had in effect under our welfare plans immediately prior to his termination of employment; and

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a lump sum stipend equal to 24 times the full monthly premium payable to our life insurance carrier for the type and level of life insurance coverage (including, if applicable, dependent life insurance coverage) in effect for him immediately prior to his or her termination of employment;

*provided, however,* that in the event that any payments to one of these other Named Executive Officers under the Senior Executive Severance Plan or otherwise in connection with an acceleration event would be subject to any excise tax under Section 4999 of the IRC, then those payments will be reduced to the extent necessary to prevent any portion of the payments from being subject to an excise tax under that section of the IRC, but only if such reduction would allow the executive to retain a greater net after-tax benefit than he or she would have received if the payments had not been reduced and the executive had paid all applicable income, employment and excise taxes.

The Senior Executive Severance Plan provides that, in order to receive any severance benefits under that plan, the covered executive must agree to comply with certain restrictive covenants, including that the covered executive:

will not be employed by, work for, consult with, lend assistance to or engage in businesses competitive with ours for a period of one year after termination of employment;

will not solicit or induce to leave any of our employees for a period of one year after the executive's termination of employment;

will not urge or induce any of our customers or others with whom we have a business relationship to terminate or limit their business with us for a period of one year after termination of employment;

will not disparage us for a period of one year after termination of employment; and

will not disclose or use our confidential information for as long a period of time as permitted by applicable law, and in any event for a period of at least three years after termination of employment.

The covered executive must also execute a general release releasing us and certain related entities and individuals from all claims that he or she has or may have against us or them that arise on or before the date the executive signs the release.

The Senior Executive Severance Plan provides that the severance amounts will be paid by us in a lump sum cash payment within 30 calendar days following the covered executive's termination or, if later, on the first business day after expiration of the revocation period of the general release. Payment of any gross-up amount to Mr. Modany is to be made within five business days after a chosen accounting firm determines whether such a payment is due. In all cases, any amounts due under the Senior Executive Severance Plan must be paid no later than March 15 of the calendar year following the calendar year in which the executive's termination of employment occurs.

An acceleration event under the Senior Executive Severance Plan will occur if:

a report on Schedule 13D is filed with the SEC disclosing that any person, other than us or one of our subsidiaries or any employee benefit plan that we or one of our subsidiaries sponsors, is the beneficial owner of 20% or more of the outstanding shares of our common stock, other than as a result of an increase in the percentage of the outstanding shares beneficially owned by such person solely as a result of a reduction in the number of shares then outstanding due to the repurchase by us of our common stock, provided that any subsequent acquisition of shares of our common stock by any person resulting in such person beneficially owning 20% or more of the outstanding shares of our common stock shall constitute an acceleration event;

a person, other than us or one of our subsidiaries or any employee benefit plan that we or one of our subsidiaries sponsors, purchases shares of our common stock in connection with a tender or exchange offer, if after consummation of the offer the person purchasing the shares is the beneficial owner of 15% or more of the outstanding shares of our common stock;

our shareholders approve:

any consolidation or merger of us in which we are not the continuing or surviving corporation or our common stock is converted into cash, securities or other property, unless the transaction was a merger in which our shareholders immediately prior to the merger would have the same proportionate ownership of common stock of the surviving corporation that they held in us immediately prior to the merger; or

any sale, lease, exchange or other transfer of all or substantially all of our assets; or

a majority of the members of our Board of Directors changes within a 12-month period, unless the election or nomination for election of each of the new Directors by our shareholders had been approved by two-thirds of the Directors still in office who had been Directors at the beginning of the 12-month period.

An imminent acceleration event period under the Senior Executive Severance Plan means the period:

beginning on the first to occur of:

a public announcement of a proposal or offer that, if consummated, would be an acceleration event;

a making to one or more of our Directors or executive officers of a written proposal that, if consummated, would be an acceleration event; or

approval by our Board of Directors or shareholders of a transaction that, upon closing, would be an acceleration event; and



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ending upon the first to occur of:

a public announcement that the contemplated acceleration event has been terminated or abandoned;

the occurrence of the contemplated acceleration event; or

18 months after the beginning of the imminent acceleration event period.

A resignation for "good reason" means:

a material diminution in the covered executive's base compensation;

a material diminution in the covered executive's authority, duties or responsibilities;

a material diminution in the authority, duties or responsibilities of the person to whom the covered executive is required to report (including, for example, a requirement that a covered executive who previously reported to the Board of Directors instead report to a corporate officer or employee);

a material diminution in the budget over which the covered executive retains authority;

a material change in the geographic location at which the covered executive must perform services; and

if the terms and conditions of a covered executive's employment are governed by an agreement, any other action or inaction that constitutes a material breach by us or any successor of the agreement.

A termination for "cause" means any action by a covered executive involving willful malfeasance or his or her failure to act involving material nonfeasance that would have a materially adverse effect on us. No act or omission on the part of the covered executive will be considered "willful," unless it is done or omitted in bad faith or without reasonable belief that the action or omission was in our interests.

If termination of employment and an acceleration event or imminent acceleration event under the Senior Executive Severance Plan occurred that entitled the Named Executive Officers to severance benefits under the Senior Executive Severance Plan, the value that could have been realized from those benefits as if employment terminated on December 31, 2014 is set forth in the following table for the Named Executive Officers other than Mr. Dean and Mr. Hamm. Mr. Dean is not eligible for benefits under the Senior Executive Severance Plan. Mr. Hamm did not receive any benefits or other payments under the Senior Executive Severance Plan in connection with his resignation effective May 15, 2015.

**Value of Benefit that Could have been Realized by the Named Executive Officers  
under the Senior Executive Severance Plan as of December 31, 2014**

| Type of Benefit   | Modany              | Fitzpatrick         | Feichtner           |
|---|---------------------|---------------------|---------------------|
| Salary  | \$ 2,472,229        | \$ 824,000          | \$ 638,822          |
| Bonus   | \$ 3,000,279        | \$ 650,000          | \$ 465,162          |
| Stipend in Lieu of Health Insurance Benefits <sup>(1)</sup> | \$ 39,549           | \$ 26,366           | \$ 26,366           |
| Stipend in Lieu of Life Insurance Benefits <sup>(1)</sup>   | \$ 18               | \$ 12               | \$ 12               |
| Foregone Savings Plan Benefits <sup>(1)</sup>               | \$ 22,950           | \$ 15,300           | \$ 15,300           |
| Tax Gross-Up Payment to Cover Excise Tax <sup>(2)</sup>     | \$ 0                | N/A                 | N/A                 |
| Reduction to Limit Excise Taxes <sup>(2)</sup>              | N/A                 | \$ (0)              | \$ (0)              |
| <b>Total</b>  | <b>\$ 5,535,025</b> | <b>\$ 1,515,678</b> | <b>\$ 1,145,662</b> |

- (1) The estimated value of the severance benefit is based on the cost to us using the assumptions used for financial reporting purposes under generally accepted accounting principles in the United States.
- (2) The estimated value of any excise tax, and thereby the amount of any tax gross-up payment and the calculation of any reduction to limit excise taxes, are based on the highest marginal rate of federal, state and local taxes related to the severance benefits specified in the table and any other payments to the Named Executive Officer arising from an acceleration event. These amounts are also based on an assumption that, as a result of the covenant not to compete in the Senior Executive Severance Plan, the value of one year's base salary and target bonus would constitute reasonable compensation under Section 280G of the IRC and therefore would be excluded from the calculation of the amount of any excise tax, the amount of any tax gross-up payment and the reduction, if any, required to limit excise taxes.

**Modany Letter Agreement.** We entered into the Modany Letter Agreement with Mr. Modany on August 4, 2014. See Employment Contracts for a further discussion of the Modany Letter Agreement. If we had terminated the Applicable Period on December 31, 2014 for any reason other than cause, Mr. Monday would have been entitled to the cash compensation he would have been paid through February 4, 2015, as the last day of the Applicable Period, as it existed as of December 31, 2014. During the 18-month period following the Applicable Period, Mr. Modany will serve as a consultant to us in exchange for a monthly fee equivalent to his current monthly base salary and continued vesting of his equity-based awards. Mr. Modany will not be entitled to receive any severance pay or other separation benefits in connection with his resignation, but we will pay him a lump sum cash payment equal to 18 times his monthly premium with respect to COBRA for continued health, dental and vision coverage.

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If we had terminated Mr. Modany's employment without cause on December 31, 2014, he would have been entitled to the following amounts:

base salary amount through February 4, 2015, payable in a lump sum: \$88,747;

short-term compensation amount with respect to 2014, payable in a lump sum in late January 2015: \$721,067;

COBRA amount, payable in a lump sum: \$20,170; and

aggregate incremental value of continued use of company car through February 4, 2015: \$2,105.

Further, subject to Mr. Modany's compliance with a release requirement and restrictive covenants and cooperation provisions, if we had terminated Mr. Modany's employment without cause as of December 31, 2014, he would have become a consultant to us for the 18 month period following his termination. Pursuant to that consulting arrangement, we would pay Mr. Modany a monthly fee equivalent to his current monthly base salary (which is \$68,673), there would be continued vesting of his equity-based awards and he would have continued use of the company-provided automobile during the consulting period.

***Amended 2006 Plan.*** If a Named Executive Officer's employment with us terminates as a result of the Named Executive Officer's death or disability:

all outstanding stock options with time-based vesting restrictions granted to the Named Executive Officer under the Amended 2006 Plan will become exercisable immediately;

all restrictions imposed on restricted stock and RSUs with time-based vesting restrictions granted to the Named Executive Officer under the Amended 2006 Plan will lapse immediately, and the RSUs will be settled immediately thereafter; and

the Plan Committee will determine the extent to which a Named Executive Officer will have the right to receive other stock awards granted to the Named Executive Officer under the Amended 2006 Plan.

In the event of a change in control of us under the Amended 2006 Plan:

all outstanding stock options with time-based vesting restrictions granted to the Named Executive Officer under the Amended 2006 Plan will become exercisable immediately;

all restrictions imposed on restricted stock and RSUs with time-based vesting restrictions granted to the Named Executive Officer under the Amended 2006 Plan will lapse immediately, and the RSUs will be settled immediately thereafter; and

in the discretion of the Plan Committee, all outstanding stock options may be terminated and each participant may receive, with respect to each share subject to the options, an amount in cash equal to the excess of the consideration payable with respect to one share in connection with the change in control over the option's exercise price.

A change in control under the Amended 2006 Plan means the occurrence of one or more of the following:

the acquisition by any person (within the meaning of Section 13(d) of the Exchange Act), other than us, a subsidiary of ours or any employee benefit plan sponsored by us or a subsidiary of ours, of a beneficial ownership directly or indirectly of 20% or more of the outstanding shares of our common stock, provided that an increase in the percentage of the outstanding shares of our common stock beneficially owned by any person (within the meaning of Section 13(d) of the Exchange Act) solely as a result of a reduction in the number of shares of our common stock then outstanding due to the repurchase by us of such common stock shall not constitute a change in control, however any subsequent acquisition of shares of our common stock by any person (within the meaning of Section 13(d) of the Exchange Act) resulting in such person beneficially owning 20% or more of the outstanding shares of our common stock shall constitute a change in control;

the purchase by any person (within the meaning of Section 13(d) of the Exchange Act), other than us, a subsidiary of ours or any employee benefit plan sponsored by us or a subsidiary of ours, of shares pursuant to a tender offer or exchange offer to acquire our common stock (or securities convertible into common stock) for cash, securities or any other consideration, provided that after consummation of the offer, the person in question is the beneficial owner (as such term is defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of 15% or more of the outstanding shares of our common stock (calculated as provided in paragraph (d) of Rule 13d-3 under the Exchange Act in the case of rights to acquire common stock);

our shareholders approve (a) any consolidation or merger of us in which we are not the continuing or surviving corporation or pursuant to which shares of our common stock would be converted into cash, securities or other property, other than a merger of us in which holders of our common stock immediately prior to the merger have the same proportionate ownership of common stock of the surviving corporation immediately after the merger as immediately before, or (b) any sale, lease, exchange or other transfer (in one transaction or a series of related transactions) of all or substantially all of our assets;

a change in a majority of the members of our Board of Directors within a 12-month period, unless the election or nomination for election by our shareholders of each new Director during such 12-month period was approved by the vote of two-thirds of the Directors then still in office who were Directors at the beginning of such 12-month period; or

the liquidation or dissolution of us.



In addition, one or more outstanding unvested awards under the Amended 2006 Plan may become fully vested and exercisable and the restrictions on the transfer and repurchase or forfeiture rights on the awards may be terminated in connection with a disposition of a subsidiary of ours, but only with respect to those participants who are at the time engaged primarily in service with the subsidiary involved in the subsidiary disposition. See [Equity Compensation and Qualified Savings Plans](#) *Amended 2006 Plan*.

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If any of the following occurs:

a Named Executive Officer's employment with us terminates as a result of the Named Executive Officer's death or disability;

there is a change in control of us; or

the Plan Committee determines to fully vest awards in a disposition of a subsidiary with which the officer was engaged primarily in service, the value that could have been realized from the exercise or acceleration of unvested awards with time-based vesting restrictions granted to the Named Executive Officer under the Amended 2006 Plan as of December 31, 2014, is as follows:

| Named Executive Officer | December 31, 2014 Value of Unvested Awards<br>Termination Due<br>to Death or<br>Disability |                     |                              |                     |
|-------------------------|--|---------------------|------------------------------|---------------------|
|                         | Stock Options <sup>(1)</sup>   | RSUs <sup>(2)</sup> | Stock Options <sup>(1)</sup> | RSUs <sup>(2)</sup> |
| Kevin M. Modany         | \$ 0   | \$ 945,336          | \$ 0                         | \$ 945,336          |
| Daniel M. Fitzpatrick   | \$ 0   | \$ 202,521          | \$ 0                         | \$ 202,521          |
| John E. Dean            | \$ 0   | \$ 1,295,947        | \$ 0                         | \$ 1,295,947        |
| Eugene W. Feichtner     | \$ 0   | \$ 158,017          | \$ 0                         | \$ 158,017          |

- (1) Amounts shown represent the aggregate dollar amount that could be realized from all outstanding, unvested stock option awards granted to the Named Executive Officer under the Amended 2006 Plan, if those options became vested and were exercised by the Named Executive Officer on December 31, 2014.
- (2) Amounts shown are calculated by multiplying the number of unvested RSUs held by the Named Executive Officer that would vest upon the specified event by the closing market price of a share of our common stock on December 31, 2014.

Mr. Hamm is not included in the table above because his resignation did not constitute any of the types of events that would have resulted in an acceleration of vesting of any of his equity-based compensation awards.

In addition, the Plan Committee, in its discretion, may amend the terms of any outstanding award granted under the Amended 2006 Plan in the event of a participant's termination of employment or service or in the event of a change in control of us, subject to certain limitations. See *Equity Compensation and Qualified Savings Plans Amended 2006 Plan*.

**ESI 401(k) Plan.** If a Named Executive Officer's employment with us terminates, the Named Executive Officer may withdraw from his or her account under the ESI 401(k) Plan all of the Named Executive Officer's contributions, all of our vested contributions and all earnings on both types of contributions. Payments are normally made in a single lump sum, but if the Named Executive Officer's balance is above a threshold amount, he or she may elect to receive

payments in annual or monthly installments. See Equity Compensation and Qualified Savings Plans *ESI 401(k) Plan*.

If a Named Executive Officer's employment with us terminated, the amount that could have been realized from the distribution of the contributions and earnings thereon in the Named Executive Officer's account under the ESI 401(k) Plan as of December 31, 2014 is as follows:

| Named Executive Officer | Amount of<br>Employee<br>Contributions,<br>ITT/ESI Vested<br>Contributions<br>and<br>Earnings on Those<br>Contributions as of<br>December 31, 2014 |
|-------------------------|--|
| Kevin M. Modany         | \$ 327,414   |
| Daniel M. Fitzpatrick   | \$ 318,202   |
| John E. Dean            | \$ 432   |
| Eugene W. Feichtner     | \$ 1,315,014   |
| Ronald F. Hamm          | \$ 28,474 <sup>(1)</sup>   |

(1) Reflects the amount of employee contributions, vested company contributions and earnings thereon in Mr. Hamm's account under the ESI 401(k) Plan as of May 15, 2015, the effective date of his resignation. ***ESI Excess Savings Plan.*** If the employment of a Named Executive Officer who is a participant in the ESI Excess Savings Plan terminates, all eligible employee salary deferrals, our vested contributions and the attributable interest accrued on those deferrals and contributions under the ESI Excess Savings Plan would be paid in a single lump sum cash payment to him on the first day that is six months following his termination of employment (because each Named Executive Officer participant is a specified employee within the meaning of Section 409A of the IRC), or within 60 days of his death if death occurs prior to payment. If a Change in Control

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occurs, the Named Executive Officer participants would receive the balance of their accounts under the ESI Excess Savings Plan in a single lump sum cash payment within 60 day after the Change in Control. See Nonqualified Deferred Compensation Plans *ESI Excess Savings Plan*. If a Named Executive Officer participant's employment with us terminated or a Change in Control under the ESI Excess Savings Plan occurred, the amount that would have been realized from the distribution of the deferrals, contributions and interest thereon in the Named Executive Officer's account under the ESI Excess Savings Plan as of December 31, 2014 is as follows:

| <b>Named Executive Officer</b> | <b>Amount of<br/>Salary<br/>Deferrals, ITT/<br/>ESI Vested<br/>Contributions<br/>and<br/>Accrued<br/>Interest as of<br/>December 31, 2014</b> |
|--------------------------------|---|
| Kevin M. Modany                | \$ 59,279   |
| Daniel M. Fitzpatrick          | \$ 0  |
| John E. Dean                   | \$ 0  |
| Eugene W. Feichtner            | \$ 4,192  |
| Ronald F. Hamm                 | \$ 0  |

**Deferred Bonus Plan.** If a Named Executive Officer's employment with us terminates and he had elected to receive the deferred portion of his annual bonus compensation under the Deferred Bonus Plan following his termination, or the termination was a result of his death, the balance of the Named Executive Officer participant's account under the Deferred Bonus Plan will be paid in a lump sum on the first day that is six months following his termination of employment, or within 60 days of death if his death occurs prior to payment. See Nonqualified Deferred Compensation Plans *Deferred Bonus Plan*. If a Named Executive Officer's employment with us terminated, triggering the payment of the balance of his account under the Deferred Bonus Plan, the Named Executive Officer would not have realized any amount as of December 31, 2014, because none of them had any amount in his account as of that date.

**Directors Deferred Compensation Plan.** If Mr. Dean's status as a Director and employee of ours terminated as of December 31, 2014, and he was no longer performing services for us in any capacity, he would have received payment of that number of shares of our common stock as were credited to his deferred stock account under the Directors Deferred Compensation Plan on that date. The number of deferred shares credited to Mr. Dean's account as of that date was 16,195, and the fair value of those shares as of that date was \$155,634, calculated by multiplying that number of shares by the closing price of a share of our common stock on December 31, 2014.

**ESI Pension Plan.** If a Named Executive Officer participant has completed three or more years of vesting service, then upon his retirement on or after age 55, disability, death or after he has both terminated employment and reached age 55, a distribution of the Named Executive Officer participant's accrued benefit under the ESI Pension Plan will be paid to him in the form and on the date elected by him beginning on the first day of any month following the termination of employment after the participant becomes entitled to begin distribution. The Named Executive Officer participant can elect to receive payment of the distribution in the form of a lump sum, qualified joint and survivor annuity (if he is married on the annuity starting date) or life annuity (if he is not married on the annuity starting date). See Pension Plans *ESI Pension Plan*. If one of the triggering events occurred and a Named Executive Officer

participant elected a lump sum distribution under the ESI Pension Plan, the amount of the Named Executive Officer participant's benefit that would have been accrued and payable under the ESI Pension Plan as of December 31, 2014 is as follows:

| <b>Named Executive Officer</b> | <b>Balance of ESI<br/>Pension<br/>Plan Account<br/>as of<br/>December 31, 2014</b> |
|--------------------------------|--|
| Kevin M. Modany                | \$ 38,932 <sup>(1)</sup>   |
| Daniel M. Fitzpatrick          | \$ 0   |
| John E. Dean                   | \$ 0   |
| Eugene W. Feichtner            | \$ 292,109   |
| Ronald F. Hamm                 | \$ 0   |

- (1) Benefit payable upon death or disability as of December 31, 2014. If the employment of Mr. Modany was terminated for any reason other than death or disability on December 31, 2014, his benefit would not be payable until he reaches age 55, because he was not at least age 55 as of that date.

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**ESI Excess Pension Plan.** Following the restatement of the ESI Excess Pension Plan effective January 1, 2008, upon a Named Executive Officer participant's death, retirement or other termination of employment, a distribution of the Named Executive Officer's accrued benefit under the ESI Excess Pension Plan will be paid to him in a lump sum on the first day that is six months following his termination of employment (because each Named Executive Officer participant is a specified employee within the meaning of Section 409A of the IRC), or within 60 days of his death if death occurs prior to payment. See Pension Plans *ESI Excess Pension Plan*. If one of the triggering events occurred and a Named Executive Officer participant received a lump sum distribution under the ESI Excess Pension Plan, the amount of the Named Executive Officer participant's benefit that would have been accrued and payable under the ESI Excess Pension Plan as of December 31, 2014 is as follows:

| <b>Named Executive Officer</b> | <b>Balance of ESI<br/>Excess Pension<br/>Plan Account as of<br/>December 31, 2014</b> |
|--------------------------------|---|
| Kevin M. Modany                | \$ 50,197   |
| Daniel M. Fitzpatrick          | \$ 0  |
| John E. Dean                   | \$ 0  |
| Eugene W. Feichtner            | \$ 78,226   |
| Ronald F. Hamm                 | \$ 0  |

**Old Pension Plan.** If a Named Executive Officer participant's employment with us terminates and he qualifies for retirement under the Old Pension Plan, a distribution will be paid to him. The Named Executive Officer participant can elect to receive payment of the distribution of his accumulated benefit under the Old Pension Plan in the form of a qualified joint and survivor annuity or life annuity. See Pension Plans *Old Pension Plan*. If a Named Executive Officer participant qualified for retirement under the Old Pension Plan, the actuarial present value of his accumulated benefit under the Old Pension Plan as of December 31, 2014 is set forth in the Pension Benefits Table. See Pension Benefits Table. As of December 31, 2014, Mr. Feichtner was the only Named Executive Officer participant who qualified for retirement under the Old Pension Plan, but he has not elected to receive the early retirement annual benefit under the Old Pension Plan. See Pension Benefits Table.

**Director Compensation Table**

The following table sets forth information concerning the compensation of our non-employee Directors in 2014 for their service on our Board of Directors in 2014. Mr. Modany was a Director of ours in 2014 until his resignation on August 4, 2014. Mr. Modany did not receive any compensation for his services as a Director of ours in 2014. Mr. Modany's compensation as an executive officer of ours is disclosed in previous sections of this document. Mr. Dean was a non-employee Director of ours in 2014 until August 4, 2014, when he was appointed Executive Chairman of the Board, at which time he became an employee of ours and remained a Director. Mr. Dean's compensation in 2014 in all capacities in which he served our company (employee, executive officer and Director) is disclosed in previous sections of this document.

**Director Compensation Table for Fiscal Year 2014**

| <b>Name</b> | <b>Fees Earned or<br/>Paid in Cash <sup>(1)</sup></b> | <b>Stock<br/>Awards <sup>(2)</sup></b> | <b>Option<br/>Awards <sup>(3)</sup></b> | <b>Nonqualified<br/>Deferred</b> | <b>All<br/>Other</b> | <b>Total <sup>(5)</sup></b> |
|-------------|---|--|---|----------------------------------|----------------------|-----------------------------|
|-------------|---|--|---|----------------------------------|----------------------|-----------------------------|

| (a)                  | Compensation |      |      |                         |      |      | (g)       |
|----------------------|--------------|------|------|-------------------------|------|------|-----------|
|                      | (b)          | (c)  | (d)  | Earnings <sup>(4)</sup> | (f)  | (g)  |           |
| Jerry M. Cohen       | \$ 21,781    | \$ 0 | \$ 0 | \$ 0                    | \$ 0 | \$ 0 | \$ 21,781 |
| John F. Cozzi        | \$ 75,000    | \$ 0 | \$ 0 | \$ 0                    | \$ 0 | \$ 0 | \$ 75,000 |
| James D. Fowler, Jr. | \$ 75,000    | \$ 0 | \$ 0 | \$ 0                    | \$ 0 | \$ 0 | \$ 75,000 |
| Joanna T. Lau        | \$ 75,000    | \$ 0 | \$ 0 | \$ 0                    | \$ 0 | \$ 0 | \$ 75,000 |
| Thomas I. Morgan     | \$ 75,000    | \$ 0 | \$ 0 | \$ 0                    | \$ 0 | \$ 0 | \$ 75,000 |
| Samuel L. Odle       | \$ 75,000    | \$ 0 | \$ 0 | \$ 4,840                | \$ 0 | \$ 0 | \$ 79,840 |
| Vin Weber            | \$ 75,000    | \$ 0 | \$ 0 | \$ 0                    | \$ 0 | \$ 0 | \$ 75,000 |
| John A. Yena         | \$ 75,000    | \$ 0 | \$ 0 | \$ 0                    | \$ 0 | \$ 0 | \$ 75,000 |

- (1) Amounts shown represent the aggregate dollar amount of all fees earned or paid for services as a Director, which consists of an annual retainer. In 2014, the annual retainer was paid in cash, but each non-employee Director elected to receive payment of the annual retainer in cash or shares of our common stock, in increments of 25% each. See *Director Compensation Directors Deferred Compensation Plan*. The full amount of the annual retainer that was paid to or deferred by a non-employee Director, whether in cash or shares of our common stock, is reported in this column. The grant date fair value of any portion of the annual retainer that a non-employee Director elected to receive in shares of our common stock is set forth in footnote (2) below. The amount of the annual retainer paid to Mr. Cohen in 2014 was pro-rated based on the date he was appointed to the Board, September 17, 2014.
- (2) In 2014, the annual RSU awards to our non-employee Directors was postponed due to our company not being current in its filings with the SEC. As described below under *Director Compensation Retainer and Fees*, the compensation program for our non-employee Directors includes an annual grant under the Amended 2006 Plan of RSUs that is effective

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on May 1 of each year. The 2014 grant, however, was postponed until the third business day following the date that we become current in our filings with the SEC. Because that date did not occur in 2014, the annual grant of RSUs also did not occur in 2014. In 2014, each non-employee Director elected to receive payment of the annual retainer in cash or shares of our common stock, in increments of 25% each. See *Director Compensation Directors Deferred Compensation Plan*. The amount related to any portion of the annual retainer that a non-employee Director elected to receive in shares of our common stock is included in column (b) of the table, but the grant date fair value of such shares is disclosed in the table below.

To determine the grant date fair value of stock awards, we use the closing market price of a share of our common stock on the effective date of the stock award. The amounts ultimately realized by the non-employee Directors from the stock awards will depend on the price of our common stock in the future and may be quite different from the value shown. The following table sets forth information regarding the fair value of the portion of the 2014 annual retainer that certain non-employee Directors elected to receive in the form of shares of our common stock:

**Grant Date Fair Value of Stock Awards in Fiscal Year 2014**

| Name                                 | Grant Date Fair<br>Value of Stock Award |
|--------------------------------------|---|
| (a)                                  | (b)                                     |
| Jerry M. Cohen                       |   |
| Portion of Retainer Payable in Stock | N/A                                     |
| John F. Cozzi                        |   |
| Portion of Retainer Payable in Stock | \$ 74,984                               |
| James D. Fowler, Jr.                 |   |
| Portion of Retainer Payable in Stock | \$ 37,475                               |
| Joanna T. Lau                        |   |
| Portion of Retainer Payable in Stock | N/A                                     |
| Thomas I. Morgan                     |   |
| Portion of Retainer Payable in Stock | N/A                                     |
| Samuel L. Odle                       |   |
| Portion of Retainer Payable in Stock | N/A                                     |
| Vin Weber                            |   |
| Portion of Retainer Payable in Stock | \$ 74,984                               |
| John A. Yena                         |   |
| Portion of Retainer Payable in Stock | N/A                                     |

N/A means not applicable.



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The following table sets forth information regarding the aggregate number of unvested stock awards granted by us to the non-employee Directors that were outstanding on December 31, 2014:

**Outstanding Stock Awards at Fiscal Year-End 2014**

| Name                          | Number of Shares or<br>Units of Stock<br>that<br>have Not<br>Vested <sup>(A)</sup> | Market Value of Shares<br>or Units of Stock<br>that<br>have Not Vested<br><sup>(B)</sup> |
|-------------------------------|--|--|
| (a)                           | (b)  | (c)  |
| Jerry M. Cohen                |  |  |
| N/A                           |  |  |
| John F. Cozzi                 |  |  |
| 05/22/12 Award <sup>(C)</sup> | 1,722  | \$ 16,548  |
| 05/21/13 Award <sup>(D)</sup> | 3,598  | \$ 34,577  |
| James D. Fowler, Jr.          |  |  |
| 05/22/12 Award <sup>(C)</sup> | 1,722  | \$ 16,548  |
| 05/21/13 Award <sup>(D)</sup> | 3,598  | \$ 34,577  |
| Joanna T. Lau                 |  |  |
| 05/22/12 Award <sup>(C)</sup> | 1,722  | \$ 16,548  |
| 05/21/13 Award <sup>(D)</sup> | 3,598  | \$ 34,577  |
| Thomas I. Morgan              |  |  |
| 05/21/13 Award <sup>(D)</sup> | 3,598  | \$ 34,577  |
| Samuel L. Odle                |  |  |
| 05/22/12 Award <sup>(C)</sup> | 1,722  | \$ 16,548  |
| 05/21/13 Award <sup>(D)</sup> | 3,598  | \$ 34,577  |
| Vin Weber                     |  |  |
| 05/22/12 Award <sup>(C)</sup> | 1,722  | \$ 16,548  |
| 05/21/13 Award <sup>(D)</sup> | 3,598  | \$ 34,577  |
| John A. Yena                  |  |  |
| 05/22/12 Award <sup>(C)</sup> | 1,722  | \$ 16,548  |
| 05/21/13 Award <sup>(D)</sup> | 3,598  | \$ 34,577  |

(A) Amounts shown represent the total number of shares or units of our common stock that have not vested.

(B) Amounts shown represent the aggregate market value of RSUs that have not vested. The aggregate market value is calculated by multiplying the number of RSUs by the closing market price of a share of our common stock on December 31, 2014.

(C) This RSU award vests in full on May 22, 2015 or, if earlier, upon termination of the Director's service on our Board of Directors due to the expiration of the last term that the Director is permitted to serve pursuant to any then-effective term or age limitation contained in any of our guidelines, policies, principles or other corporate document that results in the Director not being able to be nominated to a new term on our Board of Directors.

(D) This RSU award vests in full on May 21, 2016 or, if earlier, upon termination of the Director's service on our Board of Directors due to the expiration of the last term that the Director is permitted to serve pursuant to

any then-effective term or age limitation contained in any of our guidelines, policies, principles or other corporate document that results in the Director not being able to be nominated to a new term on our Board of Directors.

- (3) In 2014, none of the non-employee Directors received any stock options or SARs from us. There were no adjustments or amendments made in 2014 to the exercise price of any option awards held by any of the non-employee Directors, whether through amendment, cancellation or replacement grants, or any other means (such as a repricing), or that otherwise materially modified any option awards. None of the non-employee Directors held any outstanding option awards at December 31, 2014.
- (4) Amounts shown represent the above-market or preferential earnings on compensation deferred under the Directors Deferred Compensation Plan. See *Director Compensation Directors Deferred Compensation Plan*. Interest is above-market only if the rate of interest exceeds 120% of the applicable federal long-term rate, with compounding (as prescribed under Section 1274(d) of the IRC), at the rate that corresponds most closely to the rate under the applicable plan at the time the interest rate or formula is set. In the event of a discretionary reset of the interest rate, the requisite calculation is made on the basis of the interest rate at the time of such reset, rather than when originally established. Only the above-market portion of the interest is included.
- (5) Amounts shown represent the sum of the dollar values for each compensation element shown in columns (b) through (f).

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**Director Compensation**

***Retainer and Fees.*** We do not compensate any Director who is an employee of ours for service as a member of our Board of Directors or any standing committee of our Board of Directors. The compensation for non-employee Directors consists of:

an annual retainer of \$75,000 payable in one installment on the first business day of each year, at the election of each non-employee Director, in cash or shares of our common stock in increments of 25% each;

no separate meeting fees; and

an annual grant under the Amended 2006 Plan of RSUs with a time-based period of restriction that:

has a value of \$100,000, plus the value associated with any fractional RSU necessary to cause the grant to be for a whole number of RSUs, pursuant to which the value is determined based on the closing market price of a share of our common stock on the effective date of the grant;

is effective on May 1 in each year (except with respect to the 2014 and 2015 RSU awards, the grant date has been postponed until the third trading day following the date that we become current in our filings with the SEC);

has a time-based period of restriction of one year, except that the grant of RSUs that was to occur in 2014, when granted, will be fully vested and the grant of RSUs that was to occur on May 1, 2015 will vest on May 1, 2016; and

is settled on the first business day following the last day of the period of restriction or as soon as practicable thereafter by the delivery of one share of our common stock for each RSU in the grant.

We also reimburse Directors for reasonable, out-of-pocket travel expenses related to attending our Board of Directors and its committee meetings and other business of the Board.

Mr. Cohen was appointed to our Board of Directors in September 2014. In May 2015, the Board of Directors determined to base the pro-rata calculation of the number of RSUs to be granted to him related to the 2014 equity award to outside directors on a May 1 to April 30 basis, instead of a calendar year basis. As a result, the value of the RSUs to be granted to Mr. Cohen pursuant to his pro-rated 2014 equity award will be \$61,918.

***Timing of Equity-Based Compensation Grants.*** The Compensation Committee makes recommendations to our Board of Directors regarding grants of equity-based compensation to our non-employee Directors. All equity-based compensation awards to our non-employee Directors are granted exclusively by our Board of Directors. Beginning in

2014, our Board of Directors established May 1 of each year as the effective date of grant of equity-based compensation to our non-employee Directors. The 2014 grant, however, has been postponed until the third business day following the date that we become current in our filings with the SEC. The exercise price of any stock options included in those equity-based compensation grants is the closing market price of a share of our common stock on the effective date of the grant. The number of RSUs included in those grants is based on the closing market price of a share of our common stock on the effective date of the grant.

We do not time our release of material non-public information for the purpose of affecting the value of our non-employee Directors' compensation. Nevertheless, our process for granting equity-based compensation may result in equity-based compensation, including stock options, being granted to our non-employee Directors at times when our Board of Directors or the Compensation Committee is in possession of material non-public information about us. This possibility is not taken into account in determining whether to make the equity-based compensation awards or the amount or value of those awards.

***Directors Deferred Compensation Plan.*** On October 1, 1999, we established, and effective January 1, 2008, we restated, the Directors Deferred Compensation Plan, an unfunded, nonqualified plan covering all of our non-employee Directors. The Directors Deferred Compensation Plan provides that each non-employee Director may elect to receive payment of the annual retainer in cash or in shares of our common stock, in increments of 25% each. A non-employee Director who elects payment in shares of our common stock will receive that number of shares equal to the number obtained by dividing the dollar amount of the portion of the annual retainer to be paid in shares of our common stock by the fair market value of one share of our common stock determined as of the payment date. The value of any fractional share resulting from this calculation will be paid to the Director in cash.

The Directors Deferred Compensation Plan also provides that each non-employee Director may elect to defer payment of all or a portion of the annual retainer. The deferral of payment of cash or shares of our common stock can only be made in increments of 25%. Any deferred cash amounts will accrue interest at the rate of 6% compounded annually. Any deferred shares of our common stock will be credited with any cash dividends on those shares and, on a semi-annual basis, those cash dividends will be converted to shares of our common stock based on its fair market value at the time of the conversion.

No cash or shares of our common stock deferred by a non-employee Director under the Directors Deferred Compensation Plan will be paid to the non-employee Director until he or she is no longer a Director.

***Non-Employee Director Participation in Pension Plans.*** None of our non-employee Directors participate in any of our defined benefit or actuarial pension plans (including supplemental plans). Mr. Fowler, however, participates in the Old Pension Plan as a result of his prior employment by ITT Corporation or one of its affiliated companies that participated in that plan. Any change in the actuarial present value of Mr. Fowler's accumulated benefit under the Old Pension Plan in 2014 was not affected by his service as a non-employee Director on our Board of Directors. See Pension Plans *Old Pension Plan*.

**Table of Contents****Compensation Committee Interlocks and Insider Participation**

None of the Compensation Committee members during 2014 was:

an officer or employee of ours;

a former officer of ours; or

involved in a relationship requiring disclosure as a related person transaction pursuant to Item 404 of Regulation S-K under the Exchange Act or as an interlocking executive officer/director pursuant to Item 407(e)(4)(iii) of Regulation S-K under the Exchange Act.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.****Equity Compensation Plan Information**

The following table sets forth information, as of December 31, 2014, about shares of our common stock that may be issued under our equity compensation plans that (a) have been approved by our shareholders and (b) have not been approved by our shareholders.

**Equity Compensation Plan Information**

| <b>Plan Category</b>  | <b>Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)</b> | <b>Weighted Average Exercise Price of Outstanding Options, Warrants and Rights (b)</b> | <b>Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)</b> |
|---|--|--|--|
| Equity compensation plans approved by security holders <sup>(1)</sup> | 1,984,580  | \$ 76.92 <sup>(2)</sup>  | 2,817,686 <sup>(3)(4)(5)</sup>   |
|   | 55,635   | N/A  | N/A <sup>(7)</sup>   |

Equity compensation plans not approved by security holders <sup>(6)</sup>

|       |           |                         |           |
|-------|-----------|-------------------------|-----------|
| Total | 2,040,215 | \$ 76.92 <sup>(2)</sup> | 2,817,686 |
|-------|-----------|-------------------------|-----------|

- (1) Consists of the Amended 2006 Plan. The material terms of the Amended 2006 Plan are described above. See *Amended 2006 Plan*.
- (2) The weighted average exercise price is calculated based on those awards included in column (a) that have a specified exercise price, namely, outstanding stock options. Since the outstanding RSUs and the shares credited under the Directors Deferred Compensation Plan that are included in column (a) have no exercise price, they have been excluded from the weighted average exercise price calculations in this column (b).
- (3) The total number of shares of our common stock available for awards under the Amended 2006 Plan is 7,350,000, subject to antidilution adjustments. Each share underlying stock options and SARs granted under the Amended 2006 Plan, and not forfeited or terminated, will reduce the number of shares available for future awards under the Amended 2006 Plan by one share. The delivery of a share in connection with a full-value award (i.e., an award of restricted stock, RSUs, performance shares, performance units or any other stock-based award with value denominated in shares) will reduce the number of shares remaining for other awards by three shares, if the full-value award was granted prior to May 7, 2013, and by two shares, if the full-value award was granted after that date.
- (4) The aggregate fair market value (determined on the date of grant) of the shares subject to incentive stock options awarded to employees under the Amended 2006 Plan that become exercisable for the first time by the employee in any calendar year may not exceed \$100,000.
- (5) Securities remaining available for future issuance under the Amended 2006 Plan include stock options (incentive and nonqualified), SARs, restricted stock, RSUs, performance shares, performance units and other stock-based awards, or any combination of the foregoing, as the Compensation Committee and Board of Directors may determine. The maximum number of performance shares under the Amended 2006 Plan that may be granted to any eligible participant in any given calendar year is 250,000 shares.
- (6) These equity compensation plans include the:

Directors Deferred Compensation Plan; and

Deferred Bonus Plan.

The material terms of each of these plans are described elsewhere in this document. See *Director Compensation*, *Directors Deferred Compensation Plan* and *Nonqualified Deferred Compensation Plans* *Deferred Bonus Plan*.

- (7) There is no limit on the number of shares of our common stock available for future issuance under either the Directors Deferred Compensation Plan or the Deferred Bonus Plan.

**Table of Contents****Stock Ownership of Certain Beneficial Owners and Management**

The following table sets forth, as of May 15, 2015, the number of shares of our common stock beneficially owned by any person (including any group) known by management to beneficially own more than 5% of our common stock, by each Director, by each of the Named Executive Officers and by all of our current Directors and the executive officers as a group. Unless otherwise indicated in a footnote, each individual or group possesses sole voting and investment power with respect to all shares indicated as beneficially owned. None of the shares owned by our Directors and executive officers are pledged as security. No Director owns any qualifying shares.

| <b>Name of Beneficial Owner</b>   | <b>ITT/ESI Common Stock<br/>Number of Shares<br/>Beneficially<br/>Owned<sup>(1)</sup></b> | <b>Percent of Class</b> |
|---|---|-------------------------|
| Putnam Investments, LLC   |   |                         |
| Putnam Investment Management, LLC   |   |                         |
| The Putnam Advisory Company, LLC  |   |                         |
| Putnam Voyager Fund<br>One Post Office Square<br><br>Boston, MA 02109                                     | 3,427,286 <sup>(2)</sup>  | 14.5%                   |
| Warburg Pincus Asset Management, Inc.<br>466 Lexington Avenue<br><br>New York, NY 10017                   | 2,933,150 <sup>(3)</sup>  | 12.4%                   |
| Select Equity Group, L.P.   |   |                         |
| George S. Loening<br>380 Lafayette Street, 6 <sup>th</sup> Floor<br><br>New York, NY 10003                | 2,258,955 <sup>(4)</sup>  | 9.6%                    |
| Capital World Investors<br>333 South Hope Street<br><br>Los Angeles, CA 90071                             | 1,869,000 <sup>(5)</sup>  | 7.9%                    |
| Nantahala Capital Management, LLC<br>19 Old Kings Highway South, Suite 200<br><br>Darien, CT 06820        | 1,788,000 <sup>(6)</sup>  | 7.6%                    |
| Clifton Park Capital Management, LLC<br>2711 Centerville Road, Suite 400<br><br>Wilmington, DE 19808-1645 | 1,606,366 <sup>(7)</sup>  | 6.8%                    |
| Providence Equity Partners VI L.P.  | 1,483,610 <sup>(8)</sup>  | 6.3%                    |

Providence Equity GP VI L.P.

Providence Equity Partners VI L.L.C.

Jonathan M. Nelson

Glenn M. Creamer

Paul J. Salem

c/o Providence Equity Partners L.L.C.

50 Kennedy Plaza, 18<sup>th</sup> Floor

Providence, RI 02903

Barnstar Opportunities Master Fund, Ltd.

|  |                          |      |
|--|--------------------------|------|
| Barnstar Asset Management, LP<br>2999 NE 191 Street, Suite PH8 | 1,271,955 <sup>(9)</sup> | 5.4% |
|--|--------------------------|------|

Aventura, FL 33180

|  |                           |      |
|--|---------------------------|------|
| BlackRock, Inc.<br>55 East 52 <sup>nd</sup> Street | 1,259,813 <sup>(10)</sup> | 5.3% |
|--|---------------------------|------|

New York, NY 10022

|                 |                         |      |
|-----------------|-------------------------|------|
| Kevin M. Modany | 540,272 <sup>(11)</sup> | 2.2% |
|-----------------|-------------------------|------|

|              |                        |   |
|--------------|------------------------|---|
| John E. Dean | 39,718 <sup>(12)</sup> | * |
|--------------|------------------------|---|

|                     |                        |   |
|---------------------|------------------------|---|
| Eugene W. Feichtner | 88,931 <sup>(13)</sup> | * |
|---------------------|------------------------|---|

|                       |                        |   |
|-----------------------|------------------------|---|
| Daniel M. Fitzpatrick | 99,007 <sup>(14)</sup> | * |
|-----------------------|------------------------|---|

|                |                        |   |
|----------------|------------------------|---|
| Ronald F. Hamm | 13,071 <sup>(15)</sup> | * |
|----------------|------------------------|---|

|                |   |   |
|----------------|---|---|
| C. David Brown | 0 | * |
|----------------|---|---|



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| Name of Beneficial Owner   | ITT/ESI Common Stock                               |                  |
|--|--|------------------|
|  | Number of Shares Beneficially Owned <sup>(1)</sup> | Percent of Class |
| Jerry M. Cohen   | 0  | *                |
| John F. Cozzi  | 26,149 <sup>(16)</sup>                             | *                |
| James D. Fowler, Jr.   | 14,401 <sup>(17)</sup>                             | *                |
| Joanna T. Lau  | 15,148 <sup>(18)</sup>                             | *                |
| Thomas I. Morgan   | 0  | *                |
| Samuel L. Odle   | 10,414 <sup>(19)</sup>                             | *                |
| Vin Weber  | 32,055 <sup>(20)</sup>                             | *                |
| John A. Yena   | 12,387 <sup>(21)</sup>                             | *                |
| All Directors and executive officers as of 5/15/15 as a group (20 individuals) | 1,083,011 <sup>(22)</sup>                          | 4.4%             |

\* Less than 1%.

- (1) All shares of our common stock are owned directly except as otherwise indicated. Pursuant to the SEC's regulations, shares (a) receivable by Directors and executive officers upon exercise of stock options exercisable within 60 days after March 31, 2015, (b) receivable by Directors and executive officers upon vesting of RSUs within 60 days after March 31, 2015, (c) allocated to the accounts of certain Directors and executive officers under the ESI 401(k) Plan at March 31, 2015 or (d) credited to the accounts of certain Directors under the Directors Deferred Compensation Plan at March 31, 2015, are deemed to be beneficially owned by such Directors and executive officers.
- (2) Based solely on information in reports filed by the beneficial owners under Section 13(d) or 13(g) of the Exchange Act. Putnam Investments, LLC, d/b/a Putnam Investments ( "PI" ) wholly owns two registered investment advisers, Putnam Investment Management, LLC ( "PIM" ) and the Putnam Advisory Company, LLC ( "PAC" ). Both subsidiaries have dispositive power over the shares as investment managers. Putnam Voyager Fund ( "PVF" ) is part of the Putnam Family of Funds. PI possesses sole power to vote or to direct the vote of 2,988 shares and sole power to dispose or direct the disposition of 3,427,286 shares. PIM possesses sole power to dispose or direct the disposition of 3,423,794 shares. PAC possesses sole power to vote or to direct the vote of 2,988 shares and sole power to dispose or direct the disposition of 3,492 shares. PVF possesses sole power to vote or to direct the vote of, and sole power to dispose or direct the disposition of, 1,995,959 shares.
- (3) Based solely on information in reports filed by the beneficial owner under Section 13(d) or 13(g) of the Exchange Act. The beneficial owner is a registered investment adviser and has (a) sole power to vote or direct the vote of 2,396,100 shares, (b) shared power to vote or direct the vote of 513,450 shares and (c) sole power to dispose or direct the disposition of 2,933,150 shares.
- (4) Based solely on information in reports filed by the beneficial owners under Section 13(d) or 13(g) of the Exchange Act. George S. Loening is the majority owner of Select Equity Group L.P. ( "Select LP" ) and the managing member of its general partner. Select LP is an investment adviser and George S. Loening is a control person, and they possess shared power to vote or direct the vote of, and shared power to dispose or direct the disposition of, 2,258,955 shares.
- (5) Based solely on information in reports filed by the beneficial owner under Section 13(d) or 13(g) of the Exchange Act. The beneficial owner is an investment adviser and a division of Capital Research and Management Company, which acts as an investment adviser to various investment companies. The beneficial owner indicates that it holds the shares on behalf of its client SMALLCAP World Fund, Inc. The beneficial owner possesses sole power to vote or to direct the vote of, and sole power to dispose or direct the disposition of, 1,869,000 shares.
- (6)

- Based solely on information in reports filed by the beneficial owner under Section 13(d) or 13(g) of the Exchange Act. The beneficial owner is an investment adviser and possesses sole power to vote or to direct the vote of, and sole power to dispose or direct the disposition of, 1,788,000 shares.
- (7) Based solely on information in reports filed by the beneficial owner under Section 13(d) or 13(g) of the Exchange Act. The beneficial owner possesses shared power to vote or direct the vote of, and dispose or direct the disposition of, 1,606,366 shares.
- (8) Based solely on information in reports filed by the beneficial owners under Section 13(d) or 13(g) of the Exchange Act. Providence Equity Partners VI L.P. ( PEP VI ), a partnership, is the record holder of 1,483,610 shares. Based on the following relationships, the beneficial owners reported shared voting and dispositive power over 1,483,610 shares: (a) Providence Equity GP VI L.P. ( PEP GP VI ) is the sole general partner of PEP VI; (b) Providence Equity Partners VI L.L.C. ( PEP VI LLC ) is the sole general partner of PEP GP VI; and (c) Messrs. Nelson, Creamer and Salem each are members of PEP VI LLC and partners of PEP GP VI. Each of PEP GP VI, PEP VI LLC and Messrs. Nelson, Creamer and Salem disclaims beneficial ownership of the shares reported, except to the extent of its or his pecuniary interest therein.
- (9) Based solely on information in reports filed by the beneficial owners under Section 13(d) or 13(g) of the Exchange Act. The beneficial owners report that the shares are held by Barnstar Opportunities Master Fund, Ltd., a Cayman Islands exempted company, and managed by Barnstar Asset Management, LP, a Delaware limited partnership. The reporting persons possess shared power to vote or direct the vote of, and dispose or direct the disposition of, 1,271,955 shares.

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- (10) Based solely on information in reports filed by the beneficial owner under Section 13(d) or 13(g) of the Exchange Act. The beneficial owner is a parent holding company or control person and possesses sole power to (a) vote or direct the vote of 1,200,743 shares, and (b) dispose or direct the disposition of 1,259,813 shares. The beneficial owner reported that the following of its subsidiaries acquired the shares: BlackRock Advisors (UK) Limited, BlackRock Advisors, LLC, BlackRock Asset Management Canada Limited, BlackRock Fund Advisors, BlackRock Institutional Trust Company, N.A., BlackRock Investment Management (Australia) Limited, BlackRock Investment Management (UK) Ltd., BlackRock Investment Management, LLC and BlackRock Life Limited.
- (11) This number includes 65,048 shares owned directly, 225 shares owned under the ESI 401(k) Plan and 474,999 shares subject to presently exercisable options.
- (12) This number includes 21,801 shares owned directly, 16,195 shares deferred under the Directors Deferred Compensation Plan and 1,722 RSUs that will vest within 60 days.
- (13) This number includes 13,484 shares owned directly, 7,948 shares owned under the ESI 401(k) Plan and 67,499 shares subject to presently exercisable options.
- (14) This number includes 14,507 shares owned directly and 84,500 shares subject to presently exercisable options.
- (15) This number includes 3,072 shares owned directly and 9,999 shares subject to presently exercisable options.
- (16) This number includes 9,297 shares owned directly, 2,000 shares owned by Mr. Cozzi's children, 13,130 shares deferred under the Directors Deferred Compensation Plan and 1,722 RSUs that will vest within 60 days.
- (17) This number includes 9,072 shares owned directly, 3,607 shares held by a revocable trust for the benefit of Mr. Fowler and his spouse and 1,722 RSUs that will vest within 60 days.
- (18) This number includes 10,877 shares owned directly, 2,549 shares deferred under the Directors Deferred Compensation Plan and 1,722 RSUs that will vest within 60 days.
- (19) This number includes 5,835 shares owned directly, 2,857 shares deferred under the Directors Deferred Compensation Plan and 1,722 RSUs that will vest within 60 days.
- (20) This number includes 11,797 shares owned directly, 18,536 shares deferred under the Directors Deferred Compensation Plan and 1,722 RSUs that will vest within 60 days.
- (21) This number includes 8,297 shares owned directly, 2,368 shares deferred under the Directors Deferred Compensation Plan and 1,722 RSUs that will vest within 60 days.
- (22) This number includes 204,714 shares owned directly, 5,607 shares owned indirectly, 8,173 shares owned under the ESI 401(k) Plan, 796,828 shares subject to presently exercisable options, 12,054 RSUs that will vest within 60 days and 55,635 shares deferred under the Directors Deferred Compensation Plan.

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**Item 13. Certain Relationships and Related Transactions, and Director Independence.  
Certain Relationships and Related Person Transactions**

Our written policies and procedures for the review, approval or ratification of any current or proposed transaction potentially involving an amount in excess of \$120,000 in which we are or will become a participant and in which any related person had, or will have, a direct or indirect material interest ( Transaction ) are set forth in our Corporate Governance Guidelines and are posted on our website at [www.ittesi.com](http://www.ittesi.com). These policies and procedures are as follows:

Our Board of Directors must be notified in advance or as soon as practicable of the Transaction.

The notification to our Board should be in writing and contain the following information regarding the Transaction:

the name of the related person;

the basis on which the person is a related person;

a detailed description of the related person's interest in the Transaction, including the related person's position(s) or relationship(s) with, or ownership in, a firm, corporation or other entity that is a party to, or has an interest in, the Transaction;

the approximate dollar value of the amount involved in the Transaction;

the approximate dollar amount of the related person's interest in the Transaction, which must be computed without regard to the amount of profit or loss;

in the case of an indebtedness Transaction:

the largest aggregate amount of all indebtedness outstanding at any time since the beginning of our last fiscal year and all amounts of interest payable on the outstanding indebtedness during our last fiscal year (excluding amounts due from the related person for purchases of goods and services subject to usual trade terms, for ordinary business travel and expense payments and for other transactions in the ordinary course of business);

the largest aggregate amount of principal that could be outstanding;

a schedule specifying the principal amount that is anticipated to be outstanding from time to time during the Transaction;

the term of the indebtedness;

the repayment schedule of the principal amount;

the total amount of any interest that is anticipated to accrue on the principal amount;

the interest rate; and

the payment schedule of the interest that accrues on the principal amount;

in the case of a lease or other Transaction providing for periodic payments or installments, the aggregate amount of all periodic payments or installments due on or after the beginning of our last fiscal year, including any required or optional payments due during or at the conclusion of the Transaction;

in the case of a Transaction involving a purchase or sale of assets by or to us otherwise than in the ordinary course of business, the cost of the assets to the purchaser and, if acquired within two years of the Transaction, the cost of the assets to the seller and related information about the price of the assets; and

any other information regarding the Transaction or related person in the context of the Transaction that a reasonable investor of ours would consider material in light of the circumstances of the Transaction.

Upon receipt of the above information, all of the members of our Board of Directors (except for any Director who is the related person or whose immediate family member is the related person) will review and consider the information and determine whether it is in our and our shareholders' best interests for the Board to approve or ratify the Transaction.

Our Board of Directors is of the general belief that, except in exceptional circumstances, we should try to avoid participating in any Transaction, regardless of the Transaction's merit or benefit to us or our shareholders, in order to avoid any appearance of a conflict of interest or impropriety that may be perceived from our participation in the Transaction.

If our Board of Directors approves or ratifies our participation in a Transaction, we may participate in the Transaction.

If our Board of Directors does not approve or ratify our participation in a Transaction:

we will not participate in the Transaction, if our participation has not yet begun; or

we will attempt to end or limit as much as possible our participation in the Transaction without breaching any of our obligations arising from the Transaction.

We will disclose our participation in any Transaction in accordance with Item 404(a) of Regulation S-K under the Exchange Act.

A transaction includes, but is not limited to, any financial transaction, arrangement or relationship (including any indebtedness or guarantee of indebtedness) or any series of similar transactions, arrangements or relationships, except for:

any indebtedness transaction in which the related person qualifies as such solely because he or she is a beneficial owner of more than 5% of any class of our voting securities or is an immediate family member of the beneficial owner;

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any employment relationship or transaction involving any of our executive officers and any related compensation solely resulting from that employment relationship or transaction, if:

we report the compensation arising from the relationship or transaction to the SEC in accordance with Item 402 of Regulation S-K under the Exchange Act; or

the executive officer is not an immediate family member of the related person and we would have reported such compensation to the SEC in accordance with Item 402 of Regulation S-K under the Exchange Act as compensation earned for services to us if the executive officer was a named executive officer of ours (as that term is defined in Item 402(a)(3) of Regulation S-K under the Exchange Act) and such compensation had been approved as such by the Compensation Committee of our Board of Directors;

any compensation paid to any of our Directors, if the compensation is reported to the SEC in accordance with Item 402(k) of Regulation S-K under the Exchange Act;

any transaction in which the rates or charges involved in the transaction are determined by competitive bids;

any transaction that involves the rendering of services as a common or contract carrier or public utility at rates or charges fixed in conformity with law or governmental authority;

any transaction that involves services as a bank depository of funds, transfer agent, registrar, trustee under a trust indenture or similar services; or

any transaction in which the interest of the related person arises solely from the ownership of a class of our equity securities and all holders of that class of equity securities received the same benefit or a pro rata basis.

A related person means:

any of our Directors or executive officers;

anyone who has been nominated to be elected one of our Directors;

any beneficial owner of more than 5% of any class of our voting securities; and

any immediate family member of any of the foregoing persons.

An immediate family member means any child, stepchild, parent, stepparent, spouse, sibling, father and mother-in-law, son and daughter-in-law, brother and sister-in-law, and any person (other than a tenant or employee) who shares the household of a Director, executive officer, nominee for Director or beneficial owner of more than 5% of any class of our voting securities.

A person who has a position or relationship with a firm, corporation or other entity that engages in a transaction with us will not be deemed to have an indirect material interest where:

the interest arises only:

from such person's position as a director of another corporation or organization that is a party to the transaction;

from the direct or indirect ownership by such person and all other related persons, in the aggregate, of less than a 10% equity interest in another person (other than a partnership) that is a party to the transaction; or

from both such position and ownership; or

the interest arises only from such person's position as a limited partner in a partnership in which the person and all other related persons, in the aggregate, have an interest of less than 10%, and the person is not a general partner of and does not hold another position in the partnership.

There have been no such Transactions since January 1, 2014 and none are currently proposed.

### **Independent Directors**

Our Board of Directors currently contains nine non-employee Directors: Messrs. Brown, Cohen, Cozzi, Fowler, Morgan, Odle, Weber and Yena, and Ms. Lau. Our Board of Directors has adopted categorical standards to assist it in making determinations of independence. Any transactions, relationships or arrangements that we may have with any of our Directors are immaterial, so long as none of those transactions, relationships or arrangements caused the Director to violate any of our categorical standards of independence. Our categorical standards of independence are contained in Section 5 of our Corporate Governance Guidelines and are posted on our website at [www.ittesi.com](http://www.ittesi.com). Our Board of Directors has determined that each of our current non-employee Directors is independent, and each of the non-employee Directors in 2014 was independent, pursuant to our categorical standards of independence and in accordance with Section 303A.02 of the NYSE Listed Company Manual. John E. Dean, a Director of ours since December 1994, was appointed our Executive Chairman and became an employee of ours on August 4, 2014. Prior to that date, Mr. Dean was a non-employee and independent Director. Due to the fact that Mr. Dean became an employee of ours on August 4, 2014 and was not independent at that time, on that date Mr. Dean resigned as a member and Chairman of the Audit Committee of our Board of Directors and as a member of the Nominating and Corporate Governance Committee of our Board of Directors. The letter agreement between us and Mr. Dean provides that after we eliminate the role of Executive Chairman (which is expected to occur when we hire a new Chief Executive Officer), Mr. Dean will remain on our Board of Directors as a non-employee Director for the remainder of his term. In the application of our categorical standards of independence to determine the independence of each non-employee Director for service on our Board of Directors and on its Audit, Compensation and Nominating and Corporate Governance Committees, there were no transactions, relationships or arrangements with our non-employee Directors



that were required to be disclosed pursuant to Item 404(a) of Regulation S-K under the Exchange Act, or if not disclosed, that our Board considered.

**Table of Contents****Item 14. Principal Accountant Fees and Services.  
Audit, Audit-Related, Tax and All Other Fees**

The following table sets forth fees for services provided by Deloitte related to 2014. Deloitte was engaged as our independent registered public accounting firm in 2014, and did not provide any services to us in, or related to, the year ended December 31, 2013. The following table also sets forth fees for services provided by PricewaterhouseCoopers LLP ( PWC ), our former independent registered public accounting firm, related to 2013 and 2014.

| Type of Service | Deloitte & Touche LLP       |                           | PricewaterhouseCoopers LLP  |      |
|-----------------|-----------------------------|---------------------------|-----------------------------|------|
|                 | 2014                        | 2014                      | 2014                        | 2013 |
| Audit           | \$ 1,760,000 <sup>(1)</sup> | \$ 250,000 <sup>(2)</sup> | \$ 5,798,603 <sup>(3)</sup> |      |
| Audit-Related   | \$ 0                        | \$ 0                      | \$ 140,317 <sup>(4)</sup>   |      |
| Tax             | \$ 0                        | \$ 339,845 <sup>(5)</sup> | \$ 264,532 <sup>(5)</sup>   |      |
| All Other       | \$ 0                        | \$ 1,600 <sup>(6)</sup>   | \$ 2,000 <sup>(6)</sup>     |      |

(1) Represents fees for the following services associated with the audit or review of our financial statements:

auditing our annual consolidated financial statements for our 2014 fiscal year;

reviewing our consolidated financial statements included in our Quarterly Report on Form 10-Q for the third quarter of 2014;

conducting reviews of our internal control over financial reporting and assisting with requirements related to internal control over financial reporting as of December 31, 2014;

conducting statutory audits (such as federal and state student financial aid compliance audits) for 2014; and

providing other audit services in connection with statutory and regulatory filings or engagements for our 2014 fiscal year.

Those services were rendered in both the 2014 and 2015 calendar years.

(2) Represents fees for services associated with the review of our consolidated financial statements included in our Quarterly Reports on Form 10-Q for the first and second quarters of 2014.

(3) Represents fees for the following services associated with the audit or review of our financial statements:

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auditing our annual consolidated financial statements for our 2013 fiscal year;

reviewing our consolidated financial statements included in our Quarterly Reports on Form 10-Q and our amended Quarterly Reports on Form 10-Q/A for the quarters in our 2013 fiscal year;

conducting reviews of our internal control over financial reporting and assisting with requirements related to internal control over financial reporting as of December 31, 2013;

conducting statutory audits (such as federal and state student financial aid compliance audits) for 2013; and

providing other audit services in connection with statutory and regulatory filings or engagements for our 2013 fiscal year.

Those services were rendered in both the 2013 and 2014 calendar years.

- (4) Represents fees for services rendered in the period indicated that were related to the performance of the audit or review of our financial statements and were not reported as Audit services. The nature of those services included, without limitation:

financial statement audits of our employee benefit plans; and

assistance with respect to accounting, financial reporting and disclosure treatment of transactions or events, including:

consultations with us;

assistance with understanding and implementing related final and proposed rules, guidance, standards and interpretations from accounting rulemakers, the SEC and the NYSE;

helping us assess the actual or potential impact of final or proposed rules, guidance, standards and interpretations from accounting rulemakers, the SEC and the NYSE;

in 2013, review of our Registration Statement on Form S-8; and

in 2013, responding to a subpoena from the SEC related to the SEC's investigation of us.

- (5)

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Represents fees for tax services rendered in the period indicated. The nature of those services included, without limitation:

the preparation and/or review of original and amended income, franchise and other tax returns with respect to federal, state and local tax authorities;

assistance with tax audits and appeals before federal, state and local tax authorities; and

tax advice and assistance related to employee benefit plans and statutory, regulatory or administrative developments, and tax credits and refund opportunities.

(6) Represents fees for a subscription to PWC's accounting research tool.

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**Audit and Non-Audit Services Pre-Approval Policy**

The Audit Committee has adopted a policy that sets forth the procedures and conditions pursuant to which services proposed to be performed by our independent registered public accounting firm may be pre-approved by the Audit Committee. Under the Audit Committee's policy, unless a type of service has received pre-approval by the Audit Committee without consideration of specific case-by-case services ( general pre-approval ), it requires specific pre-approval by the Audit Committee if it is to be provided by our independent registered public accounting firm.

For both types of pre-approval, the Audit Committee considers whether such services are consistent with the SEC's rules on auditor independence. The Audit Committee also considers whether our independent registered public accounting firm is best positioned to provide the most effective and efficient service, for reasons such as its familiarity with our business, people, culture, accounting systems, risk profile and other factors, and whether the service might enhance our ability to manage or control risk or improve audit quality. All such factors are considered as a whole, and no one factor is necessarily determinative.

In deciding whether to pre-approve any audit and non-audit services, the Audit Committee is also mindful of the relationship between fees for audit and non-audit services and may determine, for each fiscal year, the appropriate ratio between the total amount of fees for audit, audit-related and tax services and the total amount of fees for certain permissible non-audit services classified as all other services.

The term of any general pre-approval is 12 months from the date of pre-approval, unless the Audit Committee considers a different period and states otherwise and except that the pre-approvals related to an audit of our annual consolidated financial statements will last until that audit is completed. The Audit Committee annually reviews and pre-approves the services that may be provided by our independent registered public accounting firm without obtaining specific pre-approval. The Audit Committee may add to or subtract from the list of general pre-approved services from time to time, based on subsequent determinations.

The policy does not delegate the Audit Committee's responsibilities to pre-approve services performed by our independent registered public accounting firm to our management. The Audit Committee may delegate either type of pre-approval authority to one or more of its members. The member to whom such authority is delegated must report, for informational purposes only, any pre-approval decisions to the Audit Committee at its next scheduled meeting. The Audit Committee has delegated both types of pre-approval authority to the Chairperson of the Audit Committee with respect to any requests for services to be performed by our independent registered public accounting firm that cannot be delayed without inconvenience until the next scheduled Audit Committee meeting.

Pre-approval fee levels or budgeted amounts for all services to be provided by our independent registered public accounting firm are established annually by the Audit Committee. Any proposed services exceeding those levels or amounts require specific pre-approval by the Audit Committee.

All requests or applications for services to be provided by our independent registered public accounting firm that do not require specific approval by the Audit Committee are submitted to our Chief Financial Officer and must include a detailed description of the services to be rendered. Our Chief Financial Officer will determine whether such services are included within the list of services that have received the general pre-approval of the Audit Committee.

Requests or applications to provide services that require specific approval by the Audit Committee are submitted to the Audit Committee by both our independent registered public accounting firm and Chief Financial Officer.

All of the fees reported in the table above as Audit, Audit-Related, Tax and All Other services rendered by Deloitte and related to, 2014 were pre-approved by the Audit Committee.

The annual audit services engagement terms and fees are subject to the specific pre-approval of the Audit Committee. Audit services include all services performed to comply with the standards of the Public Company Accounting Oversight Board, including, without limitation, the annual financial statement audit (including required quarterly reviews) and other procedures required to be performed by our independent registered public accounting firm to be able to form an opinion on our consolidated financial statements. These other procedures include information systems and procedural reviews and testing performed in order to understand and place reliance on the systems of internal control, and consultations relating to the audit or quarterly review. Audit services also include services performed in connection with the independent registered public accounting firm's report on internal control over financial reporting. The Audit Committee monitors the audit services engagement as necessary and also approves, if necessary, any changes in terms, conditions and fees resulting from changes in audit scope, our structure or other items.

In addition to the annual audit services engagement approved by the Audit Committee, the Audit Committee may grant general pre-approval of other audit services, which are those services that our independent registered public accounting firm reasonably can provide. Other audit services include:

statutory audits (such as federal and state student financial aid compliance audits) or financial audits for our subsidiaries or affiliates;

services associated with SEC registration statements, periodic reports and other documents filed with the SEC or other documents issued in connection with securities offerings; and

consultations with our management concerning accounting, financial reporting or treatment of transactions or events.

Any audit services that the Audit Committee generally pre-approves are reflected in the minutes of the Audit Committee meeting at which the services were pre-approved. All other audit services not reflected in the Audit Committee's meeting minutes must be specifically approved by the Audit Committee before they are performed.

Audit-related services are assurance and related services that are reasonably related to the performance of the audit or review of our financial statements or that are traditionally performed by the independent registered public accounting firm. Since the Audit Committee believes that the provision of audit-related services does not impair the independence of the auditor and is consistent with the SEC's rules on auditor independence, the Audit Committee may grant general pre-approval to audit-related services. Audit-related services include, among others:

due diligence services pertaining to potential business acquisitions or dispositions;

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consultations concerning accounting, financial reporting or disclosure treatment of transactions or events not classified as audit services ;

assistance with understanding and implementing new and proposed accounting and financial reporting guidance from rulemaking authorities;

financial statement audits of employee benefit plans;

assistance with assessing the actual or potential impact of final or proposed rules, standards or interpretations from accounting authorities;

agreed-upon or expanded audit procedures related to accounting and/or billing records required to respond to or comply with financial, accounting or regulatory reporting matters;

attest services not required by statute or regulation;

information systems reviews not performed in connection with the financial statement audit;

subsidiary or equity investee audits not required by statute or regulation that are incremental to the audit of the consolidated financial statements;

review of the effectiveness of the internal audit function;

general assistance with understanding and implementing requirements of SEC rules and stock exchange listing standards; and

consultations and audits in connection with acquisitions.

Any audit-related services that the Audit Committee generally pre-approves are reflected in the minutes of the Audit Committee meeting at which the services were pre-approved. All other audit-related services not reflected in the Audit Committee's meeting minutes must be specifically approved by the Audit Committee before they are performed.

Tax services include tax compliance, planning and advice, as well as tax only valuation services. Since the Audit Committee believes that the provision of tax services does not impair our independent registered public accounting firm's independence, and the SEC has stated that the independent registered public accounting firm may provide such services, the Audit Committee believes it may grant general pre-approval to tax services. The Audit Committee will not permit the retention of the independent registered public accounting firm in connection with a transaction initially recommended by our independent registered public accounting firm, the sole business purpose of which may be tax avoidance and the tax treatment of which may not be supported in the IRC and related regulations. The Audit

Committee will consult with our Chief Financial Officer or outside counsel to determine that the tax planning and reporting positions are consistent with the policy.

Any tax services that the Audit Committee generally pre-approves are reflected in the minutes of the Audit Committee meeting at which the services were pre-approved. All tax services not reflected in the Audit Committee's meeting minutes must be specifically approved by the Audit Committee before they are performed.

The Audit Committee believes, based on the SEC's rules prohibiting the independent registered public accounting firm from providing specific non-audit services, that other types of non-audit services are permitted. Accordingly, the Audit Committee believes it may grant general pre-approval to those permissible non-audit services classified as all other services that it believes are routine and recurring services, would not impair the independence of our independent registered public accounting firm and are consistent with the SEC's rules on auditor independence.

Any other services that the Audit Committee generally pre-approves are reflected in the minutes of the Audit Committee meeting at which the services were pre-approved. All other services not reflected in the Audit Committee's meeting minutes must be specifically approved by the Audit Committee before they are performed.



**Table of Contents****PART IV****Item 15. Exhibits and Financial Statement Schedules.**

## 1. Financial Statements:

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| <u>Report of Deloitte &amp; Touche LLP, Independent Registered Public Accounting Firm</u>                          | F-2           |
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| <u>Consolidated Statements of Shareholders' Equity for the years ended December 31, 2014, 2013 and 2012</u>        | F-9           |
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## 2. Financial Statement Schedules:

Schedule II Valuation and Qualifying Accounts of the Company for the years ended December 31, 2014, 2013 and 2012 appear on page F-61 of this Annual Report.

## 3. Quarterly Financial Results for 2014 and 2013 (unaudited) appear on page F-62 of this Annual Report.

## 4. Exhibits:

A list of exhibits required to be filed as part of this report is set forth in the Index to Exhibits appearing on pages S-2 through S-9 of this Annual Report, which immediately precedes such exhibits, and is incorporated herein by reference.

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**Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act (ICFR). Our ICFR is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

pertain to the maintenance of our records that in reasonable detail accurately and fairly reflect our transactions and asset dispositions;

provide reasonable assurance that our transactions are recorded as necessary to permit the preparation of our financial statements in accordance with generally accepted accounting principles;

provide reasonable assurance that our receipts and expenditures are being made only in accordance with authorizations of our management and Board of Directors (as appropriate); and

provide reasonable assurance regarding the prevention or timely detection of any unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Reasonable assurance, as defined in Section 13(b)(7) of the Exchange Act, is the level of detail and degree of assurance that would satisfy prudent officials in the conduct of their own affairs in devising and maintaining a system of internal accounting controls.

Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we assessed the effectiveness of our ICFR as of December 31, 2014. Our assessment included extensive documenting, evaluating and testing of the design and operating effectiveness of our ICFR. In making this assessment, our management used the criteria for the 1992 *Internal Control-Integrated Framework* set forth by The Committee of Sponsoring Organizations of the Treadway Commission. These criteria are in the areas of control environment, risk assessment, control activities, information and communication, and monitoring. Based on our assessment using these criteria, our management has identified control deficiencies that constituted material weaknesses in our ICFR as of December 31, 2014, as described below. A material weakness is a deficiency, or a combination of deficiencies, in ICFR, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.

Our management has concluded that there were three material weaknesses in our ICFR as of December 31, 2014. Specifically, we did not maintain effective internal controls related to:

the assessment of the completeness and accuracy of the data obtained from third parties related to the private education loans that are owned by variable interest entities that we were required to consolidate;

the aggregation of design and operating effectiveness control deficiencies relating to property, plant, and equipment, including logical access controls related to information systems relevant to property, plant, and equipment, the design of controls over the impairment of long-lived assets and the design and operation of review controls over accounting for leasehold improvements, which lead to individually immaterial adjustments; and

the aggregation of control deficiencies relating to design and operation of review controls over the financial close and reporting and income tax reporting processes, which lead to individually immaterial adjustments.

Our management determined that these control deficiencies could result in a material misstatement of our annual or interim consolidated financial statements that would not be prevented or detected on a timely basis. As a result, our management determined that these deficiencies constituted a material weakness in our ICFR as of December 31, 2014, and our ICFR was not effective as of that date.

The effectiveness of our ICFR as of December 31, 2014 has been audited by Deloitte & Touche LLP, our independent registered public accounting firm, as stated in its accompanying report.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of

ITT Educational Services, Inc.

Carmel, Indiana

We have audited the accompanying consolidated balance sheet of ITT Educational Services, Inc. and subsidiaries (the Company ) as of December 31, 2014, and the related consolidated statement of operations, comprehensive income (loss), cash flows, and shareholders' equity for the year then ended. Our audit also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of ITT Educational Services, Inc. and subsidiaries as of December 31, 2014, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 16 to the consolidated financial statements, the Company is subject to risks and uncertainties including claims and contingencies arising from litigation and governmental investigations and increasing liquidity pressures that could affect amounts reported in the Company's financial statements in future periods.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2014, based on the criteria established in *Internal Control - Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated May 29, 2015 expressed an adverse opinion on the Company's internal control over financial reporting because of material weaknesses.

/s/ Deloitte & Touche LLP

Indianapolis, Indiana

May 29, 2015

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of

ITT Educational Services, Inc.

Carmel, Indiana

We have audited the internal control over financial reporting of ITT Educational Services, Inc. and subsidiaries (the Company ) as of December 31, 2014 based on criteria established in *Internal Control – Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on that risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed by, or under the supervision of, the company’s principal executive and principal financial officers, or persons performing similar functions, and effected by the company’s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company’s annual or interim financial statements will not be prevented or detected on a timely basis. The following material weaknesses have been identified and included in management’s assessment. Management has identified material weaknesses in internal control over financial reporting related to:

The assessment of the completeness and accuracy of the data obtained from third parties related to the private education loans that are owned by variable interest entities that the Company was required to consolidate;

The aggregation of design and operating effectiveness control deficiencies relating to property, plant, and equipment, including logical access controls related to information systems relevant to property, plant, and equipment, the design of controls over the impairment of long-lived assets and the design and operation of review controls over accounting for leasehold improvements, which lead to individually immaterial adjustments;

The aggregation of control deficiencies relating to design and operation of review controls over the financial close and reporting and income tax reporting processes, which lead to individually immaterial adjustments. These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2014, of the Company and this report does not affect our report on such financial statements and financial statement schedule.

In our opinion, because of the effect of the material weaknesses identified above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2014, based on the criteria established in *Internal Control - Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2014, of the Company and our report dated May 29, 2015 expressed an unqualified opinion on those financial statements and financial statement schedule and included an explanatory paragraph regarding risks and uncertainties including claims and contingencies arising from litigation and governmental investigations and increasing liquidity pressures that could affect amounts reported in the Company's financial statements in future periods.

/s/ Deloitte & Touche LLP

Indianapolis, Indiana

May 29, 2015

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders of

ITT Educational Services, Inc.

In our opinion, the consolidated balance sheet as of December 31, 2013 and the related consolidated statements of operations, comprehensive income (loss), cash flows and shareholders' equity for each of the two years in the period ended December 31, 2013 present fairly, in all material respects, the financial position of ITT Educational Services, Inc. and its subsidiaries at December 31, 2013, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule for each of the two years in the period ended December 31, 2013 presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 16 to the consolidated financial statements, the Company is subject to risks and uncertainties including litigation, governmental investigations and increasing liquidity pressures that could affect amounts reported in the Company's financial statements in future periods.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Indianapolis, Indiana

October 15, 2014

**Table of Contents****ITT EDUCATIONAL SERVICES, INC.****CONSOLIDATED BALANCE SHEETS****(Dollars in thousands, except per share data)**

|   | <b>As of December 31,</b> |                   |
|---|---------------------------|-------------------|
|   | <b>2014</b>               | <b>2013</b>       |
| <b>Assets</b>   |                           |                   |
| Current assets:   |                           |                   |
| Cash and cash equivalents   | \$ 135,937                | \$ 215,771        |
| Restricted cash   | 6,040                     | 5,636             |
| Accounts receivable, less allowance for doubtful accounts of \$2,351 and \$9,174                            | 46,383                    | 99,530            |
| Private education loans, less allowance for loan losses of \$0 and \$0                                      | 10,584                    | 7,730             |
| Deferred income taxes   | 34,547                    | 77,549            |
| Prepaid expenses and other current assets   | 57,923                    | 28,400            |
| <b>Total current assets</b>   | <b>291,414</b>            | <b>434,616</b>    |
| Property and equipment, net   | 157,072                   | 168,509           |
| Private education loans, excluding current portion, less allowance for loan losses of \$44,392 and \$29,349 | 80,292                    | 76,479            |
| Deferred income taxes   | 68,041                    | 68,324            |
| Collateral deposits   | 97,932                    | 8,626             |
| Other assets  | 54,409                    | 50,297            |
| <b>Total assets</b>   | <b>\$ 749,160</b>         | <b>\$ 806,851</b> |
| <b>Liabilities and Shareholders Equity</b>  |                           |                   |
| Current liabilities:  |                           |                   |
| Current portion of long-term debt   | \$ 9,635                  | \$ 50,000         |
| Current portion of PEAKS Trust senior debt  | 37,545                    | 157,883           |
| Current portion of CUSO secured borrowing obligation  | 20,813                    | 0                 |
| Accounts payable  | 67,848                    | 58,021            |
| Accrued compensation and benefits   | 12,264                    | 18,107            |
| Other current liabilities   | 27,050                    | 42,136            |
| Deferred revenue  | 147,475                   | 147,630           |
| <b>Total current liabilities</b>  | <b>322,630</b>            | <b>473,777</b>    |
| Long-term debt, excluding current portion   | 86,714                    | 0                 |
| PEAKS Trust senior debt, excluding current portion  | 38,658                    | 71,341            |
| CUSO secured borrowing obligation, excluding current portion  | 100,194                   | 0                 |
| Other liabilities   | 52,959                    | 146,087           |
| <b>Total liabilities</b>  | <b>601,155</b>            | <b>691,205</b>    |
| Commitments and contingent liabilities (Note 15)  |                           |                   |



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Shareholders' equity:

|   |                   |                   |
|---|-------------------|-------------------|
| Preferred stock, \$.01 par value, 5,000,000 shares authorized, none issued      | 0                 | 0                 |
| Common stock, \$.01 par value, 300,000,000 shares authorized, 37,068,904 issued | 371               | 371               |
| Capital surplus   | 198,883           | 200,040           |
| Retained earnings   | 969,670           | 940,449           |
| Accumulated other comprehensive income  | 1,201             | 3,146             |
| Treasury stock, 13,619,010 and 13,698,716 shares, at cost                       | (1,022,120)       | (1,028,360)       |
| <b>Total shareholders' equity</b>   | <b>148,005</b>    | <b>115,646</b>    |
| <b>Total liabilities and shareholders' equity</b>                               | <b>\$ 749,160</b> | <b>\$ 806,851</b> |

The accompanying notes are an integral part of the consolidated financial statements.

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**ITT EDUCATIONAL SERVICES, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

(Amounts in thousands, except per share data)

|  | Year Ended December 31, |                    |                   |
|--|-------------------------|--------------------|-------------------|
|  | 2014                    | 2013               | 2012              |
| <b>Revenue</b>   | \$ 961,783              | \$ 1,072,311       | \$ 1,286,633      |
| <b>Costs and expenses:</b>   |                         |                    |                   |
| Cost of educational services   | 460,782                 | 486,353            | 538,350           |
| Student services and administrative expenses   | 389,116                 | 397,541            | 400,856           |
| Goodwill and asset impairment  | 2,454                   | 0                  | 15,166            |
| Legal and professional fees related to certain lawsuits, investigations and accounting matters | 32,008                  | 6,923              | 873               |
| Loss related to loan program guarantees  | 2,019                   | 90,964             | 101,025           |
| Provision for private education loan losses  | 14,150                  | 29,349             | 0                 |
| <b>Total costs and expenses</b>  | <b>900,529</b>          | <b>1,011,130</b>   | <b>1,056,270</b>  |
| <b>Operating income</b>  | <b>61,254</b>           | <b>61,181</b>      | <b>230,363</b>    |
| Gain (loss) on consolidation of variable interest entities                                     | 16,631                  | (73,248)           | 0                 |
| Interest income  | 65                      | 108                | 1,348             |
| Interest (expense)   | (28,300)                | (25,277)           | (3,723)           |
| <b>Income (loss) before provision for income taxes</b>   | <b>49,650</b>           | <b>(37,236)</b>    | <b>227,988</b>    |
| Provision (benefit) for income taxes   | 20,397                  | (10,212)           | 89,018            |
| <b>Net income (loss)</b>   | <b>\$ 29,253</b>        | <b>\$ (27,024)</b> | <b>\$ 138,970</b> |
| <b>Earnings (loss) per share:</b>  |                         |                    |                   |
| Basic  | \$ 1.25                 | \$ (1.15)          | \$ 5.82           |
| Diluted  | \$ 1.23                 | \$ (1.15)          | \$ 5.79           |
| <b>Weighted average shares outstanding:</b>  |                         |                    |                   |
| Basic  | 23,474                  | 23,412             | 23,880            |
| Diluted  | 23,762                  | 23,412             | 23,999            |

The accompanying notes are an integral part of the consolidated financial statements.

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## ITT EDUCATIONAL SERVICES, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Dollars in thousands)

|   | Year Ended December 31, |             |            |
|---|-------------------------|-------------|------------|
|   | 2014                    | 2013        | 2012       |
| <b>Net income (loss)</b>  | \$ 29,253               | \$ (27,024) | \$ 138,970 |
| <b>Other comprehensive income (loss), net of tax:</b>   |                         |             |            |
| Net actuarial pension (loss) gain, net of income tax of \$683, \$6,811 and \$242                  | (1,077)                 | 10,755      | 379        |
| Net actuarial pension loss amortization, net of income tax of \$0, \$790 and \$1,062              | 0                       | 1,247       | 1,656      |
| Prior service cost (credit) amortization, net of income tax of \$603, \$604 and \$607             | (952)                   | (951)       | (948)      |
| Pension settlement, net of income tax of \$53, \$17 and \$309                                     | 84                      | 25          | 483        |
| Unrealized gains (losses) on available-for-sale securities, net of income tax of \$0, \$0 and \$0 | 0                       | 0           | (21)       |
| Other comprehensive income (loss), net of tax   | (1,945)                 | 11,076      | 1,549      |
| <b>Comprehensive income (loss)</b>  | \$ 27,308               | \$ (15,948) | \$ 140,519 |

The accompanying notes are an integral part of the consolidated financial statements.

**Table of Contents****ITT EDUCATIONAL SERVICES, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Dollars in thousands)**

|   | <b>Year Ended December 31,</b> |             |             |
|---|--------------------------------|-------------|-------------|
|   | <b>2014</b>                    | <b>2013</b> | <b>2012</b> |
| <b>Cash flows from operating activities:</b>  |                                |             |             |
| Net income (loss)   | \$ 29,253                      | \$ (27,024) | \$ 138,970  |
| Adjustments to reconcile net income (loss) to net cash flows from operating activities: |                                |             |             |
| Depreciation and amortization   | 26,456                         | 27,252      | 29,350      |
| Provision for doubtful accounts   | 63,928                         | 67,640      | 56,818      |
| Deferred income taxes   | 41,969                         | (54,102)    | (59,571)    |
| Excess tax benefit from stock option exercises  | 0                              | 0           | (1,382)     |
| Stock-based compensation expense  | 10,336                         | 11,638      | 16,658      |
| Settlement cost   | 0                              | (46,000)    | 21,750      |
| Goodwill and asset impairment   | 2,454                          | 0           | 15,166      |
| Accretion of discount on private education loans  | (12,170)                       | (12,996)    | 0           |
| Accretion of discount on long-term debt   | 118                            | 0           | 0           |
| Accretion of discount on PEAKS Trust senior debt  | 6,712                          | 4,926       | 0           |
| Accretion of discount on CUSO secured borrowing obligation                              | 231                            | 0           | 0           |
| Provision for private education loan losses   | 14,150                         | 29,349      | 0           |
| (Gain) loss on consolidation of variable interest entities                              | (16,631)                       | 73,248      | 0           |
| Other   | (613)                          | 315         | 6,992       |
| Changes in operating assets and liabilities, net of acquisition:                        |                                |             |             |
| Restricted cash   | 2,334                          | (455)       | 3,794       |
| Accounts receivable   | (10,010)                       | (87,225)    | (87,138)    |
| Private education loans   | 18,552                         | 11,554      | 0           |
| Accounts payable  | 9,591                          | (5,574)     | (15,572)    |
| Other operating assets and liabilities  | (48,727)                       | 73,880      | 72,429      |
| Deferred revenue  | (1,156)                        | 11,299      | (90,643)    |
| Net cash flows from operating activities  | 136,777                        | 77,725      | 107,621     |
| <b>Cash flows from investing activities:</b>  |                                |             |             |
| Capital expenditures, net   | (6,092)                        | (5,147)     | (18,250)    |
| Acquisition of company, net of cash acquired  | (5,220)                        | (7,150)     | 0           |
| Collateralization of letters of credit  | (89,304)                       | 0           | 0           |
| Proceeds from sales and maturities of investments and repayment of notes                | 293                            | 461         | 217,301     |
| Note advances and purchases of investments  | (2)                            | (1,242)     | (75,887)    |
| Net cash flows from investing activities  | (100,325)                      | (13,078)    | 123,164     |
| <b>Cash flows from financing activities:</b>  |                                |             |             |

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|  |                   |                   |                   |
|--|-------------------|-------------------|-------------------|
| Excess tax benefit from stock option exercises           | 0                 | 0                 | 1,382             |
| Proceeds from exercise of stock options                  | 0                 | 0                 | 8,345             |
| Debt issue costs   | (4,938)           | 0                 | (1,525)           |
| Proceeds from term and revolving borrowings              | 100,000           | 0                 | 175,000           |
| Repayment of revolving borrowings                        | (50,000)          | (90,000)          | (185,000)         |
| Repayment of PEAKS Trust senior debt                     | (158,668)         | (1,946)           | 0                 |
| Repayment of CUSO secured borrowing obligation           | (1,766)           | 0                 | 0                 |
| Repurchase of common stock and shares tendered for taxes | (914)             | (395)             | (209,371)         |
| Net cash flows from financing activities                 | (116,286)         | (92,341)          | (211,169)         |
| Net change in cash and cash equivalents                  | (79,834)          | (27,694)          | 19,616            |
| Cash and cash equivalents at beginning of period         | 215,771           | 243,465           | 223,849           |
| <b>Cash and cash equivalents at end of period</b>        | <b>\$ 135,937</b> | <b>\$ 215,771</b> | <b>\$ 243,465</b> |

Supplemental disclosures of cash flow information:

|   |            |            |            |
|---|------------|------------|------------|
| Cash paid during the period for:                        |            |            |            |
| Income taxes (net of refunds)                           | \$ 14,466  | \$ 61,131  | \$ 139,919 |
| Interest  | \$ 20,897  | \$ 3,310   | \$ 3,047   |
| Non-cash operating activities:                          |            |            |            |
| Consolidation of variable interest entities assets      | \$ 30,136  | \$ 113,819 | \$ 0       |
| Consolidation of variable interest entities liabilities | \$ 2,564   | \$ 471     | \$ 0       |
| Non-cash operating and investing activities:            |            |            |            |
| Accrued capital expenditures                            | \$ 236     | \$ 0       | \$ 0       |
| Non-cash financing activities:                          |            |            |            |
| Issuance of treasury stock for Directors compensation   | \$ 38      | \$ 0       | \$ 37      |
| Consolidation of PEAKS Trust senior debt                | \$ 0       | \$ 226,096 | \$ 0       |
| Consolidation of CUSO secured borrowing obligation      | \$ 122,542 | \$ 0       | \$ 0       |

The accompanying notes are an integral part of the consolidated financial statements.

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## ITT EDUCATIONAL SERVICES, INC.

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(Dollars and shares in thousands)

|  | Common Stock<br>Shares | Common Stock<br>Amount | Capital<br>Surplus | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Common Stock in<br>Treasury<br>Shares | Common Stock in<br>Treasury<br>Amount | Total      |
|--|------------------------|------------------------|--------------------|----------------------|--|---------------------------------------|---------------------------------------|------------|
| <b>Balance as of<br/>December 31,<br/>2011</b>         | 37,069                 | \$ 371                 | \$ 184,207         | \$ 833,347           | \$ (9,479)   | (10,969)                              | \$ (839,341)                          | \$ 169,105 |
| Net income   |                        |                        |                    | 138,970              |  |                                       |                                       | 138,970    |
| Other<br>comprehensive<br>income, net of<br>income tax |                        |                        |                    |                      | 1,549  |                                       |                                       | 1,549      |
| Equity award<br>vesting and<br>exercises               |                        |                        | (4,224)            | (4,843)              |  | 272                                   | 17,412                                | 8,345      |
| Tax benefit from<br>equity awards                      |                        |                        | 918                |                      |  |                                       |                                       | 918        |
| Stock-based<br>compensation                            |                        |                        | 16,212             |                      |  |                                       |                                       | 16,212     |
| Common shares<br>repurchased                           |                        |                        |                    |                      |  | (3,026)                               | (207,918)                             | (207,918)  |
| Shares tendered for<br>taxes                           |                        |                        |                    |                      |  | (22)                                  | (1,453)                               | (1,453)    |
| Issuance of shares<br>for Directors<br>compensation    |                        |                        |                    | (1)                  |  | 1                                     | 38                                    | 37         |
| <b>Balance as of<br/>December 31,<br/>2012</b>         | 37,069                 | 371                    | 197,113            | 967,473              | (7,930)  | (13,744)                              | (1,031,262)                           | 125,765    |
| Net (loss)   |                        |                        |                    | (27,024)             |  |                                       |                                       | (27,024)   |
| Other<br>comprehensive<br>income, net of<br>income tax |                        |                        |                    |                      | 11,076   |                                       |                                       | 11,076     |
| Equity award<br>vesting                                |                        |                        | (3,297)            |                      |  | 68                                    | 3,297                                 | 0          |
| Tax benefit from<br>equity awards                      |                        |                        | (5,414)            |                      |  |                                       |                                       | (5,414)    |
|  |                        |                        | 11,638             |                      |  |                                       |                                       | 11,638     |

|   |        |        |            |            |          |          |                |            |
|---|--------|--------|------------|------------|----------|----------|----------------|------------|
| Stock-based compensation                      |        |        |            |            |          |          |                |            |
| Shares tendered for taxes                     |        |        |            |            |          | (23)     | (395)          | (395)      |
| <b>Balance as of December 31, 2013</b>        | 37,069 | 371    | 200,040    | 940,449    | 3,146    | (13,699) | (1,028,360)    | 115,646    |
| Net income                                    |        |        |            | 29,253     |          |          |                | 29,253     |
| Other comprehensive (loss), net of income tax |        |        |            |            | (1,945)  |          |                | (1,945)    |
| Equity award vesting                          |        |        | (7,084)    |            |          | 121      | 7,084          | 0          |
| Tax benefit from equity awards                |        |        | (4,409)    |            |          |          |                | (4,409)    |
| Stock-based compensation                      |        |        | 10,336     |            |          |          |                | 10,336     |
| Shares tendered for taxes                     |        |        |            |            |          | (42)     | (914)          | (914)      |
| Issuance of shares for Directors compensation |        |        |            | (32)       |          | 1        | 70             | 38         |
| <b>Balance as of December 31, 2014</b>        | 37,069 | \$ 371 | \$ 198,883 | \$ 969,670 | \$ 1,201 | (13,619) | (\$ 1,022,120) | \$ 148,005 |

The accompanying notes are an integral part of the consolidated financial statements.

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**ITT EDUCATIONAL SERVICES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Dollars in thousands, except per share data and unless otherwise stated)**

**1. Business and Significant Accounting Policies**

**Business Overview.** ITT Educational Services, Inc. is a leading proprietary provider of postsecondary degree programs in the United States based on revenue and student enrollment. References in these Notes to we, us and our refer to ITT Educational Services, Inc., its wholly-owned subsidiaries and the variable interest entities ( VIEs ) that it consolidates, unless the context requires or indicates otherwise. As of December 31, 2014, we were offering:

master, bachelor and associate degree programs to approximately 53,000 students at ITT Technical Institute and Daniel Webster College locations; and

short-term information technology and business learning solutions for individuals.

In addition, we offered one or more of our online education programs to students who are located in all 50 states. As of December 31, 2014, we had 144 college locations in 39 states. All of our college locations are authorized by the applicable education authorities of the states in which they operate and are accredited by an accrediting commission recognized by the U.S. Department of Education ( ED ). We have provided career-oriented education programs since 1969 under the ITT Technical Institute name and since 2009 under the Daniel Webster College name. In January 2014, we acquired certain assets and assumed certain liabilities of CompetenC Solutions, Inc. and Great Equalizer, Inc. CompetenC Solutions, Inc. and Great Equalizer, Inc. were education companies that operated primarily under the name of Ascolta ( Ascolta ) and offered short-term information technology and business learning solutions for career advancers and other professionals. In August 2013, we acquired all of the membership interests of Cable Holdings, LLC ( Cable Holdings ), an education company that offers short-term information technology and business learning solutions for career advancers and other professionals. See Note 3 Acquisitions, for additional discussion of the acquisition of the Ascolta business and Cable Holdings. Our corporate headquarters are located in Carmel, Indiana.

**Basis of Presentation.** The accompanying consolidated financial statements include the accounts of our wholly-owned subsidiaries and the VIEs that we consolidate, and have been prepared in accordance with generally accepted accounting principles in the United States ( GAAP ) and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ( SEC ). Arrangements where we have a variable interest in another party are evaluated in accordance with the provisions of Financial Accounting Standards Board ( FASB ) Accounting Standards Codification™ ( ASC or Codification ) 810, Consolidation ( ASC 810 ), to determine whether we are required to consolidate the other party in our consolidated financial statements. See Note 8 Variable Interest Entities, for a further discussion of the VIEs in which we held a variable interest and the consolidation of those entities in our consolidated financial statements as of and for the years ended December 31, 2014 and December 31, 2013. All significant intercompany balances and transactions are eliminated upon consolidation. Certain reclassifications have been made in the consolidated financial statements of prior years to conform to the current year presentation. These reclassifications have no impact on previously reported net income, total shareholders' equity or cash flows. We review the operations of our business on a regular basis to determine our reportable operating segments, as defined in ASC 280, Segment Reporting. As of December 31, 2014, we reported our financial results under one reportable



operating segment.

***Use of Estimates.*** The preparation of these consolidated financial statements, in accordance with GAAP, requires estimates and assumptions that affect amounts reported and disclosed in our consolidated financial statements and accompanying notes. Actual results could differ materially from the estimates. Significant accounting estimates and assumptions are used for, but not limited to:

the allowance for doubtful accounts;

the allowance for private education loan losses;

useful lives of tangible and intangible assets;

goodwill and asset impairments;

fair value of the assets and liabilities of the VIEs upon consolidation;

fair value of the assets acquired and liabilities assumed related to acquisitions;

self-insurance;

pension liabilities;

stock-based compensation;

guarantee obligations;

income tax valuation allowances and unrecognized income tax benefits; and

litigation liabilities.

Our accounting estimates may be adjusted or refined due to changes in the facts and circumstances supporting the accounting estimates. Such changes and refinements are reflected in our consolidated financial statements in the period in which they are made and, if material, their effects are disclosed in our consolidated financial statements.

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**Cash Equivalents.** Highly liquid investments purchased with an original maturity of three months or less are considered cash equivalents.

**Restricted Cash.** The funds from the federal student financial aid programs under Title IV ( Title IV Programs ) of the Higher Education Act of 1965, as amended ( HEA ), and certain other monies transferred to us by electronic funds transfer, are subject to holding restrictions before they can be drawn into our cash account. The funds subject to these holding periods are identified as restricted cash until they are applied to the students' accounts. In addition, funds held for students from Title IV Programs that result in a credit balance on a student's account are also reflected as restricted cash on our Consolidated Balance Sheet. The amount of these funds included on our Consolidated Balance Sheet was \$1,967 as of December 31, 2014 and \$2,433 as of December 31, 2013.

We consolidated two VIEs in our consolidated financial statements, one beginning on February 28, 2013 and the other beginning on September 30, 2014. Funds held by these VIEs are classified as restricted cash on our Consolidated Balance Sheet, because those funds can only be used to satisfy the obligations of the related VIE. Funds held by the VIEs included in restricted cash on our Consolidated Balance Sheet were \$4,073 as of December 31, 2014 and \$2,593 as of December 31, 2013.

**Collateral Deposits.** We maintain an escrow account to secure our guarantee obligation to the VIE that we consolidated in our consolidated financial statements beginning September 30, 2014. The amount of funds that are required to be held in the escrow account is based on a percentage of the aggregate principal balance of the private education loans associated with our guarantee obligation to the VIE. We may be required to increase the amount held in this escrow account if we are not in compliance with certain covenants. The amount of funds in this escrow account that are included in the line item Collateral deposits on our Consolidated Balance Sheet was \$8,628 as of December 31, 2014 and \$8,626 as of December 31, 2013. The funds held in this escrow account are not available for use by us. See Note 15 Commitments and Contingencies, for a further discussion of the collateral requirements associated with our guarantee obligation.

Beginning in 2014, we were required to provide cash collateral in an amount equal to 109% of the face amount of a letter of credit payable to the ED and 103% of the face amount of all other letters of credit issued for our account. The funds held as cash collateral are not available for use by us and could be paid to the issuing bank for the letters of credit if the letters of credit are drawn upon. The funds held as cash collateral will remain subject to such restriction and potential use until the cancellation, termination, expiration or reduction of the face amount of the outstanding letters of credit. As of December 31, 2014, the balance of this cash collateral was \$89,304 and was included in the line item Collateral deposits on our Consolidated Balance Sheet. Of this amount, \$86,882 related to the letter of credit that was issued on October 31, 2014 to the ED. See Note 15 Commitments and Contingencies, for a further discussion of the letter of credit payable to the ED.

**Accounts Receivable and Allowance for Doubtful Accounts.** We extend unsecured credit to our institutions' students for tuition and fees, and we record a receivable for the tuition and fees earned in excess of the payment received from or on behalf of a student. The average student receivable balance is insignificant. We record an allowance for doubtful accounts with respect to accounts receivable based on the students' credit profiles and our historical collection experience related to amounts owed by our students with similar credit profiles. If our collection trends were to differ significantly from our historical collection experience, we would make a corresponding adjustment to our allowance for doubtful accounts.

When a student is no longer enrolled in an education program at one of our campuses, we increase the allowance for doubtful accounts related to the former student's receivable balance to reflect the amount we estimate will not be collected. The amount that we estimate will not be collected is based on a review of the historical collection

experience for our campuses, adjusted as needed to reflect other facts and circumstances. We review the collection activity after a student withdraws or graduates from an education program and write off the accounts receivable, if we conclude that collection of the balance is not probable.

**Private Education Loans.** We consolidate two VIEs that purchased, own and collect private education loans made to our students in our consolidated financial statements. Beginning on February 28, 2013, we consolidated a VIE, which is a trust (the PEAKS Trust ) that purchased, owns and collects private education loans (the PEAKS Trust Student Loans ) made under a private education loan program for our students (the PEAKS Program ), in our consolidated financial statements (the PEAKS Consolidation ). Beginning on September 30, 2014, we consolidated a VIE (the CUSO ) that purchased, owns and collects private education loans (the CUSO Student Loans ) made under a private education loan program for our students (the CUSO Program ), in our consolidated financial statements (the CUSO Consolidation ).

Certain of the PEAKS Trust Student Loans and the CUSO Student Loans (collectively, the Private Education Loans ) had evidence of credit deterioration since the date those loans were originated and, therefore, we determined that, at the date of the PEAKS Consolidation and the CUSO Consolidation, it was probable that all contractually required payments under the applicable loans would not be collected. We recorded those loans at fair value at the date of the PEAKS Consolidation and the CUSO Consolidation, as applicable. We also recorded at fair value the Private Education Loans that did not individually have evidence of deteriorated credit quality at the date of the PEAKS Consolidation and the CUSO Consolidation, because we determined that the application of an expected cash flow model provided the most reasonable presentation and this accounting treatment was consistent with the American Institute of Certified Public Accountants (the AICPA ) December 18, 2009 Confirmation Letter (the Confirmation Letter ). No allowance for loan losses was recorded at the date of the PEAKS Consolidation or the CUSO

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Consolidation, because all of the Private Education Loans were recorded at fair value and future credit losses are considered in the estimate of fair value. Cash flows from the Private Education Loans expected to be collected within the 12 month period after December 31, 2014 have been classified as current on our Consolidated Balance Sheet. The remaining balance is classified as non-current.

As of the date of the applicable Consolidation, we aggregated the PEAKS Trust Student Loans into 24 separate pools of loans and the CUSO Student Loans into 48 separate pools of loans, based on common risk characteristics of the loans, which included:

the fiscal quarter in which the Private Education Loan was purchased by the PEAKS Trust or the CUSO; and;

the consumer credit score of the borrower.

Loans that did not have evidence of deteriorated credit quality were not aggregated in the same pools with loans that had evidence of deteriorated credit quality. The same aggregation criteria, however, were used to determine those loan pools. Each loan pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows.

On a quarterly basis subsequent to the PEAKS Consolidation and the CUSO Consolidation, as applicable, we estimate the total principal and interest expected to be collected over the remaining life of each loan pool. These estimates include assumptions regarding default rates, forbearances and other factors that reflect then-current market conditions. Prepayments of loans were not considered when estimating the expected cash flows, because historically, few Private Education Loans have been prepaid.

If a decrease in the expected cash flows of a loan pool is probable and would cause the expected cash flows to be less than the expected cash flows at the end of the previous fiscal quarter, we would record the impairment as:

a provision for private education loan losses in our Consolidated Statement of Operations; and

an increase in the allowance for loan losses on our Consolidated Balance Sheet.

The provision for private education loan losses represents the increase in the allowance for loan losses that occurred during the period. The allowance for loan losses is the difference between the carrying value and the total present value of the expected principal and interest collections of each loan pool, discounted by the loan pool's effective interest rate at the end of the previous fiscal quarter. If a significant increase in the expected cash flows of a loan pool is probable and would cause the expected cash flows to be greater than the expected cash flows at the end of the previous fiscal quarter, we would:

first reverse any allowance for loan losses with respect to that loan pool that was previously recorded on our Consolidated Balance Sheet, up to the amount of that allowance; and

record any remaining increase prospectively as a yield adjustment over the remaining estimated lives of the loans in the loan pool.

The impact of prepayments, changes in variable interest rates and any other changes in the timing of the expected cash flows of a loan pool are recognized prospectively as adjustments to interest income.

The impact of modifications made to loans in a loan pool is incorporated into our quarterly assessment of whether a significant change in the expected cash flows of the loan pool is probable or has occurred. We consider the historical loss experience associated with the Private Education Loans in estimating the future probabilities of default for all of the outstanding Private Education Loans.

The excess of any cash flows expected to be collected with respect to a loan pool of the Private Education Loans over the carrying value of the loan pool is referred to as the accretable yield. The accretable yield is not reported on our Consolidated Balance Sheets, but it is accreted and included as interest income at a level rate of return over the remaining estimated life of the loan pool. If we determine that the timing and/or amounts of expected cash flows with respect to a loan pool are not reasonably estimable, no interest income would be accreted and the loans in that loan pool would be reported as nonaccrual loans. We recognize the accretable yield of the Private Education Loans as interest income, because the timing and the amounts of the expected cash flows are reasonably estimable.

If a Private Education Loan is paid in full or charged-off, that loan is removed from the loan pool. If the amount of the proceeds received for that loan, if any, is less than the unpaid principal balance of the loan, the difference is first applied against the loan pool's nonaccretable difference for principal losses (i.e., the lifetime credit loss estimate established at the date of the related Consolidation). If the nonaccretable difference for principal losses with respect to a loan pool has been fully depleted, any unpaid loan principal balance in excess of the proceeds received for the loan is charged-off against the loan pool's allowance for loan losses. We do not recognize charge-offs of individual Private Education Loans when those loans reach certain stages of delinquency, because those loans are accounted for at a loan pool level.

If any portion of a Private Education Loan that had previously been charged-off is recovered, the amount collected increases the applicable loan pool's nonaccretable difference. If the nonaccretable difference with respect to the applicable loan pool has been fully depleted, the amount collected increases that loan pool's allowance for loan losses.

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**Property and Equipment.** Property and equipment is recorded on our consolidated financial statements at cost, less accumulated depreciation and amortization. Maintenance and repairs are expensed as incurred. Expenditures that extend the useful lives of our assets are capitalized.

Developed or purchased software is capitalized in accordance with ASC 350, Intangibles – Goodwill and Other. Facility construction costs are capitalized as incurred, with depreciation commencing when the facility is placed in service.

Provisions for depreciation and amortization of property and equipment have generally been made using the straight-line method over the following ranges of useful lives:

| <b>Type of Property and Equipment</b>     | <b>Estimated Useful Life</b> |
|---|------------------------------|
| Furniture and equipment                   | 3 to 10 years                |
| Leasehold, building and land improvements | 3 to 14 years                |
| Buildings                                 | 20 to 40 years               |

We amortize leasehold improvements using the straight-line method over the shorter of the life of the improvement or the term of the underlying lease. Land is not depreciated.

**Long-Lived Assets.** We review our long-lived assets (which are primarily property and equipment) for possible impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable. We assess the recoverability of the carrying value of the long-lived assets at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities.

An impairment of a long-lived asset or asset group exists when the carrying value of a long-lived asset or asset group exceeds the total amount of the estimated undiscounted future cash flows from that asset or asset group. An impairment loss is measured and recognized based on the amount of the difference between the estimated fair value and carrying value of the asset or asset group. We base our impairment analyses of long-lived assets on our current business strategy, expected growth rates and estimates of future economic and regulatory conditions. The estimated cash flows used in the evaluation of impairment and the fair value used to determine the impairment are based on assumptions. Changes in assumptions resulting from changes in actual results from those anticipated may result in a future impairment charge.

We consider a note receivable to be impaired when, based on current information or events, it is probable that we will be unable to collect all amounts of principal and interest owed on the underlying note according to the terms of the note. If the present value of the expected future cash flows from the note receivable discounted at the underlying note's effective interest rate is less than the carrying value of the underlying note, we recognize an impairment loss in the amount of the difference. We evaluate each note receivable individually for impairment.

**Goodwill and Other Indefinite-Lived Intangible Assets.** Goodwill and certain other intangible assets (primarily trademarks) are not amortized, because there are no legal, regulatory, contractual, economic or other factors that limit the useful life of those intangible assets. Intangible assets that are not amortized (indefinite-lived intangible assets) are subject to evaluation for impairment. We perform this evaluation annually, during the fourth quarter, or more frequently if facts and circumstances warrant. Certain triggering events are considered by us when evaluating whether an interim impairment analysis is warranted. These events may include a significant long-term decrease in our market capitalization based on events specific to our operations, as well as deteriorating operating results and current period and projected future operating results that negatively differ from the operating plans used in the most recent

impairment analysis. We also consider changes in the accreditation, regulatory or legal environment; increased competition; innovation changes and changes in the market acceptance of our educational programs and the graduates of those programs, among other factors, when determining whether an interim impairment analysis is warranted.

We assess whether goodwill or other indefinite-lived intangible assets may be impaired by determining the estimated fair value of the reporting unit and comparing that value to the carrying value of the reporting unit. If the carrying value of the reporting unit exceeds the estimated fair value of the reporting unit, we allocate the estimated fair value of the reporting unit to the assets (including intangible assets) and liabilities of the reporting unit, with the residual representing the implied fair value of goodwill. We recognize an impairment loss if, and to the extent that, the carrying value of the goodwill or other indefinite-lived intangible asset exceeds its estimated fair value.

***Insurance Liabilities.*** We record liabilities and related expenses for medical, workers compensation and other insurance in accordance with the contractual terms of the insurance policies. We record the total liabilities that are estimable and probable as of the reporting date for our insurance liabilities that we self-insure. The accounting for our self-insured arrangements involves estimates and judgments to determine the liability to be recorded for reported claims and claims incurred but not reported. We consider our historical experience in determining the appropriate insurance liability to record. If our current insurance claim trends were to differ significantly from our historic claim experience, however, we would make a corresponding adjustment to our insurance liability.

***Contingent Liabilities.*** We are subject to various claims and contingencies, including those related to litigation, government

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investigations, business transactions, guarantee obligations and employee-related matters, among others. When we are aware of a claim or potential claim, we assess the likelihood of any loss or exposure. If it is probable that a loss will result and the amount of the loss can be reasonably estimated, we record a liability for the loss. The liability recorded includes probable and estimable legal costs associated with the claim or potential claim. If the loss is not probable or the amount of the loss cannot be reasonably estimated, we disclose the claim if the likelihood of a potential loss is reasonably possible and the amount involved is material.

Prior to the CUSO Consolidation, we determined the amount of our contingent liability for our guarantee obligations related to the CUSO Program by estimating the expected payments to be made by us under the guarantee and the amount that we expected to be repaid to us. We also considered the payment options available to us. To the extent that we projected that we would have sufficient funds available to pay the full amount of the outstanding balance of those private education loans that have been charged off at the time that they default to satisfy our guarantee obligations, we incorporated that assumption into our estimate of the contingent liability. If we did not believe that we would have sufficient funds available, we assumed that we would make monthly payments to satisfy our guarantee obligations related to the CUSO Program. We discounted the amount of those expected future monthly payments at a risk-free rate of interest. Making payments for the full amount of the charged-off loans at the time that they default results in us paying a lesser amount than we otherwise would have been required to pay under our guarantee obligations in future periods and, therefore, results in an estimated contingent liability that is less than if we had assumed we would make monthly payments in the future.

The difference between the amount of the guarantee payments that we expected to make and the amount that we expected would be repaid to us, each discounted at a risk-free rate of interest, as applicable, was included in our estimate of the amount of our contingent liability related to our guarantee obligations under the CUSO Program prior to the date of the CUSO Consolidation. Beginning on September 30, 2014, we no longer record a contingent liability related to the CUSO Program on our Consolidated Balance Sheet because the contingent liability was eliminated upon the CUSO Consolidation.

**Debt.** The PEAKS Trust issued senior debt in the initial aggregate principal amount of \$300,000 (the PEAKS Senior Debt ). In accordance with ASC 810, we included the PEAKS Senior Debt on our consolidated balance sheet at its fair value as of February 28, 2013, the date of the PEAKS Consolidation. The difference between the fair value of the PEAKS Senior Debt and its outstanding aggregate principal balance at the date of the PEAKS Consolidation was recorded as an accrued discount on our consolidated balance sheet at the date of the PEAKS Consolidation. The accrued discount is being recognized in interest expense at a level rate of return over the life of the PEAKS Senior Debt.

Commitment fees and other amounts that we paid to or on behalf of a third-party lender to realize the proceeds of debt financing have been recorded as a discount to the associated debt on our Consolidated Balance Sheet and are amortized into interest expense using an effective interest rate method.

**CUSO Secured Borrowing Obligation.** The owners of the CUSO (the CUSO Participants ) purchased participation interests in the CUSO Student Loans from the CUSO. The terms of the agreements between the CUSO Participants and the CUSO did not meet the requirements under ASC 860, Transfers and Servicing , to be considered a sale. As a result, the CUSO was required to record a liability (the CUSO Secured Borrowing Obligation ) on its balance sheet for the cash received from the CUSO Participants. The CUSO Secured Borrowing Obligation represents the estimated amount that the CUSO owes to the CUSO Participants related to their participation interests in the CUSO Student Loans, which amount is expected to be paid to the CUSO Participants by the CUSO from payments received by the CUSO related to the CUSO Student Loans, whether from the borrower or from us under the risk-sharing agreement (the CUSO RSA ) that we entered into with the CUSO on February 20, 2009.



In accordance with ASC 810, we included the CUSO Secured Borrowing Obligation on our consolidated balance sheet at its fair value as of September 30, 2014, the date of the CUSO Consolidation. The difference between the estimated fair value of the CUSO Secured Borrowing Obligation and the amount expected to be paid by the CUSO to the CUSO Participants was recorded as an accrued discount on our consolidated balance sheet at the date of the CUSO Consolidation. The accrued discount is being recognized in interest expense at a level rate of return over the expected life of the CUSO Secured Borrowing Obligation.

The expected life of the CUSO Secured Borrowing Obligation is an estimate of the period of time over which payments are expected to be made by the CUSO to the CUSO Participants related to their participation interests in the CUSO Student Loans. The period of time over which payments are expected to be made by the CUSO to the CUSO Participants is based on when the CUSO Student Loans enter a repayment status and the period of time they remain in a repayment status. Since all of the CUSO Student Loans have not entered repayment, and those loans that have entered repayment may be granted forbearances or deferments, the period of time over which payments are expected to be made to the CUSO Participants is an estimate. The assumptions used to estimate the expected life of the CUSO Secured Borrowing Obligation are reviewed periodically and updated accordingly, which may result in an adjustment to the expected life of the CUSO Secured Borrowing Obligation and the related recognized interest expense.

**Treasury Stock.** Repurchases of outstanding shares of our common stock are recorded at cost. Treasury stock issued in fulfillment of stock-based compensation awards or other obligations is accounted for under the last in, first out method. We record losses from the sale of treasury stock that exceed previous net gains from the sale of treasury stock as a charge to retained earnings.

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**Recognition of Revenue.** Tuition revenue is recorded on a straight-line basis over the length of the applicable course to the extent that we consider the collectability of that revenue to be reasonably assured. If a student withdraws from an institution, the standards of most state education authorities that regulate our institutions, the accrediting commissions that accredit our institutions and our own internal policy limit a student's obligation for tuition and fees to the institution depending on when a student withdraws during an academic term ( Refund Policies ). The terms of the Refund Policies vary by state, and the limitations imposed by the Refund Policies are generally based on the portion of the academic term that has elapsed at the time the student withdraws. Generally, the greater the portion of the academic term that has elapsed at the time the student withdraws, the greater the student's obligation is to the institution for the tuition and fees related to that academic term. We record revenue net of any refunds that result from any applicable Refund Policy. On an individual student basis, tuition earned in excess of cash received is recorded as accounts receivable, and cash received in excess of tuition earned is recorded as deferred revenue.

We do not charge a separate fee for textbooks that students use in their education programs. We record the cost of these textbooks in Prepaid expenses and other current assets and amortize the cost of textbooks on a straight-line basis over the applicable course length. Tool kit sales, and the related cost, are recognized when the student receives the tool kit. Academic fees (which are charged only one time to students on their first day of class attendance) are recognized as revenue on a straight-line basis over the average length of the education program. If a student withdraws from an institution, all unrecognized revenue relating to his or her fees, net of any refunds that result from any applicable Refund Policy, is recognized upon the student's departure. An administrative fee is charged to a student and recognized as revenue when the student withdraws or graduates from an education program at an institution. We reassess the collectability of tuition revenue on a student-by-student basis throughout our revenue recognition period. We reassess the collectability of tuition revenue that we may earn based on new information and changes in the facts and circumstances relevant to a student's ability to pay, which primarily include when a student withdraws from a program of study.

We report 12 weeks of tuition revenue in each of our four fiscal quarters. We standardized the number of weeks of revenue reported in each fiscal quarter, because the timing of student breaks in a calendar quarter can fluctuate from quarter to quarter each year. The total number of weeks of school during each year is 48.

We provide institutional scholarships and awards to our institutions' students, which those students use to help reduce their educational expenses. Institutional scholarships and awards reduce the students' tuition charges and are recorded as offsets to revenue in the period in which the tuition is earned.

Interest income on the Private Education Loans, which is the accretion of the accretable yield on the Private Education Loans, is included in revenue and recognized based on the effective interest method as described in Note 9 Private Education Loans.

**Advertising Costs.** We expense all advertising costs as incurred. Advertising expense, which is included in Student services and administrative expenses in our Consolidated Statements of Operations, was \$177,564 in the year ended December 31, 2014, \$177,791 in the year ended December 31, 2013 and \$174,009 in the year ended December 2012.

**Equity-Based Compensation.** Stock-based compensation cost for our equity instruments exchanged for employee and director services is measured at the date of grant, based on the calculated fair value of the grant and is recognized as an expense on a straight-line basis over the period of time that the grantee must provide services to us before the stock-based compensation is fully vested. The vesting period is generally the period set forth in the agreement granting the stock-based compensation. Under the terms of our stock-based compensation plans, some grants immediately vest in full when the grantee's employment or service terminates due to death or disability. As a result, in certain circumstances, the period of time that the grantee provides services to us in order for that stock-based

compensation to fully vest may be less than the vesting period set forth in the agreement granting the stock-based compensation. In these instances, compensation expense will be recognized over this shorter period.

We use a binomial option pricing model to determine the fair value of stock options granted and we use the market price of our common stock to determine the fair value of restricted stock units ( RSUs ) granted. The binomial option pricing model takes into account the variables defined below:

Volatility is a statistical measure of the extent to which the stock price is expected to fluctuate during a period and combines our historical stock price volatility and the implied volatility as measured by actively traded stock options.

Expected life is the weighted average period that those stock options are expected to remain outstanding, based on the historical patterns of our stock option exercises, as adjusted to reflect the current position-level demographics of the stock option grantees.

Risk-free interest rate is based on interest rates for terms that are similar to the expected life of the stock options.

Dividend yield is based on our historical and expected future dividend payment practices. We generally issue shares of our common stock from treasury shares upon the exercise of stock options or vesting of RSUs. As of December 31, 2014, approximately 13.6 million shares of our common stock were held in treasury. Our Board of Directors has authorized us to repurchase outstanding shares of our common stock, but we do not expect to repurchase any outstanding shares of our common stock in 2015.

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**Operating Leases.** We lease our non-owned facilities under operating lease agreements. Common provisions within our operating lease agreements include:

renewal options, which can be exercised after the initial lease term;

rent escalation clauses;

tenant improvement allowances; and

rent holidays.

We record the rent expense associated with each operating lease agreement evenly over the term of the lease. The difference between the amount of rent expense recorded and the amount of rent actually paid is recorded as either prepaid or accrued rent, which is included in Other assets or Other liabilities, on our Consolidated Balance Sheets. We recognize a liability for the costs to terminate the lease of a leased facility when we cease using that leased facility.

**Income Taxes.** We account for income taxes using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for expected future tax consequences of temporary differences that currently exist between the tax bases and financial reporting bases of our assets and liabilities.

We follow the guidance under ASC 740, Income Taxes ( ASC 740 ), which prescribes a single, comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on its tax returns. This guidance requires us to evaluate whether it is more likely than not, based on the technical merits of a tax position, that the benefits resulting from the position will be realized by us.

We record interest and penalties related to unrecognized tax benefits in income tax expense.

## **2. New Accounting Guidance**

In April 2015, the FASB issued Accounting Standards Update ( ASU ) No. 2015-03, Simplifying the Presentation of Debt Issuance Costs, which is included in the Codification under ASC 835, Interest ( ASC 835 ). This guidance requires that debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the carrying amount of that liability. This guidance will be effective for our interim and annual reporting periods beginning January 1, 2016, with early adoption permitted. We are assessing the impact that this guidance may have on our consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, Amendment to the Consolidation Analysis ( ASU 2015-02 ), which is included in the Codification under ASC 810. This guidance changes the analysis that an entity must perform to determine whether it should consolidate certain types of legal entities. This guidance will be effective for our interim and annual reporting periods beginning January 1, 2016, with early adoption permitted. We are assessing the impact that this guidance may have on our consolidated financial statements.

In January 2015, the FASB issued ASU No. 2015-01, *Income Statement - Extraordinary and Unusual Items* ( ASU 2015-01 ), which is included in the Codification under ASC 225, *Income Statement* ( ASC 225 ). This guidance eliminates the concept of extraordinary items from GAAP. This guidance will be effective for our interim and annual reporting periods beginning January 1, 2016, with early adoption permitted. We are assessing the impact that this guidance may have on our consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, *Presentation of Financial Statements - Going Concern* ( ASU 2014-15 ), which is included in the Codification under ASC 205, *Presentation of Financial Statements* ( ASC 205 ). This guidance was issued to define management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosure in certain circumstances. Under the new guidance, management is required to evaluate, at each annual and interim reporting period, whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date the financial statements are issued and to provide related disclosures. The guidance will be effective for our interim and annual reporting periods beginning January 1, 2017, with early adoption permitted. We are assessing the impact that this guidance may have on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* ( ASU 2014-09 ), which is included in the Codification under ASC 606, *Revenue Recognition* ( ASC 606 ). This guidance requires the recognition of revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration expected in exchange for those goods or services. This guidance will become effective for our interim and annual reporting periods beginning January 1, 2017. Early adoption is not permitted. We are assessing the impact that this guidance may have on our consolidated financial statements.

In April 2014, the FASB issued ASU No. 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* ( ASU 2014-08 ), which is included in the Codification under ASC 205, *Presentation of Financial Statements* ( ASC 205 ). This update changes the requirements for reporting discontinued operations and clarifies when disposals of groups of assets qualify for a discontinued operations presentation under ASC 205. This guidance became effective for our

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interim and annual reporting periods beginning January 1, 2015. Early adoption was permitted, but only for disposals that have not been reported in financial statements previously issued. We do not expect the adoption of ASU 2014-08 to have a material impact on our consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists ( ASU 2013-11 ), which is included in the Codification under ASC 740. This update provides guidance on the financial statement presentation of unrecognized tax benefits when net operating loss carryforwards, similar tax losses or tax credit carryforwards exist. This guidance became effective for our interim and annual reporting periods beginning January 1, 2014. The adoption of this guidance did not have a material impact on our consolidated financial statements.

**3. Acquisitions**

On January 31, 2014, we acquired certain assets and assumed certain liabilities of CompetenC Solutions, Inc. and Great Equalizer, Inc. for approximately \$5,220. CompetenC Solutions, Inc. and Great Equalizer, Inc. were education companies that operated primarily under the name of Ascolta and offered short-term information technology and business learning solutions for career advancers and other professionals. The acquisition of the Ascolta business allowed us to expand our offerings in the short-term learning solutions market by integrating the Ascolta operations into the Center for Professional Development @ ITT Technical Institute (the CPD ).

Our consolidated financial statements include the results of the Ascolta business beginning as of the acquisition date. The revenue and expenses of the Ascolta business included in our Consolidated Statement of Operations for the year ended December 31, 2014 were not significant. Our revenue, net income and earnings per share would not have been significantly affected, if the revenue and expenses of the Ascolta business were presented for the year ended December 31, 2014, 2013 and 2012 as if the transaction had occurred at the beginning of the earliest period presented. The costs incurred to acquire the Ascolta business were expensed and were not significant.

We accounted for the acquisition of the Ascolta business in accordance with ASC 805, Business Combinations ( ASC 805 ), which requires the use of the acquisition method of accounting for all business combinations. We considered the report of a third-party valuation firm in allocating the purchase price to identifiable net assets. The excess of the consideration paid over the estimated fair values of the identifiable net assets acquired was recognized as goodwill and is expected to be deductible for income tax purposes. The identifiable intangible assets acquired consist of customer relationships and non-compete agreements, which are being amortized over a weighted-average life of approximately five years.

The following table sets forth the estimated fair values allocated to the major classes of assets acquired and liabilities assumed in the Ascolta business acquisition as of the acquisition date:

|  | <b>Assets<br/>Acquired</b> | <b>Liabilities<br/>Assumed</b> |
|--|----------------------------|--------------------------------|
| Accounts receivable and other current assets | \$ 849                     |                                |
| Furniture and equipment                      | 370                        |                                |
| Identifiable intangible assets               | 1,670                      |                                |
| Goodwill                                     | 3,332                      |                                |
| Other liabilities                            |                            | \$ 1,001                       |

On August 1, 2013, we acquired all of the membership interests of Cable Holdings for \$7,150 in cash, net of cash acquired. Cable Holdings was an education company that operated under the name of Benchmark Learning and offered short-term information technology and business learning solutions for career advancers and other professionals. The acquisition of Cable Holdings allowed us to immediately begin operating in the short-term learning solutions market, and we integrated Cable Holdings operations into the CPD.

Our consolidated financial statements include the results of Cable Holdings from the acquisition date. The revenue and expenses of Cable Holdings included in our Consolidated Statements of Operations for the year ended December 31, 2013 were not significant. Our revenue, net income and earnings per share would not have been significantly affected, if the revenue and expenses of Cable Holdings were presented for the years ended December 31, 2013, 2012 and 2011 as if the transaction had occurred at the beginning of the earliest period presented. The costs incurred to acquire Cable Holdings were expensed and were not significant.

We accounted for the acquisition of Cable Holdings in accordance with ASC 805. We considered the report of a third-party valuation firm in allocating the purchase price to identifiable net assets. The excess of the consideration paid over the estimated fair values of the identifiable net assets acquired was recognized as goodwill and is expected to be deductible for income tax purposes. The identifiable intangible assets acquired consist of customer relationships, non-compete agreements and training materials, which are being amortized over a weighted-average life of approximately five years.

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The following table sets forth the estimated fair values to be allocated to the major classes of assets acquired and liabilities assumed in the Cable Holdings acquisition as of the acquisition date:

|  | Assets<br>Acquired | Liabilities<br>Assumed |
|--|--------------------|------------------------|
| Accounts receivable and other current assets | \$ 1,110           |                        |
| Furniture and equipment                      | 480                |                        |
| Identifiable intangible assets               | 2,390              |                        |
| Goodwill                                     | 3,958              |                        |
| Accounts payable and other liabilities       |                    | \$ 788                 |

**4. Fair Value and Credit Risk of Financial Instruments**

Fair value for financial reporting is defined as the price that would be received upon the sale of an asset or paid upon the transfer of a liability in an orderly transaction between market participants at the measurement date. The fair value measurement of our financial assets utilized assumptions categorized as observable inputs under the accounting guidance. Observable inputs are assumptions based on independent market data sources.

The following table sets forth information regarding the recurring fair value measurement of our financial assets as reflected on our Consolidated Balance Sheet as of December 31, 2014:

| Description          | Fair Value Measurements at Reporting Date Using |  |   |  |
|----------------------|---|--|---|--|
|                      | As of<br>December 31,<br>2014                   | (Level 1)<br>Quoted Prices in<br>Active Markets for<br>Identical<br>Assets | (Level 2)<br>Significant<br>Other<br>Observable<br>Inputs | (Level 3)<br>Significant<br>Unobservable<br>Inputs |
| Cash equivalents:    |   |  |   |  |
| Money market fund    | \$ 60,960                                       | \$ 60,960  | \$ 0  | \$ 0   |
| Restricted cash:     |   |  |   |  |
| Money market fund    | 1,967   | 1,967  | 0   | 0  |
| Collateral deposits: |   |  |   |  |
| Money market fund    | 8,628   | 8,628  | 0   | 0  |
|                      | \$ 71,555                                       | \$ 71,555  | \$ 0  | \$ 0   |

The following table sets forth information regarding the recurring fair value measurement of our financial assets as reflected on our Consolidated Balance Sheet as of December 31, 2013:



| Description          | Fair Value Measurements at Reporting Date Using |   |  |  |
|----------------------|---|---|--|--|
|                      | As of December 31, 2013                         | (Level 1)<br>Quoted Prices in Active Markets for Identical Assets | (Level 2)<br>Significant Other Observable Inputs | (Level 3)<br>Significant Unobservable Inputs |
| Cash equivalents:    |   |   |  |  |
| Money market fund    | \$ 214,985                                      | \$ 214,985  | \$ 0   | \$ 0   |
| Restricted cash:     |   |   |  |  |
| Money market fund    | 2,433   | 2,433   | 0  | 0  |
| Collateral deposits: |   |   |  |  |
| Money market fund    | 8,626   | 8,626   | 0  | 0  |
|                      | \$ 226,044                                      | \$ 226,044  | \$ 0   | \$ 0   |

We used quoted prices in active markets for identical assets as of the measurement dates to value our financial assets that were categorized as Level 1.

The carrying value for cash and cash equivalents, restricted cash, accounts receivable, accounts payable, and other current liabilities approximate fair value because of the immediate or short-term maturity of these financial instruments. We did not have any financial assets or liabilities recorded at estimated fair value on a non-recurring basis on our Consolidated Balance Sheets as of December 31, 2014 or 2013.

The carrying value of the Private Education Loans was \$90,876 as of December 31, 2014 and \$84,209 as of December 31, 2013. The estimated fair value of the Private Education Loans was approximately \$101,623 as of December 31, 2014 and approximately \$99,100 as of December 31, 2013. The fair value of the Private Education Loans was estimated using the income approach with estimated discounted expected cash flows. We utilized inputs that were unobservable in determining the estimated fair

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value of the Private Education Loans. The significant inputs used in determining the estimated fair value included the default rate, repayment rate and discount rate. Fair value measurements that utilize significant unobservable inputs are categorized as Level 3 measurements under the accounting guidance.

Each of the carrying value and the estimated fair value of our debt under our Financing Agreement (as defined in Note 12 Debt) was approximately \$96,349 as of December 31, 2014. The fair value of our debt under the Financing Agreement was estimated by discounting the future cash flows using current rates for similar loans with similar characteristics and remaining maturities. We utilized inputs that were unobservable to estimate the fair value of our debt under the Financing Agreement. Fair value measurements that utilize significant unobservable inputs are categorized as Level 3 measurements under the accounting guidance.

The carrying value of the PEAKS Senior Debt was \$76,203 as of December 31, 2014 and \$229,224 as of December 31, 2013. The estimated fair value of the PEAKS Senior Debt was approximately \$85,248 as of December 31, 2014 and approximately \$239,400 as of December 31, 2013. The fair value of the PEAKS Senior Debt was estimated using the income approach with estimated discounted cash flows. We utilized inputs that were unobservable in determining the estimated fair value of the PEAKS Senior Debt. The significant input used in determining the estimated fair value was the discount rate utilized for both credit and liquidity purposes. Fair value measurements that utilize significant unobservable inputs are categorized as Level 3 measurements under the accounting guidance.

The carrying value of the CUSO Secured Borrowing Obligation was \$121,007 as of December 31, 2014 and the estimated fair value of the CUSO Secured Borrowing Obligation was approximately \$116,933. The fair value of the CUSO Secured Borrowing Obligation was estimated using the income approach with estimated discounted cash flows. We utilized inputs that were unobservable in determining the estimated fair value of the CUSO Secured Borrowing Obligation. The significant input used in determining the estimated fair value was the discount rate utilized for both credit and liquidity purposes. Fair value measurements that utilized significant unobservable inputs are categorized as Level 3 measurements under the accounting guidance.

Financial instruments that potentially subject us to credit risk consist primarily of accounts receivable, cash equivalents and the Private Education Loans. There is no concentration of credit risk of our accounts receivable, as the total is comprised of a large number of individual balances owed by students whose credit profiles vary and who are located throughout the United States. Our cash equivalents generally consist of money market funds which invest in high-quality securities issued by various entities. The Private Education Loans consist of a large number of individual loans owed by borrowers, whose credit profiles vary and who are located throughout the United States.

## **5. Financial Aid Programs**

We participate in various Title IV Programs of the HEA. In 2014, in the aggregate, our institutions derived approximately 80% of their applicable revenue from funds distributed under those Title IV Programs, as determined on a cash accounting basis under the calculation of the provision of the HEA commonly referred to as the 90/10 Rule.

We administer the Title IV Programs in separate accounts as required by government regulation. We are required to administer the funds in accordance with the requirements of the HEA and the ED's regulations and must use due diligence in approving and disbursing funds. In the event we do not comply with federal requirements, or if student loan default rates rise to a level considered excessive by the federal government, we could lose our eligibility to participate in Title IV Programs or could be required to repay funds determined to have been improperly disbursed. Our management believes that we are in substantial compliance with the federal requirements.

**6. Equity Compensation Plans**

We have adopted the following equity compensation plans, referred to collectively as the Plans :

*2006 ITT Educational Services, Inc. Equity Compensation Plan* On May 9, 2006, our shareholders approved the 2006 ITT Educational Services, Inc. Equity Compensation Plan (the Original 2006 Plan ).

*ITT Educational Services, Inc. Amended and Restated 2006 Equity Compensation Plan* On May 7, 2013, our shareholders approved the ITT Educational Services, Inc. Amended and Restated 2006 Equity Compensation Plan and on October 20, 2014, we approved an amendment to that plan (as so amended, the Amended 2006 Plan ). Awards may be granted to our employees and directors under the Amended 2006 Plan in the form of stock options (incentive and nonqualified), stock appreciation rights ( SARs ), restricted stock, RSUs, performance shares, performance units and other stock-based awards as defined in the plan. The Amended 2006 Plan increased the maximum number of shares of our common stock that may be issued pursuant to awards under the plan to 7,350,000, an increase of 3,350,000 over the 4,000,000 maximum under the Original 2006 Plan. Each share underlying stock options and SARs granted and not forfeited or terminated, reduces the number of shares available for future awards by one share. The delivery of a share in connection with a full-value award (i.e., an award of restricted stock, RSUs, performance shares, performance units or any other stock-based award with value denominated in shares) reduces the number of shares remaining for other awards by two shares. As of December 31, 2014, restricted stock, RSUs and nonqualified stock options have been awarded under this plan.

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All awards granted under equity compensation plans other than the Plans expired in or prior to 2014.

The amount of stock-based compensation expense and the line items in which those amounts are included in our Consolidated Statements of Operations and the related estimated income tax benefit recognized in the periods indicated were as follows:

|   | <b>Year Ended December 31,</b> |                  |                  |
|---|--------------------------------|------------------|------------------|
|   | <b>2014</b>                    | <b>2013</b>      | <b>2012</b>      |
| Cost of educational services                  | \$ 4,790                       | \$ 4,799         | \$ 6,084         |
| Student services and administrative expenses  | 5,546                          | 6,839            | 10,574           |
| <b>Total stock-based compensation expense</b> | <b>\$ 10,336</b>               | <b>\$ 11,638</b> | <b>\$ 16,658</b> |
| Income tax (benefit)                          | (\$ 3,980)                     | (\$ 4,481)       | (\$ 6,414)       |

As of December 31, 2014, we estimated that pre-tax compensation expense for unvested stock-based compensation grants in the amount of approximately \$9,000, net of estimated forfeitures, will be recognized in future periods. This expense will be recognized over the remaining service period applicable to the grantees which, on a weighted-average basis, is approximately 1.6 years.

**Stock Options.** Under the Plans, the stock option exercise price may not be less than 100% of the fair market value of our common stock on the date of grant. The maximum term of any stock option granted under the Amended 2006 Plan and Original 2006 Plan may not exceed seven years from the date of grant, and those stock options will be exercisable at such times and under conditions as determined by the Compensation Committee of our Board of Directors, subject to the limitations contained in the plan. All stock options awarded under the Amended 2006 Plan and Original 2006 Plan typically vest and become exercisable in three equal installments commencing with the first anniversary of the date of grant.

The stock options granted, forfeited, exercised and expired in the period indicated were as follows:

|                                    | <b># of<br/>Shares</b> | <b>Year Ended December 31, 2014</b>                |   |  | <b>Aggregate<br/>Intrinsic<br/>Value<br/>(1)</b> |
|------------------------------------|------------------------|--|---|--|--|
|                                    |                        | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Aggregate<br/>Exercise<br/>Price</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contractual Term</b> |  |
| Outstanding at beginning of period | 1,332,448              | \$ 81.77   | \$ 108,955                              |  |  |
| Granted                            | 168,500                | \$ 27.94   | 4,708                                   |  |  |
| Forfeited                          | (10,334)               | \$ 30.29   | (313)                                   |  |  |
| Exercised                          | 0                      | \$ 0.00  | 0                                       |  |  |
| Expired                            | (337,341)              | \$ 73.04   | (24,638)                                |  |  |
| Outstanding at end of period       | 1,153,273              | \$ 76.92   | \$ 88,712                               | 2.2 years  | \$ 0   |
| Exercisable at end of period       | 848,098                | \$ 93.33   | \$ 79,153                               | 1.8 years  | \$ 0   |

- (1) The aggregate intrinsic value of stock options is calculated by identifying those stock options that had a lower exercise price than the closing market price of our common stock on December 31, 2014 and multiplying the difference between the closing market price of our common stock and the exercise price of each of those stock options by the number of shares subject to those stock options that were outstanding or exercisable, as applicable. Since the closing market price of our common stock on December 31, 2014 was lower than the exercise price of all outstanding stock options and exercisable stock options, the aggregate intrinsic value of the stock options was zero.

The following table sets forth information regarding the stock options granted and exercised in the periods indicated:

|  | <b>Year Ended December 31,</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2014</b>                    | <b>2013</b> | <b>2012</b> |
| Shares subject to stock options granted            | 168,500                        | 156,500     | 156,500     |
| Weighted average grant date fair value             | \$ 12.62                       | \$ 9.27     | \$ 31.36    |
| Shares subject to stock options exercised          | 0                              | 0           | 202,820     |
| Intrinsic value of stock options exercised         | \$ 0                           | \$ 0        | \$ 4,802    |
| Proceeds received from stock options exercised     | \$ 0                           | \$ 0        | \$ 8,345    |
| Tax benefits realized from stock options exercised | \$ 0                           | \$ 0        | \$ 1,602    |

The intrinsic value of a stock option is the difference between the fair market value of the stock and the option exercise price.

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The fair value of each stock option grant was estimated on the date of grant using the following assumptions:

|                           | Year Ended December 31, |      |      |
|---------------------------|-------------------------|------|------|
|                           | 2014                    | 2013 | 2012 |
| Risk-free interest rates  | 1.3%                    | 0.7% | 0.7% |
| Expected lives (in years) | 4.7                     | 4.6  | 4.5  |
| Volatility                | 55%                     | 60%  | 51%  |
| Dividend yield            | None                    | None | None |

**Restricted Stock Units.** Under the Amended 2006 Plan and Original 2006 Plan, RSUs awarded are subject to a restriction period of at least: (a) for awards made prior to November 24, 2010, three years in the case of a time-based period of restriction and one year in the case of a performance-based period of restriction; and (b) for awards made after November 24, 2010, one year, unless the Compensation Committee determines otherwise. All RSUs awarded under the Amended 2006 Plan and Original 2006 Plan that were not vested as of December 31, 2014 have a time-based restriction period that ranges from ending on the first to the third anniversary of the date of grant.

The following table sets forth the number of RSUs that were granted, forfeited and vested in the period indicated:

|                                 | Year Ended December 31, 2014 |  |
|---------------------------------|------------------------------|--|
|                                 | # of RSUs                    | Weighted Average Grant Date Fair Value |
| Unvested at beginning of period | 737,844                      | \$ 39.96                               |
| Granted                         | 402,890                      | \$ 21.46                               |
| Forfeited                       | (188,887)                    | \$ 30.09                               |
| Vested                          | (120,540)                    | \$ 61.08                               |
| Unvested at end of period       | 831,307                      | \$ 30.17                               |

The total fair market value of the RSUs that vested and were settled in shares of our common stock was \$2,512 in the year ended December 31, 2014, \$1,241 in the year ended December 31, 2013 and \$4,568 in the year ended December 31, 2012. Also, in the year ended December 31, 2012, 48,935 RSUs vested and were settled in cash for \$3,073.

## 7. **Earnings (Loss) Per Common Share**

Earnings (loss) per common share for all periods have been calculated in conformity with ASC 260, Earnings Per Share. This data is based on historical net income (loss) and the weighted average number of shares of our common stock outstanding during each period as set forth in the following table:

|  | <b>Year Ended December 31,</b> |                   |             |
|--|--------------------------------|-------------------|-------------|
|  | <b>2014</b>                    | <b>2013</b>       | <b>2012</b> |
|  | <b>(In thousands)</b>          |                   |             |
| <b>Shares:</b>   |                                |                   |             |
| Weighted average number of shares of common stock outstanding                      | 23,474                         | 23,412            | 23,880      |
| Shares assumed issued (less shares assumed purchased for stock-based compensation) | 288                            | Not<br>Applicable | 119         |
| Outstanding shares for diluted earnings (loss) per share calculation               | 23,762                         | 23,412            | 23,999      |

A total of approximately 1.3 million shares for fiscal year 2014, approximately 1.4 million shares for fiscal year 2013 and approximately 1.7 million shares for fiscal year 2012 were excluded from the calculation of our diluted earnings per common share, because the effect was anti-dilutive.

#### **8. Variable Interest Entities**

Under ASC 810, an entity that holds a variable interest in a VIE and meets certain requirements would be considered to be the primary beneficiary of the VIE and required to consolidate the VIE in its consolidated financial statements. In order to be considered the primary beneficiary of a VIE, an entity must hold a variable interest in the VIE and have both:

the power to direct the activities that most significantly impact the economic performance of the VIE;  
and

the right to receive benefits from, or the obligation to absorb losses of, the VIE that could be potentially significant to the VIE.

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We hold variable interests in the PEAKS Trust as a result of:

a subordinated note issued to us by the PEAKS Trust in exchange for the portion of each private education loan disbursed to us under the PEAKS Program that we transferred to the PEAKS Trust ( Subordinated Note ); and

our guarantee of the payment of the principal and interest owed on the PEAKS Senior Debt, the administrative fees and expenses of the PEAKS Trust and a minimum required ratio of assets of the PEAKS Trust to outstanding PEAKS Senior Debt ( PEAKS Guarantee ).

We hold variable interests in the CUSO as a result of:

the CUSO RSA; and

a revolving note owed to us by the CUSO (the Revolving Note ).

Primary Beneficiary Analysis. The PEAKS Trust and the CUSO are VIEs as defined under ASC 810. To determine whether we are the primary beneficiary of the PEAKS Trust or the CUSO, we:

assessed the risks that the VIE was designed to create and pass through to its variable interest holders;

identified the variable interests in the VIE;

identified the other variable interest holders and their involvement in the activities of the VIE;

identified the activities that most significantly impact the VIE's economic performance;

determined whether we have the power to direct those activities; and

determined whether we have the right to receive the benefits from, or the obligation to absorb the losses of, the VIE that could potentially be significant to the VIE.

We determined that the activities of the PEAKS Trust and the CUSO that most significantly impact the economic performance of the PEAKS Trust and the CUSO involve the servicing (which includes the collection) of the PEAKS Trust Student Loans and the CUSO Student Loans. To make that determination, we analyzed various possible scenarios of student loan portfolio performance to evaluate the potential economic impact on the PEAKS Trust and the CUSO. In our analysis, we made what we believe are reasonable assumptions based on historical data for the following key variables:



the composition of the credit profiles of the borrowers;

the interest rates and fees charged on the loans;

the default rates and the timing of defaults associated with similar types of loans; and

the prepayment and the speed of repayment associated with similar types of loans.

Based on our analysis, we concluded that we became the primary beneficiary of the PEAKS Trust on February 28, 2013. This was the first date that we had the power to direct the activities of the PEAKS Trust that most significantly impact the economic performance of the PEAKS Trust, because we could have exercised our right to terminate the servicing agreement that governs the servicing activities of the PEAKS Trust Student Loans (the PEAKS Servicing Agreement), due to the failure of the entity that performs those servicing activities for the PEAKS Trust Student Loans on behalf of the PEAKS Trust to meet certain performance criteria specified in the PEAKS Servicing Agreement. We have not, however, exercised our right to terminate the PEAKS Servicing Agreement. As a result of our primary beneficiary conclusion, we consolidated the PEAKS Trust in our consolidated financial statements beginning on February 28, 2013. Prior to February 28, 2013, the PEAKS Trust was not required to be consolidated in our consolidated financial statements, because we concluded that we were not the primary beneficiary of the PEAKS Trust prior to that time. The PEAKS Trust is discussed in more detail below.

Our consolidated financial statements for periods as of and after February 28, 2013 include the PEAKS Trust, because we were considered to have control over the PEAKS Trust under ASC 810, as a result of our substantive unilateral right to terminate the PEAKS Servicing Agreement. We do not, however, actively manage the operations of the PEAKS Trust, and the assets of the consolidated PEAKS Trust can only be used to satisfy the obligations of the PEAKS Trust. Our obligations under the PEAKS Guarantee remain in effect, until the PEAKS Senior Debt and the PEAKS Trust's fees and expenses are paid in full. See Note 15 Commitments and Contingencies, for a further discussion of the PEAKS Guarantee.

Based on our analysis, we concluded that we became the primary beneficiary of the CUSO on September 30, 2014. This was the first date that we determined we had the power to direct the activities of the CUSO that most significantly impact the economic performance of the CUSO, because the entity that performs the servicing activities on behalf of the CUSO (the CUSO Program Servicer) failed to meet certain performance criteria specified in the servicing agreement that governs the servicing activities of the CUSO Student Loans (the CUSO Servicing Agreement) on that date. The CUSO Servicing Agreement provides that in the event that the CUSO Program Servicer fails to meet certain performance criteria specified in the CUSO Servicing Agreement, and the CUSO Program Servicer does not affect a cure of that failure during a specified cure period, we would have the right to terminate the CUSO Servicing Agreement. We determined that it was not reasonably possible that the CUSO Program Servicer would be able to affect a cure during the specified cure period and, therefore, because the cure period was not substantive, we effectively had the right to terminate the CUSO Servicing Agreement as of the date that the CUSO Program Servicer failed to meet the performance criteria. We have not, however, exercised our right to terminate the CUSO Servicing Agreement.

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As a result of our primary beneficiary conclusion, we consolidated the CUSO in our consolidated financial statements beginning on September 30, 2014. Prior to September 30, 2014, the CUSO was not required to be consolidated in our consolidated financial statements, because we concluded that we were not the primary beneficiary of the CUSO prior to that time. The CUSO is discussed in more detail below.

Our consolidated financial statements for periods as of and after September 30, 2014 include the CUSO, because we were considered to have control over the CUSO under ASC 810, as a result of our substantive right to terminate the CUSO Servicing Agreement after a cure period that was not substantive. We do not, however, actively manage the operations of the CUSO, and the assets of the consolidated CUSO can only be used to satisfy the obligations of the CUSO. Our obligations under the CUSO RSA remain in effect, until all CUSO Student Loans are paid in full. See Note 15 Commitments and Contingencies, for a further discussion of the CUSO RSA.

***PEAKS Private Student Loan Program.*** On January 20, 2010, we entered into agreements with unrelated third parties to establish the PEAKS Program, which was a private education loan program for our students. We entered into the PEAKS Program to offer our students another source of private education loans that they could use to help pay their education costs owed to us and to supplement the limited amount of private education loans available to our students under other private education loan programs, including the CUSO Program. Under the PEAKS Program, our students had access to a greater amount of private education loans, which resulted in a reduction in the amount of internal financing that we provided to our students in 2010 and 2011. No new private education loans were or will be originated under the PEAKS Program after July 2011, but immaterial amounts related to loans originated prior to that date were disbursed by the lender through March 2012.

Under the PEAKS Program, an unrelated lender originated private education loans to our eligible students and, subsequently, sold those loans to the PEAKS Trust. The PEAKS Trust issued the PEAKS Senior Debt to investors. The lender disbursed the proceeds of the private education loans to us for application to the students' account balances with us that represented their unpaid education costs. We transferred a portion of the amount of each private education loan disbursed to us under the PEAKS Program to the PEAKS Trust in exchange for the Subordinated Note.

The Subordinated Note issued by the PEAKS Trust to us does not bear interest and was recorded net of an unamortized discount based on an imputed interest rate of 9.0% prior to the PEAKS Consolidation. Prior to October 1, 2012, the discount was amortized and recognized in Interest income in our Consolidated Statements of Operations over the term of the Subordinated Note. The maturity date of the Subordinated Note is in March 2026 and principal is due on the Subordinated Note following:

the repayment of the PEAKS Senior Debt;

the repayment of fees and expenses of the PEAKS Trust; and

the reimbursement of the amounts of any payments made by us under the PEAKS Guarantee, other than Payments on Behalf of Borrowers (as defined below).

The carrying value of the Subordinated Note was eliminated from our consolidated balance sheet when we consolidated the PEAKS Trust in our consolidated financial statements beginning on February 28, 2013. In the three months ended December 31, 2012, we determined it was probable that we would not collect the carrying value of the Subordinated Note and, therefore, recorded an impairment charge in the amount of approximately \$10,300, which

equaled the total carrying value of the Subordinated Note prior to recording the impairment charge. We did not recognize any interest income related to the Subordinated Note in our Consolidated Statements of Operations after September 30, 2012.

The PEAKS Trust utilized the proceeds from the issuance of the PEAKS Senior Debt and the Subordinated Note to purchase the private education loans made by the lender to our students. The assets of the PEAKS Trust (which include, among other assets, the PEAKS Trust Student Loans) serve as collateral for, and are intended to be the principal source of, the repayment of the PEAKS Senior Debt and the Subordinated Note.

Under the PEAKS Guarantee we guarantee payment of the principal and interest owed on the PEAKS Senior Debt, the administrative fees and expenses of the PEAKS Trust and a minimum required ratio of assets of the PEAKS Trust to outstanding PEAKS Senior Debt (the Asset/Liability Ratio). Our guarantee obligations under the PEAKS Program remain in effect until the PEAKS Senior Debt and the PEAKS Trust's fees and expenses are paid in full. At such time, we will be entitled to repayment of the amounts that we paid under the PEAKS Guarantee (which do not include Payments on Behalf of Borrowers, as defined below), to the extent of available funds remaining in the PEAKS Trust. See Note 15 Commitments and Contingencies, for a further discussion of our obligations to make guarantee payments pursuant to the PEAKS Guarantee.

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*Assets and Liabilities of the PEAKS Trust.* We concluded that we became the primary beneficiary of the PEAKS Trust on February 28, 2013 and, therefore, were required to consolidate the PEAKS Trust in our consolidated financial statements. In accordance with ASC 810, the consolidation of the PEAKS Trust was treated as an acquisition of assets and liabilities and, therefore, the assets and liabilities of the PEAKS Trust were included in our consolidated financial statements at their fair value as of February 28, 2013. The following table sets forth the fair value of the assets and liabilities of the PEAKS Trust as of February 28, 2013 that were included on our Consolidated Balance Sheet on that date:

|  | <b>As of February 28,<br/>2013</b> |                    |
|--|------------------------------------|--------------------|
|  | <b>Assets</b>                      | <b>Liabilities</b> |
| Restricted cash                                      | \$ 1,703                           |                    |
| Current portion of PEAKS Trust student loans         | 7,282                              |                    |
| PEAKS Trust student loans, excluding current portion | 104,834                            |                    |
| Current portion of PEAKS Trust senior debt           |                                    | \$ 103,356         |
| Other current liabilities                            |                                    | 471                |
| PEAKS Trust senior debt, excluding current portion   |                                    | 122,740            |
| <b>Total</b>   | <b>\$ 113,819</b>                  | <b>\$ 226,567</b>  |

The following table sets forth the carrying value of the assets and liabilities related to the PEAKS Program as of February 28, 2013 that we eliminated from our consolidated balance sheet when we consolidated the PEAKS Trust in our consolidated financial statements, and the line items within which those assets and liabilities were included:

|                           | <b>As of February 28, 2013</b> |                    |
|---------------------------|--------------------------------|--------------------|
|                           | <b>Assets</b>                  | <b>Liabilities</b> |
| Other assets              | \$ 6,614                       |                    |
| Other current liabilities |                                | \$ 3,060           |
| Other liabilities         |                                | 43,054             |
| <b>Total</b>              | <b>\$ 6,614</b>                | <b>\$ 46,114</b>   |

The fair value of the PEAKS Trust's liabilities exceeded the fair value of the PEAKS Trust's assets as of February 28, 2013 by \$112,748. The amount of this excess was reduced by \$39,500, which represented the net amount of the carrying value of the assets and liabilities related to the PEAKS Program that had been recorded in our consolidated financial statements as of February 28, 2013 and were eliminated upon the PEAKS Consolidation. As a result, we recognized a total loss of \$73,248 in our Consolidated Statement of Operations for the three months ended March 31, 2013 related to the PEAKS Consolidation.

The following table sets forth the carrying values of assets and liabilities of the PEAKS Trust that were included on our Consolidated Balance Sheet as of the dates indicated:

|   | <b>As of December 31,</b> |                   |
|---|---------------------------|-------------------|
|   | <b>2014</b>               | <b>2013</b>       |
| <b>Assets</b>   |                           |                   |
| Restricted cash   | \$ 1,556                  | \$ 2,593          |
| Current portion of PEAKS Trust student loans  | 7,169                     | 7,730             |
| PEAKS Trust student loans, excluding current portion, less allowance for loan losses of \$42,353 and \$29,349 | 59,902                    | 76,479            |
| <b>Total assets</b>   | <b>\$ 68,627</b>          | <b>\$ 86,802</b>  |
| <b>Liabilities</b>  |                           |                   |
| Current portion of PEAKS Trust senior debt  | \$ 37,545                 | \$ 157,883        |
| Other current liabilities   | 199                       | 697               |
| PEAKS Trust senior debt, excluding current portion  | 38,658                    | 71,341            |
| <b>Total liabilities</b>  | <b>\$ 76,402</b>          | <b>\$ 229,921</b> |

The assets of the PEAKS Trust can only be used to satisfy the obligations of the PEAKS Trust. Payment of the administrative fees and expenses of the PEAKS Trust and the principal and interest owed on the PEAKS Senior Debt are guaranteed by us under the PEAKS Guarantee.

Revenue and Expenses of PEAKS Trust. The following table sets forth the revenue and expenses of the PEAKS Trust, excluding the loss on consolidation of the PEAKS Trust, that were included in our Consolidated Statements of Operations for the periods indicated:

|   | <b>Year Ended December 31,</b> |                    |
|---|--------------------------------|--------------------|
|   | <b>2014</b>                    | <b>2013</b>        |
| Revenue   | \$ 11,471                      | \$ 12,996          |
| Student services and administrative expenses    | 4,479                          | 5,288              |
| Provision for private education loan losses     | 12,111                         | 29,349             |
| Interest expense                                | 20,814                         | 21,288             |
| <b>(Loss) before provision for income taxes</b> | <b>\$ (25,933)</b>             | <b>\$ (42,929)</b> |

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The revenue of the PEAKS Trust consists of interest income on the PEAKS Trust Student Loans, which is the accretion of the accretable yield on the PEAKS Trust Student Loans. The servicing, administrative and other fees incurred by the PEAKS Trust are included in Student services and administrative expenses in our Consolidated Statements of Operations. The provision for PEAKS Trust student loan losses represents the increase in the allowance for loan losses that occurred during the period. The allowance for loan losses represents the difference between the carrying value and the total present value of the expected principal and interest collections of each loan pool of the PEAKS Trust Student Loans, discounted by the loan pool's effective interest rate as of the end of the reporting period. Interest expense of the PEAKS Trust represents interest expense on the PEAKS Senior Debt, which includes the contractual interest obligation and the accretion of the discount on the PEAKS Senior Debt.

Payments on Behalf of Borrowers. Beginning in the fourth quarter of 2012 and continuing through January 2014, we made payments on behalf of certain student borrowers under the PEAKS Program to the PEAKS Trust to avoid defaults by those borrowers on their PEAKS Trust Student Loans ( Payments on Behalf of Borrowers ), which defaults would have triggered much larger contractually required payments by us under the PEAKS Guarantee. At the time we made Payments on Behalf of Borrowers, we believed that those payments were contractually permitted and a form of payment to the PEAKS Trust that would satisfy obligations that were contractually required. Since that time, however, we have determined that Payments on Behalf of Borrowers are not permitted or required to support the PEAKS Trust. If we had not made Payments on Behalf of Borrowers, we would have had to make contractually required payments under the PEAKS Guarantee in greater amounts. We made Payments on Behalf of Borrowers after assessing:

the likelihood of us being contractually required to make payments under the PEAKS Guarantee in the near future;

the effect on our liquidity that would result from making payments under the PEAKS Guarantee compared to making Payments on Behalf of Borrowers;

the effect that Payments on Behalf of Borrowers may have on the funds available to the PEAKS Trust to repay the Subordinated Note to us following full payment of the PEAKS Trust's other obligations; and

the fact that we will not be able to recover Payments on Behalf of Borrowers from the PEAKS Trust or the student borrowers on whose behalf we made those payments.

Payments on Behalf of Borrowers assisted in:

maintaining the Asset/Liability Ratio at the required level; and

satisfying the following month's required payment of interest on the PEAKS Senior Debt and administrative fees and expenses of the PEAKS Trust.

Prior to the PEAKS Consolidation, Payments on Behalf of Borrowers were reflected on our financial statements as a reduction to our contingent liability. Following the PEAKS Consolidation, Payments on Behalf of Borrowers were not

reflected on our financial statements, since those payments were intercompany transactions, which were eliminated from our financial statements as a result of the PEAKS Consolidation.

In January 2014, we made Payments on Behalf of Borrowers of \$1,832. We entered into a letter agreement, dated as of March 17, 2014, with the trustee under the PEAKS Program and the holders of the PEAKS Senior Debt (the PEAKS Letter Agreement ), in order to resolve differing interpretations of the permissibility of the Payments on Behalf of Borrowers under the PEAKS Program documents. Pursuant to the PEAKS Letter Agreement, the trustee agreed to waive, and the holders of the PEAKS Senior Debt consented to the waiver of, any:

breach of the PEAKS Program documents caused by us making Payments on Behalf of Borrowers, including any failure to make payments under the PEAKS Guarantee as a result thereof ; and

event of default under the PEAKS Program documents that may have arisen or resulted by us making Payments on Behalf of Borrowers.

In the PEAKS Letter Agreement, we agreed that, after the date of the PEAKS Letter Agreement, we would not make any further payments of any kind on behalf of any borrower in respect of a private education loan made under the PEAKS Program, and that any such payments in lieu of making payments to maintain the applicable required Asset/Liability Ratio would constitute a breach of the terms of the PEAKS Guarantee and an event of default under the indenture and credit agreement for the PEAKS Program. In accordance with the terms of the PEAKS Letter Agreement, we paid \$40,000 on March 20, 2014, which is considered to be a payment under the PEAKS Guarantee and was applied primarily to make a mandatory prepayment of the PEAKS Senior Debt.

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*PEAKS Guarantee Payments and Payments on Behalf of Borrowers.* The following table sets forth the PEAKS Guarantee payments and Payments on Behalf of Borrowers that were made in the periods indicated:

| <b>Type of Payment</b>          | <b>Year Ended</b>   |                         |
|---------------------------------|---------------------|-------------------------|
|                                 | <b>December 31,</b> | <b>2013</b>             |
|                                 | <b>2014</b>         | <b>2013</b>             |
| PEAKS Guarantee                 | \$ 159,255          | \$ 2,413 <sup>(1)</sup> |
| Payments on Behalf of Borrowers | 1,832               | 11,499 <sup>(2)</sup>   |
| <b>Total</b>                    | <b>\$ 161,087</b>   | <b>\$ 13,912</b>        |

(1) Of this amount, \$854 was paid prior to the PEAKS Consolidation.

(2) Of this amount, \$532 was paid prior to the PEAKS Consolidation.

**CUSO Program.** On February 20, 2009, we entered into agreements with the CUSO to create the CUSO Program. Under the CUSO Program, an unrelated lender originated private education loans to our eligible students and, subsequently, sold those loans to the CUSO. The CUSO purchased the private education loans from the lender utilizing funds received from its owners in exchange for participation interests in the private education loans acquired by the CUSO. The lender disbursed the proceeds of the private education loans to us for application to the students account balances with us that represented their unpaid education costs. No new private education loans were or will be originated under the CUSO Program after December 31, 2011, but immaterial amounts related to loans originated prior to that date were disbursed by the lender through June 2012.

In connection with the CUSO Program, we entered into the CUSO RSA with the CUSO. Under the CUSO RSA, we guarantee the repayment of any private education loans that are charged off above a certain percentage of the private education loans made under the CUSO Program, based on the annual dollar volume. Under the CUSO RSA, we have an obligation to make the monthly payments due and unpaid on those private education loans that have been charged off above a certain percentage ( Regular Payments ). Instead of making Regular Payments, however, we may elect to discharge our obligations to make Regular Payments on specified charged-off private education loans by:

paying the then outstanding balance (plus accrued and unpaid interest) of those private education loans that have been charged off above a certain percentage and, with respect to which, an amount equal to at least ten monthly payments has been paid; or

paying the then outstanding balance (plus accrued and unpaid interest) of those private education loans that have been charged off above a certain percentage and, with respect to which, an amount equal to at least ten monthly payments has not been paid, plus any interest that would otherwise have been payable until ten monthly payments had been made, discounted at the rate of 10% per annum

(collectively, Discharge Payments ).

See Note 15 Commitments and Contingencies, for a further discussion of our obligations to make guarantee payments pursuant to the CUSO RSA.



Assets and Liabilities of the CUSO. We concluded that we became the primary beneficiary of the CUSO on September 30, 2014 and, therefore, were required to consolidate the CUSO in our consolidated financial statements. In accordance with ASC 810, the consolidation of the CUSO was treated as an acquisition of assets and liabilities and, therefore, the assets and liabilities of the CUSO were included in our consolidated financial statements at their fair value as of September 30, 2014.

We recorded the CUSO Secured Borrowing Obligation at the time of the CUSO Consolidation. The CUSO Secured Borrowing Obligation represents the estimated amount that the CUSO owes to the CUSO Participants related to their participation interests in the CUSO Student Loans, which amount is expected to be paid to the CUSO Participants by the CUSO from payments received by the CUSO related to the CUSO Student Loans, whether from the borrower or from us under the CUSO RSA.

In accordance with ASC 810, we included the CUSO Secured Borrowing Obligation on our consolidated balance sheet at its fair value as of September 30, 2014, the date of the CUSO Consolidation. The difference between the estimated fair value of the CUSO Secured Borrowing Obligation and the amount expected to be paid by the CUSO to the CUSO Participants was recorded as an accrued discount on our consolidated balance sheet at the date of the CUSO Consolidation. The accrued discount is being recognized in interest expense at a level rate of return over the expected life of the CUSO Secured Borrowing Obligation.

The expected life of the CUSO Secured Borrowing Obligation is an estimate of the period of time over which payments are expected to be made by the CUSO to the CUSO Participants related to their participation interests in the CUSO Student Loans. The period of time over which payments are expected to be made by the CUSO to the CUSO Participants is based upon when the CUSO Student Loans enter a repayment status and the period of time they remain in a repayment status. Since all of the CUSO Student Loans have not entered repayment, and those loans that have entered a repayment status may be granted forbearances or deferments, the period of time over which payments are expected to be made to the CUSO Participants is an estimate. The assumptions used to estimate the expected life of the CUSO Secured Borrowing Obligation are reviewed periodically and updated accordingly, which may result in an adjustment to the expected life of the CUSO Secured Borrowing Obligation and the related recognized interest expense.

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The following table sets forth the fair value of the assets and liabilities of the CUSO as of September 30, 2014 that were included on our consolidated balance sheet on that date:

|  | <b>As of September 30, 2014</b> |                    |
|--|---------------------------------|--------------------|
|  | <b>Assets</b>                   | <b>Liabilities</b> |
| Restricted cash  | \$ 2,738                        |                    |
| Current portion of CUSO Student Loans                        | 3,406                           |                    |
| CUSO Student Loans, excluding current portion                | 23,793                          |                    |
| Other assets   | 199                             |                    |
| Current portion of CUSO Secured Borrowing Obligation         |                                 | \$ 20,662          |
| Other current liabilities                                    |                                 | 624                |
| CUSO Secured Borrowing Obligation, excluding current portion |                                 | 101,880            |
| Other liabilities  |                                 | 1,940              |
| <b>Total</b>   | <b>\$ 30,136</b>                | <b>\$ 125,106</b>  |

The assets of the CUSO can only be used to satisfy the obligations of the CUSO.

The following table sets forth the carrying value of the assets and liabilities related to the CUSO Program as of September 30, 2014 that we eliminated from our consolidated balance sheet when we consolidated the CUSO in our consolidated financial statements, and the line items within which those assets and liabilities were included:

|   | <b>As of September 30, 2014</b> |                    |
|---|---------------------------------|--------------------|
|   | <b>Assets</b>                   | <b>Liabilities</b> |
| Prepaid expenses and other current assets | \$ 3,260                        |                    |
| Other current liabilities                 |                                 | \$ 23,887          |
| Other liabilities                         |                                 | 90,974             |
| <b>Total</b>                              | <b>\$ 3,260</b>                 | <b>\$ 114,861</b>  |

Upon the CUSO Consolidation, we recorded the CUSO's assets and liabilities at their fair value in our consolidated financial statements and we eliminated the carrying value of the assets and liabilities related to the CUSO Program that had been recorded in our consolidated financial statements as of September 30, 2014. The fair value of the CUSO's liabilities exceeded the fair value of the CUSO's assets as of September 30, 2014 by \$94,970. As of September 30, 2014, the carrying value of the liabilities related to the CUSO Program that had been recorded in our consolidated financial statements exceeded the carrying value of the assets related to the CUSO Program that had been recorded in our consolidated financial statements by \$111,601. As a result, we recognized a total gain of \$16,631 in our Consolidated Statements of Operations for the year ended December 31, 2014, which represented the difference between (i) the fair value of the net liabilities of the CUSO that we recorded upon the CUSO Consolidation, and (ii) the carrying value of the net liabilities related to the CUSO Program that had been recorded in our consolidated financial statements and were eliminated upon the CUSO Consolidation, in each case, as of September 30, 2014.

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The following table sets forth the carrying values of assets and liabilities of the CUSO that were included on our Consolidated Balance Sheet as of the date indicated:

|  | <b>As of<br/>December 31,<br/>2014</b> |
|--|--|
| <b>Assets</b>  |  |
| Restricted cash  | \$ 2,517                               |
| Current portion of CUSO Student Loans  | 3,415                                  |
| CUSO Student Loans, excluding current portion, less allowance for loan losses of \$2,039 | 20,390                                 |
| Other assets   | 284                                    |
| <br>Total assets   | <br>\$ 26,606                          |
| <b>Liabilities</b>   |  |
| Current portion of CUSO Secured Borrowing Obligation                                     | \$ 20,813                              |
| Other current liabilities  | 179                                    |
| CUSO Secured Borrowing Obligation, excluding current portion                             | 100,194                                |
| Other liabilities  | 1,073                                  |
| <br>Total liabilities  | <br>\$ 122,259                         |

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The assets of the CUSO can only be used to satisfy the obligations of the CUSO.

Revenue and Expenses of the CUSO. The following table sets forth the revenue and expenses of the CUSO, excluding the gain on consolidation of the CUSO, which were included in our Consolidated Statement of Operations for the period indicated:

|  | <b>Year Ended<br/>December 31,<br/>2014</b> |             |
|--|---|-------------|
| Revenue                                      | \$  | 1,136       |
| Student services and administrative expenses |   | 437         |
| Provision for private education loan losses  |   | 2,039       |
| Interest expense                             |   | 3,725       |
| <br>(Loss) before provision for income taxes | <br>\$                                      | <br>(5,065) |

The revenue of the CUSO consists of interest income on the CUSO Student Loans, which is the accretion of the accretable yield on the CUSO Student Loans, and an administrative fee paid by the CUSO Participants to the CUSO on a monthly basis. The servicing, administrative and other fees incurred by the CUSO are included in Student services and administrative expenses in our Consolidated Statements of Operations. The provision for private education loan losses represents the increase in the allowance for loan losses that occurred during the period. The allowance for loan losses represents the difference between the carrying value and the total present value of the expected principal and interest collections of each loan pool of the CUSO Student Loans, discounted by the loan pool's effective interest rate as of the end of the reporting period. Interest expense of the CUSO represents interest expense on the CUSO Secured Borrowing Obligation, which includes the contractual interest obligation on the CUSO Student Loans and the accretion of the discount on the CUSO Secured Borrowing Obligation.

CUSO RSA Payments, Recoveries and Offsets. Pursuant to the CUSO RSA, we are entitled to all amounts that the CUSO recovers from loans in a particular loan pool made under the CUSO Program that have been charged off, until all payments that we made under the CUSO RSA with respect to that loan pool have been repaid to us by the CUSO. We have the right to offset payment amounts that we owe under the CUSO RSA by the amount of recoveries from charged-off loans made under the CUSO Program that are owed, but have not been paid, to us. We exercised this offset right in the year ended December 31, 2014. We did not exercise this offset right in the year ended December 31, 2013.

The following table sets forth the payments that we made to the CUSO related to our guarantee obligations under the CUSO RSA and the amount of recoveries from charged-off loans paid to us by the CUSO in the periods indicated:

|                                   | <b>Year Ended December 31,</b> |             |
|-----------------------------------|--------------------------------|-------------|
|                                   | <b>2014</b>                    | <b>2013</b> |
| Regular Payments                  | \$ 6,562 <sup>(1) (2)</sup>    | \$ 1,791    |
| Discharge Payments                | 2,577                          | 912         |
| Recoveries from Charged-Off Loans | 0                              | (103)       |

\$ 9,139                      \$ 2,600

(1) This amount is net of \$466 of recoveries from charged-off loans owed to us that we offset against the amount we owed under the CUSO RSA.

(2) Of this amount, \$4,556 was paid prior to the CUSO Consolidation.

The CUSO did not remit to us, and we did not offset payments under the CUSO RSA for, the following amounts of recoveries from charged-off loans that were owed to us:

\$475 in the fiscal year ended December 31, 2014; and

\$574 in the fiscal year ended December 31, 2013.

We recorded the amount of recoveries from charged-off loans that were owed to us, but not paid or offset, as of December 31, 2013 in Prepaid expenses and other current assets on our Consolidated Balance Sheet. The amounts of recoveries from charged-off loans that were owed to us by the CUSO as of December 31, 2014 were not recorded on our financial statements, since those amounts were intercompany transactions that were eliminated from our financial statements as a result of the CUSO Consolidation.

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In the fiscal year ended December 31, 2013, we also offset \$8,472 owed by us under the CUSO RSA against amounts owed to us by the CUSO under the Revolving Note, instead of making additional payments in those amounts. Approximately \$6,786 of the amount that we claimed as an offset against the Revolving Note represented Discharge Payments. We recorded the amounts that we claimed as offsets against amounts owed to us under the Revolving Note in Other current liabilities on our Consolidated Balance Sheet as of December 31, 2013. The amounts that we claimed as offset under the Revolving Note as of December 31, 2014 were not reflected in our financial statements, since those amounts were intercompany transactions that were eliminated from our financial statements as a result of the CUSO Consolidation. See Note 15 – Commitments and Contingencies, for a further discussion of the offset and CUSO RSA.

We made advances to the CUSO under the Revolving Note in years prior to 2012. We made the advances so that the CUSO could use those funds primarily to provide additional funding to the CUSO to purchase additional private education loans made under the CUSO Program. The period of time during which we could make additional advances under the Revolving Note ended on January 1, 2014. We did not make any advances in the fiscal year ended December 31, 2013 to the CUSO under the Revolving Note that we were not contractually required to make. Certain of the assets of the CUSO serve as collateral for the Revolving Note. The Revolving Note bears interest, is subject to customary terms and conditions and is currently due and payable in full.

The amount owed to us under the Revolving Note, excluding the offsets described above, was approximately \$8,200 as of December 31, 2013 and December 31, 2014. In the three months ended December 31, 2012, we determined it was probable that we would not collect the full carrying value of the Revolving Note and, therefore, recorded an impairment charge in the amount of \$4,900, which equaled the amount that the carrying value of the Revolving Note exceeded the present value of the expected future cash flows from that note. The carrying value of the Revolving Note was approximately \$2,500 as of December 31, 2013, and was included on our Consolidated Balance Sheet in Prepaid expenses and other current assets. The amount of the Revolving Note as of December 31, 2014 was not reflected in our financial statements, since that amount was an intercompany transaction that was eliminated from our financial statements as a result of the CUSO Consolidation.

**9. Private Education Loans**

We concluded that we were required to consolidate the PEAKS Trust in our consolidated financial statements beginning on February 28, 2013 and to consolidate the CUSO in our consolidated financial statements beginning on September 30, 2014. See Note 8 – Variable Interest Entities, for a further discussion of the consolidation of the PEAKS Trust and the CUSO (the Consolidated VIEs). As a result, the assets and liabilities of the Consolidated VIEs were included on our Consolidated Balance Sheet as of December 31, 2014. The assets and liabilities of the PEAKS Trust were included on our Consolidated Balance Sheet as of December 31, 2013.

As of December 31, 2014, the aggregate carrying amount of the Private Education Loans included under the Private education loan line items on our Consolidated Balance Sheet was \$90,876. The outstanding principal balance of the Private Education Loans, including accrued interest, was approximately \$184,710 as of December 31, 2014.

***Initial Measurement.*** A significant number of the Private Education Loans were determined to be credit impaired upon consolidation. Loans determined to be credit impaired upon consolidation or acquisition ( Purchased Credit Impaired Loans or PCI Loans ), are initially measured at fair value in accordance with ASC 310-30, Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality ( ASC 310-30 ). A loan is considered a PCI Loan, if it has evidence of deteriorated credit quality following the loan's origination date. As a result, at the date of consolidation or acquisition, it is probable that all contractually required payments under a PCI Loan will not be collected.

The Private Education Loans that did not individually have evidence of deteriorated credit quality at the time of consolidation were also initially measured at fair value and are accounted for in accordance with ASC 310-30. We believe that following the guidance of ASC 310-30 by analogy with respect to those loans provides the most reasonable presentation of the value of those loans, primarily due to:

the evidence of deteriorated credit quality of a significant number of the Private Education Loans; and

the probability that all contractually required payments with respect to those loans will not be collected.

All of the Private Education Loans are, therefore, considered to be, and reported as, PCI Loans.

This accounting treatment is consistent with the AICPA December 18, 2009 Confirmation Letter, in which the AICPA summarized the SEC staff's view regarding the accounting in subsequent periods for discount accretion associated with loan receivables acquired in a business combination or asset purchase. In this letter, the AICPA states that it understands that the SEC staff will not object to an accounting policy based on contractual or expected cash flow. We believe that following ASC 310-30 by analogy with respect to the Private Education Loans that did not individually have evidence of deteriorated credit quality at the time of consolidation is an appropriate application of the accounting guidance to determine the initial measurement of the value of those loans.



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Aggregation of Loans. PCI Loans recognized upon consolidation or acquisition in the same fiscal quarter may be aggregated into one or more pools, provided that the PCI Loans in each pool have common risk characteristics. The Private Education Loans were considered to be PCI Loans upon consolidation. As of the date of the PEAKS Consolidation or CUSO Consolidation, as applicable, we aggregated the PEAKS Trust Student Loans into 24 separate pools of loans and the CUSO Student Loans into 48 separate pools of loans, based on common risk characteristics of the loans, which included:

the fiscal quarter in which the Private Education Loan was purchased by the PEAKS Trust or the CUSO; and

the consumer credit score of the borrower.

PCI Loans that do not have evidence of deteriorated credit quality are not aggregated in the same pools with PCI Loans that have evidence of deteriorated credit quality. The same aggregation criteria, however, were used to determine those loan pools. Each loan pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows.

Estimated Fair Value, Accretable Yield and Expected Cash Flows. The Private Education Loans were recorded at their estimated fair value upon consolidation. The estimated fair value of the PEAKS Trust Student Loans as of February 28, 2013 and the CUSO Student Loans as of September 30, 2014 was determined using an expected cash flow methodology. Projected default rates and forbearances were considered in applying the estimated cash flow methodology. Prepayments of loans were not considered when estimating the expected cash flows, because, historically, few Private Education Loans have been prepaid. No allowance for loan loss was established as of the date of consolidation of the PEAKS Trust and the CUSO, because all of the Private Education Loans were recorded at fair value and future credit losses are considered in the estimate of fair value.

The excess of any cash flows expected to be collected with respect to a loan pool of the Private Education Loans over the carrying value of the loan pool is referred to as the accretable yield. The accretable yield is not reported on our Consolidated Balance Sheets, but it is accreted and included as interest income using the effective interest method, which is at a level rate of return over the remaining estimated life of the loan pool.

The following table sets forth the estimated fair value, accretable yield and expected cash flows for the PEAKS Trust Student Loans and the CUSO Student Loans, in total and for those loans pursuant to which ASC 310-30 was applied by analogy, as of the dates indicated

|                      | <b>PEAKS Trust Student<br/>Loans</b> |                | <b>CUSO Student Loans</b>            |                |
|----------------------|--------------------------------------|----------------|--------------------------------------|----------------|
|                      | <b>As of February 28, 2013</b>       |                | <b>As of September 30,<br/>2014</b>  |                |
|                      | <b>ASC 310-30<br/>Applied<br/>By</b> |                | <b>ASC 310-30<br/>Applied<br/>By</b> |                |
|                      | <b>Total</b>                         | <b>Analogy</b> | <b>Total</b>                         | <b>Analogy</b> |
| Estimated fair value | \$ 112,116                           | \$ 60,177      | \$ 27,199                            | \$ 12,799      |

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|                     |            |            |           |           |
|---------------------|------------|------------|-----------|-----------|
| Accrutable yield    | \$ 100,953 | \$ 58,843  | \$ 12,498 | \$ 5,651  |
| Expected cash flows | \$ 213,069 | \$ 119,020 | \$ 39,697 | \$ 18,450 |

The following tables set forth information regarding aggregate changes in accrutable yield of the loan pools of the PEAKS Trust Student Loans, in total, and for those loans pursuant to which ASC 310-30 was applied by analogy, for the periods indicated:

|   | <b>Year Ended<br/>December 31,<br/>2014</b> |  |
|---|---|--|
|   | <b>Total</b>                                | <b>ASC 310-30<br/>Applied<br/>By<br/>Analogy</b> |
| Balance as of January 1   | \$ 70,580                                   | \$ 42,274  |
| Additions resulting from the PEAKS Consolidation                                  | 0   | 0  |
| Accretion   | (11,471)                                    | (6,700)  |
| Reclassification from nonaccrutable difference and changes in expected cash flows | (7,290)                                     | (2,920)  |
| Balance as of December 31   | \$ 51,819                                   | \$ 32,654  |

|   | <b>Year Ended<br/>December 31,<br/>2013</b> |  |
|---|---|--|
|   | <b>Total</b>                                | <b>ASC 310-30<br/>Applied<br/>By<br/>Analogy</b> |
| Balance as of January 1   | \$ 0  | \$ 0   |
| Additions resulting from the PEAKS Consolidation                                  | 100,953                                     | 58,843   |
| Accretion   | (12,996)                                    | (7,243)  |
| Reclassification from nonaccrutable difference and changes in expected cash flows | (17,377)                                    | (9,326)  |
| Balance as of December 31   | \$ 70,580                                   | \$ 42,274  |

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The following table sets forth information regarding aggregate changes in accretable yield of the loan pools of the CUSO Student Loans, in total, and for those loans pursuant to which ASC 310-30 was applied by analogy, for the periods indicated:

|   | <b>Year Ended<br/>December 31, 2014</b> |  |
|---|---|--|
|   | <b>Total</b>                            | <b>ASC 310-30<br/>Applied<br/>By<br/>Analogy</b> |
| Balance as of January 1   | \$ 0                                    | \$ 0   |
| Additions resulting from the CUSO Consolidation                                   | 12,498                                  | 5,651  |
| Accretion   | (699)                                   | (333)  |
| Reclassification from nonaccretable difference and changes in expected cash flows | (71)                                    | 539  |
| <b>Balance as of December 31</b>  | <b>\$ 11,728</b>                        | <b>\$ 5,857</b>                                  |

*Contractually Required Payments.* The excess of the contractually required payments of the Private Education Loans over the expected cash flows is referred to as the nonaccretable difference. The following table sets forth the contractually required future principal and interest payments, expected cash flows and the nonaccretable difference, in total and for those loans pursuant to which ASC 310-30 was applied by analogy for the PEAKS Trust Student Loans and the CUSO Student Loans, as of the dates indicated:

|  | <b>PEAKS Trust Student<br/>Loans</b> |  | <b>CUSO Student Loans<br/>As of September 30,<br/>2014</b> |  |
|--|--------------------------------------|--|--|--|
|  | <b>As of February 28, 2013</b>       |  | <b>ASC 310-30<br/>Applied<br/>By<br/>Analogy</b>           |  |
|  | <b>Total</b>                         | <b>ASC 310-30<br/>Applied<br/>By<br/>Analogy</b> | <b>Total</b>   | <b>ASC 310-30<br/>Applied<br/>By<br/>Analogy</b> |
| Contractual future principal and interest payments | \$ 487,800                           | \$ 213,600                                       | \$ 111,159   | \$ 36,715  |
| Expected cash flows                                | 213,069                              | 119,020  | 39,697   | 18,450   |
| <b>Nonaccretable difference</b>                    | <b>\$ 274,731</b>                    | <b>\$ 94,580</b>                                 | <b>\$ 71,462</b>   | <b>\$ 18,265</b>                                 |

*Allowance for Private Education Loan Losses.* On a quarterly basis subsequent to the PEAKS Consolidation and the CUSO Consolidation, as applicable, we estimate the principal and interest expected to be collected over the remaining life of each loan pool. These estimates include assumptions regarding default rates, forbearances and other factors that reflect then-current market conditions. Prepayments of loans were not considered when estimating the expected cash flows, because, historically, few Private Education Loans have been prepaid.

If a decrease in the expected cash flows of a loan pool is probable and would cause the expected cash flows to be less than the expected cash flows at the end of the previous fiscal quarter, we would record the impairment as:

a provision for private education loan losses in our Consolidated Statement of Operations; and

an increase in the allowance for loan losses on our Consolidated Balance Sheet.

The provision for private education loan losses represents the increase in the allowance for loan losses that occurred during the period. The allowance for loan losses is the difference between the carrying value and the total present value of the expected principal and interest collections of each loan pool, discounted by the loan pool's effective interest rate at the end of the previous fiscal quarter. If a significant increase in the expected cash flows of a loan pool is probable and would cause the expected cash flows to be greater than the expected cash flows at the end of the previous fiscal quarter, we would:

first reverse any allowance for loan losses with respect to that loan pool that was previously recorded on our Consolidated Balance Sheet, up to the amount of that allowance; and

record any remaining increase prospectively as a yield adjustment over the remaining estimated lives of the loans in the loan pool.

The following table sets forth information regarding changes in the allowance for loan losses of the loan pools of the PEAKS Trust Student Loans in the aggregate for the periods indicated:

|                                   | <b>Year Ended</b>   |             |
|-----------------------------------|---------------------|-------------|
|                                   | <b>December 31,</b> |             |
|                                   | <b>2014</b>         | <b>2013</b> |
| Balance at beginning of period    | \$ 29,349           | \$ 0        |
| Loans charged off                 | (1,199)             | 0           |
| Recoveries from charged off loans | 2,092               | 0           |
| Provision for loan losses         | 12,111              | 29,349      |
| Balance at end of period          | \$ 42,353           | \$ 29,349   |

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The following table sets forth information regarding changes in the allowance for loan losses of the loan pools of the CUSO Student Loans in the aggregate for the period indicated:

|                                   | <b>Year Ended<br/>December 31,<br/>2014</b> |
|-----------------------------------|---|
| Balance at beginning of period    | \$ 0  |
| Loans charged off                 | 0   |
| Recoveries from charged off loans | 0   |
| Provision for loan losses         | 2,039                                       |
| <b>Balance at end of period</b>   | <b>\$ 2,039</b>                             |

Adjustments to the interest income of a loan pool are recognized prospectively, if those adjustments are due to:

changes in variable interest rates; or

any other changes in the timing of the expected cash flows of the loan pools.

Loan Modifications and Charge Offs. Modifications were made to PCI Loans in the fiscal years ended December 31, 2014 and 2013 and were primarily due to forbearances granted with respect to the payment of those loans. We consider the impact of any modifications made to PCI Loans as part of our quarterly assessment of whether:

a probable and significant change in the expected cash flows of the PCI Loans has occurred; and

the loans should continue to be accounted for and reported as PCI loans.

In evaluating the impact of modifications made to PCI Loans on the expected cash flows of those loans, we consider the effect of any foregone interest and the potential for future default. These default estimates are used to calculate expected credit losses with respect to each loan pool. In developing these probabilities of default estimates, we considered the relationship between the credit quality characteristics of the loans in the loan pool and certain assumptions based on the performance history of the Private Education Loans and industry data related to the severity and recovery lag of defaults applicable to private education loans. Loans for which Payments on Behalf of Borrowers were made were assumed to be defaulted loans in our default estimates.

The charge off of a PCI Loan results in the removal of that loan from the underlying PCI Loan pool and reduces the loan pool discount. If the discount for principal losses for a particular PCI Loan pool has been fully depleted, the charge off of a PCI Loan will reduce the PCI Loan pool's allowance for loan losses. Removal of a PCI Loan from the underlying PCI Loan Pool does not change the effective yield of the PCI Loan Pool.

**10. Property and Equipment**

The following table sets forth our property and equipment, net, as of the dates indicated:

|   | <b>As of December 31,</b> |                   |
|---|---------------------------|-------------------|
|   | <b>2014</b>               | <b>2013</b>       |
| Furniture and equipment                         | \$ 161,994                | \$ 162,128        |
| Buildings and building improvements             | 135,241                   | 134,993           |
| Land and land improvements                      | 39,609                    | 39,609            |
| Leasehold improvements                          | 35,738                    | 20,953            |
| Software  | 8,263                     | 8,620             |
| Construction in progress                        | 766                       | 156               |
|   | <b>\$ 381,611</b>         | <b>\$ 366,459</b> |
| Less: Accumulated depreciation and amortization | (224,539)                 | (197,950)         |
| <b>Property and equipment, net</b>              | <b>\$ 157,072</b>         | <b>\$ 168,509</b> |

Software includes purchased and internally developed software.

The following table sets forth the depreciation and amortization expense for the assets listed above in the periods indicated:

|                                       | <b>Year Ended December 31,</b> |             |             |
|---------------------------------------|--------------------------------|-------------|-------------|
|                                       | <b>2014</b>                    | <b>2013</b> | <b>2012</b> |
| Depreciation and amortization expense | \$ 25,603                      | \$ 27,007   | \$ 29,320   |

**11. Goodwill and Other Intangibles**

We recognized goodwill and certain other intangible assets on our consolidated balance sheet as a result of the acquisition of:

certain assets and liabilities of CompetenC Solutions, Inc and Great Equalizer, Inc. on January 31, 2014;

the membership interests of Cable Holdings, Inc. on August 1, 2013; and

all the assets and certain liabilities of Daniel Webster College on June 10, 2009.

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The acquired intangible assets consist of certain identifiable intangible assets that are amortized over the asset's estimated life, and other indefinite-lived intangible assets, including goodwill. Goodwill represents the excess of the consideration paid over the estimated fair value of identifiable net assets acquired.

The following tables set forth the carrying value of our acquired intangible assets that are included in Other assets on our Consolidated Balance Sheets as of the dates indicated:

|                                | As of December 31, 2014    |                             |                          | Weighted<br>Average<br>Amorti-<br>zation<br>Period<br>(months) |
|--------------------------------|----------------------------|-----------------------------|--------------------------|--|
|                                | Gross<br>Carrying<br>Value | Accumulated<br>Amortization | Net<br>Carrying<br>Value |  |
| Amortizable intangible assets: |                            |                             |                          |  |
| Customer relationships         | \$ 2,500                   | \$ (578)                    | \$ 1,922                 | 60   |
| Non-compete agreements         | 1,120                      | (280)                       | 840                      | 60   |
| Training materials             | 440                        | (178)                       | 262                      | 42   |
| Accreditation                  | 210                        | (165)                       | 45                       | 84   |
|                                | \$ 4,270                   | \$ (1,201)                  | \$ 3,069                 |  |

|                                | As of December 31, 2013    |                             |                          | Weighted<br>Average<br>Amorti-<br>zation<br>Period<br>(months) |
|--------------------------------|----------------------------|-----------------------------|--------------------------|--|
|                                | Gross<br>Carrying<br>Value | Accumulated<br>Amortization | Net<br>Carrying<br>Value |  |
| Amortizable intangible assets: |                            |                             |                          |  |
| Customer relationships         | \$ 1,200                   | \$ (100)                    | \$ 1,100                 | 60   |
| Non-compete agreements         | 750                        | (63)                        | 687                      | 60   |
| Training materials             | 440                        | (52)                        | 388                      | 42   |
| Accreditation                  | 210                        | (135)                       | 75                       | 84   |
|                                | \$ 2,600                   | \$ (350)                    | \$ 2,250                 |  |

All amortizable intangible assets are being amortized on a straight-line basis. Amortization expense for amortized intangible assets was:

\$851 in the year ended December 31, 2014;

\$245 in the year ended December 31, 2013; and

\$30 in the year ended December 31, 2012.

The following table sets forth our estimate of the amortization expense for our amortizable intangible assets in each of the next five fiscal years:

| <b>Fiscal Year Ending December 31,</b> | <b>Estimated<br/>Amortization<br/>Expense</b> |
|--|---|
| 2015                                   | \$ 880  |
| 2016                                   | 865   |
| 2017                                   | 734   |
| 2018                                   | 562   |
| 2019                                   | 28  |
|  | \$ 3,069                                      |



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The following tables set forth the carrying value of our indefinite-lived intangible assets that are included in Other assets on our Consolidated Balance Sheets as of the dates indicated.

|  | <b>As of December 31, 2014</b> |                          |                           |
|--|--------------------------------|--------------------------|---------------------------|
|  | <b>Gross Carrying Value</b>    | <b>Impairment Charge</b> | <b>New Carrying Value</b> |
| <b>Indefinite-lived intangible assets:</b> |                                |                          |                           |
| Goodwill                                   | \$ 7,290                       | \$ (2,044)               | \$ 5,246                  |
| Trademark                                  | 660                            | (410)                    | 250                       |
|  | \$ 7,950                       | \$ (2,454)               | \$ 5,496                  |

|  | <b>As of December 31, 2013</b> |                          |                           |
|--|--------------------------------|--------------------------|---------------------------|
|  | <b>Gross Carrying Value</b>    | <b>Impairment Charge</b> | <b>New Carrying Value</b> |
| <b>Indefinite-lived intangible assets:</b> |                                |                          |                           |
| Goodwill                                   | \$ 3,958                       | \$ 0                     | \$ 3,958                  |
| Trademark                                  | 660                            | 0                        | 660                       |
|  | \$ 4,618                       | \$ 0                     | \$ 4,618                  |

Indefinite-lived intangible assets include trademarks and goodwill, which are not amortized, since there are no legal, regulatory, contractual, economic or other factors that limit the useful life of those intangible assets by us.

Intangible assets that are not subject to amortization are required to be tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset may be impaired. We perform our impairment evaluation annually, during the fourth quarter, or more frequently if facts and circumstances warrant. All of our goodwill relates to one reporting unit, which is defined as one level below an operating segment.

We performed our annual impairment test as of October 1, 2014 and determined that certain of our indefinite-lived intangible assets were impaired, because the carrying values of those assets exceeded their estimated fair value. In the fourth quarter of 2014, we recorded a \$2,044 charge for the impairment of goodwill associated with the acquisitions of Cable Holdings and Ascolta and a \$410 charge for the impairment of the trademark associated with the acquisition of Daniel Webster College. The amount of each impairment charge equaled the difference between the estimated fair value and the carrying value of the applicable assets. The goodwill impairment was due to a decrease in the fair value of the forecasted cash flows, primarily resulting from lower projected revenue and margins. The impairment of the trademark was due to a decrease in projected revenue.

To calculate the amount of the goodwill impairment charge, we estimated the fair value of the reporting unit using a discounted cash flow method. This approach calculates fair value by estimating the after-tax cash flows attributable to a reporting unit and discounting these after-tax cash flows to a present value using a risk-adjusted discount rate. In applying this methodology to calculate the fair value of the reporting unit, we used assumptions about future revenue and costs. In addition, the application of the discounted cash flow method requires judgment in determining a risk-adjusted discount rate. We considered the report of a third-party valuation firm in determining the risk-adjusted

discount rate used for the valuation. The estimated fair value of the reporting unit is allocated to all of its assets and liabilities, including certain unrecognized intangible assets, in order to determine the implied fair value of the goodwill. This allocation process required judgment and the use of additional valuation assumptions in determining the individual fair values of the assets and liabilities of the reporting unit. To calculate the amount of the trademark impairment charge, we estimated the fair value of the trademark using a discounted cash flow method. In applying this methodology, we made certain assumptions about future revenue, royalty rates and the risk-adjusted discount rate.

The assumptions and estimates underlying the fair value calculations used in our annual impairment test are uncertain by their nature and can vary significantly from actual results. Therefore, as circumstances and assumptions change, we may be required to recognize additional impairment charges for goodwill and other intangible assets in future periods.

## **12. Debt**

As of December 31, 2014, our Consolidated Balance Sheet included: (i) outstanding borrowings under the Term Loans (as defined below), as described further below under *Term Loans*, (ii) the PEAKS Senior Debt issued by the PEAKS Trust, which was consolidated in our consolidated financial statements beginning February 28, 2013, as described further below under *PEAKS Trust Senior Debt*, and (iii) the CUSO Secured Borrowing Obligation of the CUSO, which was consolidated in our consolidated financial statements beginning September 30, 2014, as described further in Note 8 Variable Interest Entities.

**Term Loans.** On December 4, 2014, we and certain of our subsidiaries entered into a financing agreement (the Original Financing Agreement ) with Cerberus Business Finance, LLC ( Cerberus ), as administrative agent and collateral agent, and the

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lenders party thereto. Under the Financing Agreement, we borrowed \$100,000 aggregate principal amount of senior secured term loans (the Term Loans ). On December 23, 2014, we entered into Amendment No. 1 to Financing Agreement ( Amendment No. 1 ), on March 17, 2015, we entered into Amendment No. 2 to Financing Agreement ( Amendment No. 2 ) and on May 26, 2015, we entered into a Limited Consent to Financing Agreement (the FA Consent ). The Original Financing Agreement, as amended by Amendment No. 1 and Amendment No. 2 and including the FA Consent, is referred to herein as the Financing Agreement.

Amendment No. 1 made modifications to the Original Financing Agreement to extend the time by which we were required to establish certain cash management accounts. Amendment No. 2 provided:

for an amendment to the limitation on the aggregate amount of payments that we can make related to the PEAKS Program and the CUSO Program in any fiscal year after 2014, modifying it from \$20,000 per program in each year to \$45,000 under both programs in 2015 and \$35,000 under both programs in any year after 2015 that the Financing Agreement is still in effect;

that our consolidated financial statements (and related certificates) as of and for the fiscal year ended December 31, 2014 do not have to be furnished by us to the lenders until May 31, 2015; and

for an amendment to the definition of Fixed Charge Coverage Ratio (as defined in the Financing Agreement) to provide that, for purposes of calculating the Fixed Charge Coverage Ratio for any period that includes the fiscal quarter ended December 31, 2014, the amount of payments made during that fiscal quarter in respect of the PEAKS Program will be deemed to have been \$5,000.

The FA Consent provides that our consolidated financial statements (and related certificates) as of and for the fiscal quarter ended March 31, 2015 do not have to be furnished by us to the lenders until June 15, 2015.

We believe that we will make payments of approximately \$29,800 under the PEAKS Guarantee and approximately \$13,000, net of approximately \$1,400 in recoveries, under the CUSO RSA in 2015. The Financing Agreement limits the aggregate amount of payments that we can make related to the PEAKS Guarantee and the CUSO RSA to \$45,000 under both programs in 2015 and to \$35,000 under both programs in any year after 2015 that the Financing Agreement is in effect. See Note 15 Commitments and Contingencies for a further discussion of our projected payments under the PEAKS Guarantee and CUSO RSA.

A portion of the proceeds of the Term Loans and other funds were used by us on December 4, 2014 to provide approximately \$89,200 in cash collateral for certain letters of credit that remain outstanding for our account, which was in addition to the approximately \$100 of cash collateral we had previously provided related to a letter of credit in September 2014, under the Credit Agreement, dated as of March 21, 2012 (as amended and including consents, the Amended Credit Agreement ), among us, the lenders party thereto, JPMorgan Chase Bank, N.A., as administrative agent, Bank of America, N.A., as syndication agent, and Wells Fargo, N.A., as documentation agent. See below for a further description of terms of the Amended Credit Agreement, including following the issuance of the Term Loans. A portion of the proceeds of the Term Loans and other funds were used by us on December 4, 2014 to repay all outstanding loans, including accrued interest and fees, owed under the Amended Credit Agreement, in the amount of approximately \$50,400. All commitments of the lenders to lend additional amounts under the Amended Credit Agreement were terminated. A portion of the proceeds of the Term Loans, as well as other funds, were used for payment of fees in connection with the Financing Agreement.

The Term Loans will mature on December 4, 2017. The Term Loans bear interest, at our option, at:

the higher of (a) the London Interbank Offered Rate ( LIBOR ) and (b) 1.00%, plus a margin of 8.50%;  
or

the highest of (a) 2.00%, (b) the federal funds rate plus 0.50%, (c) LIBOR plus 1.00% and (d) the U.S. Prime Rate, plus a margin of 8.00%.

The outstanding principal balance under the Financing Agreement must be repaid by us in quarterly installments on the first business day of each March, June, September and December, commencing March 1, 2015 and ending on the maturity date. Each installment payment must be in an amount equal to \$2,500 in each quarter of 2015, \$5,000 in each quarter of 2016, and \$7,500 in each quarter of 2017, provided the last such installment payment shall be in the amount necessary to repay the then outstanding principal balance in full. In addition, the Financing Agreement provides for mandatory prepayment of outstanding principal in an amount equal to 50% of Excess Cash Flow (as defined in the Financing Agreement) calculated based on our cash flows for the fiscal years ended December 31, 2015 and 2016. Any mandatory prepayment amounts due under this provision are payable with the scheduled principal payment due on the first business day of March of the following year.

The Financing Agreement provides that we must pay a premium on any prepayment of outstanding principal that we make during the first two years of the Financing Agreement that is not specifically required under the Excess Cash Flow mandatory prepayment provision. The premium for any such prepayment of principal is 2.0% of the amount of any prepayment we make through December 4, 2015, and 1.0% of the amount of any prepayment we make from December 5, 2015 through December 4, 2016.

We paid a one-time commitment fee of \$3,000 in the fourth quarter of 2014 in connection with the Financing Agreement. Under the Financing Agreement, we are required to pay a quarterly administration fee to the Administrative Agent of \$25, of which a ratable portion was paid by us on December 4, 2014 for the remainder of the 2014 calendar year.

The Term Loans are guaranteed by certain of our subsidiaries (the Guarantors and together with us, the Loan Parties ) and are secured, subject to certain agreed upon exceptions, by: (i) a first-priority lien on and perfected security interest in substantially all the Loan Parties assets, including a pledge of the equity of the Guarantors and our other subsidiaries, (ii) a mortgage on the Loan Parties owned real estate, and (iii) control agreements on certain of the Loan Parties deposit accounts.

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The Financing Agreement contains certain affirmative and negative covenants, including restrictions on the Loan Parties' ability to incur debt and liens, make investments, dispose of assets, pay dividends and make prepayments on existing indebtedness, in each case subject to customary exceptions.

The Financing Agreement requires us to maintain compliance with a Leverage Ratio (as defined in the Financing Agreement) and a Fixed Charge Coverage Ratio (as defined in the Financing Agreement), as well as with certain educational regulatory measurements. Compliance with the Leverage Ratio and the Fixed Charge Coverage Ratio is determined on a quarterly basis, covering certain prior periods as described in the Financing Agreement.

The educational regulatory measurements are calculated over different time periods, based on statutory guidelines. The educational regulatory measurements are set forth in the Financing Agreement, and include the following tests:

a minimum composite score of our equity, primary reserve and net income ratios;

our institutions' loan cohort default rates under Title IV Programs of the HEA;

our institutions' compliance with the 90/10 Rule of the HEA;

our compliance with the ED's gainful employment regulations; and

our institutions' student retention rate.

The Financing Agreement contains certain events of default, including:

the failure by us to pay any amount owed under the Financing Agreement when due;

an inaccuracy in any material respect of the representations or warranties that the Loan Parties made in the Financing Agreement;

a violation of any covenant that the Loan Parties made in the Financing Agreement and the related loan documents;

a default by us under any other material indebtedness owed by us, including without limitation, a failure to pay any amounts due under the PEAKS Guarantee or CUSO RSA;

a change of control of us;

the invalidity of certain liens or guarantees granted or made by the Loan Parties in the Financing Agreement;

the occurrence of certain regulatory events; and

certain bankruptcy or insolvency events affecting the Loan Parties.

If an event of default occurs under the Financing Agreement, the lenders may declare all Term Loans then outstanding to be immediately due and payable in full.

**Credit Facility.** On March 21, 2012, we entered into a credit agreement (the *Credit Agreement*) that provided for a \$325,000 senior revolving credit facility. We entered into amendments to the *Credit Agreement* on March 31, 2014, May 29, 2014, June 30, 2014 (the *Third Amendment*), July 30, 2014 (the *Fourth Amendment*) and September 15, 2014 (the *Fifth Amendment*). We entered into a Consent to *Credit Agreement* effective October 15, 2014 (the *October Consent*) and a Consent to *Credit Agreement*, as of November 14, 2014 (the *November Consent* and together with the *October Consent*, the *Consents*). The *Credit Agreement*, as so amended and including *Consents*, is referred to herein as the *Amended Credit Agreement*. The *Amended Credit Agreement* had a maturity date of March 21, 2015. On December 4, 2014, we used a portion of the proceeds of the Term Loans and other funds to repay all outstanding borrowings under the *Amended Credit Agreement*, and all commitments of the lenders thereunder to make revolving loans, to issue or participate in new letters of credit, and to amend, renew, or extend letters of credit outstanding under the *Amended Credit Agreement* were terminated.

A portion of the initial borrowings under the *Credit Agreement* were used to prepay the entire outstanding indebtedness under a prior credit agreement which was terminated on March 21, 2012. In addition to the prepayment of the outstanding indebtedness under the prior credit agreement, borrowings under the *Amended Credit Agreement* were used for general corporate purposes.

Under the *Amended Credit Agreement*, the aggregate commitment of the lenders, effective June 30, 2014, was reduced to \$135,000, and the portion of the commitments available for letters of credit was increased from \$25,000 to \$85,000. Certain letters of credit in an aggregate amount of approximately \$2,352 previously issued by JPMorgan Chase Bank, N.A. are deemed to be letters of credit issued pursuant to the *Amended Credit Agreement*. We caused a letter of credit payable to the ED (*ED Letter of Credit*) in the amount of \$79,708 to be issued on October 31, 2014. The letters of credit for our account that were issued under the *Amended Credit Agreement* remain outstanding and a portion of the Term Loans was used to provide cash collateral for such letters of credit. See Note 15 *Commitments and Contingencies*, for a further discussion of the *ED Letter of Credit*.

The *ED Letter of Credit* provides that the ED may draw on the *ED Letter of Credit* upon certification by the ED that the drafted funds will be used for one or more of the following purposes:

to pay refunds of institutional or non-institutional charges owed to or on behalf of current or former students of our institutions, whether our institutions remain open or have closed;

to provide for the *teach-out* of students enrolled at the time of closure of our institutions; and

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to pay any liabilities owing to the ED arising from acts or omissions by our institutions, on or before the expiration of the ED Letter of Credit, in violation of requirements set forth in the HEA, including the violation of any agreement entered into by our institutions with the ED regarding the administration of Title IV Programs.

In addition to the participation fee required to be paid by us pursuant to the original terms of the Credit Agreement related to letters of credit, which accrues at the same rate used to determine the interest rate applicable to Eurodollar Revolving Loans (as defined in the Amended Credit Agreement), the Amended Credit Agreement provides that an additional participation fee is required to be paid by us related to the ED Letter of Credit, which accrues at a ticking fee rate on the average daily amount of the lenders' letter of credit exposure with respect to the ED Letter of Credit. The ticking fee rate is defined as:

0.00% per annum for the period from September 15, 2014 through and including March 21, 2015;

1.00% per annum for the period from March 22, 2015 through and including March 21, 2016;

2.00% per annum for the period from March 22, 2016 through and including March 21, 2017;

3.00% per annum for the period from March 22, 2017 through and including March 21, 2018;

4.00% per annum for the period from March 22, 2018 through and including March 21, 2019; and

5.00% per annum for the period from March 22, 2019 through November 15, 2019.

The Amended Credit Agreement contained, among other things, covenants, representations and warranties and events of default customary for credit facilities. We were required to maintain compliance with a maximum leverage ratio, a minimum fixed charge coverage ratio, a minimum liquidity amount, and several covenants related to the ED's regulations. In addition, the amendments to the Amended Credit Agreement, taken together:

amended certain covenants to allow for the PEAKS Consolidation beginning on February 28, 2013, and for other factors; and

waived certain defaults related to our financial reporting.

The Amended Credit Agreement was, but effective December 4, 2014, no longer is:

secured by a pledge of the equity interests of our subsidiaries;

guaranteed by one of our subsidiaries;

secured by security interests in substantially all of our personal property and the personal property of the subsidiary guarantor; and

secured by mortgages on 30 separate parcels of land owned by us, including all of the improvements thereto and fixtures thereon.

In connection with the termination of the commitments and payment of loans outstanding under the Amended Credit Agreement, our obligations under all affirmative and negative covenants in the Amended Credit Agreement, including financial covenants, were released and discharged, and representations and warranties and default provisions in the Amended Credit Agreement were terminated, all effective as of December 4, 2014.

Under the Amended Credit Agreement, we were required to provide cash collateral (in an amount equal to 109% of the face amount of the ED Letter of Credit and 103% of the face amount of all other letters of credit) for any letter of credit issued under the Amended Credit Agreement. As required, we utilized a portion of the proceeds from the Term Loans, as well as other funds, to provide cash collateral for the outstanding letters of credit in the amount of approximately \$89,300. The cash collateral may be released partially to us from time to time upon cancellation, termination, expiration or reduction of the face amount of any of the outstanding letters of credit, provided that the remaining cash collateral is not less than 103% of the amount available to be drawn under the letters of credit then remaining outstanding, except the ED Letter of Credit, for which the cash collateral must be not less than 109% of the amount available to be drawn.

Borrowings under the Amended Credit Agreement bore interest, at our option, at the LIBOR plus an applicable margin or at an alternative base rate, as defined under the Amended Credit Agreement, plus an applicable margin. The applicable margin for borrowings under the Amended Credit Agreement was determined based on the ratio of our total Indebtedness (as defined in the Amended Credit Agreement and which primarily included outstanding borrowings, recorded contingent liabilities related to our guarantee obligations, letters of credit and surety bonds) to EBITDA (as defined in the Amended Credit Agreement) (the Credit Agreement Leverage Ratio ) as of the end of each fiscal quarter. We also paid a commitment fee on the amount of the unutilized commitments under the Amended Credit Agreement. The amount of the commitment fee was determined based on the Credit Agreement Leverage Ratio as of the end of each quarter.

The effective interest rate on our borrowings under the Financing Agreement, the Amended Credit Agreement or the credit agreement that was in effect prior to the Amended Credit Agreement, as applicable, was approximately:

4.90% per annum in the year ended December 31, 2014;

3.60% per annum in the year ended December 31, 2013; and

2.40% per annum in the year ended December 31, 2012.



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The following table sets forth the total amount of interest expense and fees (including the commitment fee and amortized debt discount) that we recognized on our borrowings under the Financing Agreement, the Amended Credit Agreement or the credit agreement that was in effect prior to the Amended Credit Agreement, as applicable, in the periods indicated:

|                           | <b>Year Ended December 31,</b> |             |             |
|---------------------------|--------------------------------|-------------|-------------|
|                           | <b>2014</b>                    | <b>2013</b> | <b>2012</b> |
| Interest expense and fees | \$ 3,761                       | \$ 3,424    | \$ 3,303    |

**PEAKS Trust Senior Debt.** In January 2010, the PEAKS Trust issued the PEAKS Senior Debt in the aggregate principal amount of \$300,000 to investors. Beginning on February 28, 2013, the PEAKS Trust was consolidated in our consolidated financial statements. See Note 8 Variable Interest Entities, for a further discussion of the PEAKS Consolidation. The PEAKS Senior Debt was recorded on our consolidated balance sheet as of February 28, 2013 at its estimated fair value on that date, which was approximately \$226,096. The outstanding principal balance of the PEAKS Senior Debt as of February 28, 2013 was \$257,533. The \$31,437 difference between the estimated fair value and the outstanding principal balance of the PEAKS Senior Debt as of February 28, 2013 was recorded as an accrued discount on our consolidated balance sheet and is being recognized as Interest expense in our Consolidated Statements of Operations using an effective interest rate method over the term of the PEAKS Senior Debt. As of December 31, 2014, the outstanding principal balance of the PEAKS Senior Debt was \$96,918 and the carrying value was \$76,203. We recorded \$37,545 as a current liability as of December 31, 2014, which represented our estimate of the amount of the carrying value that we expect to be due in the 12 months immediately following December 31, 2014.

The PEAKS Senior Debt matures in January 2020 and bears interest at a variable rate based on the LIBOR, plus a 550 basis point margin. The minimum LIBOR rate applied to the PEAKS Senior Debt cannot be less than 2.00%. There are no scheduled principal repayment requirements for the PEAKS Senior Debt prior to the January 2020 maturity date. Under the terms of the PEAKS Program documents, however, amounts received on a monthly basis by the PEAKS Trust that exceed the fees and expenses of the PEAKS Trust then due and the interest then due on the PEAKS Senior Debt are to be paid to reduce the outstanding principal balance of the PEAKS Senior Debt. The assets of the PEAKS Trust (which include, among other assets, the PEAKS Trust Student Loans) serve as collateral for, and are intended to be the principal source of, the repayment of the PEAKS Senior Debt. Payment of the PEAKS Senior Debt may be accelerated by the indenture trustee of the PEAKS Trust or by the holders of the PEAKS Senior Debt in response to certain events of default under the indenture under the PEAKS Program (the PEAKS Indenture ), including, among other things:

a payment default by the PEAKS Trust;

a default in the performance or observation of the PEAKS Trust's covenants, agreements or conditions under the PEAKS Indenture;

a breach of our obligations under the PEAKS Guarantee; and

certain bankruptcy events with respect to the PEAKS Trust or us.

An acceleration of the payment of the PEAKS Senior Debt would result in an acceleration of our obligation to pay the full amount of the PEAKS Senior Debt pursuant to the terms of the PEAKS Guarantee, if the PEAKS Trust was not able to make that payment (and we believe that it is unlikely that the PEAKS Trust would be able to make that payment). The acceleration of our obligation to pay the full amount of the PEAKS Senior Debt, and/or our inability to make that payment, could also result in cross-defaults under the Financing Agreement.

The following table sets forth the total amount of interest expense and discount accretion that we recognized on the PEAKS Senior Debt in the periods indicated:

|                    | <b>Year Ended December 31,</b> |             |
|--------------------|--------------------------------|-------------|
|                    | <b>2014</b>                    | <b>2013</b> |
| Interest expense   | \$ 20,814                      | \$ 21,288   |
| Discount accretion | \$ 6,712                       | \$ 4,926    |

The effective interest rate on the PEAKS Senior Debt was approximately:

10.30% per annum in the year ended December 31, 2014; and

9.90% per annum in the year ended December 31, 2013.

Asset/Liability Ratio. The PEAKS Trust must maintain a minimum required Asset/Liability Ratio. The minimum required Asset/Liability Ratio is 1.05/1.00. The applicable required Asset/Liability Ratio as of each monthly measurement date, however, is based on our compliance, as of the prior quarterly measurement date, with certain metrics specified in the PEAKS Program documents, including maximum leverage ratios and minimum liquidity amounts. If we are not in compliance with those metrics as of the end of a fiscal quarter, the required Asset/Liability Ratio increases to 1.40/1.00, until the monthly measurement date following the end of a succeeding quarter at which we are in compliance with those metrics. As a result of the PEAKS Consolidation and other factors, we were not in compliance with those metrics as of December 31, 2014. For purposes of computing the Asset/Liability Ratio, as of December 31, 2014, the amount of the assets of the PEAKS Trust was \$127,652 and the amount of the liabilities was

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\$96,918. The amounts used to calculate the Asset/Liability Ratio primarily include, for the assets, the contractual balance of the PEAKS Trust Student Loans that have not defaulted, and, for the liabilities, the amount of the contractual balance of the PEAKS Senior Debt .

If the amount of the assets of the PEAKS Trust does not equal or exceed the outstanding PEAKS Senior Debt by the applicable required Asset/Liability Ratio on a monthly measurement date, we are required to make a payment under the PEAKS Guarantee in an amount that would reduce the outstanding principal balance of the PEAKS Senior Debt to the extent necessary to cause the ratio of the assets of the PEAKS Trust to the resulting outstanding PEAKS Senior Debt to equal or exceed the applicable required Asset/Liability Ratio.

As a consequence of the restatement of our unaudited condensed consolidated financial statements in our Quarterly Reports on Form 10-Q for the fiscal quarters ended March 31, 2013, June 30, 2013 and September 30, 2013, certain quarterly reports that we were required to deliver to the indenture trustee of the PEAKS Trust under the PEAKS Guarantee were inaccurate. We delivered corrected quarterly reports to the indenture trustee on October 9, 2014. If we had delivered accurate quarterly reports or, with respect to periods in 2014 through September 30, 2014, delivered quarterly reports to the indenture trustee of the PEAKS Trust, we believe that the indenture trustee would have made payment demands beginning in April 2013, requiring us to make additional payments under the PEAKS Guarantee totaling approximately \$60,340, in the aggregate, in order to maintain an Asset/Liability Ratio of 1.40/1.00. On October 9, 2014, we made a payment under the PEAKS Guarantee of \$50,000, which payment, along with other payments that we made to the PEAKS Trust in the third quarter of 2014, included amounts that would have become due between April 2013 and September 2014, had we delivered accurate quarterly reports. The delivery of inaccurate quarterly reports constituted a breach of the PEAKS Guarantee and an event of default under the PEAKS Indenture. In the event of a default under the PEAKS Indenture, the payment of the entire amount of the PEAKS Senior Debt could be accelerated, which would trigger our obligation to pay the full amount of the PEAKS Senior Debt pursuant to our obligations under the PEAKS Guarantee, additional remedies could be sought against us and there could be a cross-default under the Financing Agreement, any of which would have a material adverse effect on our results of operations, financial condition and cash flows. We believe that the delivery of the corrected quarterly reports and the payments we made under the PEAKS Guarantee through October 9, 2014 satisfied our obligations under the PEAKS Guarantee with respect to these matters and cured the breach of the PEAKS Guarantee and event of default under the PEAKS Indenture. We cannot predict, however, whether the holders of the PEAKS Senior Debt will assert other breaches of the PEAKS Guarantee by us or that any breach of the PEAKS Guarantee or event of default under the PEAKS Indenture was not properly cured.

In order to cause the PEAKS Trust to maintain the applicable required Asset/Liability Ratio, we made payments of approximately \$156,600 in the year ended December 31, 2014 under the PEAKS Guarantee that were applied by the PEAKS Trust to reduce the amount of the PEAKS Senior Debt. That amount included the:

\$40,000 that we paid in March 2014 pursuant to the PEAKS Letter Agreement, which was applied primarily to make a mandatory prepayment of the PEAKS Senior Debt (see Note 8 Variable Interest Entities for a further discussion of the PEAKS Letter Agreement);

payments totaling approximately \$51,700 that we made from July 2014 through September 2014 to satisfy our obligations under the PEAKS Guarantee with respect to the increased minimum required Asset/Liability Ratio in prior periods; and

payments totaling approximately \$64,900 that we made from October 2014 through December 2014 to satisfy our obligations under the PEAKS Guarantee with respect to the increased minimum required Asset/Liability Ratio in the current and prior periods.

We also made additional payments under the PEAKS Guarantee in the year ended December 31, 2014 that were not related to maintaining the required Asset/Liability Ratio. See Note 15 Commitments and Contingencies, for a further discussion of the payments made under the PEAKS Program in the year ended December 31, 2014.

The following table sets forth the estimated principal payments on the PEAK Senior Debt in the periods indicated:

| <b>Fiscal Year Ending December 31,</b> | <b>Amount</b>    |
|--|------------------|
| 2015                                   | \$ 37,545        |
| 2016                                   | 12,226           |
| 2017                                   | 8,830            |
| 2018                                   | 9,678            |
| 2019                                   | 10,673           |
| 2020                                   | 17,966           |
| <b>Total</b>                           | <b>\$ 96,918</b> |

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The following table sets forth the components of the provision for income taxes in the periods indicated:

|   | <b>Year Ended December 31,</b> |                    |                    |
|---|--------------------------------|--------------------|--------------------|
|   | <b>2014</b>                    | <b>2013</b>        | <b>2012</b>        |
| <b>Current income tax expense:</b>                |                                |                    |                    |
| U.S. federal                                      | \$ (21,345)                    | \$ 39,279          | \$ 126,585         |
| State and local                                   | (227)                          | 4,611              | 22,004             |
| <b>Total</b>                                      | <b>\$ (21,572)</b>             | <b>\$ 43,890</b>   | <b>\$ 148,589</b>  |
| <b>Deferred income tax (benefit):</b>             |                                |                    |                    |
| U.S. federal                                      | \$ 39,227                      | \$ (46,345)        | \$ (51,145)        |
| State and local                                   | 2,742                          | (7,757)            | (8,426)            |
| <b>Total</b>                                      | <b>\$ 41,969</b>               | <b>\$ (54,102)</b> | <b>\$ (59,571)</b> |
| <b>Total provision (benefit) for income taxes</b> | <b>\$ 20,397</b>               | <b>\$ (10,212)</b> | <b>\$ 89,018</b>   |

We recognized approximately \$5,687 of state income tax benefit in the year ended December 31, 2014, as a result of state operating losses.

We are not required to include the Consolidated VIEs in our consolidated income tax returns. Therefore, we did not recognize income tax expense or benefit for the Consolidated VIEs in the provision for income taxes included in our Consolidated Statements of Operations for the years ended December 31, 2014 and 2013. The effect of the exclusion of the Consolidated VIEs from our income tax provision is shown in the reconciliation of our effective income tax rate as a percentage of income shown below.

The following table sets forth the components of our deferred income tax assets (liabilities) as of the dates indicated:

|   | <b>As of December 31,</b> |                    |
|---|---------------------------|--------------------|
|   | <b>2014</b>               | <b>2013</b>        |
| Deferral of book costs                  | \$ (1,575)                | \$ (1,748)         |
| Property and equipment                  | 0                         | (1,807)            |
| Pension                                 | (11,113)                  | (10,566)           |
| Other                                   | (1,972)                   | (1,189)            |
| <b>Gross deferred tax (liabilities)</b> | <b>\$ (14,660)</b>        | <b>\$ (15,310)</b> |
| Deferred revenue                        | \$ 10,082                 | \$ 10,902          |
| Accounts receivable                     | 910                       | 3,551              |
| Property and equipment                  | 2,495                     | 0                  |
| Legal accrual                           | 5,796                     | 3,455              |
| Compensation and benefits               | 2,410                     | 3,316              |
| Stock-based compensation                | 19,394                    | 20,794             |

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|                                  |                   |                   |
|----------------------------------|-------------------|-------------------|
| Operating leases                 | 2,189             | 2,386             |
| Other assets                     | 9,736             | 8,356             |
| Other contingent liabilities     | 64,236            | 108,423           |
| <b>Gross deferred tax assets</b> | <b>\$ 117,248</b> | <b>\$ 161,183</b> |
| Net deferred income tax asset    | \$ 102,588        | \$ 145,873        |

Our deferred tax assets decreased primarily due to the payments that we made under the PEAKS Guarantee and CUSO RSA, which are deductible for income tax purposes when paid. As a result of these tax-deductible payments, we expect to report a net operating loss on our federal income tax return for the year ended December 31, 2014, which will be carried back to a prior year to reduce the amount of federal taxable income and the income tax liability in that year.

The difference between the U.S. federal statutory income tax rate and our effective income tax rate as a percentage of income in the periods indicated is reconciled in the following table:

|  | <b>Year Ended December 31,</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2014</b>                    | <b>2013</b> | <b>2012</b> |
| U.S. federal statutory income tax rate     | 35.0%                          | (35.0%)     | 35.0%       |
| Rate differential on VIEs                  | 0.8%                           | 11.9%       | 0%          |
| State income taxes, net of federal benefit | 3.1%                           | (5.6%)      | 3.4%        |
| Permanent book/tax differences             | 2.5%                           | 2.8%        | 0.9%        |
| Other                                      | (0.3%)                         | (1.5%)      | (0.3%)      |
| Effective income tax rate                  | 41.1%                          | (27.4%)     | 39.0%       |

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The following table sets forth the activity with respect to our unrecognized tax benefits in the period indicated:

|   | <b>Year Ended December 31,</b> |             |             |
|---|--------------------------------|-------------|-------------|
|   | <b>2014</b>                    | <b>2013</b> | <b>2012</b> |
| Balance as of January 1                       | \$ 22,291                      | \$ 20,690   | \$ 22,050   |
| Increases (decreases) from:                   |                                |             |             |
| Tax positions taken during a prior period     | 5,620                          | 1,675       | 195         |
| Tax positions taken during the current period | 537                            | 870         | 759         |
| Settlements with taxing authorities           | (2,551)                        | 186         | (1,027)     |
| Lapse of statute of limitations               | (997)                          | (1,130)     | (1,287)     |
| Balance as of December 31                     | \$ 24,900                      | \$ 22,291   | \$ 20,690   |

The amount of unrecognized tax benefits that, if recognized, would have affected our effective tax rate as of December 31, 2014 was \$11,109. We may resolve certain federal and state income tax matters presently under examination within the 12 months immediately following the date of this filing. As of December 31, 2014, we estimated that it was reasonably possible that unrecognized tax benefits, excluding interest and penalties, could decrease in an amount ranging from \$0 to \$6,932 in the 12 months immediately following the date of this filing due to the resolution of those matters. The amount of interest and penalties related to unrecognized tax benefits accrued on our Consolidated Balance Sheets was \$6,135 as of December 31, 2014 and \$6,371 as of December 31, 2013. In each of the years ended December 31, 2014, 2013 and 2012, the amount of interest expense and penalties related to our unrecognized tax benefits that we recognized in our Consolidated Statements of Operations was not significant.

We file income tax returns in the United States (federal) and in various state and local jurisdictions. As of December 31, 2014, our federal, state or local income tax returns were no longer subject to examination for tax years prior to 2010, except in nine states where our income tax returns are still subject to examinations for tax year 2009 and one state where our income tax return is still subject to examination for the tax year 2008.

**14. Employee Benefit Plans**

**Employee Pension Benefits.** Our ESI Pension Plan, a non-contributory defined benefit pension plan, commonly referred to as a cash balance plan, covers substantially all of our employees who began their employment with us prior to June 2, 2003. This plan provides benefits based on an employee's annual earnings times an established percentage of pay determined by the employee's age and years of benefit service. Effective June 2, 2003, we closed participation in the ESI Pension Plan to all new employees. Employees who begin their employment with us on or after June 2, 2003 do not participate in the ESI Pension Plan.

Our ESI Excess Pension Plan, a nonqualified, unfunded retirement plan, covers a select group of our management. The purpose of the ESI Excess Pension Plan is to restore benefits earned, but not available, to eligible employees under the ESI Pension Plan due to federal statutory limitations on the amount of benefits that can be paid and compensation that may be recognized under a tax-qualified retirement plan.

The benefit accruals under the ESI Pension Plan and the ESI Excess Pension Plan for all participants in those plans were frozen effective March 31, 2006, such that no further benefits accrue under those plans after March 31, 2006. Participants in those plans, however, continue to be credited with vesting service and interest according to the terms of

the ESI Pension Plan and the ESI Excess Pension Plan.

The information presented below is based on an actuarial valuation date as of December 31, 2014 and 2013.

The following table sets forth the change in projected benefit obligation for the periods indicated:

|   | <b>Year Ended December 31,</b> |             |
|---|--------------------------------|-------------|
|   | <b>2014</b>                    | <b>2013</b> |
| Projected benefit obligation at beginning of year | \$ 49,412                      | \$ 57,246   |
| Service cost                                      | 0                              | 0           |
| Actuarial (gain) loss                             | 4,742                          | (5,345)     |
| Interest cost                                     | 1,993                          | 1,756       |
| Benefits paid                                     | (3,727)                        | (4,245)     |
| Plan amendments                                   | 0                              | 0           |
| <br>  |                                |             |
| Projected benefit obligation at end of year       | \$ 52,419                      | \$ 49,412   |
| Fair value of plan assets at end of year          | 81,130                         | 76,710      |
| <br>  |                                |             |
| Funded status at end of year                      | \$ 28,711                      | \$ 27,298   |

Our accumulated benefit obligation was \$52,419 at December 31, 2014 and \$49,412 at December 31, 2013.

The following table sets forth the funded status of our defined benefit plans that was recognized on our Consolidated Balance Sheets as of the dates indicated:

|                           | <b>As of December 31,</b> |             |
|---------------------------|---------------------------|-------------|
|                           | <b>2014</b>               | <b>2013</b> |
| Non-current assets        | \$ 29,028                 | \$ 27,584   |
| Non-current (liabilities) | (317)                     | (286)       |
| <br>                      |                           |             |
| Total                     | \$ 28,711                 | \$ 27,298   |



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The weighted-average assumptions used to determine benefit obligations as of December 31, 2014 and 2013 are as follows:

|                               | 2014  | 2013  |
|-------------------------------|-------|-------|
| Discount rate                 | 3.25% | 4.25% |
| Rate of compensation increase | N/A   | N/A   |

The following table sets forth the change in the fair value of plan assets for the periods indicated:

|  | Year Ended December 31, |           |
|--|-------------------------|-----------|
|  | 2014                    | 2013      |
| Fair value of plan assets at beginning of year | \$ 76,710               | \$ 64,390 |
| Actual return on plan assets                   | 8,147                   | 16,565    |
| Employer contributions                         | 0                       | 0         |
| Benefits paid                                  | (3,727)                 | (4,245)   |
| Fair value of plan assets at end of year       | \$ 81,130               | \$ 76,710 |

The following tables set forth the fair value of total plan assets by major asset category as of the dates indicated:

| Asset Category                         | Total     | Fair Value Measurements as of December 31, 2014                               |  |  |
|--|-----------|---|--|--|
|  |           | (Level 1)<br>Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets | (Level<br>2)<br>Significant<br>Other<br>Observable<br>Inputs | (Level 3)<br>Significant<br>Unobservable<br>Inputs |
| Cash and cash equivalents              | \$ 995    | \$ 995  | \$ 0   | \$ 0   |
| Fixed income securities <sup>(a)</sup> | 9,258     | 9,258   | 0  | 0  |
| Equity securities:                     |           |   |  |  |
| Domestic large cap                     | 45,137    | 45,137  | 0  | 0  |
| Mid cap value/growth <sup>(a)</sup>    | 13,725    | 13,725  | 0  | 0  |
| Small cap value/growth <sup>(a)</sup>  | 7,894     | 7,894   | 0  | 0  |
| Foreign equities                       | 4,121     | 4,121   | 0  | 0  |
| Total                                  | \$ 81,130 | \$ 81,130   | \$ 0   | \$ 0   |

(a) Mutual funds.

**Fair Value Measurements as of December 31, 2013**

| <b>Asset Category</b>                  | <b>Total</b>     | <b>(Level 1)<br/>Quoted Prices<br/>in Active<br/>Markets for<br/>Identical<br/>Assets</b> | <b>(Level 2)<br/>Significant<br/>Other<br/>Observable<br/>Inputs</b> | <b>(Level 3)<br/>Significant<br/>Unobservable<br/>Inputs</b> |
|--|------------------|---|--|--|
| Cash and cash equivalents              | \$ 934           | \$ 934  | \$ 0   | \$ 0   |
| Fixed income securities <sup>(a)</sup> | 12,596           | 12,596  | 0  | 0  |
| <b>Equity securities:</b>              |                  |   |  |  |
| Domestic large cap                     | 40,669           | 40,669  | 0  | 0  |
| Mid cap value/growth <sup>(a)</sup>    | 12,610           | 12,610  | 0  | 0  |
| Small cap value/growth <sup>(a)</sup>  | 7,163            | 7,163   | 0  | 0  |
| Foreign equities                       | 2,738            | 2,738   | 0  | 0  |
| <b>Total</b>                           | <b>\$ 76,710</b> | <b>\$ 76,710</b>  | <b>\$ 0</b>  | <b>\$ 0</b>  |

(a) Mutual funds.

We used quoted prices in active markets for identical assets as of the measurement dates to value our plan assets that were categorized as Level 1.

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The following table sets forth the amounts in Accumulated other comprehensive income on our Consolidated Balance Sheets that have not been recognized as components of net periodic pension benefit cost as of the dates indicated:.

|   | <b>As of December 31,</b> |                 |
|---|---------------------------|-----------------|
|   | <b>2014</b>               | <b>2013</b>     |
| Net actuarial (loss)  | \$ (2,169)                | \$ (546)        |
| Prior service credit  | 4,023                     | 5,578           |
| <b>Total accumulated other comprehensive income</b>             | <b>\$ 1,854</b>           | <b>\$ 5,032</b> |
| Income tax (expense)  | (653)                     | (1,886)         |
| <b>Total accumulated other comprehensive income, net of tax</b> | <b>\$ 1,201</b>           | <b>\$ 3,146</b> |

The following table sets forth the changes in the components of Accumulated other comprehensive income on our Consolidated Balance Sheets in the fiscal years ended December 31, 2013 and 2014:

|                                     | <b>Defined Benefit Pension Items</b>                             |   |  |
|-------------------------------------|--|---|--|
|                                     | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Income (Loss)</b> | <b>Income Tax<br/>Benefit<br/>(Expense)</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Income (Loss) Net<br/>of Income Tax</b> |
| Balance at December 31, 2012        | \$ (13,058)  | \$ 5,128                                    | \$ (7,930)   |
| Net actuarial gain                  | 17,566   | (6,811)                                     | 10,755   |
| Settlement gain                     | 42   | (17)  | 25   |
| Amortization of:                    |  |   |  |
| Actuarial (gains)/losses            | 2,037  | (790)                                       | 1,247  |
| Prior service costs/(credits)       | (1,555)  | 604   | (951)  |
| <b>Balance at December 31, 2013</b> | <b>\$ 5,032</b>  | <b>\$ (1,886)</b>                           | <b>\$ 3,146</b>  |
| Net actuarial (loss)                | (1,760)  | 683   | (1,077)  |
| Settlement gain                     | 137  | (53)  | 84   |
| Amortization of:                    |  |   |  |
| Actuarial (gains)/losses            | 0  | 0   | 0  |
| Prior service costs/(credits)       | (1,555)  | 603   | (952)  |
| <b>Balance at December 31, 2014</b> | <b>\$ 1,854</b>  | <b>\$ (653)</b>                             | <b>\$ 1,201</b>  |

The reclassification of prior service costs or credits, actuarial gains or losses and settlement gains or losses from Accumulated other comprehensive income are included in the computation of net periodic pension benefit cost (income). Net periodic pension benefit cost (income) was included in compensation expense in Cost of educational services and Student services and administrative expenses in our Consolidated Statements of Operations in the fiscal years ended December 31, 2014 and 2013.

The following table sets forth the components of net periodic pension benefit (income) in the periods indicated:

|   | <b>Year Ended December 31,</b> |                |              |
|---|--------------------------------|----------------|--------------|
|   | <b>2014</b>                    | <b>2013</b>    | <b>2012</b>  |
| Interest cost                                   | \$ 1,993                       | \$ 1,756       | \$ 2,062     |
| Expected return on assets                       | (5,164)                        | (4,344)        | (4,231)      |
| Recognized net actuarial loss                   | 0                              | 2,037          | 2,718        |
| Amortization of prior service (credit) cost     | (1,555)                        | (1,555)        | (1,555)      |
| Settlement loss                                 | 137                            | 42             | 792          |
| <br>Total net periodic pension benefit (income) | <br>\$ (4,589)                 | <br>\$ (2,064) | <br>\$ (214) |

The benefit accruals under the ESI Pension Plan and ESI Excess Pension Plan were frozen effective March 31, 2006. As a result, no service cost has been included in the net periodic pension benefit income.

The following table sets forth the amounts related to changes in plan assets and projected benefit obligations that were recognized in other comprehensive (income) loss in the periods indicated:

|   | <b>Year Ended December 31,</b> |                 |                |
|---|--------------------------------|-----------------|----------------|
|   | <b>2014</b>                    | <b>2013</b>     | <b>2012</b>    |
| Net actuarial (gain) loss   | \$ 1,760                       | \$ (17,566)     | \$ (621)       |
| Amortization of net actuarial loss  | 0                              | (2,037)         | (2,718)        |
| Prior service cost (credit)   | 0                              | 0               | 0              |
| Amortization of prior service cost (credit)   | 1,555                          | 1,555           | 1,555          |
| Settlement  | (137)                          | (42)            | (792)          |
| <br>Other comprehensive (income) loss   | <br>\$ 3,178                   | <br>\$ (18,090) | <br>\$ (2,576) |
| <br>Total recognized in net periodic pension benefit (income) and other comprehensive (income) loss | <br>\$ (1,411)                 | <br>\$ (20,154) | <br>\$ (2,790) |

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The amortization of any prior service cost is determined using a straight-line amortization of the cost over the average remaining service period for employees expected to receive benefits under the pension plans. The estimated net actuarial loss that is expected to be amortized from accumulated other comprehensive income and recognized in net periodic pension benefit cost for the year ended December 31, 2015 is \$0 and the estimated prior service credit that is expected to be amortized from accumulated other comprehensive income and recognized in net periodic pension benefit cost for the year ended December 31, 2015 is \$1,555.

The weighted-average assumptions used to determine net periodic pension benefit cost in the years ended December 31, 2014, 2013 and 2012 are as follows:

|  | 2014  | 2013  | 2012  |
|--|-------|-------|-------|
| Discount rate                            | 4.25% | 3.25% | 4.00% |
| Expected long-term return on plan assets | 7.00% | 7.00% | 7.50% |
| Rate of compensation increase            | N/A   | N/A   | N/A   |

The following table sets forth the benefit payments that we expect to pay from the pension plans in the periods indicated:

| Year               | Amount    |
|--------------------|-----------|
| Fiscal 2015        | \$ 4,291  |
| Fiscal 2016        | \$ 4,266  |
| Fiscal 2017        | \$ 4,115  |
| Fiscal 2018        | \$ 3,775  |
| Fiscal 2019        | \$ 3,416  |
| Fiscal 2020 - 2024 | \$ 15,890 |

We invest plan assets based on a total return on investment approach, pursuant to which the plan assets include a diversified blend of equity and fixed income investments toward a goal of maximizing the long-term rate of return without assuming an unreasonable level of investment risk. We determine the level of risk based on an analysis of plan liabilities, the extent to which the value of the plan assets satisfies the plan liabilities and our financial condition. Our investment policy includes target allocations ranging from 30% to 70% for equity investments, 20% to 60% for fixed income investments and 0% to 50% for cash equivalents. Actual asset allocations may vary from the targeted allocations for various reasons, including market conditions and the timing of transactions. The equity portion of the plan assets represents growth and value stocks of small, medium and large companies. We measure and monitor the investment risk of the plan assets both on a quarterly basis and annually when we assess plan liabilities.

We use a building block approach to estimate the long-term rate of return on plan assets. This approach is based on the capital market principle that the greater the volatility, the greater the return over the long term. An analysis of the historical performance of equity and fixed income investments, together with current market factors such as the inflation and interest rates, are used to help us make the assumptions necessary to estimate a long-term rate of return on plan assets. Once this estimate is made, we review the portfolio of plan assets and make adjustments thereto that we believe are necessary to reflect a diversified blend of equity and fixed income investments that is capable of achieving the estimated long-term rate of return without assuming an unreasonable level of investment risk. We also compare the portfolio of plan assets to those of other pension plans to help us assess the suitability and appropriateness of the plan investments.

We determine our discount rate by performing a yield curve analysis based on a portfolio of high-quality fixed income investments with various maturities. Our expected future benefit payments are discounted to their present value at the appropriate yield curve rate to generate the overall discount rate for pension obligations.

In 2014 and 2013, we made no contributions to the ESI Excess Pension Plan or the ESI Pension Plan. We do not expect to make any contributions to either the ESI Pension Plan or the ESI Excess Pension Plan in 2015.

**Retirement Savings Plan.** Our ESI 401(k) Plan, a defined contribution plan, covers substantially all of our employees. All of our contributions under the ESI 401(k) Plan are in the form of cash to plan investment options directed by the participant.

On July 1, 2013, we changed the rate at which we made contributions to the ESI 401(k) Plan on behalf of our employees. Prior to July 1, 2013, we contributed 100% of the first 1% and 50% of the next 4% of an employee's salary that the employee contributed to his or her ESI 401(k) Plan account. Beginning July 1, 2013, we contribute 50% of the first 6% of an employee's salary that the employee contributes to his or her ESI 401(k) Plan account.

Our ESI Excess Savings Plan, a nonqualified, unfunded deferred compensation plan, covers a select group of our management. The plan provided for salary deferral of contributions that the participants were unable to make under the ESI 401(k) Plan and our contributions that could not be paid under the ESI 401(k) Plan due to federal statutory limits on the amount that an employee could contribute under a defined contribution plan. Effective for plan years beginning on and after January 1, 2008, we froze the ESI

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Excess Savings Plan, such that employees may no longer make salary deferrals and we will no longer make contributions under the ESI Excess Savings Plan. Amounts previously credited to an employee under the ESI Excess Savings Plan will, however, continue to accrue interest in accordance with the terms of the ESI Excess Savings Plan, until those amounts are distributed pursuant to the plan's terms.

The costs of providing the benefits under the ESI 401(k) Plan and ESI Excess Savings Plan (including certain administrative costs of the plans) were approximately:

\$3,073 in the year ended December 31, 2014;

\$3,454 in the year ended December 31, 2013; and

\$4,597 in the year ended December 31, 2012.

**15. Commitments and Contingencies**

As part of our normal operations, one of our insurers issues surety bonds for us that are required by various education authorities that regulate us. We are obligated to reimburse our insurer for any of those surety bonds that are paid by the insurer. As of December 31, 2014, the total face amount of those surety bonds was approximately \$19,000. As of December 31, 2014, we also had caused approximately \$2,352 of letters of credit to be issued to our workers compensation insurers and one of our state regulatory agencies.

Our institutions' failure to submit their 2013 audited consolidated financial statements and the 2013 compliance audits of their administration of the Title IV Programs in which they participate ( Compliance Audits ) to the ED by the due date resulted in sanctions imposed by the ED on our institutions that included, among other things, our institutions having to submit a letter of credit payable to the ED. We caused the ED Letter of Credit in the amount of \$79,708 to be issued on October 31, 2014. The term of the ED Letter of Credit ends on November 4, 2019. As of December 31, 2014, the total amount of the outstanding letters of credit that we have caused to be issued was \$82,060.

The ED Letter of Credit provides that the ED may draw on the ED Letter of Credit upon certification by the ED that the drafted funds will be used for one or more of the following purposes:

to pay refunds of institutional or non-institutional charges owed to or on behalf of current or former students of our institutions, whether our institutions remain open or have closed;

to provide for the teach-out of students enrolled at the time of closure of our institutions; and

to pay any liabilities owing to the ED arising from acts or omissions by our institutions, on or before the expiration of the ED Letter of Credit, in violation of requirements set forth in the HEA, including the violation of any agreement entered into by our institutions with the ED regarding the

administration of Title IV Programs.

**Lease Commitments.** We lease our non-owned facilities under operating lease agreements. A majority of the operating leases contain renewal options that can be exercised after the initial lease term. Renewal options are generally for periods of one to five years. All operating leases will expire over the next nine years and we expect that:

most of those leases will be renewed or replaced by other leases in the normal course of business;

we may purchase the facilities represented by those leases; or

we may purchase or build other replacement facilities.

There are no material restrictions imposed by the lease agreements, and we have not entered into any significant guarantees related to the leases. We are required to make additional payments under the operating lease terms for taxes, insurance and other operating expenses incurred during the operating lease period.

Rent expense under our operating leases was:

\$46,268 in the year ended December 31, 2014;

\$53,212 in the year ended December 31, 2013; and

\$50,817 in the year ended December 31, 2012.

Future minimum rental payments required under our operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of December 31, 2014 are as follows:

|                     |                   |
|---------------------|-------------------|
| 2015                | \$ 41,207         |
| 2016                | 36,226            |
| 2017                | 27,617            |
| 2018                | 21,529            |
| 2019                | 15,235            |
| 2020 and thereafter | 8,144             |
|                     | <b>\$ 149,958</b> |



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Future minimum rental payments related to equipment leases are not significant.

**Claims and Contingencies.** We are also subject to various claims and contingencies, including those related to litigation, government investigations, business transactions, guarantee arrangements and employee-related matters, among others. We record a liability for those claims and contingencies, if it is probable that a loss will result and the amount of the loss can be reasonably estimated. Although we believe that our estimates related to any claims and contingencies are reasonable, we cannot make any assurances with regard to the accuracy of our estimates, and actual results could differ materially.

The following table sets forth the components of our recorded liability related to our claims and contingencies and where the amounts were included on our Consolidated Balance Sheets as of the dates indicated:

|                           | <b>As of December 31,</b> |                   |
|---------------------------|---------------------------|-------------------|
|                           | <b>2014</b>               | <b>2013</b>       |
| CUSO RSA                  | \$ 0                      | \$ 116,923        |
| Other                     | 15,574                    | 8,957             |
| <b>Total</b>              | <b>\$ 15,574</b>          | <b>\$ 125,880</b> |
| Other current liabilities | \$ 14,976                 | \$ 25,893         |
| Other liabilities         | 598                       | 99,987            |
| <b>Total</b>              | <b>\$ 15,574</b>          | <b>\$ 125,880</b> |

Other current liabilities primarily represented our estimate of the loss that we believed we would realize during the 12-month period following the dates indicated. The amounts included in Other liabilities primarily related to our estimated contingent liability for the CUSO RSA as of December 31, 2013 (prior to the CUSO Consolidation) and represented our estimate of the loss that we believed we would realize after the 12-month period following the dates indicated and over a period that could exceed ten years. See below for a discussion of the method by which we determined the amount of the contingent liability that we recorded related to our guarantee obligations under the CUSO RSA prior to the CUSO Consolidation.

The following table sets forth the activity with respect to our recorded liability related to our claims and contingencies in the periods indicated:

|                             | <b>Year Ended</b>   |             |
|-----------------------------|---------------------|-------------|
|                             | <b>December 31,</b> |             |
|                             | <b>2014</b>         | <b>2013</b> |
| Balance as of January 1     | \$ 125,880          | \$ 126,978  |
| Increases (decreases) from: |                     |             |
| Additional accruals:        |                     |             |
| CUSO RSA                    | 2,019               | 90,964      |
| Other                       | 36,634              | 18,768      |
|                             | (29,542)            | (14,730)    |

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|  |           |            |
|--|-----------|------------|
| Payments, other, net of recoveries owed of \$475 and \$574 <sup>(1)</sup>      |           |            |
| Payments under CUSO RSA, net of recoveries of \$466 and \$103 <sup>(2)</sup>   | (9,139)   | (2,600)    |
| Payments under PEAKS Guarantee, net of estimated recoveries of \$0 and \$1,408 | (159,255) | (1,005)    |
| Payments on Behalf of Borrowers  | (1,832)   | (11,499)   |
| Settlement payment 2007 RSA  | 0         | (46,000)   |
| Elimination of PEAKS Trust intercompany transactions <sup>(3)</sup>            | 161,087   | 11,118     |
| Elimination of PEAKS Guarantee accrual <sup>(4)</sup>                          | 0         | (46,114)   |
| Elimination of CUSO intercompany transactions <sup>(5)</sup>                   | 4,583     | 0          |
| Elimination of CUSO RSA accrual <sup>(6)</sup>                                 | (114,861) | 0          |
| Balance as of December 31  | \$ 15,574 | \$ 125,880 |

- (1) Consists of payments for legal and other contingencies, net of recoveries from charged-off loans made under the CUSO Program that were owed, but had not been remitted, to us.
- (2) Consists of payments made under the CUSO RSA, net of recoveries from charged-off CUSO Student Loans that we received or offset against payments owed under the CUSO RSA.
- (3) We consolidated the PEAKS Trust in our consolidated financial statements as of February 28, 2013 and, as a result, we eliminated from our consolidated financial statements the amount of payments under the PEAKS Guarantee and Payments on Behalf of Borrowers that we made following the PEAKS Consolidation. See Note 8 Variable Interest Entities, for a further discussion of the PEAKS Consolidation.
- (4) As a result of the PEAKS Consolidation, we eliminated from our consolidated financial statements the contingent liability related to the PEAKS Guarantee that we had previously recorded.

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- (5) We consolidated the CUSO in our consolidated financial statements as of September 30, 2014 and, as a result, we eliminated from our consolidated financial statements the amount of payments under the CUSO RSA that we made following the CUSO Consolidation. See Note 8 Variable Interest Entities, for a further discussion of the CUSO Consolidation.
- (6) As a result of the CUSO Consolidation, we eliminated from our consolidated financial statements the contingent liability related to the CUSO RSA that we had previously recorded.

We had guaranteed the repayment of private education loans made by a lender to our students in 2007 and early 2008 (the 2007 RSA ) that the lender charged off above a certain percentage of the total dollar volume of private education loans made under the 2007 RSA. In January 2013, we paid \$46,000 in a settlement to absolve us from any further obligations with respect to our guarantee obligations under the 2007 RSA, which amount is included in the Settlement payment 2007 RSA line item in the year ended December 31, 2013 in the table above.

Prior to the CUSO Consolidation, in order to determine the amount of the contingent liability to record related to our guarantee obligations under the CUSO RSA, we utilized estimates of, among other things, the projected repayment performance of the private education loans made under the CUSO Program, which projections involved numerous assumptions. We consulted with third-party consumer credit consulting firms in developing certain repayment assumptions. Based on those projections and other factors, we estimated the amount of payments that we expected to make and the amounts that we expected to be repaid to us.

In connection with determining the amount of the contingent liability to record related to our guarantee obligations under the CUSO RSA prior to the CUSO Consolidation, we also considered the payment options available to us under the CUSO Program, including our ability to make Discharge Payments under the CUSO RSA. To the extent that we projected that we would have sufficient funds available to make Discharge Payments under the CUSO RSA, we incorporated an assumption that we would make Discharge Payments into our estimate of the amount of payments that we expected to make when determining the contingent liability. If we did not believe that we would have sufficient funds available to make Discharge Payments, we assumed that we would make Regular Payments to satisfy our obligations under the CUSO RSA. We discounted the amount of those expected future monthly Regular Payments at a risk-free rate of interest. Making Discharge Payments results in us paying a lesser amount than we otherwise would have been required to pay under our guarantee obligations in future periods under the CUSO RSA and, therefore, results in an estimated contingent liability amount that is less than if we had assumed that we would make Regular Payments in future periods.

Under the CUSO RSA, we are entitled to all amounts that the CUSO recovers from loans in a particular loan pool made under the CUSO Program that have been charged off, until all payments that we made under the CUSO RSA with respect to that loan pool have been repaid to us by the CUSO. We discounted the amounts of recoveries that we expected would be repaid to us under the CUSO RSA at a risk-free rate of interest. The difference between the amount of the discounted guarantee payments that we expected to make and the discounted amount that we expected would be repaid to us under the CUSO RSA is recorded as the amount of our estimated contingent liability related to our guarantee obligations under the CUSO RSA, prior to the CUSO Consolidation.

In connection with estimating our recorded liability for claims and contingencies as of December 31, 2014 and 2013, we considered whether additional losses for claims and contingencies were reasonably possible, could be estimated and might be material to our financial condition, results of operations or cash flows. As with any estimate, as facts and circumstances change, the recorded liability and estimated range of reasonably possible losses could change significantly. With respect to legal proceedings, we determined that we cannot provide an estimate of the possible losses, or the range of possible losses, in excess of the amount, if any, accrued, for various reasons, including but not limited to some or all of the following:

there are significant factual issues to be resolved;

there are novel or unsettled legal issues presented;

the proceedings are in the early stages;

there is uncertainty as to the likelihood of a class being certified or decertified or the ultimate size and scope of the class;

there is uncertainty as to the outcome of pending appeals or motions; and

in many cases, the plaintiffs have not specified damages in their complaint or in court filings.

We have presented legal and professional fees related to certain lawsuits, investigations and accounting matters as a separate line item in our Consolidated Statements of Operations. The amounts included in this line item represent expenses for various lawsuits, investigations and accounting matters that we believe are not representative of those normally incurred in the ordinary course of business. Certain of those lawsuits and investigations are described in detail, below. The expenses for the accounting matters included in this line item relate primarily to services identified as relating to accounting for, and the audit work performed in connection with, the consolidation of the PEAKS Trust and the restatement of our 2013 quarterly consolidated financial statements.

***Guarantees. PEAKS Guarantee and Purchase Obligation.*** Under the PEAKS Guarantee, we guarantee payment of the principal and interest owed on the PEAKS Senior Debt, the administrative fees and expenses of the PEAKS Trust and a minimum required Asset/Liability Ratio. The PEAKS Guarantee contains, among other things, representations and warranties and events of default that we believe are customary for guarantees of this type. In addition, under the PEAKS Program, some or all of the holders

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of the PEAKS Senior Debt could require us to purchase their PEAKS Senior Debt, if the law is changed to reduce the maximum allowable percentage of our annual revenue derived from Title IV Program funds from 90% to 75% or less. At this time, we believe that the likelihood of such a change in the law is remote. Our guarantee and purchase obligations under the PEAKS Program remain in effect until the PEAKS Senior Debt and the PEAKS Trust's fees and expenses are paid in full. At such time, we will be entitled to repayment of the amount of any payments we made under the PEAKS Guarantee (which do not include Payments on Behalf of Borrowers) to the extent that funds are remaining in the PEAKS Trust. The PEAKS Senior Debt matures in January 2020 and, therefore, we do not expect to begin receiving any repayment of amounts that we previously paid under the PEAKS Guarantee until February 2020.

We concluded that we were required to consolidate the PEAKS Trust in our consolidated financial statements beginning on February 28, 2013. See Note 8 Variable Interest Entities, for a further discussion of the PEAKS Consolidation. As a result, the assets and liabilities of the PEAKS Trust have been included on, and all intercompany transactions have been eliminated from, our Consolidated Balance Sheets as of December 31, 2014 and 2013. While we no longer record a contingent liability for the PEAKS Guarantee on our Consolidated Balance Sheet beginning on February 28, 2013, our obligations under the PEAKS Guarantee remain in effect.

*PEAKS Program Payments in 2014.* In the year ended December 31, 2014, we made payments related to the PEAKS Program of approximately \$161,100. Included in this amount were:

the \$40,000 payment we made in March 2014 pursuant to the PEAKS Letter Agreement, which is considered to be a payment under the PEAKS Guarantee;

the payments totaling approximately \$51,700 that we made from July 2014 through September 2014 to satisfy our obligation under the PEAKS Guarantee with respect to the increased minimum required Asset/Liability Ratio in prior periods;

payments totaling approximately \$64,900 that we made from October 2014 through December 2014 to satisfy our obligations under the PEAKS Guarantee with respect to the increased minimum required Asset/Liability Ratio in current and prior periods;

payments totaling approximately \$2,700 that we made from March 2014 through September 2014 to satisfy our obligations under the PEAKS Guarantee with respect to interest owed on the PEAKS Senior Debt and administrative fees and expenses of the PEAKS Trust; and

Payments on Behalf of Borrowers of approximately \$1,800 that we made in January 2014.

See also *PEAKS Program and CUSO RSA Payments in Certain Periods* for additional information regarding certain payments we have made related to the PEAKS Program.

*Projected PEAKS Guarantee Payments.* We believe that it is probable that we will make additional payments under the PEAKS Guarantee and estimate that those payments may be approximately \$29,800 in 2015, \$4,300 in 2016 and \$15,300 in 2020. The vast majority of these payments are expected to reduce the outstanding principal balance of the

PEAKS Senior Debt, which would result in an outstanding principal balance of the PEAKS Senior Debt of approximately \$59,400 as of December 31, 2015 and \$0 as of January 31, 2020. See Note 12 Debt, for a further discussion of the PEAKS Senior Debt. After the PEAKS Senior Debt matures in January 2020, the PEAKS Trust will continue to collect on PEAKS Trust Student Loans that remain in repayment and collect recoveries on PEAKS Trust Student Loans that have been charged off. The only obligation of the PEAKS Trust, at that time, will be the payment of the fees and expenses of the PEAKS Trust. As a result, we believe that, after that time, we may recover from the PEAKS Trust, in the aggregate, approximately \$47,000 of the amount that we have paid or will pay under the PEAKS Guarantee. See below for information regarding the assumptions on which those estimates are based.

The estimated amount and timing of future payments and recoveries with respect to the PEAKS Guarantee discussed above and elsewhere in this report are only estimates, are based on numerous assumptions and are subject to change. As with any estimate, as facts and circumstances change, the estimated amounts and timing could change. We made a number of assumptions in preparing the estimates, which assumptions may not be correct. The assumptions included, among other things, the following:

the repayment performance of the PEAKS Trust Student Loans, the proceeds from which will be used to repay the PEAKS Senior Debt and to pay the fees and expenses of the PEAKS Trust, and the performance of which also affects the Asset/Liability Ratio;

the fact that those loans will consist of a large number of loans of individually immaterial amounts;

the fact that the interest rate on the PEAKS Senior Debt is a variable rate based on the LIBOR plus a margin; and

the amount of fees and expenses of the PEAKS Trust, much of which is based on the principal balance of the PEAKS Trust Student Loans.

CUSO RSA. On February 20, 2009, we entered into the CUSO RSA in connection with the CUSO Program. Under the CUSO RSA, we guarantee the repayment of the principal amount (including capitalized origination fees) and accrued interest payable on any private education loans that are charged off above a certain percentage of the private education loans made under the CUSO Program, based on the annual dollar volume. The total initial principal amount of private education loans that the CUSO purchased under the CUSO Program was approximately \$141,000. No new private education loans were or will be originated under the CUSO

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Program after December 31, 2011, but immaterial amounts related to loans originated prior to that date were disbursed by the lender through June 2012. Our obligations under the CUSO RSA will remain in effect, until all private education loans made under the CUSO Program are paid in full. The standard repayment term for a private education loan made under the CUSO Program is ten years, with repayment generally beginning six months after a student graduates or three months after a student withdraws or is terminated from his or her program of study.

Pursuant to the CUSO RSA, we are required to maintain collateral to secure our guarantee obligation in an amount equal to a percentage of the outstanding balance of the private education loans disbursed to our students under the CUSO Program. As of December 31, 2014 and 2013, the total collateral maintained in a restricted bank account was approximately \$8,600. This amount was included in Collateral deposits on our Consolidated Balance Sheets as of each of those dates. The CUSO RSA also requires that we comply with certain covenants, including that we maintain certain financial ratios which are measured on a quarterly basis and deliver compliance certificates on a quarterly basis setting forth the status of our compliance with those financial ratios. If we are not in compliance with those covenants at the end of each fiscal quarter, we are required to increase the amount of collateral maintained in the restricted bank account to a predetermined amount, until the end of a succeeding quarter at which we are in compliance with those covenants. The predetermined amount is based on the percentage of the aggregate principal balance of the private education loans made under the CUSO Program that exceeds a certain percentage as of the end of each fiscal quarter.

Under the CUSO RSA, we have the right to elect to make Discharge Payments with respect to private education loans made under the CUSO Program that have been charged off. The effect of a making a Discharge Payment related to a private education loan is to reduce the aggregate amount that we may have to pay under our guarantee obligations with respect to that loan. We have claimed as an offset against amounts owed to us under the Revolving Note amounts that would have the effect of discharging our obligations with respect to certain charged off loans under the CUSO RSA. In addition, in the years ended December 31, 2014 and 2013, we made Discharge Payments to the CUSO. Making Discharge Payments results in us paying amounts to the CUSO in advance of when a guarantee payment would be due, which would negatively impact our liquidity in a particular period, but results in us paying a lesser amount than we otherwise would have been required to pay under our guarantee obligation in future periods under the CUSO RSA. See Note 8 Variable Interest Entities, for a further discussion of Discharge Payments.

We concluded that we were required to consolidate the CUSO in our consolidated financial statements beginning on September 30, 2014. See Note 8 Variable Interest Entities, for a further discussion of the CUSO Consolidation. As a result, the assets and liabilities of the CUSO have been included on, and all intercompany transactions have been eliminated from, our Consolidated Balance Sheet as of December 31, 2014. While we no longer record a contingent liability for the CUSO RSA on our Consolidated Balance Sheet beginning on September 30, 2014, our obligations under the CUSO RSA remain in effect.

*CUSO RSA Payments in 2014.* In the year ended December 31, 2014, we made payments under the CUSO RSA of approximately \$9,139. Reflected in this amount were:

Regular Payments of \$7,028;

a Discharge Payment of \$2,577 that we made pursuant to the Fourth Amendment to CUSO RSA (as defined below); and

\$466 in recoveries from charged-off loans that were owed to us from the CUSO and that we applied to reduce the amount payable by us to the CUSO pursuant to our offset right.

In the year ended December 31, 2014, the CUSO did not remit to us \$475 of recoveries from charged-off loans that were owed to us. See also *PEAKS Program and CUSO RSA Payments in Certain Periods* for additional information regarding certain payments we have made related to the CUSO Program.

*CUSO RSA Amendments.* As a consequence of the restatement of our unaudited condensed consolidated financial statements in our Quarterly Reports on Form 10-Q for the fiscal quarters ended March 31, 2013, June 30, 2013 and September 30, 2013, certain quarterly compliance certificates that we were required to deliver to the CUSO under the CUSO RSA were inaccurate. Those inaccuracies did not affect our compliance with the financial ratio covenants in the CUSO RSA as of March 31, 2013. We were not, however, in compliance with certain financial ratio covenants in the CUSO RSA as of June 30, 2013 or subsequent fiscal quarter measurement dates through September 30, 2014. Further, due to our failure to timely file our Annual Report on Form 10-K for the fiscal year ended December 31, 2013 and our Quarterly Reports on Form 10-Q for the fiscal quarters ended March 31, 2014, June 30, 2014 and September 30, 2014, we did not timely deliver the required compliance certificates under the CUSO RSA with respect to those periods. As a result of our noncompliance with certain financial ratio covenants as of June 30, 2013 and subsequent fiscal quarter measurement dates through September 30, 2014, the amount of collateral required to be maintained in the restricted bank account would have been increased by approximately \$2,600. On November 6, 2014, we entered into a Fourth Amendment to the CUSO RSA with the CUSO (the Fourth Amendment to CUSO RSA ). The Fourth Amendment to CUSO RSA provides that we are not required to comply with certain financial ratio covenants under the CUSO RSA that we otherwise would not have been in compliance with from June 30, 2013 through September 30, 2014 and that we did not expect to be in compliance with as of December 31, 2014. In lieu of an increase in the required collateral under the CUSO RSA, we made a payment of \$2,577 to the CUSO on November 12, 2014, pursuant to the Fourth Amendment to CUSO RSA, which payment was considered a Discharge Payment under the CUSO RSA.



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On March 17, 2015, we entered into a Fifth Amendment to the CUSO RSA with the CUSO (the Fifth Amendment to CUSO RSA ). The Fifth Amendment to CUSO RSA provides that we are not required to comply with certain financial ratio covenants under the CUSO RSA that we otherwise would not have been in compliance with from June 30, 2013 through: (i) March 31, 2015 related to our debt service ratio, and (ii) December 31, 2015 related to our current ratio. Additionally, the Fifth Amendment to CUSO RSA provides that for any fiscal quarter end in which the CUSO (or its owned or managed assets) are consolidated into our financial statements that the financial covenant and persistence percentage provisions and the corresponding compliance certificate requirements will be based on our relevant quarterly and annual reports that we file with the SEC, but excluding the effects of any such consolidation. Furthermore, any financial statements for periods ending prior to March 17, 2015 that we are required to deliver to the CUSO, but have not been delivered as of that date, must be delivered to the CUSO on or before May 31, 2015. In lieu of an increase in the required collateral under the CUSO RSA, we made a payment of \$2,709 to the CUSO on March 19, 2015 pursuant to the Fifth Amendment to CUSO RSA, which payment was considered a Discharge Payment under the CUSO RSA.

*Projected CUSO RSA Payments.* We believe that it is probable that we will make additional payments under the CUSO RSA. We are entitled to all amounts that the CUSO recovers from loans in a particular loan pool made under the CUSO Program that have been charged-off, until all amounts that we made under the CUSO RSA with respect to that loan pool have been repaid to us by the CUSO. Pursuant to the CUSO RSA, we have the right to offset amounts that we owe under the CUSO RSA by the amount of recoveries from charged-off loans made under the CUSO Program that are owed, but have not been paid to us. The following table sets forth, in the periods indicated, our projections of the estimated amount of Regular Payments and Discharge Payments that we expect to pay (or that we expect will be owed by us, which amounts could be reduced prior to payment thereof by the amount of recoveries from charged-off loans owed to us as described in the immediately preceding sentence) and the estimated amount of recoveries from charged-off loans that we expect to be paid to us by the CUSO (or that we may utilize to offset a portion of the amounts of Regular Payments or Discharge Payments owed by us):

| <b>Year</b>    | <b>Estimated Regular Payments</b> | <b>Estimated Discharge Payments</b> | <b>Estimated Total Payments</b> | <b>Estimated Recoveries</b> |
|----------------|-----------------------------------|-------------------------------------|---------------------------------|-----------------------------|
| 2015           | \$ 11,723                         | \$ 2,709 <sup>(1)</sup>             | \$ 14,432                       | \$ (1,393)                  |
| 2016           | 15,895                            | 0                                   | 15,895                          | (1,479)                     |
| 2017           | 17,615                            | 0                                   | 17,615                          | (1,545)                     |
| 2018 and later | 0                                 | 78,747                              | 78,747                          | (1,580)                     |
|                | \$ 45,233                         | \$ 81,456                           | \$ 126,689                      | \$ (5,997)                  |

(1) Represents the Discharge Payment of \$2,709 that we made on March 19, 2015 pursuant to the terms of the Fifth Amendment to CUSO RSA.

We believe that the vast majority of the \$78,747 of estimated payments projected to be paid after 2017 will be made by us in 2018. The estimated future payment amounts and timing related to the CUSO RSA assume, among other factors, that we do not make any Discharge Payments in 2015, 2016 or 2017 (other than the Discharge Payment made in March 2015 pursuant to the terms of the Fifth Amendment to CUSO RSA) and do make Discharge Payments to the fullest extent possible in 2018 and later years. If we do not make the Discharge Payments as assumed in 2018 and later years, we estimate that we would make approximately \$100,273 of Regular Payments in 2018 through

approximately 2026. Of this amount, approximately \$18,600 to \$20,000 would be paid annually in each of 2018 through 2021, and approximately \$22,700 in the aggregate, would be paid in 2022 through 2026.

The estimated amount and timing of future payments and recoveries with respect to the CUSO RSA discussed above are only estimates, are based on numerous assumptions and are subject to change. As with any estimate, as facts and circumstances change, the estimated amounts and timing could change. We made a number of assumptions in preparing the estimates, which assumptions may not be correct. The assumptions included, among other things, the following:

the repayment performance of the private education loans made under the CUSO Program;

the timing and rate at which those private education loans will be paid;

the changes in the variable interest rates applicable to those private education loans;

the amounts and timing of collections in the future on those private education loans that have been charged off; and

our ability to utilize the available options for payment of our obligations under the CUSO RSA.

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PEAKS Program and CUSO RSA Payments in Certain Periods. The following table sets forth the approximate aggregate amount of guarantee payments, Discharge Payments and Payments on Behalf of Borrowers that were made related to the PEAKS Program and CUSO RSA and the amount of recoveries from charged-off loans paid to us by the CUSO, in the periods indicated:

| Type of Payment (Receipt)                  | Year Ended December 31, |                         |
|--|-------------------------|-------------------------|
|  | 2014                    | 2013                    |
| Guarantee:                                 |                         |                         |
| PEAKS Program                              | \$ 159,255              | \$ 2,413 <sup>(1)</sup> |
| CUSO RSA Regular Payments                  | 6,562 <sup>(2)(3)</sup> | 1,791                   |
| CUSO RSA Discharge Payments                | 2,577                   | 912                     |
| Payments on Behalf of Borrowers            | 1,832                   | 11,499 <sup>(4)</sup>   |
| CUSO RSA-Recoveries from Charged-Off Loans | 0                       | (103)                   |
| <b>Total</b>                               | <b>\$ 170,226</b>       | <b>\$ 16,512</b>        |

(1) Of this amount, \$854 was paid prior to the PEAKS Consolidation.

(2) This amount is net of \$466 of recoveries from charged-off loans owed to us that we offset against the amount we owed under the CUSO RSA.

(3) Of this amount, \$4,556 was paid prior to the CUSO Consolidation.

(4) Of this amount, \$532 was paid prior to the PEAKS Consolidation.

The CUSO did not remit to us, and we did not offset payments under the CUSO RSA for, the following amounts of recoveries from charged-off loans that were owed to us:

\$475 in the year ended December 31, 2014; and

\$574 in the year ended December 31, 2013.

We recorded the amount of recoveries from charged-off loans that were owed to us, but not paid or offset, as of December 31, 2013 in Prepaid expenses and other current assets on our Consolidated Balance Sheet. The amounts of recoveries from charged-off loans that were owed to us by the CUSO as of December 31, 2014 were not reflected on our consolidated financial statements, since those amounts were intercompany transactions that were eliminated from our financial statements as a result of the CUSO Consolidation.

We also offset the following amounts owed by us under the CUSO RSA against amounts owed to us by the CUSO under the Revolving Note, instead of making additional payments in those amounts:

\$0 in the year ended December 31, 2014; and

\$8,472 in the year ended December 31, 2013.

We recorded all of the amounts that we claimed as offsets against amounts owed to us under the Revolving Note in Other current liabilities on our Consolidated Balance Sheet as of December 31, 2013. The amounts that we claimed as offsets against amounts owed to us under the Revolving Note as of December 31, 2014 were not recorded on our consolidated financial statements, since those amounts were intercompany transactions that were eliminated from our financial statements as a result of the CUSO Consolidation.

In the first quarter of 2013, we notified the CUSO that:

we had determined that the CUSO was in default of its obligations to us under the loan and security agreement pursuant to which the Revolving Note was issued (the CUSO Loan Agreement );

as a result of that default, all amounts under the Revolving Note were immediately due and payable; and

we would not make payments under the CUSO RSA until we received credit for the full amount due us under the Revolving Note, based on the provisions of the CUSO Loan Agreement and the CUSO RSA that allow us to set off amounts owed by us under the CUSO RSA against amounts owed to us by the CUSO under the Revolving Note.

At that time, the outstanding amount of the Revolving Note due to us was approximately \$8,200, representing principal and accrued interest. In response to our notification, the CUSO:

denied that it had defaulted under the CUSO Loan Agreement and, therefore, our ability to accelerate the payment of the Revolving Note; and

refused our demand to immediately pay the Revolving Note in full.

As a consequence, over the period from February 2013 through August 2013, we offset our then current payment obligations under the CUSO RSA and the amount of Discharge Payments we elected to make during that period against all of the CUSO's obligations owed to us under the Revolving Note (the Offset ).

We understand that the CUSO's position is that the Offset was improper, because:

it has not defaulted under the CUSO Loan Agreement; and

even if it had defaulted under the CUSO Loan Agreement, the assets of the CUSO against which we could offset or exercise our other remedies, were limited.

We further understand the CUSO's position to be that, because the Offset was improper, we are in default under the CUSO RSA. In April 2013, the CUSO notified us that it had taken control of the restricted account containing the cash collateral that we deposited to secure our obligations under the CUSO RSA (the Collateral ). At that time, the amount of funds in that account was approximately \$8,600. To our knowledge, the CUSO has taken no further action related to the Collateral. We believe that our good faith exercise of our right of offset provided for in the CUSO Loan

Agreement and the CUSO RSA does not constitute an event of default under the

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CUSO RSA, and that the CUSO's seizure of control of the restricted account containing the Collateral constitutes an additional default by the CUSO. We cannot assure you, however, that the Offset will ultimately be determined to have been proper. In the event of a default by us under the CUSO RSA related to the Offset, we may be required to pay to the CUSO approximately \$9,200, net of approximately \$1,049 of recoveries from charged-off loans that are owed, but have not been paid, to us. If, instead, the CUSO was to withdraw Collateral in that amount from the restricted bank account, we would be required to deposit that amount of cash in the account to maintain the required level of Collateral.

Assessment of Guarantee Contingent Liability. At the end of each reporting period prior to the CUSO Consolidation, we assessed whether we should recognize a contingent liability related to our guarantee obligations under the CUSO RSA and, if so, in what amount. The contingent liability was calculated by estimating the amount and timing of projected future payments that we expected to make under the CUSO RSA and the projected future amounts that we expected to be repaid to us by the CUSO from recoveries of charged-off loans and the timing of those repayments. As with any estimate, as facts and circumstances changed, the recorded liability changed.

In order to estimate the amount of the contingent liability, we made certain assumptions with respect to the performance of the CUSO Student Loans over the life of those loans. The life of a CUSO Student Loan may be in excess of ten years from the date of disbursement. Therefore, our estimates were based on assumptions for periods in excess of ten years, and those assumptions included, among other things, the following:

the repayment performance of the CUSO Student Loans, which includes both payments on non-defaulted loans and recoveries from defaulted, or charged-off, loans;

the timing and rate at which the CUSO Student Loans will be paid;

the changes in the variable interest rates applicable to the CUSO Student Loans;

the amounts and timing of collections that will be collected in the future on CUSO Student Loans that have defaulted; and

our ability to utilize the available options for payment of our obligations under the CUSO RSA.

Because the amount of the contingent liability takes into consideration the projected repayment performance of the CUSO Student Loans that could extend for ten or more years, and the repayment performance data develops over a period that is several years from the date the loans were originated, we continually refined our assumptions based on new data and information. We consulted with third-party consumer credit consulting firms in determining certain repayment performance assumptions.

The projected future payments that we expected to make under the CUSO RSA were based on a methodology to forecast future default rates and amounts, which methodology utilized the historical amount of CUSO Student Loans that had defaulted. The historical default experience by itself, however, may not be indicative of the future default performance of the CUSO Student Loans. Therefore, we made certain assumptions regarding the expected future default performance of the loans. In estimating the projected future amounts that we expected to be repaid to us by the

CUSO from recoveries from charged-off loans, we considered the actual collections on defaulted loans made under the CUSO Program, as well as other factors. As the CUSO Student Loans matured, additional data related to the repayment performance of the loans and other information regarding the loans became available to us that we utilized to estimate the related contingent liability. The assumptions used for our projections of future payments and recoveries have changed significantly over time as actual repayment performance became known, which resulted in changes to the estimated contingent liability.

We also considered our ability to utilize Discharge Payments for payment of our obligations under the CUSO RSA in our estimates of the contingent liability. Making Discharge Payments results in an estimated contingent liability amount that is less than if we had assumed we would make Regular Payments in future periods. As circumstances and our future cash flow projections changed over time, we adjusted our assumptions related to our ability to make Discharge Payments, which resulted in an increase in our estimated contingent liability amount in certain periods.

In addition, in certain prior reporting periods, there were disruptions in the servicing of a portion of the CUSO Student Loans, as well as indications that servicing activities were not being performed as required by the applicable servicing agreement, which we believe had a negative impact on the repayment performance of those loans. We cannot predict with any certainty whether other servicing disruptions or servicing issues will occur in the future.

**Litigation.** We are subject to various litigation. We cannot assure you of the ultimate outcome of any litigation involving us. Although we believe that our estimates related to any litigation are reasonable, deviations from our estimates could produce a materially different result. Any litigation alleging violations of education or consumer protection laws and/or regulations, misrepresentation, fraud or deceptive practices may also subject our affected campuses to additional regulatory scrutiny. The following is a description of pending litigation that falls outside the scope of litigation incidental to the ordinary course of our business.

On December 22, 2008, we were served with a qui tam action that was filed on July 3, 2007 in the United States District Court for the Southern District of Indiana by a former employee ( relator ) on behalf of herself and the federal government under the following caption: *United States of America ex rel. Debra Leveski v. ITT Educational Services, Inc.* (the Leveski Litigation ). We were served with the Leveski Litigation after the U.S. Department of Justice declined to intervene in the litigation. On June 3, 2008,

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the relator filed an amended complaint in the Leveski Litigation. On September 23, 2009, the court dismissed the Leveski Litigation without prejudice and gave the relator an opportunity to replead her complaint. On October 8, 2009, the relator filed a second amended complaint. In the second amended complaint, the relator alleges that we violated the False Claims Act, 31 U.S.C. § 3729, *et seq.*, and the HEA by compensating our sales representatives and financial aid administrators with commissions, bonuses or other incentive payments based directly or indirectly on success in securing enrollments or federal financial aid. The relator alleges that all of our revenue derived from the federal student financial aid programs from July 3, 2001 through July 3, 2007 was generated as a result of our violating the HEA. The relator seeks various forms of recovery on behalf of herself and the federal government, including:

treble the amount of unspecified funds paid to us for federal student grants;

treble the amount of unspecified default payments, special allowance payments and interest received by lenders with respect to federal student loans received by our students;

all civil penalties allowed by law; and

attorney's fees and costs.

A qui tam action is a civil lawsuit brought by one or more individuals (a qui tam relator) on behalf of the federal or state government for an alleged submission to the government of a false claim for payment. A qui tam action is always filed under seal and remains under seal, until the government decides whether to intervene in the litigation. Whenever a relator files a qui tam action, the government typically initiates an investigation in order to determine whether to intervene in the litigation. If the government intervenes, it has primary control over the litigation. If the government declines to intervene, the relator may pursue the litigation on behalf of the government. If the government or the relator is successful in the litigation, the relator receives a portion of the government's recovery.

On August 8, 2011, the district court granted our motion to dismiss all of the relator's claims in the Leveski Litigation for lack of subject-matter jurisdiction and issued a judgment for us. On February 16, 2012, the relator in the Leveski Litigation filed a Notice of Appeal with the 7<sup>th</sup> Circuit Court of Appeals regarding the final judgment entered by the district court dismissing all claims against us. On March 26, 2012, the district court in the Leveski Litigation awarded us approximately \$395 in sanctions against the relator's attorneys for filing a frivolous lawsuit. Relator's attorneys also appealed this award to the 7<sup>th</sup> Circuit Court of Appeals. On July 8, 2013, the 7<sup>th</sup> Circuit Court of Appeals reversed the district court's dismissal of the Leveski Litigation for lack of subject-matter jurisdiction and the award of sanctions against relator's attorneys. In addition, the 7<sup>th</sup> Circuit Court of Appeals remanded the Leveski Litigation back to the district court for further proceedings.

We have defended, and intend to continue to defend, ourselves vigorously against the allegations made in the complaint.

On March 11, 2013, a complaint in a securities class action lawsuit was filed against us and two of our current executive officers in the United States District Court for the Southern District of New York under the following caption: *William Koetsch, Individually and on Behalf of All Others Similarly Situated v. ITT Educational Services, Inc., et al.* (the Koetsch Litigation). On April 17, 2013, a complaint in a securities class action lawsuit was filed



against us and two of our current executive officers in the United States District Court for the Southern District of New York under the following caption: *Massachusetts Laborers Annuity Fund, Individually and on Behalf of All Others Similarly Situated v. ITT Educational Services, Inc., et al* (the MLAF Litigation ). On July 25, 2013, the court consolidated the Koetsch Litigation and MLAF Litigation under the following caption: *In re ITT Educational Services, Inc. Securities Litigation* (the New York Securities Litigation ), and named the Plumbers and Pipefitters National Pension Fund and Metropolitan Water Reclamation District Retirement Fund as the lead plaintiffs. On October 7, 2013, an amended complaint was filed in the New York Securities Litigation, and on January 15, 2014, a second amended complaint was filed in the New York Securities Litigation. The second amended complaint alleges, among other things, that the defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended ( the Exchange Act ) and Rule 10b-5 promulgated thereunder by:

our failure to properly account for the 2007 RSA, CUSO RSA and PEAKS Program;

employing devices, schemes and artifices to defraud;

making untrue statements of material facts, or omitting material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading;

making the above statements intentionally or with reckless disregard for the truth;

engaging in acts, practices, and a course of business that operated as a fraud or deceit upon lead plaintiffs and others similarly situated in connection with their purchases of our common stock;

deceiving the investing public, including lead plaintiffs and the purported class, regarding, among other things, our artificially inflated statements of financial strength and understated liabilities; and

causing our common stock to trade at artificially inflated prices and causing the plaintiff and other putative class members to purchase our common stock at inflated prices.

The putative class period in this action is from April 24, 2008 through February 25, 2013. The plaintiffs seek, among other things, the designation of this action as a class action, an award of unspecified compensatory damages, interest, costs and expenses, including counsel fees and expert fees, and such equitable/injunctive and other relief as the court deems appropriate. On July 22, 2014, the district court denied most of our motion to dismiss all of the plaintiffs' claims for failure to state a claim for which relief

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can be granted. On August 5, 2014, we filed our answer to the second amended complaint denying all of the plaintiffs claims and the parties are currently engaged in discovery. Plaintiffs filed their motion for class certification on March 27, 2015. All of the defendants have defended, and intend to continue to defend, themselves vigorously against the allegations made in the second amended complaint.

On September 30, 2014, a complaint in a securities class action lawsuit was filed against us and two of our current executive officers in the United States District Court for the Southern District of Indiana under the following caption: *David Banes, on Behalf of Himself and All Others Similarly Situated v. Kevin M. Modany, et al.* (the Banes Litigation ). On October 3, 2014, October 9, 2014 and November 25, 2014, three similar complaints were filed against us and two of our current executive officers in the United States District Court for the Southern District of Indiana under the following captions: *Babulal Tarapara, Individually and on Behalf of All Others Similarly Situated v. ITT Educational Services, Inc. et al.* (the Tarapara Litigation ), *Kumud Jindal, Individually and on Behalf of All Others Similarly Situated v. Kevin Modany, et al.* (the Jindal Litigation ) and *Kristopher Hennen, Individually and on Behalf of All Others Similarly Situated v. ITT Educational Services, Inc. et al.* (the Hennen Litigation ). On November 17, 2014, the Tarapara Litigation and the Jindal Litigation were consolidated into the Banes Litigation. On January 21, 2015, the Hennen Litigation was consolidated into that consolidated action (the Indiana Securities Litigation ). On December 1, 2014, motions were filed in the Indiana Securities Litigation for the appointment of lead plaintiff and lead counsel. On March 16, 2015, the court appointed a lead plaintiff and lead counsel. Subsequently, the caption for the Indiana Securities Litigation was changed to the following: *In re ITT Educational Services, Inc. Securities Litigation (Indiana)*.

On May 26, 2015, an amended complaint was filed in the Indiana Securities Litigation. The amended complaint alleges, among other things, that the defendants violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder by knowingly or recklessly making false and/or misleading statements and failing to disclose material adverse facts about our business, operations, prospects and financial results. Plaintiffs assert that the defendants engaged in a fraudulent scheme and course of business and that alleged misstatements and/or omissions by the defendants caused members of the putative class to purchase our securities at artificially inflated prices. The amended complaint includes allegations relating to:

the performance of the PEAKS Program and the CUSO Program;

our guarantee obligations under the PEAKS Program and the CUSO Program;

our accounting treatment of the PEAKS Program and the CUSO Program;

consolidation of the PEAKS Trust in our consolidated financial statements;

the impact of the PEAKS Program and the CUSO Program on our liquidity and overall financial condition;

our compliance with Department of Education financial responsibility standards; and

our internal controls over financial reporting.

The putative class period in the Indiana Securities Litigation is from February 26, 2013 through May 12, 2015. The plaintiffs in the Indiana Securities Litigation seek, among other things, the designation of the action as a proper class action, an award of unspecified compensatory damages against all defendants, interest, costs, expenses, counsel fees and expert fees, and such other relief as the court deems proper. All of the defendants have defended, and intend to continue to defend, themselves vigorously against the allegations made in the amended complaint.

On May 8, 2013, a complaint in a shareholder derivative lawsuit was filed against three of our current executive officers and all but one of our current Directors in the United States District Court for the Southern District of New York under the following caption: *Sasha Wilfred, Derivatively on Behalf of Nominal Defendant ITT Educational Services, Inc. v. Kevin M. Modany, et al.* (the Wilfred Litigation ). On August 6, 2013, the parties agreed to stay the Wilfred Litigation until the New York Securities Litigation was dismissed with prejudice or the defendants filed an answer in the New York Securities Litigation. On September 8, 2014, the district court approved the parties' agreement for an additional stay of the Wilfred Litigation, until the earlier of a final disposition of the New York Securities Litigation or 30 days after written notice terminating the stay was provided by any of the parties in the Wilfred Litigation to all other parties. On October 15, 2014, the plaintiff terminated the stay. Following plaintiff's termination of the stipulated stay, an amended complaint was filed on November 17, 2014 that alleges, among other things, that the defendants violated state law, including breaching their fiduciary duties to us, grossly mismanaging us, wasting our corporate assets and being unjustly enriched, by:

causing or allowing us to disseminate to our shareholders materially misleading and inaccurate information relating to a series of risk-sharing agreements through SEC filings, press releases, conference calls, and other public statements and disclosures;

willfully ignoring obvious and pervasive problems with our internal controls and practices and procedures, and failing to make a good faith effort to correct these problems or prevent their recurrence;

violating and breaching fiduciary duties of care, loyalty, reasonable inquiry, oversight, good faith and supervision;

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causing or allowing us to misrepresent material facts regarding our financial position and business prospects; and

abandoning their responsibilities and duties with regard to prudently managing our businesses in a manner imposed upon them by law.

The amended complaint also refers to certain subsequent events, including the agreement that we entered into with Mr. Modany, dated August 4, 2014, setting forth terms of Mr. Modany's resignation (the Modany Letter Agreement), the CFPB complaint against us, our submission of a letter of credit to the ED, and our receipt of a Wells Notice from the SEC.

The amended complaint seeks:

unspecified damages;

restitution;

disgorgement of all profits, benefits and other compensation obtained by the individual defendants;

an order directing us to take all necessary actions to reform and improve our corporate governance and internal procedures; and

costs and disbursements, including attorneys', accountants' and experts' fees, costs and expenses.

On January 5, 2015, the defendants moved to dismiss or stay the Wilfred Litigation.

On May 27, 2014, a complaint in a shareholder derivative lawsuit was filed against three of our current executive officers, all but one of our current Directors and one former Director in the United States District Court for the District of Delaware under the following caption: *Janice Nottenkamper, Derivatively on Behalf of Nominal Defendant ITT Educational Services, Inc. v. Kevin M. Modany, et al.* (the Nottenkamper Litigation). On November 14, 2014, an amended complaint was filed in the Nottenkamper Litigation. The amended complaint alleges, among other things, that the defendants breached their fiduciary duties to us, were unjustly enriched, abused their control of us and grossly mismanaged us by:

causing or allowing us to disseminate to our shareholders materially misleading and inaccurate information relating to a series of risk-sharing agreements through SEC filings, press releases, conference calls, and other public statements and disclosures;

causing or allowing us to misrepresent material facts regarding student financing;

willfully ignoring obvious and pervasive problems with our internal controls and practices and procedures, and failing to make a good faith effort to correct these problems or prevent their recurrence;

violating and breaching fiduciary duties of care, loyalty, good faith, diligence and candor;

causing or allowing us to misrepresent material facts regarding our financial position and business prospects; and

abandoning and abdicating their responsibilities and duties with regard to prudently managing our businesses in a manner imposed upon them by law; and

permitting Mr. Modany to resign as our Chief Executive Officer and allowing us to enter into the Modany Letter Agreement setting forth the terms of Mr. Modany's resignation.

The amended complaint seeks:

unspecified damages;

restitution;

disgorgement of all profits, benefits and other compensation obtained by the individual defendants;

an order directing us to take all necessary actions to reform and improve our corporate governance and internal procedures; and

costs and disbursements, including attorneys', accountants' and experts' fees, costs and expenses.

On January 13, 2015, the defendants filed a motion to dismiss the Nottenkamper Litigation, as well as a separate motion to stay the litigation or to transfer the litigation to the United States District Court for the Southern District of New York. On April 29, 2015, the Nottenkamper Litigation was transferred to the United States District Court for the Southern District of New York. On May 6, 2015, the Nottenkamper plaintiff moved to consolidate the Nottenkamper Litigation and the Wilfred Litigation.

On December 23, 2014, a complaint in a shareholder derivative lawsuit was filed against three of our current executive officers and all but three of our current Directors in the United States District Court for the Southern District of Indiana under the following caption: *Michelle Lawrence, Derivatively on Behalf of Nominal Defendant ITT Educational Services, Inc. v. Kevin M. Modany, et al.* (the Lawrence Litigation). The complaint alleges among that the individual defendants breached their fiduciary duties to us, abused their control, grossly mismanaged us and were unjustly enriched by:

participating in misrepresentation of our business operations;

failing to correct our public statements;

failing to oversee our business and internal controls;

causing us to issue false and misleading statements of material fact in our consolidated financial statements in our quarterly reports;

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subjecting us to multiple federal securities fraud class action lawsuits;

causing us to restate our consolidated financial statements in our quarterly reports; and

causing us to receive a Wells Notice from the SEC.

The complaint seeks:

unspecified damages,

restitution

disgorgement of all profits, benefits and other compensation obtained by the individual defendants;

an order directing us to take all necessary actions to reform and improve our corporate governance and internal procedure, including taking action to strengthen the Board's supervision of operations, procedures for greater shareholder input and for effective oversight of compliance; and

costs and disbursements, including attorneys' and experts' fees, costs and expenses.

On March 11, 2015, the district court approved the parties' agreement to stay the Lawrence Litigation, until the earlier of 30 days after written notice of termination has been provided by any party or the Indiana Securities Litigation is dismissed with prejudice or an answer in the Indiana Securities Litigation is filed.

Although the Wilfred Litigation, Nottenkamper Litigation and Lawrence Litigation are each brought nominally on behalf of us, we expect to incur defense costs and other expenses in connection with those actions.

On May 18, 2012, we received a Civil Investigative Demand (the "Original CID") from the U.S. Consumer Financial Protection Bureau (the "CFPB"). In September 2013, the CFPB withdrew the Original CID, and we received a new Civil Investigative Demand (the "New CID") from the CFPB. Both the Original CID and the New CID provided that the purpose of the CFPB's investigation was, in part, to determine whether for-profit post-secondary companies, student loan origination and servicing providers, or other unnamed persons have engaged or are engaging in unlawful acts or practices relating to the advertising, marketing, or origination of private student loans. Both the Original CID and the New CID contained broad requests for oral testimony, production of documents and written reports related to private education loans made to our students, internal financing provided to our students and certain other aspects of our business. We provided documentation and other information to the CFPB, while preserving our rights to object to its inquiry.

On February 26, 2014, the CFPB filed a complaint against us in the United States District Court for the Southern District of Indiana under the following caption: *Consumer Financial Protection Bureau v. ITT Educational Services, Inc.* (the "CFPB Litigation"). The complaint claimed, among other things, that we violated:

Section 1036(a)(1) of the Consumer Financial Protection Act of 2010 (the "CFPA"), 12 U.S.C. § 5536(a)(1), which prohibits unfair, deceptive and abusive acts and practices, from July 21, 2011 through December 2011, by:

subjecting consumers to undue influence or coercing them into taking out private education loans through a variety of unfair acts and practices designed to interfere with the consumers' ability to make informed, uncoerced choices;

taking unreasonable advantage of consumers' inability to protect their interest in selecting or using the private education loans; and

taking unreasonable advantage of consumers' reasonable reliance on us to act in the consumers' interests; and

the Truth in Lending Act, 15 U.S.C. §§ 1601 *et seq.*, and Regulation Z thereunder, 12 C.F.R. Part 1026, which require certain disclosures to be made in writing to consumers in connection with the extension of consumer credit, since March 2009, by failing to disclose a discount that constituted a finance charge.

We filed a motion to dismiss the CFPB Litigation on several grounds. On March 6, 2015, the court issued an order denying our motion in part and granting it in part, including dismissing the CFPB's claim under the Truth in Lending Act. On April 8, 2015, we filed a notice of appeal to the United States Court for the Seventh Circuit from the order on the motion to dismiss. We have defended, and intend to continue to defend, ourselves vigorously against the remaining allegations made in the complaint.

On February 27, 2014, the New Mexico Attorney General filed a complaint against us in the District Court of New Mexico under the following caption: *State of New Mexico, ex rel. Gary K King, Attorney General v. ITT Educational Services, Inc., et al.* (the "New Mexico Litigation"). On April 4, 2014, we removed the New Mexico Litigation to the U.S. District Court for the District of New Mexico. In April 2014, the Attorney General filed a motion to remand the New Mexico Litigation to the District Court of New Mexico. The complaint alleges, among other things, that we engaged in a pattern and practice of exploiting New Mexico consumers by using deceptive, unfair, unconscionable and unlawful business practices in the marketing, sale, provision and financing of education goods and services in violation of New Mexico's Unfair Practices Act. In particular, the complaint contains allegations that:

we misrepresented matters related to our nursing education program, including, without limitation, its programmatic accreditation status, the transferability of credits earned in the program and the curriculum of the program;

we misrepresented the terms of the financial aid available to students and the cost of our programs;

we engaged in unfair or deceptive trade practices;





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we failed to issue refunds; and

our form enrollment agreement contained unenforceable and unconscionable provisions.

The complaint seeks:

an order declaring portions of our enrollment agreement illusory, unconscionable and unenforceable;

preliminary and permanent injunctive relief;

disgorgement of unjust enrichment amounts;

unspecified civil penalty amounts;

restitution; and

reasonable costs, including investigative costs.

We have defended, and intend to continue to defend, ourselves vigorously against the allegations made in the complaint.

On December 17, 2013, a complaint was filed against us in a purported class action in the Superior Court of the State of California for the County of Los Angeles under the following caption: *La Sondra Gallien, an individual, James Rayonez, an individual, Giovanni Chilin, an individual, on behalf of themselves and on behalf of all persons similarly situated v. ITT Educational Services, Inc., et al.* (the Gallien Litigation ). The plaintiffs filed an amended complaint on February 13, 2014. The amended complaint alleges, among other things, that under California law, we:

failed to pay wages owed;

failed to pay overtime compensation;

failed to provide meal and rest periods;

failed to provide itemized employee wage statements;

engaged in unlawful business practices; and

are liable for civil penalties under the California Private Attorney General Act. The purported class includes recruiting representatives employed by us during the period of December 17, 2009 through December 17, 2013. The amended complaint seeks:

compensatory damages, including lost wages and other losses;

general damages;

pay for missed meal and rest periods;

restitution;

liquidated damages;

statutory penalties;

interest;

attorneys' fees, cost and expenses;

civil and statutory penalties;

injunctive relief; and

such other and further relief as the court may deem equitable and appropriate.

We have defended, and intend to continue to defend, ourselves vigorously against the allegations made in the amended complaint.

Kevin M. Modany and Daniel M. Fitzpatrick are named in the New York Securities Litigation, Indiana Securities Litigation, Wilfred Litigation, Nottenkamper Litigation and Lawrence Litigation. John E. Dean is also named in the Wilfred Litigation, Nottenkamper Litigation and Lawrence Litigation.

On May 12, 2015, the SEC filed a civil enforcement action against us, our Chief Executive Officer, Kevin M. Modany, and our Chief Financial Officer, Daniel M. Fitzpatrick, in the United States District Court for the Southern District of Indiana under the following caption: *United States Securities and Exchange Commission v. ITT Educational Services, Inc., Kevin M. Modany and Daniel M. Fitzpatrick* (the SEC Litigation). As we previously disclosed, we received several SEC subpoenas beginning on February 8, 2013. The SEC's subpoenas requested the production of documents and communications that, among other things, relate to our actions, disclosures, and accounting associated with the CUSO Program and the PEAKS Program. We provided the information requested, including testimony of senior employees. On August 7, 2014, we received a Wells Notice from the Staff of the SEC notifying us that the Staff had made a preliminary determination to recommend that the SEC file an enforcement action against us. According to the Staff, the enforcement action would allege violations of Sections 10(b), 13(a) and 13(b)(2) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-11, 13a-13 and 13a-15 under the Exchange Act. Under the SEC's procedures, a recipient of a Wells Notice has an opportunity to respond in the form of a Wells submission that seeks to persuade the SEC that such an action should not be brought. We made submissions to the Staff in response to the Wells Notice we received that set forth why the factual record does not support the enforcement action recommended by the Staff and explained that any of our perceived shortcomings were acts taken in good faith. Our Chief Executive Officer and Chief Financial Officer each made similar submissions.

The SEC Litigation relates to the matters addressed in the Wells Notice that we received, and the complaint alleges violations of Sections 10(b), 13(a) and 13(b)(2) of the Exchange Act; Rules 10b-5, 12b-20, 13a-1, 13a-11, 13a-13 and 13a-15 under the Exchange Act; and Section 17(a) of the Securities Act. Among other assertions, the complaint alleges that the defendants engaged in

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a fraudulent scheme and course of business and made various false and misleading statements to our investors relating to the CUSO Program and the PEAKS Program. The remedies sought by the SEC in the complaint include:

a finding that each of the defendants committed the alleged violations;

an injunction permanently restraining and enjoining each of the defendants from violating, directly or indirectly, the laws and rules alleged in the complaint;

an order that Messrs. Modany and Fitzpatrick be permanently prohibited from acting as an officer or director of any public company;

disgorgement of any and all ill-gotten gains, together with pre- and post-judgment interest, derived from the improper conduct alleged in the complaint;

civil money penalties pursuant to Section 20(d) of the Securities Act and Section 21(d) of the Exchange Act in an amount to be determined by the court, plus post-judgment interest;

an order that Messrs. Modany and Fitzpatrick reimburse us for all bonuses, incentive-based and equity-based compensation, and/or profits realized from their sale of our stock pursuant to Section 304 of the Sarbanes-Oxley Act of 2002; and

such other relief as the court may deem just or appropriate.

We intend to defend ourselves vigorously against the allegations in the SEC's complaint. Nevertheless, we cannot predict the outcome of any legal action or whether the matter will result in any settlement. We cannot assure you that the ultimate outcome of the SEC Litigation or any settlement will not have a material adverse effect on our financial condition, results of operations and/or cash flows.

There can be no assurance that the ultimate outcome of the Leveski Litigation, New York Securities Litigation, Indiana Securities Litigation, Wilfred Litigation, Nottenkamper Litigation, Lawrence Litigation, CFPB Litigation, New Mexico Litigation, Gallien Litigation, SEC Litigation or other actions (including other actions under federal or state securities laws) will not have a material adverse effect on our financial condition, results of operations or cash flows.

Certain of our current and former officers and Directors are or may become a party in the actions described above and/or are or may become subject to government investigations. Our By-laws and Restated Certificate of Incorporation obligate us to indemnify our officers and Directors to the fullest extent permitted by Delaware law, provided that their conduct complied with certain requirements. We are obligated to advance defense costs to our officers and Directors, subject to the individual's obligation to repay such amount if it is ultimately determined that the individual was not entitled to indemnification. In addition, our indemnity obligation can, under certain circumstances, include indemnifiable judgments, penalties, fines and amounts paid in settlement in connection with those actions and

investigations.

**Government Investigations.** We are subject to investigations and claims of non-compliance with regulatory standards and other actions brought by regulatory agencies. The more significant pending investigations, claims and actions are described below. If the results of any investigations, claims and/or actions are unfavorable to us, we may be required to pay money damages or be subject to fines, penalties, injunctions, operational limitations, loss of eligibility to participate in federal or state financial aid programs, debarments, additional oversight and reporting, or other civil and criminal sanctions. Those sanctions could have a material adverse effect on our financial condition, results of operations and cash flows.

On October 30, 2012, we received a Civil Investigative Demand ( CID ) from the Massachusetts Office of the Attorney General ( MAG ). The MAG 's CID provides that the MAG is investigating allegations that we may have violated Massachusetts General Laws, Chapter 93A, Section 2(a) by engaging in unfair or deceptive practices in connection with marketing and advertising job placement and student outcomes, the recruitment of students, and the financing of education. The MAG 's CID contains broad requests for production of documents related to our students in Massachusetts, including the financial aid available to those students, our recruitment of those students, the career services that we offer to those students, our marketing and advertising, the retention and graduation rates of those students and many other aspects of our business. We are cooperating with the MAG in its investigation, and we have provided documentation, communications and other information to the MAG in response to the CID. We believe that our acts and practices relating to our students in Massachusetts are lawful. There can be no assurance, however, that the ultimate outcome of the MAG investigation will not have a material adverse effect on our financial condition, results of operations and/or cash flows.

In January, February, April and May 2014, and in February and March 2015, we received subpoenas and/or CIDs from the Attorneys General of Arkansas, Arizona, Colorado, Connecticut, Hawaii, Idaho, Iowa, Kentucky, Maryland, Minnesota, Missouri, Nebraska, North Carolina, Oregon, Pennsylvania, Tennessee and Washington under the authority of each state's consumer protection statutes. The Attorney General of the Commonwealth of Kentucky has informed us that it will serve as the point of contact for the multistate group to respond to questions relating to the subpoenas and CIDs. The subpoenas and CIDs contain broad requests for information and the production of documents related to our students and practices, including marketing and advertising, recruitment, financial aid, academic advising, career services, admissions, programs, licensure exam pass rates, accreditation, student retention, graduation rates and job placement rates, as well as many other aspects of our business. We believe that several other companies in the proprietary postsecondary education sector have received similar subpoenas and CIDs. We are cooperating with the Attorneys General of the states involved. The ultimate outcome of the state Attorneys General investigation, however, could have a material adverse effect on our financial condition, results of operations and/or cash flows.

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**16. Risks and Uncertainties**

Many of the amounts of assets, liabilities, revenue and expenses reported in our consolidated financial statements are based on estimates and assumptions that affect the amounts reported. We are subject to risks and uncertainties that could affect amounts reported in our consolidated financial statements in future periods. Our future performance, results of operations, financial condition, cash flows, liquidity, capital resources, ability to meet our obligations and ability to comply with covenants, metrics and regulatory requirements are subject to significant risks and uncertainties that could cause actual results to be materially different from our estimated results. Those significant risks and uncertainties include, but are not limited to, the following:

The PEAKS Consolidation and other factors, among other things:

have resulted in violations by us of covenants under the Amended Credit Agreement, for which we have obtained waivers and amendments relating to those violations;

have negatively impacted our compliance with:

the ED's financial responsibility measurements, primarily our institutions' composite score; and

our compliance with the financial requirements of certain state education and professional licensing authorities (SAs); and

have negatively impacted the financial metrics to which we are subject under the PEAKS Program and the CUSO RSA.

See Note 12 Debt and Note 15 Commitments and Contingencies, for additional information.

The CUSO Consolidation, which could negatively impact our compliance with:

covenants under the Financing Agreement;

the ED's financial responsibility measurements, primarily our institutions' composite score;

the financial requirements of certain SAs; and

the financial metrics to which we are subject under the PEAKS Program and the CUSO RSA.

See Note 8 Variable Interest Entities, for additional information.



Our institutions' failure to submit their 2013 audited consolidated financial statements and 2013 Compliance Audits to the ED by the due date resulted in sanctions imposed by the ED on our institutions that include, among other things, our institutions having to submit a letter of credit, being placed on heightened cash monitoring ( HCM ) and being provisionally certified. We caused the ED Letter of Credit to be issued on October 31, 2014. The term of the ED Letter of Credit ends on November 4, 2019. We have implemented procedures to address HCM, which requirements are not expected to significantly impact the timing of our receipt of Title IV Program funds. See Note 12 Debt, for additional information.

As required, we provided cash collateral in the amount of approximately \$89,300 for the letters of credit outstanding for our account. The funds held as cash collateral are not available for use by us, and could be paid to the issuing bank for the letters of credit if the letters of credit are drawn upon. The funds held as cash collateral will remain subject to such restriction and potential use until the cancellation, termination, expiration or reduction of the face amount of the outstanding letters of credit. The remaining amount of cash collateral at any time may not be less than 103% of the amount available to be drawn under the letters of credit then remaining outstanding, except the ED Letter of Credit, for which the cash collateral must not be less than 109% of the amount available to be drawn. See Note 12 Debt, for additional information.

We are subject to various claims and contingencies, including those related to litigation, government investigations, business transactions, guarantee arrangements, tax matters and employee-related matters, among others. See Note 15 Commitments and Contingencies, for a further discussion of certain litigation and government investigations to which we are subject.

Although we have consolidated both the PEAKS Trust and the CUSO, and we no longer record a contingent liability related to those programs on our Consolidated Balance Sheets, our significant guarantee obligations under the PEAKS Guarantee and the CUSO RSA remain in effect. In 2014, we made payments of approximately \$159,300 under the PEAKS Guarantee, \$1,832 of Payments on Behalf of Borrowers and approximately \$9,139, net of \$466 of recoveries owed to us that we offset against amounts that we owed to the CUSO, related to the CUSO RSA. Based on various assumptions, including the historical and projected performance and collection of the PEAKS Trust Student Loans, we believe that we will make payments under the PEAKS Guarantee of approximately \$29,800 in 2015 and approximately \$4,300 in 2016. In addition, based upon various assumptions, including the historical and projected performance and collections of the private education loans under the CUSO Program, we believe that we will make payments under the CUSO RSA, net of recoveries, of approximately \$13,000 in 2015 and \$14,400 in 2016. See Note 12 Debt and Note 15 Commitments and Contingencies for a further discussion of the RSAs, estimated payment amounts and contingent liabilities.

On December 4, 2014, we borrowed \$100,000 aggregate principal amount of senior secured Term Loans. The proceeds of the Term Loans, along with other funds, were used to provide the cash collateral for outstanding letters of credit, to repay all outstanding borrowings under the Amended Credit Agreement and to pay fees in connection with the Financing Agreement. As a result, no portion of the proceeds of the Term Loans is available for working capital or other uses. Further, the funds held as cash collateral are not available for use by us to fund our operations.

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We incurred a net loss in the year December 31, 2013 and we had negative working capital as of December 31, 2013, primarily due to the impact of the PEAKS Consolidation and the loss that we recorded related to our guarantee obligations under the CUSO RSA. We had negative working capital as of December 31, 2014, primarily due to the impact of the Consolidated VIEs.

Based on our current projections, we believe that cash generated from operations will be sufficient for us to satisfy our RSA payments, working capital, loan repayment and capital expenditure requirements over the 12-month period following the date that this Annual Report on Form 10-K was filed with the SEC. We also believe that any reduction in cash and cash equivalents that may result from their use to make payments under the RSAs or repay loans will not have a material adverse effect on our planned capital expenditures, ability to meet any applicable regulatory financial responsibility standards, ability to satisfy the financial covenants under the Financing Agreement or ability to conduct normal operations over the 12-month period following the date that this Annual Report on Form 10-K was filed with the SEC. Accordingly, our consolidated financial statements contained in this Annual Report on Form 10-K were prepared on the basis that we will continue to operate as a going concern. There can be no assurance, however, that the ultimate outcome of those events, whether individually or in the aggregate, will not have a material adverse effect on our financial condition, results of operations or cash flows.

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## SCHEDULE II

**ITT EDUCATIONAL SERVICES, INC.**  
**VALUATION AND QUALIFYING ACCOUNTS**  
**FOR THE THREE YEARS ENDED DECEMBER 31, 2014**  
**(Amounts in thousands)**

| <b>Description</b>                      | <b>Balance at<br/>Beginning<br/>of Period</b> | <b>Charged to<br/>Expenses</b> | <b>Write-offs</b> | <b>Balance<br/>at End<br/>of<br/>Period</b> |
|---|---|--------------------------------|-------------------|---|
| <b>Allowance for Doubtful Accounts:</b> |   |                                |                   |   |
| Year Ended December 31, 2014            | \$ 9,174                                      | \$ 63,928                      | \$ (70,751)       | \$ 2,351                                    |
| Year Ended December 31, 2013            | \$ 15,663                                     | \$ 67,640                      | \$ (74,129)       | \$ 9,174                                    |
| Year Ended December 31, 2012            | \$ 9,175                                      | \$ 56,818                      | \$ (50,330)       | \$ 15,663                                   |

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## ITT EDUCATIONAL SERVICES, INC.

## QUARTERLY FINANCIAL RESULTS

## FOR 2014 AND 2013

(Amounts in thousands, except per share data)

(Unaudited)

|  | Three Months Ended |            |            |            |              |
|--|--------------------|------------|------------|------------|--------------|
|  | March 31           | June 30    | Sept 30    | Dec 31     | Year         |
| <b>2014</b>  |                    |            |            |            |              |
| Revenue  | \$ 237,923         | \$ 238,096 | \$ 242,561 | \$ 243,203 | \$ 961,783   |
| Cost of educational services   | 120,115            | 116,276    | 117,539    | 106,852    | 460,782      |
| Student services and administrative expenses   | 99,238             | 97,547     | 100,440    | 91,891     | 389,116      |
| Goodwill and asset impairment  |                    |            |            | 2,454      | 2,454        |
| Legal and professional fees related to certain lawsuits, investigations and accounting matters | 5,547              | 8,380      | 11,269     | 6,812      | 32,008       |
| Loss related to loan program guarantees  | 0                  | 0          | 2,019      | 0          | 2,019        |
| Provision for private education loan losses  | 0                  | 9,071      | 4,511      | 568        | 14,150       |
| Operating income   | 13,023             | 6,822      | 6,783      | 34,626     | 61,254       |
| Gain on consolidation of variable interest entities  | 0                  | 0          | 16,631     | 0          | 16,631       |
| Interest income  | 19                 | 15         | 17         | 14         | 65           |
| Interest (expense)   | (6,901)            | (6,263)    | (5,831)    | (9,305)    | (28,300)     |
| Income before provision for income taxes   | 6,141              | 574        | 17,600     | 25,335     | 49,650       |
| Provision for income taxes   | 2,519              | 182        | 7,278      | 10,418     | 20,397       |
| Net income   | \$ 3,622           | \$ 392     | \$ 10,322  | \$ 14,917  | \$ 29,253    |
| Earnings per share:  |                    |            |            |            |              |
| Basic  | \$ 0.15            | \$ 0.02    | \$ 0.44    | \$ 0.64    | \$ 1.25      |
| Diluted  | \$ 0.15            | \$ 0.02    | \$ 0.44    | \$ 0.63    | \$ 1.23      |
| <b>2013</b>  |                    |            |            |            |              |
| Revenue  | \$ 285,062         | \$ 260,459 | \$ 259,617 | \$ 267,173 | \$ 1,072,311 |
| Cost of educational services   | 124,176            | 123,541    | 120,204    | 118,432    | 486,353      |
| Student services and administrative expenses   | 101,721            | 98,335     | 96,182     | 101,303    | 397,541      |
| Legal and professional fees related to certain lawsuits, investigations and accounting matters | 1,500              | 213        | 2,089      | 3,121      | 6,923        |
| Loss related to loan program guarantees  | 3,803              | 0          | 4,826      | 82,335     | 90,964       |
| Provision for PEAKS Trust student loan losses  | 0                  | 4,319      | 16,382     | 8,648      | 29,349       |
| Operating income (loss)  | 53,862             | 34,051     | 19,934     | (46,666)   | 61,181       |
|  | (73,248)           | 0          | 0          | 0          | (73,248)     |

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|  |             |           |          |             |             |
|--|-------------|-----------|----------|-------------|-------------|
| <b>(Loss) on consolidation of variable interest entities</b> |             |           |          |             |             |
| Interest income  | 34          | 25        | 16       | 33          | 108         |
| Interest (expense)   | (3,574)     | (7,369)   | (7,190)  | (7,144)     | (25,277)    |
| Income (loss) before provision for income taxes              | (22,926)    | 26,707    | 12,760   | (53,777)    | (37,236)    |
| Provision (benefit) for income taxes                         | (5,655)     | 6,503     | 3,336    | (14,396)    | (10,212)    |
| Net income (loss)  | \$ (17,271) | \$ 20,204 | \$ 9,424 | \$ (39,381) | \$ (27,024) |
| <b>Earnings (loss) per share:</b>                            |             |           |          |             |             |
| Basic  | \$ (0.74)   | \$ 0.86   | \$ 0.40  | \$ (1.68)   | \$ (1.15)   |
| Diluted  | \$ (0.74)   | \$ 0.86   | \$ 0.40  | \$ (1.68)   | \$ (1.15)   |

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Table of Contents**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ITT Educational Services, Inc.

By: /s/ Kevin M. Modany  
Kevin M. Modany  
*Chief Executive Officer*

Dated: May 29, 2015

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| <b>Signature</b>                                   | <b>Title</b>  | <b>Date</b>  |
|--|---|--------------|
| /s/ Kevin M. Modany<br>Kevin M. Modany             | Chief Executive Officer<br><br>(Principal Executive Officer)                          | May 29, 2015 |
| /s/ Daniel M. Fitzpatrick<br>Daniel M. Fitzpatrick | Executive Vice President and Chief Financial<br>Officer (Principal Financial Officer) | May 29, 2015 |
| /s/ Angela K. Knowlton<br>Angela K. Knowlton       | Senior Vice President, Controller and Treasurer<br>(Principal Accounting Officer)     | May 29, 2015 |
| C. David Brown                                     | Director  |              |
| /s/ Jerry M. Cohen<br>Jerry M. Cohen               | Director  | May 29, 2015 |
| /s/ John F. Cozzi<br>John F. Cozzi                 | Director  | May 29, 2015 |
| /s/ John E. Dean<br>John E. Dean                   | Executive Chairman and Director   | May 29, 2015 |
| /s/ James D. Fowler, Jr.<br>James D. Fowler, Jr.   | Director  | May 29, 2015 |
| /s/ Joanna T. Lau<br>Joanna T. Lau                 | Director  | May 29, 2015 |

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|  |          |              |
|--|----------|--------------|
| /s/ Thomas I. Morgan<br>Thomas I. Morgan | Director | May 29, 2015 |
| /s/ Samuel L. Odle<br>Samuel L. Odle     | Director | May 29, 2015 |
| /s/ Vin Weber<br>Vin Weber               | Director | May 29, 2015 |
| /s/ John A. Yena<br>John A. Yena         | Director | May 29, 2015 |

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**Table of Contents****INDEX TO EXHIBITS**

| <b>Exhibit<br/>No.</b> | <b>Description</b>  | <b>Incorporated by Reference From</b> |                |                    | <b>Filed<br/>Herewith</b> |
|------------------------|---|---------------------------------------|----------------|--------------------|---------------------------|
|                        |   | <b>Form</b>                           | <b>Exhibit</b> | <b>Filing Date</b> |                           |
| 3.1                    | Restated Certificate of Incorporation, as Amended to Date   | 10-Q*                                 | 3.1            | 7/29/05            |                           |
| 3.2                    | Restated By-Laws, as Amended to Date  | 8-K*                                  | 3.2            | 7/22/11            |                           |
| 10.1                   | ** 1997 ITT Educational Services, Inc. Incentive Stock Plan   | 10-Q*                                 | 10.8           | 8/8/97             |                           |
| 10.2                   | ** First Amendment to the 1997 ITT Educational Services, Inc. Incentive Stock Plan                      | 10-Q*                                 | 10.38          | 7/17/03            |                           |
| 10.3                   | ** Second Amendment to 1997 ITT Educational Services, Inc. Incentive Stock Plan                         | 10-Q*                                 | 10.58          | 10/26/06           |                           |
| 10.4                   | ** 1999 Outside Directors Stock Option Plan   | S-8***                                | 4.3            | 8/10/99            |                           |
| 10.5                   | ** First Amendment to the 1999 Outside Directors Stock Option Plan                                      | 10-Q*                                 | 10.37          | 7/17/03            |                           |
| 10.6                   | ** Second Amendment to the 1999 Outside Directors Stock Option Plan                                     | 10-Q*                                 | 10.42          | 4/27/04            |                           |
| 10.7                   | ** Third Amendment to the 1999 Outside Directors Stock Option Plan                                      | 8-K*                                  | 10.47          | 1/28/05            |                           |
| 10.8                   | ** 2006 ITT Educational Services, Inc. Equity Compensation Plan   | 8-K*                                  | 10.55          | 5/10/06            |                           |
| 10.9                   | ** First Amendment to 2006 ITT Educational Services, Inc. Equity Compensation Plan                      | 10-Q*                                 | 10.57          | 10/26/06           |                           |
| 10.10                  | ** Second Amendment to 2006 ITT Educational Services, Inc. Equity Compensation Plan                     | 10-Q*                                 | 10.61          | 7/26/07            |                           |
| 10.11                  | ** Third Amendment to 2006 ITT Educational Services, Inc. Equity Compensation Plan                      | 10-K*                                 | 10.32          | 2/18/11            |                           |
| 10.12                  | ** Fourth Amendment to 2006 ITT Educational Services, Inc. Equity Compensation Plan                     | 10-K*                                 | 10.12          | 2/24/12            |                           |
| 10.13                  | ** ITT Educational Services, Inc. Amended and Restated 2006 Equity Compensation Plan                    | 8-K*                                  | 10.1           | 5/7/13             |                           |
| 10.14                  | ** First Amendment to ITT Educational Services, Inc. Amended and Restated 2006 Equity Compensation Plan | 10-Q*                                 | 10.10          | 4/29/15            |                           |





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|       |    |   |       |       |          |
|-------|----|---|-------|-------|----------|
| 10.15 | ** | Form of Nonqualified Stock Option Award Agreement under the 2006 ITT Educational Services, Inc. Equity Compensation Plan (for use prior to November 24, 2010)         | 10-Q* | 10.53 | 5/1/06   |
| 10.16 | ** | Form of Nonqualified Stock Option Award Agreement under the 2006 ITT Educational Services, Inc. Equity Compensation Plan (for use November 24, 2010 January 23, 2012) | 10-K* | 10.35 | 2/18/11  |
| 10.17 | ** | Form of Nonqualified Stock Option Award Agreement under the 2006 ITT Educational Services, Inc. Equity Compensation Plan (for use after January 23, 2012)             | 10-K* | 10.15 | 2/24/12  |
| 10.18 | ** | Form of Nonqualified Stock Option Award Agreement under the ITT Educational Services, Inc. Amended and Restated 2006 Equity Compensation Plan                         | 8-K*  | 10.2  | 5/7/13   |
| 10.19 | ** | Form of Restricted Stock Unit Award Agreement under the 2006 ITT Educational Services, Inc. Equity Compensation Plan (for use prior to January 17, 2011)              | 10-Q* | 10.59 | 7/26/07  |
| 10.20 | ** | Form of Restricted Stock Unit Award Agreement under the 2006 ITT Educational Services, Inc. Equity Compensation Plan (for use January 17, 2011 January 23, 2012)      | 10-K* | 10.33 | 2/18/11  |
| 10.21 | ** | Form of Restricted Stock Unit Award Agreement under the 2006 ITT Educational Services, Inc. Equity Compensation Plan (for use after January 23, 2012)                 | 10-K* | 10.18 | 2/24/12  |
| 10.22 | ** | Form of Restricted Stock Unit Award Agreement under the ITT Educational Services, Inc. Amended and Restated 2006 Equity Compensation Plan                             | 8-K*  | 10.3  | 5/7/13   |
| 10.23 | ** | Form of Amendment to Certain Restricted Stock Unit Award Agreements   | 10-K* | 10.22 | 10/16/14 |

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|       |    |   |       |       |          |   |
|-------|----|---|-------|-------|----------|---|
| 10.24 | ** | Form of Restricted Stock Award Agreement under the 2006 ITT Educational Services, Inc. Equity Compensation Plan (for use after November 24, 2010) | 10-K* | 10.34 | 2/18/11  |   |
| 10.25 | ** | Form of Restricted Stock Award Agreement under the ITT Educational Services, Inc. Amended and Restated 2006 Equity Compensation Plan              | 8-K*  | 10.4  | 5/7/13   |   |
| 10.26 | ** | Restated ESI 401(k) Plan  | 10-K* | 10.20 | 2/24/12  |   |
| 10.27 | ** | First Amendment of ESI 401(k) Plan  | 10-Q* | 10.1  | 7/26/13  |   |
| 10.28 | ** | Second Amendment of ESI 401(k) Plan   | 10-K* | 10.27 | 10/16/14 |   |
| 10.29 | ** | Third Amendment of ESI 401(k) Plan  | 10-Q* | 10.11 | 4/29/15  |   |
| 10.30 | ** | ESI Excess Savings Plan 2008 Restatement  | 10-K* | 10.15 | 2/21/08  |   |
| 10.31 | ** | Restated ESI Pension Plan   | 10-K* | 10.22 | 2/24/12  |   |
| 10.32 | ** | First Amendment of ESI Pension Plan   | 10-Q* | 10.1  | 7/27/12  |   |
| 10.33 | ** | ESI Excess Pension Plan 2008 Restatement  | 10-K* | 10.19 | 2/21/08  |   |
| 10.34 | ** | First Amendment to ESI Excess Pension Plan 2008 Restatement   | 10-Q* | 10.23 | 7/24/08  |   |
| 10.35 | ** | ESI Executive Deferred Bonus Compensation Plan 2008 Restatement   | 10-K* | 10.22 | 2/21/08  |   |
| 10.36 | ** | ESI Non-Employee Directors Deferred Compensation Plan 2008 Restatement  | 10-K* | 10.21 | 2/21/08  |   |
| 10.37 | ** | ITT Educational Services, Inc. Senior Executive Severance Plan  | 10-Q* | 10.26 | 10/25/07 |   |
| 10.38 | ** | First Amendment to the ITT Educational Services, Inc. Senior Executive Severance Plan   | 10-K* | 10.28 | 2/24/12  |   |
| 10.39 | ** | Summary of Certain Director and Executive Compensation  |       |       |          | X |
| 10.40 |    | Trade Name and Service Mark License Agreement between ITT/ESI and ITT Sheraton Corporation  | 10-Q* | 10.11 | 7/27/98  |   |
| 10.41 |    | First Amendment to Trade Name and Service Mark License Agreement between ITT/ESI and ITT Sheraton Corporation                                     | 10-K* | 10.18 | 2/19/99  |   |

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|       |  |       |       |          |   |
|-------|--|-------|-------|----------|---|
| 10.42 | Second Amendment to Trade Name and Service Mark License Agreement between ITT/ESI and ITT Manufacturing Enterprises, Inc. (assignee of ITT Sheraton Corporation)   | 10-Q* | 10.24 | 10/31/00 |   |
| 10.43 | Financing Agreement, dated as of December 4, 2014, by and among ITT Educational Services, Inc., the subsidiary guarantors party thereto, Cerberus Business Finance, LLC, as administrative agent and collateral agent, and the lenders party thereto                     | 8-K*  | 10.1  | 12/5/14  |   |
| 10.44 | Amendment No. 1 to Financing Agreement, dated as of December 23, 2014, by and among ITT Educational Services, Inc., the subsidiary guarantors party thereto, Cerberus Business Finance, LLC, as administrative agent and collateral agent, and the lenders party thereto | 8-K*  | 10.2  | 3/18/15  |   |
| 10.45 | Amendment No. 2 to Financing Agreement, dated as of March 17, 2015, by and among ITT Educational Services, Inc., the subsidiary guarantors party thereto, Cerberus Business Finance, LLC, as administrative agent and collateral agent, and the lenders party thereto    | 8-K*  | 10.1  | 3/18/15  |   |
| 10.46 | Limited Consent to Financing Agreement, dated as of May 26, 2015, by and among ITT Educational Services, Inc., the subsidiary guarantors party thereto, Cerberus Business Finance, LLC, as administrative agent and collateral agent, and the lenders party thereto      |       |       |          | X |
| 10.47 | Credit Agreement, dated as of March 21, 2012, among ITT Educational Services, Inc., the lenders party thereto, JPMorgan Chase Bank, N.A. as administrative agent, Bank of America, N.A., as syndication agent and Wells Fargo, N.A., as documentation agent              | 8-K*  | 10.1  | 3/27/12  |   |
| 10.48 | First Amendment to Credit Agreement, dated as of March 31, 2014, by and among ITT Educational Services, Inc., the lenders party thereto, and JPMorgan Chase Bank, N.A. as administrative agent   | 8-K*  | 10.1  | 4/4/14   |   |

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|       |  |       |       |          |
|-------|--|-------|-------|----------|
| 10.49 | Second Amendment to Credit Agreement, dated as of May 29, 2014, by and among ITT Educational Services, Inc., the lenders party thereto, and JPMorgan Chase Bank, N.A. as administrative agent                      | 8-K*  | 10.1  | 6/4/14   |
| 10.50 | Third Amendment to Credit Agreement, Consent and Waiver, dated as of June 30, 2014, by and among ITT Educational Services, Inc., the lenders party thereto, and JPMorgan Chase Bank, N.A. as administrative agent  | 8-K*  | 10.1  | 7/2/14   |
| 10.51 | Fourth Amendment to Credit Agreement, Consent and Waiver, dated as of July 30, 2014, by and among ITT Educational Services, Inc., the lenders party thereto, and JPMorgan Chase Bank, N.A. as administrative agent | 8-K*  | 10.1  | 8/1/14   |
| 10.52 | Fifth Amendment to Credit Agreement and Consent, dated as of September 15, 2014, by and among ITT Educational Services, Inc., the lenders party thereto, and JPMorgan Chase Bank, N.A. as administrative agent     | 8-K*  | 10.1  | 9/19/14  |
| 10.53 | Consent to Credit Agreement, entered into as of October 15, 2014, by and among ITT Educational Services, Inc., the lenders party thereto, and JPMorgan Chase Bank, N.A. as administrative agent                    | 10-Q* | 10.5  | 11/14/14 |
| 10.54 | Consent to Credit Agreement, entered into as of November 14, 2014, by and among ITT Educational Services, Inc., the lenders party thereto, and JPMorgan Chase Bank, N.A. as administrative agent                   | 10.Q* | 10.3  | 11/19/14 |
| 10.55 | Guarantee Agreement, dated as of January 20, 2010, between ITT Educational Services, Inc. and Deutsche Bank Trust Company Americas, as indenture trustee and collateral agent                                      | 10-K* | 10.47 | 10/16/14 |

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|       |   |       |       |          |
|-------|---|-------|-------|----------|
| 10.56 | Amended and Restated Indenture and Credit Agreement, dated as of December 31, 2010, by and among PEAKS Trust 2009-1, Deutsche Bank Trust Company Americas, as indenture trustee and collateral agent, and Deutsche Bank National Trust Company, as lender trustee       | 10-K* | 10.48 | 10/16/14 |
| 10.57 | Subordinated Note Purchase Agreement, dated as of January 20, 2010, between ITT Educational Services, Inc. and PEAKS Trust 2009-1   | 10-K* | 10.49 | 10/16/14 |
| 10.58 | Agreement for Servicing Private Student Loans, dated as of December 10, 2011, by and among PEAKS Trust 2009-1, Deutsche Bank Trust Company Americas, as indenture trustee and collateral agent, ITT Educational Services, Inc. and First Associates Loan Servicing, LLC | 10-K* | 10.50 | 10/16/14 |
| 10.59 | Purchase Obligation Agreement, dated as of January 20, 2010, by and among ITT Educational Services, Inc., Deutsche Bank Trust Company Americas, as indenture trustee and collateral agent, and the senior creditors signatory thereto                                   | 10-K* | 10.51 | 10/16/14 |
| 10.60 | Letter Agreement, dated as of March 17, 2014, between ITT Educational Services, Inc., Deutsche Bank Trust Company Americas, as indenture trustee and collateral agent, and the holders of the senior debt signatory thereto   | 8-K*  | 10.1  | 3/21/14  |
| 10.61 | Risk Sharing Agreement, dated as of February 20, 2009, between ITT Educational Services, Inc. and Student CU Connect CUSO, LLC, with the First Amendment, Second Amendment and Third Amendment thereto  | 10-K* | 10.53 | 10/16/14 |
| 10.62 | Fourth Amendment to Risk Sharing Agreement, dated as of November 6, 2014, by and between ITT Educational Services, Inc. and Student CU Connect CUSO, LLC  | 10-Q* | 10.4  | 11/14/14 |

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|       |   |       |       |          |   |
|-------|---|-------|-------|----------|---|
| 10.63 | Fifth Amendment to Risk Sharing Agreement, dated as of March 17, 2015 by and between ITT Educational Services, Inc. and Student CU Connect CUSO   | 8-K*  | 10.4  | 3/18/15  |   |
| 10.64 | Financing Program Agreement, dated as of February 20, 2009, between ITT Educational Services, Inc. and Student CU Connect CUSO, LLC, with the First Amendment, Second Amendment and Third Amendment thereto | 10-K* | 10.54 | 10/16/14 |   |
| 10.65 | Loan and Security Agreement, dated as of May 18, 2009, between ITT Educational Services, Inc. and Student CU Connect CUSO, LLC, with the First Amendment, Second Amendment and Third Amendment thereto      | 10-K* | 10.55 | 10/16/14 |   |
| 10.66 | Agreement for Servicing Private Student Loans, dated as of May 18, 2012, by and between First Associates Loan Servicing, LLC and Student CU Connect CUSO, LLC   | 10-K* | 10.56 | 10/16/14 |   |
| 10.67 | ** Letter Agreement, dated August 4, 2014, by and between ITT Educational Services, Inc. and Kevin M. Modany  | 8-K*  | 10.1  | 8/5/14   |   |
| 10.68 | ** Amendment to Letter Agreement, dated as of April 28, 2015, by and between ITT Educational Services, Inc. and Kevin M. Modany   | 8-K*  | 10.3  | 4/29/15  |   |
| 10.69 | ** Second Amendment to Letter Agreement, dated as of May 26, 2015, by and between ITT Educational Services, Inc. and Kevin M. Modany  |       |       |          | X |
| 10.70 | ** Letter Agreement, dated August 4, 2014, by and between ITT Educational Services, Inc. and John E. Dean   | 8-K*  | 10.2  | 8/5/14   |   |
| 10.71 | ** Letter Agreement, dated as of April 29, 2015, by and between ITT Educational Services, Inc. and Daniel M. Fitzpatrick  | 8-K*  | 10.1  | 4/29/15  |   |
| 10.72 | ** Amendment to Equity Award Agreements, dated as of April 29, 2015, by and between ITT Educational Services, Inc. and Daniel M. Fitzpatrick  | 8-K*  | 10.2  | 4/29/15  |   |
| 10.73 | Irrevocable Letter of Credit Payable to the U.S. Department of Education, dated October 31, 2014  | 8-K*  | 10.1  | 11/04/14 |   |
| 21    | Subsidiaries  |       |       |          | X |

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|------|---|---|
| 23.1 | Consent of Deloitte & Touche LLP, Independent Registered Public Accounting Firm   | X |
| 23.2 | Consent of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm  | X |
| 31.1 | Chief Executive Officer's Certification Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934   | X |
| 31.2 | Chief Financial Officer's Certification Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934   | X |
| 32.1 | Chief Executive Officer's Certification Pursuant to 18 U.S.C. Section 1350  | X |
| 32.2 | Chief Financial Officer's Certification Pursuant to 18 U.S.C. Section 1350  | X |
| 101  | The following materials from ITT Educational Services, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Operations; (iii) Consolidated Statements of Comprehensive Income (Loss); (iv) Consolidated Statements of Cash Flows; (v) Consolidated Statements of Shareholders' Equity; (vi) Notes to Consolidated Financial Statements; and (vii) Financial Statement Schedule II | X |

\* SEC File No. 001-13144

\*\* The indicated exhibit is a management contract, compensatory plan or arrangement required to be filed by Item 601 of Regulation S-K.

\*\*\* Registration No. 333-84871