UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

CITY OF AUSTIN POLICE RETIREMENT SYSTEM, Individually And On Behalf Of All Others Similarly Situated, Plaintiff, v. ITT EDUCATIONAL SERVICES, INC., RENE R. CHAMPAGNE, OMER E. WADDLES, KEVIN M. MODANY, GENE A. BAUGH, CLARK D. ELWOOD, THOMAS W. LAURER, RAND V. ARASKOG, HARRIS N. MILLER, JOHN E. DEAN, and DANIEL P. WEADOCK, Defendants.	Civil Action No.: 1:04-cv-00380-DFH-TAB

<u>CONSOLIDATED CLASS ACTION COMPLAINT</u>

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Lead Plaintiff City of Austin Police Retirement System individually, and on behalf of all other persons or entities similarly situated, by its undersigned attorneys, for its complaint, alleges upon personal knowledge as to itself and its own acts, and upon information and belief as to all other matters, based upon the investigation made by and through its attorneys, which investigation included, among other things, a review of public filings with the Securities and Exchange Commission ("SEC"), public documents, analyst reports, news stories and news releases of ITT Educational Services, Inc. ("ITT" or the "Company"), and interviews with former employees of the Company:

I. NATURE OF THE ACTION

1. Lead Plaintiff brings this action as a class action on behalf of itself and all other persons and entities that purchased ITT common stock on the open market during the period of October 17, 2002 through March 8, 2004 (the "Class Period") and who were damaged thereby.

2. ITT is a provider of private, for-profit post-secondary, technology-oriented programs throughout the United States. The Company offers associate, bachelor and master degree programs and non-degree programs in 77 institutes located in 30 states.

3. The Company's business is highly regulated by federal, state, and private accrediting agencies, including the Accrediting Council for Independent Colleges and Schools ("ACICS"). ITT's business and stock price is dependent upon maintaining compliance with federal and state regulations, and on maintaining its accreditation and reputation with students and investors.

4. Throughout the Class Period, ITT publicly touted its business and financial performance, the performance of its stock price, and its ability to enroll and keep students in

its institutes to entice investors to purchase its stock. Such representations were included in the Company's press releases, conference calls with analysts, and public filings with the SEC. Those representations, however, were materially false and misleading as they failed to disclose to the investing public that ITT had been regularly falsifying records used as indicators of its operational success, which were also the key metrics for approval by accrediting agencies and requirements for federal and state funding. The strong growth reported by the Company throughout the Class Period was grounded upon these fraudulent and inherently unsustainable practices, rendering ITT's reported financial historical performance and projections of future growth materially false and misleading.

5. As detailed below, more than a dozen interviews with former ITT employees throughout the United States confirm that, during the Class Period, Defendants used a host of tricks to falsify student information, including inflating enrollment figures, counting students as "enrolled" who never attended ITT, double counting enrollees, changing and falsifying grades, and misrepresenting attendance and placement rates. These efforts were mandated and regularly monitored by Defendants through ITT's extensive reporting system and frequent meetings with the heads of each institute. Significantly, a former instructor at an ITT institute in California met with Company executives as early as October 2002 and recounted specific instances of attendance and grades falsification at this ITT institute in California, but Defendants failed to take any action.

6. As discussed below, Defendants implemented their scheme in order to avoid disqualification under Title IV of the Higher Education Act of 1965, which would have jeopardized hundred of millions of dollars of revenue for ITT because Title IV federal funding comprised approximately 70% of the Company's revenue during the Class Period.

Defendants' fraudulent scheme also permitted ITT to tout unprecedented growth and exceed consensus estimates in *13* consecutive quarters, boosting ITT's stock price *following all but one* of the Company's earnings announcements during the Class Period.

7. Certain of Defendants were also able to prosper financially during the Class Period, disposing of millions of dollars worth of their ITT stock. Collectively, Defendants sold 826,166 shares and reaped more than $27 million dollars in illegal insider trading proceeds. Significantly, all these trades occurred after Defendants learned of an investigation by the California Attorney General into ITT's California institutes, but before this probe was disclosed publicly to investors.

8. On February 25, 2004, the Company shocked investors when it announced that federal agents served ITT's corporate headquarters and ten (10) of its institutes in Indiana, Texas, Louisiana, Virginia, Florida, Nevada, California and Oregon with search warrants seeking documents related to placement figures and rates, retention figures and rates, graduation figures and rates, attendance figures and rates, recruitment and admissions materials, student grades, graduate salaries and transferability of credits to other institutions.

9. In the wake of the revelation of the federal investigation by the Department of Justice, the price of ITT common stock fell from $57.40 per share on February 24, 2004 to close at $38.50 per share on February 25, 2004 – a one-day loss of 33% of the value of the stock on unusually heavy trading volume of more than 8.95 million shares, more than *16 times* ITT's average daily volume.

10. On March 9, 2004, the Company stunned investors again when it disclosed in its 2004 Proxy that two additional investigations aimed at ITT's business practices were ongoing by the SEC and the California Attorney General. In fact, for the very first time, ITT

disclosed that the California Attorney General had been investigating the Company *since October 2002* and that its investigation was focusing on whether ITT falsified student grades and attendance records used for financial aid qualification.

11. The news of the SEC and California Attorney General's investigations filtered into the market on March 9, 2004. In reaction to the announcement of the investigations, the price of ITT common stock declined approximately 6.5% during the trading day from a closing price of $34.87 on March 8, 2004, to a closing price of $32.65 on March 9, 2004. News of the California Attorney General's investigation was not reported on the wire services until the middle of the afternoon on March 9th. Thus, the full effect of the disclosure on the price of ITT common stock was not felt until the next trading day when the price dropped an additional $2.20 per share to close at $30.45 per share. Over the next three trading days the price continued to fall until it bottomed out at $28.29 per share on March 15, 2004.

II. JURISDICTION AND VENUE

12. The claims alleged herein arise under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §78j(b) and 78t, and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder.

13. The jurisdiction of this Court is based on Section 27 of the Exchange Act, 15 U.S.C. § 78aa and 28 U.S.C. § 1331 (federal question jurisdiction).

14. Many of the acts alleged herein, including the dissemination to the investing public of the misleading statements at issue, occurred in substantial part in this District and further, the Company is headquartered in this District.

15. In connection with the acts, transactions and conduct alleged herein, Defendants used the means and instrumentalities of interstate commerce, including the United

States mails, interstate telephone communications and the facilities of national securities exchanges and markets.

III. THE PARTIES

Lead Plaintiff

16. Lead Plaintiff City of Austin Police Retirement System purchased shares of ITT common stock during the Class Period at prices that were artificially inflated by Defendants' misconduct, which resulted in damages to Lead Plaintiff and the Class.

Defendants

17. ITT is a Delaware corporation with its principle executive offices located at 13000 North Meridian Street, Carmel, Indiana 46032-1404. From 1966 until its initial public offering on December 27, 1994, the Company was wholly owned by ITT Corporation, formerly a Delaware corporation now known as ITT Industries, Inc., an Indiana corporation ("Old ITT"). On September 29, 1995, ITT Corporation, a Nevada corporation ("ITT Corp."), succeeded to the interests of Old ITT in the beneficial ownership of 83.3% of ITT's common stock. On February 23, 1998, Starwood Hotels & Resorts Worldwide, Inc., a Maryland corporation, acquired ITT Corp. Public offerings of ITT common stock by ITT Corp. in June 1998 and February 1999, and the repurchase of 1.5 million shares by ITT from ITT Corp. in February 1999 completely eliminated ITT Corp.'s beneficial ownership of any ITT common stock.

18. Defendant Rene R. Champagne ("Champagne") served as Chairman of ITT's Board of Directors since October 1994 and Chief Executive Officer of ITT since September 1985. He served as President of ITT from September 1985 through December 2001, and has been a Director of ITT since October 1985. During the Class Period, Champagne sold 135,000 shares of ITT common stock for proceeds of $5,394,538.

19. Defendant Omer E. Waddles ("Waddles") served as President and Chief Operating Officer of ITT since January 2002. From April 1999 through December 2001, he served as Executive Vice President of ITT. He was a Director of ITT from January 2002 until July 12, 2004. Waddles resigned from his executive and directorial positions at ITT on July 12, 2004, and resigned from his employment with ITT on July 30, 2004. During the Class Period, Waddles sold 100,000 shares of ITT common stock for proceeds of $3,917,334.

20. Defendant Kevin M. Modany ("Modany") served as Chief Financial Officer of ITT since January 2003 and Senior Vice President of ITT since July 2002. From June 2002 through December 2002, he served as Director of Finance of ITT.

21. Defendant Gene A. Baugh ("Baugh") served as Chief Financial Officer of ITT from December 1996 and as Senior Vice President of ITT from January 1993 until his retirement from ITT in February 2003. During the Class Period, Baugh sold 67,500 shares of ITT common stock for proceeds of $1,729,350.

22. Defendant Clark D. Elwood ("Elwood") served as Senior Vice President of ITT since December 1996, Secretary of ITT since October 1992, and General Counsel of ITT since May 1991. During the Class Period, Elwood sold 161,600 shares of ITT common stock for proceeds of $4,124,100.

23. Defendant Thomas W. Lauer ("Lauer") served as Senior Vice President, Director of Operations of ITT from January 1993 until his retirement in February 2004. During the Class Period, Lauer sold 120,000 shares of ITT common stock for proceeds of $4,928,252.

24. Defendants Champagne, Waddles, Modany, Baugh, Elwood and Lauer are referred to collectively herein as the "Individual Defendants." The Individual Defendants,

because of their positions of control and authority as officers and/or directors of the Company, were able to and did control the contents of the Company's public statements and filings about its financial results. Each Individual Defendant was provided with, or had access to, copies of the Company's press releases alleged herein to be misleading prior to or shortly after their issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected. Because of their Board and/or executive and managerial positions with the Company, each Individual Defendant had access to the adverse non-public information about the Company's business, finances, markets and present and future business prospects through access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management and Board meetings and committees thereof and through reports and other information provided to them. As a result, each of the Individual Defendants is responsible for the accuracy of the public reports and releases detailed herein as "group published" information and is therefore responsible and liable for the representations contained therein.

25. Defendant Rand V. Araskog ("Araskog") served as a Director of ITT since April 1994 and has been a member of the Audit Committee since 2001. During the Class Period, Araskog sold 224,000 shares of ITT common stock for proceeds of $6,473,582. Defendant Araskog signed the Company's Forms 10-K for fiscal years 2002 and 2003.

26. Defendant Harris N. Miller ("Miller") served as a Director of ITT since July 1999 and has been a member of the Audit Committee since 2001. During the Class Period, Miller sold 18,000 shares of ITT common stock for proceeds of $934,400. Defendant Miller signed the Company's Forms 10-K for fiscal years 2002 and 2003.

27. Defendant John E. Dean ("Dean") served as a Director of ITT since December 1994 and has been a member of the Audit Committee since 2001. Defendant Dean signed the Company's Forms 10-K for fiscal years 2002 and 2003.

28. Defendant Daniel P. Weadock ("Weadock") served as a Director of ITT since April 1999 and has been a member of the Audit Committee since 2001. Defendant Weadock signed the Company's Forms 10-K for fiscal years 2002 and 2003.

29. Defendants Araskog, Miller, Dean, and Weadock are collectively referred to herein as the "Audit Committee Defendants."

IV. SUBSTANTIVE ALLEGATIONS

A. Background

30. ITT bills itself as a leading provider of technology-oriented post-secondary degree programs in the United States based on revenues and student enrollment. The Company offers associate, bachelor and master degree programs and non-degree diploma programs purportedly to more than 37,000 students at 77 institutes in 30 states. The Company claims that each of its institutes is (a) authorized by the applicable education authorities of the states in which they operate and recruit and (b) accredited by an accrediting commission recognized by the United States Department of Education (the "DOE").

31. ITT represents that its business strategy is to pursue multiple opportunities for growth, which are designed to increase revenues and operating efficiencies by increasing the number and types of program offerings and student enrollment at existing institutes, opening new institutes, licensing the use of its curricula to third parties, and expanding in international markets.

32. In 2002 and 2003, ITT derived approximately 65% and 71%, respectively, of its revenues from the federal student financial aid programs under Title IV ("Title IV

Programs") of the Higher Education Act of 1965, as amended (the "HEA"). ITT students receive grants, loans and other aid to fund the cost of their education under the following Title IV Programs:

- the Federal Family Education Loan program, which accounted in aggregate for approximately 56% and 58% of ITT's revenues in 2002 and 2003, respectively;
- the Federal Pell Grant program, which accounted in aggregate for approximately 12% and 13% of ITT's revenues in 2002 and 2003, respectively;
- the William D. Ford Federal Loan program, which accounted in aggregate for approximately 1% and less than 1% of ITT's revenues in 2002 and 2003, respectively;
- the Federal Work-Study program, which makes federal funds available to provide part-time employment to students and under which ITT institutes employed approximately 385 students and paid $1,672,000 in student wages in 2002 and employed approximately 750 students and paid $2,397,000 in student wages in 2003;
- the Federal Perkins Loan program, which accounted in aggregate for a negligible portion of ITT's revenues in 2002 and 2003; and
- the Federal Supplemental Educational Opportunity Grant program, which accounted in aggregate for a negligible portion of ITT's revenues in 2002 and 2003.

33. ITT derived approximately 4% of its revenues from state financial aid programs and 14% and 20% from unaffiliated, private loan programs, in 2002 and 2003, respectively.

B. <u>Eligibility and Participation in Title IV Programs</u>

34. ITT's financial performance is highly dependent on its eligibility to participate in Title IV Programs and ability to maintain accreditation. The critical importance of federal funding in the for-profit, post secondary education industry has frequently been highlighted by the media and analysts. For example, a July 17, 2003 US Bancorp Piper Jaffray report

cited ITT's "dependence on government-sponsored student financial aid, eligibility to participate in Title IV, and ability to maintain accreditation" as "risks to achievement of target price." A May 20, 2004 *Financial Times* article entitled "Probes Cast Shadow Over Schools" warned that losing Title IV funding can be "***a death knell for the business***." (Emphasis added). Similarly, a June 21, 2004 *Wall Street Journal* article entitled "Career Education May Be a Lesson" noted that "losing funding can put a school in financial straits." Echoing this, Barmak Nassirian of the American Association of Collegiate Registrars and Admissions Officers was quoted in a June 25, 2004 *Financial Times* article entitled "Schools Sector Falls Out of Investors' Good Books," as observing "[a]ll you need is one hiccup for corporations that have done phenomenally well to tumble down, because they are entirely dependent on Title IV funding for their existence."

35. In fact, the loss of federal accreditation, and thus federal funding, bankrupted several for-profit schools. Most notably, both Computer Learning Centers Inc., in 2000, and Phillips Colleges, in the 1990s, were forced into bankruptcy as a result of losing Title IV accreditation.

36. In order to participate in Title IV Programs, ITT institutes must each comply with the standards set forth in the HEA and the regulations promulgated thereunder by the DOE. For example, Title IV dictates specific requirements for completion and placement rates at each ITT institute. Under the HEA, ITT's institutes must have a completion rate of at least 70% and a placement rate of 70%. The HEA defines the completion rate as the number of students enrolled during the year, subtracted by the number of students who withdrew, dropped out or were expelled. The HEA further defines the placement rate as the number of

students who, within 180 days of receiving their diploma, are employed or have been employed for at least 13 weeks following receipt of the diploma.

37. Title IV also requires that a student enrolled in a program of study of 2 years or more must have a grade point average of at least a "C" or have academic standing consistent with the institution's requirements for graduation.

38. ITT's institutes are subject to audits and program compliance reviews by various external agencies, including the DOE, state agencies, guaranty agencies and the ACICS. The compliance reviews address many areas including student tuition refunds, student academic progress, student admission, graduate employment, student attendance, student financial aid applications, and a general review of student recruiting practices. These reviews measure whether ITT's institutes are in compliance with requirements such as minimum hours, number of days for school year, attendance, and passing rates.

39. If the DOE or another regulatory agency determines that an institute improperly disbursed Title IV Program funds or violated a provision of the HEA or the implementing regulations, that institute could be required to repay such funds to the DOE or the appropriate state agency or lender and could be assessed an administrative fine. Violations of Title IV Program requirements could also subject ITT to other civil and criminal penalties.

40. Significant violations of Title IV Program requirements can be the basis for a proceeding by the DOE to limit, suspend or terminate the participation of the affected institutes in Title IV Programs. If the DOE terminates an institute's participation in Title IV Programs, the institute in most circumstances must wait 18 months before requesting a reinstatement of its participation.

41. ITT is also subject to extensive and varying regulations in each of the 30 states in which it operates an institute and in 14 other states in which ITT recruits students, including receiving approval of ACICS to confer degrees and diplomas. State authorization and accreditation by an accrediting commission recognized by the DOE are required for an institute to become and remain eligible to participate in Title IV Programs. If an institute loses its accreditation, the individual institute or an entire campus (if the affected institute was a main campus) would be ineligible to participate in Title IV Programs.

C. <u>The Scheme to Defraud</u>

42. During the Class Period, Defendants engaged in a pervasive course of conduct whereby student records and statistics were systematically falsified, distorted and inflated in order to represent to the investing public that enrollment and attendance at ITT institutes were continually growing along with the Company's revenues and earnings. By doing so, Defendants were able to artificially inflate the price of ITT common stock and reap huge profits by the sale of ITT common stock from their personal portfolios.

43. In order to create the appearance that revenues and earnings were growing quarter by quarter, Defendants had to assure investors that funding via the Title IV Programs continued to flow into the Company's coffers. Thus, Defendants used a myriad of machinations to falsify, distort and inflate the key metrics monitored by the DOE to satisfy HEA's requirements, obtain ACICS accreditation, and attain DOE certification and eligibility to participate in Title IV Programs. In sum, Defendants were able to kill two birds with one stone. That is, the same misconduct which resulted in misleading the federal government to continue the flow of revenues into ITT were used to mislead investors into paying inflated amounts for ITT stock.

1. **Management Pressure to Meet Enrollment, <u>Retention, Placement and Attendance Targets</u>**

44. Former ITT employees throughout the United States confirmed that Defendants set unrealistic goals for enrollment, retention and placement and exerted enormous pressure for each ITT institute to meet these targets. The pressure to "get your numbers" began when Defendant Waddles joined the Company in 1999, according to a former academic dean of an ITT Technical Institute in Little Rock, Arkansas. Not only did this former academic dean recall receiving e-mails directly from Defendant Waddles stressing the "need to make our numbers," but Defendant Waddles also verbally told this witness "You're going to get your numbers or you're gone." According to a former academic dean in the same Arkansas ITT Technical Institute, managers were even made to sign agreements with the Company that if they did not make their goals, they would be given a letter of reprimand and then terminated.

45. Another former director of an ITT Technical Institute in Tampa, Florida, recalled that after Defendant Waddles was promoted to president in January 2002, there was "immense pressure" from headquarters and district managers to meet the goals set by management. For example, although the Tampa Institute was profitable in 2002, headquarters gave the former director an "impossible" goal for 2003 of *1500* percent improvement.

2. **Senior Management Actively Monitored Enrollment, Placement, <u>Attendance And Other Student Targets At Each ITT Institute</u>**

46. Defendants were intimately involved in monitoring and tracking the progress of each ITT institute in reaching sales quotas, according to former ITT employees. Weekly "recruitment meetings" were held to discuss the status of the start numbers for upcoming quarters. During these meetings, ITT sales representatives were each given individualized

weekly reports containing charts showing the total number of "starts" (the number of students who actually show up for class on the first day and remain in school until the Add/Drop date) that the representative must obtain for each specific education program for the quarter, the number of starts successfully obtained in the week, and the number of starts still needed to meet sales quotas. Further, each sales representative was given a rating that was used to evaluate job promotion. As explained in a weekly report, the rating is to "[d]emonstrate that you can start and retain students. Tuition revenue is used as measuring tool. In other words, how much money you generate for the school."

47. A former ITT admissions representative from the Chantilly, Virginia campus, characterized the job as selling "used cars." The former representative stated that "it was all high pressure sales on the potential students," and that "the only thing that the school cared about was making their numbers for the quarters and year." Another former ITT admissions representative from the Anaheim, California campus noted that ITT was essentially "recruiting people to fail" because the institutes would recruit students "to just get their quotas to corporate," even if the students recruited were not qualified and would likely fail in their education. As a result, according to the former ITT employee, many students had to subsequently drop out.

48. Goals for each ITT institute were set by Company headquarters, in January or February of each year during the Class Period, according to a former ITT director of finance in Memphis, Tennessee. A former director of admissions at an ITT Technical Institute in Salt Lake City, Utah stated that based on the targets from headquarters, ITT directors at each institute would then establish goals for their managers for new enrollments, attendance, total census, grades, graduation, job placement and profitability.

49. A former ITT director of financial aid in Greenville, South Carolina and a former director of admissions at an ITT Technical Institute in Salt Lake City, Utah both confirmed that the Company's headquarters closely monitored enrollments, attendance, total census, grades, graduation, job placement and profitability on a weekly, monthly and quarterly basis. A former ITT dean of academic affairs at the ITT Technical Institute in Bothell, Washington personally sent attendance numbers to headquarters through the Company's centralized computer system, Exeter, which linked all of the campuses.

50. According to the former National Director of Career Services who worked at ITT's Carmel, Indiana headquarters during the Class Period, the Company held monthly operations committee meetings where "all of the major management decisions" were made. These meetings were headed by Defendant Champagne and attended by Defendant Waddles; Defendant Modany; Defendant Lauer; Defendant Elwood; the Senior Vice President of ITT and Director of Marketing and Investor Relations; the Vice President of Human Resources; and the Vice President, Internal Audit. At the monthly operational meetings, senior managers of ITT would advise how well the Company was performing and whether each individual institute was meeting its goals.

51. In addition to the monthly operations committee meetings led by Defendant Champagne and attended by top executives, throughout the Class Period, Defendant Waddles held monthly "operational reviews" in the fourth floor boardroom at the Company's headquarters in Carmel, Indiana. The former National Director of Career Services confirmed that the Company's top executives as well as its middle managers attended these meetings. During the reviews, which lasted one to two days, Defendant Waddles ran through an entire list of key figures for the Company as a whole as well as on a district-by-district basis.

Schools that were failing to meet their goals were "red flagged" and plans of action to improve their performance were discussed. According to the former National Director of Career Services, Defendant Waddles discussed attendance, attrition, re-entries and job placement rates at the reviews "in minute detail." Once every quarter, the eight district managers joined the meeting.

52. Defendant Waddles also held monthly meetings during 2002 and 2003 through telephone conference calls with all of the ITT campuses, according to a former ITT director of finance in Memphis, Tennessee. During the monthly conference calls, in which Defendant Modany conducted Power Point presentations shown over the Internet, Defendant Waddles and other members of senior management reviewed each ITT institutes' figures for recruitment, enrollment, attrition, financial aid and job placement. During the conference calls, Defendant Waddles and other members of management posed questions to specific managers about what they were doing to improve their numbers.

53. The former director of finance at ITT in Memphis, Tennessee recalled receiving e-mails personally from Defendant Waddles regarding revenues. As did a former director of recruitment in Spokane, Washington who personally received an e-mail from Defendant Waddles, as did others in his district, regarding enrollment figures.

3. <u>Manipulation of Enrollment Figures</u>

54. As discussed above, ITT's enrollment figures were a critical metric viewed by investors and analysts and frequently touted by Defendants in their press releases, filings and conference calls. Indeed, the Company's enrollment figures were ripe for abuse because the enrollment figures are directly linked to the amount of revenue ITT obtained through student loans and other federal funding.

55. Numerous former ITT employees, each at different ITT institutes throughout the country, admitted that ITT fraudulently reported enrollment figures by counting as enrollees those students who merely expressed an interest in the school but either never showed up for class or later dropped out, double counting enrollees, and manipulating attendance and placement rates. According to a former ITT director of admissions in Salt Lake City, Utah, during 2001, a directive came from the district manager ordering recruitment directors to identify people who had merely expressed an interest in applying to the school as part of the institute's gross enrollment figures. Under this policy many students who were included as part of the institute's "gross enrollment" would not show up later in class. In all, according to this former ITT director, nearly *70 to 80 percent* of the prospects included in the gross enrollment never attended class.

56. Another former director of finance for the ITT Technical Institute in San Antonio, Texas confirmed that the Company formally enacted a "new policy" of processing and counting newly enrolled students that had the effect of enrolling individuals who "had merely expressed an interest in ITT," but never attended any classes. This former director of finance recalled that prior to this enactment, ITT only counted enrollments as those students who had paid a $100 fee, taken an admissions test, signed an agreement and applied for financial aid if they needed it. Under the new software system introduced companywide in 2001 by the marketing department at headquarters, each time a recruiter found a person who expressed an interest in enrolling in the school, that person's name was entered into the school's database as a new enrollee. After their name was entered into the database, various departments had to follow up to get the student to come in to take the test, sign the contract

and seek financial aid. Under the new policy, "[students] were counted as an enrollment before they ever came in to the school."

57. The former director of recruitment at the ITT Technical Institute in Bothell, Washington similarly stated that students were recorded in the school's Exeter system "when they walked in the door." This former director of recruitment had seven recruiters working on enrolling students. The school recorded each student's status in different categories – "applied," "accepted" and "packaged." ITT's district managers would produce Active Student Reports ("ASR") for each region of the country, which contained a breakdown of the number of students by school who fell into each of these categories. According to the former director of recruitment, the ASR could be viewed daily on ITT's shared computer system (available throughout the country, including at corporate headquarters). The ASR included a figure for the "total applied" and this was the figure that was touted to the public in press releases.

58. At the ITT Technical Institute in Bothell, anyone who "walked in the door got applied status" merely by expressing an interest in the school, and without having filled out an application, paying a $100 enrollment fee, taking an admissions test or obtaining funding. The former director of recruitment stated those students who took the admissions test and passed were categorized as "accepted" and those who had received financial aid, scholarships or grants were categorized as "packaged." Those who fell into the applied status were reported in the school's overall enrollment figures at the beginning of each semester. However, a substantial portion of those in the applied category never started school or attended classes. Based on knowledge of the breakdown in the ASR, this former director of

recruitment questioned how headquarters arrived at the numbers circulated in its press releases and filings.

59. ITT was also able to inflate enrollment figures by manipulating the "start" or "end" dates for each quarter. According to the former director of recruitment in Spokane, Washington, the Company's executives extended the quarters by a week or ten days in order to count more students as enrolled in each respective quarter. One of these directives came directly from Defendant Champagne who sent an e-mail message to recruitment directors extending the "start-date" of the semester by one week or two weeks after classes had actually started.

60. A former director of recruitment at the ITT Technical Institute in Bothell, Washington also confirmed that during 2002, administrators routinely extended the start dates of classes by two weeks, so they could continue to enroll students and boost their enrollment figures. Notably, the order to extend the start date frequently came a couple of days or more into the semester when it became apparent the school was not going to make its enrollment goals. According to this former director of recruitment, this policy was directed by corporate headquarters and, after speaking with other directors of recruitment in this region and on the East Coast about this policy, verified that it was implemented companywide.

61. In fact, so blatant were the enrollment manipulations at ITT that in an email dated May 31, 2002, from an ITT Technical Institute director in Bothell, Washington to another district manager, entitled "April/May close rate," the director stated,

> I was doing some number crunching. *We both know how to lie with statistics*, but what the heck, it reflects well for [the Institute], even if it doesn't demonstrate volume. That still remains to be seen, but if our call activity gets to the right level and we maintain our conversion rate, we should be able to expand our start for June.
> (Emphasis added).

62. The former director of recruitment at the ITT Technical Institute in Bothell, Washington was so outraged by the manipulation of the enrollment figures at this institute that she sent a letter to Defendant Champagne to bring the issues to his attention in September or October 2002. According to this witness, Champagne never addressed her concerns.

63. Another method used to boost enrollment and placement figures was to "double count" students as enrollments and placements, according to the former dean of academics at an ITT Technical Institute in Memphis, Tennessee. Specifically, during the last two quarters, the director of the ITT Technical Institute in Tennessee ordered that students who were graduating with associates degrees but could not find jobs should be convinced to enroll again for a bachelor's degree. That way, "those students would be counted twice: as a new enrollee and as a job placement." According to this former ITT dean of academics, the double counting was specifically intended to inflate enrollment rates to inflate ITT's stock price: "It was just a game to keep the numbers up so the stock would look good."

64. Similarly, a former student recruiter for an ITT Technical Institute in Anaheim, California stated that ITT concealed poor statistics for its two-year programs by having its admission representatives telephone the students who had dropped out of the programs or the unemployed graduates of the programs, and enrolling such students and graduates into four-year programs – so that these students would not adversely impact ITT's statistics. In May 2003 alone, "hundreds" of these telephone calls were made by ITT admission representatives. Additionally, according to this former ITT employee, "many of the students that were listed as enrolled had actually dropped out," and "many of the students were placed in temporary agencies and not the career where they had graduated."

65. A former ITT employee who worked as a master admissions representative at the ITT Technical Institute in San Bernardino, California also revealed that ITT concealed adverse student statistics by switching students from program to program. For example, when a two-year computer network program in the San Bernardino campus experienced low rates of enrollment, retention and graduation, ITT instructed its admission representatives to contact students who were enrolled in that program, and attempt to have the students enroll in a four-year bachelors program, regardless of the students' qualifications and abilities to handle the program. While making the telephone calls as instructed, this former ITT employee discovered that most of the students characterized by ITT as still enrolled had in fact already dropped out.

4. Inflating Attendance Records

66. In addition to inflating enrollment figures at the front end, ITT also manipulated its attendance or retention rates to maintain Title IV eligibility. According to former instructors at the ITT Technical Institute in Sylmar, California, during testimony given in connection with a workers' compensation action entitled *Hubbard v. ITT Educational Svcs., Inc.*, Workers' Compensation Appeals Board, State of California, No. MON 0276250 (the "Hubbard Action"), supervisors in the Sylmar, California ITT Technical Institute *routinely* inflated attendance figures. One former instructor stated that, "if you had a lot of absentees in your class, you were reprimanded." Notably, this former instructor indicated that at the end of the quarter he personally saw the education supervisor at Sylmar, *physically change* the attendance logs in the school's computer. Asked how often this happened, the former instructor testified "It was common . . . I had seen him change the records in the computers relative to attendance on more than one occasion."

67. Another former instructor of general education at the Sylmar ITT Technical Institute testified that:

> The amount [and] the frequency from which students were absent was greatly under exaggerated or downplayed when they become excessive. The totals were manipulated . . . those total were changed regularly throughout the entire period.
> . . . .
> With respect to the attendance records. The attendance records, I found from November to my specific knowledge, from November 1999 right through the first quarter of this year 2002. [sic] I've seen have been altered or amended or changed or whatever you want to call it on a regular basis.

68. While students were "allowed to make up 12 hours" in attendance, this former instructor of general education recalled that the discrepancies were "36, on upwards of 36, 40." One student in particular was "absent more than he was there . . . but they retained him and retained him and retained him, and changed his absentee figures *so that he wouldn't exceed the amount needed to be kicked out of school and continue to get Federal money*." (Emphasis added).

69. Instructors at the Sylmar ITT Technical Institute faced immense pressure to keep attendance rates up since each professor's individual evaluation was dependent on his/her "absentee rates." As explained by a former instructor, "Instructors, teachers are rated as managers. One of the rating factors for evaluation is absentee rate or efficiency of absence or how much a student attends the class." The attendance goals were "assigned to [each] school by headquarters which were then passed down to the instructors." As an example, this former instructor noted: "If classes have absentee rates of more than 7 percent, for instance . . . you might get a letter or a conference or both from the director of education, or the dean saying that, I guess, in layman's term warning you that their absentee rate is too high and, therefore, do something about it." Another instructor at the Sylmar ITT Technical Institute

confirmed during his sworn deposition that performance evaluations were dependent on enrollment and that "if you get [sic] dropped students, it counts against you regardless of the reason." Indeed, the former general education instructor noted that the Sylmar campus' low absentee rates and high retention were touted in public meetings and via e-mails as well as in the Company's newsletters.

70. These practices were not limited to the Sylmar ITT Technical Institute. A former ITT instructor at the ITT Technical Institute in Spokane, Washington also confirmed that the dean of his institute said that "if a student shows up for a class – even for a couple of minutes – mark them down as present."

71. An interview with a former instructor at the ITT Technical Institute in Sylmar confirmed that attendance records were "horrifically manipulated" at this institute *throughout* 2002 and that the alterations of the attendance records were so "flagrant" that it "became a staff joke." During October 2002, this former instructor met with Gary Carlson, the Vice President of National Academic Affairs at ITT, the district manager of ITT and ITT's legal counsel, and informed them all about the fraud occurring at the ITT's Sylmar Institute. Notably, Carlson reported directly to Defendant Laurer, who reported directly to Defendant Waddles. During this meeting, this former instructor not only recounted specific instances of attendance and grade falsifications, but also notified Carlson that certain incriminating documents showing the fraudulent conduct had been turned over to the Office of the Inspector General of the Department of Education. Recalling this meeting, the former instructor stated that Defendants "knew in October 2002 about the fraud and that their employees were systematically changing attendance records and the information had been turned over to the

feds." There was never any follow-up by ITT management with this former instructor on any of the issues raised at the October 2002 meeting.

5. <u>ITT Institutes Regularly Inflated Grades To Maintain Title IV Eligibility</u>

72. Interviews with former ITT employees also reveal a systematic practice of falsifying grades at ITT institutes throughout the country as well as retaliation against employees who attempted to report such manipulations. As discussed above, in order to remain eligible for federal funds under Title IV, students at ITT institutes were required to maintain a "C" grade point average. A former ITT director of finance in Greenville, South Carolina confirmed that student grades were closely monitored at the end of each quarter because if a student's grades fell below a certain grade point average, the student would no longer be eligible for federal funds.

73. A former electronics instructor at the ITT Technical Institute in Albuquerque, New Mexico also noted there was pressure from management, the dean, the institute director, and the program chairmen to keep students in school, even if they were failing, in an effort to prevent these students from dropping out or from falling below required grade point averages.

74. This pressure translated into falsification and inflation of grades at numerous ITT institutes throughout the United States. A former ITT marketing representative/recruiter at an ITT Technical Institute in Little Rock, Arkansas confirmed that students routinely received grades that were inflated. One former student received an "A" on a test that he did not even take because he was absent from school. This former student also confirmed that ITT would teach students the answers to tests to keep them enrolled in school.

75. According to the former student recruiter for the ITT Technical Institute in Anaheim, California, ITT was also inflating the numbers of students enrolled, retained,

graduated and placed. Among other things, ITT would lower passing grades for standardized tests in order to enable more students entrance to programs and courses. Further, ITT routinely avoided the disclosure of adverse student success rates, graduate rates and graduate placement rates in certain programs by simply changing the names of the programs and their course numbers and disguising them as new programs for which no prior statistics were available.

76. A former ITT instructor at the ITT Technical Institute in Spokane, Washington recalled that after failing five students in an electronics class, the dean of the institute told him, "All but one of your students have passed the course. We can't have that many students fail…if you fail that many students nobody will be able to protect your job." Later, while reviewing the schools' computer system for grades, the former instructor confirmed that the grades of four of the five students he had been told to change had been altered from F's to C's and B's.

77. Sworn testimony given by former instructors at the ITT Technical Institute in Sylmar, California, in connection with the Hubbard Action also reveal a widespread pattern of grade inflation during 2002. One former instructor at Sylmar recalled instances of grade falsification where another instructor "complained to me that her student's grade had been changed." In addition to this one instance, "may instructors complained about when people were failed, in other words, when they were given failed grades in their classes by them, but somehow turned up as passing later on." This former instructor was told of a "whole class of students given A's at the very least." Notably, an attorney for Defendant ITT was present during this former instructor's entire sworn deposition.

78. Another former instructor at the ITT Technical Institute in Sylmar, California, under oath, not only confirmed that grades and attendance figures were regularly falsified, but that he was laid off by ITT for refusing to take part in the manipulations:

> Q: Do you have any opinion as to why you were laid off and not other less senior instructors?
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> A: Well, you know, since I joined Sylmar, I found they were not carrying out duties according to ITT regulations. For instance, documents were being falsified, especially attendance and grades were being changed by supervisors without letting instructors know. The policy of ITT is whenever any grade change has to be made, has to be changed, it's supposed to be done in coordination with the instructor and the supervisor and the dean, but what was happening was when you fail a student, when a student fails, the supervisor goes behind doors and make [sic] the changes. And I kept bringing them up. I wrote e-mails to the supervisors a couple of times, and I guess it goes to the attention of the director, and I guess they felt that I was touching a wrong button, and they decided to lay me off.

6. Misrepresentation of Placement Rates

79. Another critical metric for receiving federal funds, placement rates, was similarly manipulated at ITT campuses. A former ITT assistant director of career services at the ITT Technical Institute in Troy, Michigan confirmed that ACICS standards required 65 percent of ITT's graduates to work in the field in which they were trained or a related field. In order to prove that a student had found a job, each institute had to fill out a graduate employment information sheet, known as a "GEI," which documented the student's name, job title and responsibilities. The GEI had to be signed by the student. An internal audit of the career services department at the Troy Institute raised dozens of issues, such as missing documentation and missing signatures.

80. Another former ITT employee from the Torrence, California campus stated that ITT fabricated and stretched its student statistics, and that ITT's graduate placement

figures were inaccurate by at least 20%. According to this former employee, ITT often improperly inflated its graduate placement statistics by counting as placements those students who already had jobs before and while attending ITT, even though such students had never actually left their existing jobs and were not placed into new jobs.

81. The former employee similarly stated that ITT would routinely switch students from two-year associate programs to four-year bachelor programs in order to conceal adverse student statistics regarding retention and graduate placement and to inflate enrollment numbers.

7. ITT Institutes Destroyed Documents And Deleted Relevant Information In An Attempt To Mask The Fraud

82. ITT institutes in California and Memphis both carried out systematic and orchestrated document destructions, undoubtedly to conceal the fraudulent activities from government investigators. According to a corroborated account by a former student recruiter in California, several ITT employees spent an entire Saturday in October 2003 at ITT's campus in Anaheim, California, removing and destroying financial aid documents and records relating to student attendance and grades before an impending review by California state auditors concerning student financial aid matters. The former employee recalled that "everyone was in a panic" as they removed student records from cabinets, shredded the records, and placed the shreds in large plastic bags to be transported away for disposal using an employee's car.

83. The activity started early in the morning, and continued until late in the evening. This former recruiter stated that the institute's registrar was monitoring the shredding and directed co-workers to place plastic bags of the shredded documents into her car. The institute director also came to the financial aid office to inspect the shredding.

Commenting on the document destruction, another recruiter present during the document destruction stated: "They're in a lot of trouble," because "the government is going to be here."

84. A few days after the shredding took place, when the state auditors visited the campus for the audit in the following week, as anticipated, the auditors were only able to review the scrubbed files and records that remained following the destruction of documents.

85. Another former recruiter and marketing representative at the ITT Technical Institute in Memphis, Tennessee recounted that one or two days before federal agents seized documents from ITT institutes around the country in February 2004, the director of recruitment at the school in Memphis erased about 6 weeks' worth of data related to the enrollment of students. The former recruiter and marketing representation recalled the director of recruitment erased the daily marketing data, or "tracker sheets," each representative kept to track their calls, the number of students who enrolled, and those who applied for financial aid.

V. FALSE AND MISLEADING STATEMENTS

86. The Class Period begins on October 17, 2002. On that day, ITT issued a press release announcing financial results for the quarter ended September 30, 2002, that reported "Record Increase in Third Quarter Earnings per Share," and "New Student Enrollment Increased 6.1 Percent." The press release further reported:

> During the three months ended September 30, 2002, earnings per share ("EPS") increased 36.8 percent to $0.26 compared to $0.19 in the same period of 2001. As of September 30, 2002, total student enrollment at the company's ITT Technical Institutes, excluding international enrollments, increased 6.2 percent to 33,799 compared to 31,815 as of the same date in 2001. This 6.2 percent increase in total student enrollment resulted from a 6.1 percent increase in new student enrollment to 10,660 in the third quarter of 2002 compared to 10,046 in the third quarter of 2001, and a 6.3 percent increase in continuing students to 23,139 in the third quarter of 2002 compared to 21,769 in

> the third quarter of 2001. Revenues in the third quarter of 2002 increased 13.4 percent to $120.5 million compared to $106.3 million in the third quarter of 2001. During the third quarter of 2002, operating income increased 36.0 percent to $18.8 million compared to $13.9 million in the same period of 2001. Operating margin increased 260 basis points in the third quarter of 2002 to 15.6 percent compared to 13.0 percent in the same period 2001. Net income for the three months ended September 30, 2002 increased 31.8 percent to $12.1 million compared to $9.2 million in the same period of 2001. Earnings before interest, taxes, depreciation and amortization ("EBITDA") in the third quarter of 2002 increased 30.3 percent to $23.8 million compared to $18.2 million in the third quarter of 2001. EBITDA margin in the third quarter of 2002 increased 250 basis points to 19.7 percent compared to 17.2 percent in the same period of 2001.
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> * * *
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> During the first nine months of 2002, revenues increased 13.5 percent to $338.9 million compared to $298.5 million during the same period of 2001. In the first nine months of 2002, operating income increased 35.9 percent to $38.8 million compared to $28.6 million in the first nine months of 2001. Operating margin increased 190 basis points to 11.5 percent in the first nine months of 2002 compared to 9.6 percent in the same period 2001. Net income in the first nine months of 2002 increased 32.6 percent to $25.3 million compared to $19.0 million in the first nine months of 2001. EBIDTA in the first nine months of 2002 increased 29.3 percent to $54.5 million compared to $42.2 million in the first nine months of 2001. EPS in the first nine months of 2002 increased 38.5 percent to $0.54 compared to $0.39 in first nine months of 2001.

87. Defendant Champagne specifically stated in the press release:

> In the third quarter of 2002, the company continued to produce record financial results. The 36.8 percent increase in EPS in the third quarter was primarily a result of increased total student enrollment, tuition price increases and an increase in operating margin that is attributable to the conversion of ITT/ESI's curricula to a three-day per week class schedule. Based on our strong financial performance in the first nine months of 2002, we are increasing our internal EPS goal for the full year of 2002 to a range of $0.90 to $0.91 from our previous goal of $0.84 to $0.87 and consensus estimates of $0.86. Our business model remains strong and we believe that our strong financial performance can continue into 2003.

88. During the Company's quarterly conference call with analysts on October 17, 2002, Defendant Champagne remarked:

> Our third quarter operating results, once again, produced record financial performance. For the eighth consecutive quarter our EPS in the quarter exceeded consensus estimates of sell-side analysts as reported by First Call. EPS in the third quarter was 26 cents per share, three cents above sell-side analysts' estimates of 23 cents per share, and seven cents greater than the 19 cents per share achieved in the third quarter of 2001. This EPS of 26 cents represents a 36.8 percent increase compared to the third quarter of 2001 … Total student enrollment in the third quarter increased 6.2 percent, and our fourth quarter goals for home student enrollment to increase in the range of six to eight percent compared to the fourth quarter of 2001.

89. Defendant Modany added:

> Revenues in the third quarter increased 13.4 percent. Contributing to the revenue increase is our total student enrollment increases of 6.2 percent, along with the positive affect of prior tuition increases of five percent in September of 2001, and a tuition increase of approximately nine percent in March 2002.

90. In response to the Company's announcement, its stock price increased $4.95 from a closing price of $17.10 on October 16, 2002, to close at $22.05 on October 17, 2002 on heavy volume of 1.4 million shares. An October 17, 2002 Barrington Research report commented on the Company's 3Q 2002 results, noting they "top[ped] expectation" and represented the Company's "eighth consecutive quarter of beating the Street." As a result, Barrington reiterated its "outperform" rating.

91. On October 18, 2002, ITT filed its Form 10-Q for the quarter ended September 30, 2002, with the SEC. The 2002 3Q Form 10-Q repeated the financial and enrollment information announced in the press release and conference call referenced above, and stated: "We prepared the accompanying unaudited consolidated financial statements in accordance with generally accepted accounting principles for interim periods . . . . the financial statements contain all adjustments, consisting only of normal recurring adjustments,

necessary to present fairly our financial condition and results of operations." The 2002 3Q Form 10-Q was signed by Defendant Baugh.

92. Defendants Champagne and Baugh signed Certifications annexed to the 2002 3Q Form 10-Q attesting (a) "this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;" and (b) "the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report."

93. On January 23, 2003, ITT issued a press release announcing financial results for the fourth quarter and year ended December 31, 2002, that reported "Earnings Per Share in 2002 Increased 34.3 Percent; Fourth Quarter New Student Enrollment Increased 11.2 Percent." The press release further reported:

> [E]arnings per share ("EPS") in 2002 were $0.94, a 34.3 percent increase compared to $0.70 per share in 2001. For the three months ended December 31, 2002, EPS were $0.40, a 29.0 percent increase compared to $0.31 per share in the same period of 2001. As of December 31, 2002, total student enrollment at the company's ITT Technical Institutes, excluding international enrollments, increased 6.0 percent to 32,631 compared to 30,778 as of December 31, 2001. This 6.0 increase in total student enrollment resulted from an 11.2 percent increase in new student enrollment to 5,710 in the fourth quarter of 2002 compared to 5,133 in the fourth quarter of 2001, and a 5.0 percent increase in continuing students to 26,921 in the fourth quarter of 2002 compared to 25,645 in the fourth quarter of 2001.
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> * * *
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> Revenues in the fourth quarter 2002 increased 12.5 percent to $126.1 million compared to $112.0 million in the fourth quarter of 2001. Operating income in the fourth quarter of 2002 increased 28.0 percent to $29.5 million compared to $23.0 million in the fourth quarter of 2001. Operating margin in the fourth quarter of 2002 increased 280

basis points to 23.4 percent compared to 20.6 percent in the same period of 2001. Net income in the fourth quarter of 2002 increased 26.5 percent to $18.6 million, or $0.40 per share, compared to $14.7 million, or $0.31 per share, in the fourth quarter of 2001.

* * *

Revenues in 2002 increased 13.2 percent to $464.9 million compared to $410.6 million in 2001. Operating income in 2002 increased 32.4 percent to $68.3 million compared to $51.6 million in 2001. Operating margin in 2002 increased 210 basis points to 14.7 percent compared to 12.6 percent in 2002. EBITDA in 2002 increased 27.5 percent to $89.4 million compared to $70.1 million in 2001. EBITDA margin in 2002 increased 210 basis points to 19.2 percent compared to 17.1 percent in 2001. In the fourth quarter of 2002, bad debt as a percent of revenue decreased 50 percent to 1.2 percent compared to 2.4 percent in the same period of 2001. Days Sales Outstanding as of December 31, 2002 decreased 3.9 days to 6.5 compared to 10.4 as of December 31, 2001. Deferred tuition increased 33.5 percent to $103.0 million on December 31, 2002 compared to $77.2 million as of the same date in 2001. The company's return on equity in 2002 increased 530 basis points to 52.5 percent compared to 47.2 percent in 2001.

94. Defendant Champagne specifically stated in the press release:

> Despite prolonged high unemployment and a downturn in consumer confidence in the fourth quarter, new student enrollment in the fourth quarter of 2002 was strong increasing 11.2 percent compared to the fourth quarter of 2001. We attribute the increase in new students to the broad range of degree programs of study offered by our ITT Technical Institutes, the three-day per week class schedule for most program offerings and our marketing efforts, which continue to generate a substantial number of leads for our colleges.

95. During the Company's quarterly conference call with analysts on January 23, 2003, Defendant Champagne remarked:

> New student enrollment in the fourth quarter increased 11.2%, a strong performance considering the prolonged uncertainty in the national economy and specifically within the technology sector. We attribute new student enrollment success to multiple factors, including our broad product line of degree programs, the convenient three-day per week delivery model, the availability of financing resources and the strength of our marketing efforts, which continue to generate attractive volumes of leads.

96. Defendant Waddles added "On top of the strong proceeding [sic] third quarter where we had a new student increase of 6.1%, our colleges were able to produce a new student increase of 11.2% in the fourth quarter."

97. The market and analysts reacted positively to the Company's announced results. In response to this news, the Company's stock price increased $2.34, from $23.26 on January 22, 2003 to close at $25.60 on January 23, 2003. JP Morgan, in a report dated January 23, 2003, noted that ITT's results beat their estimates and consensus estimates, representing a "strong quarter."

98. On February 26, 2003, ITT filed its Form 10-K for the fiscal year ended December 31, 2002, with the SEC. The 2002 Form 10-K repeated the financial and enrollment information announced in the press release and conference call referenced above, and stated that the financials "have been prepared in conformity with generally accepted accounting principles." The 2002 Form 10-K was signed by Defendants Champagne, Waddles, Modany, Araskog, Dean, Miller, and Weadock.

99. Defendants Champagne, Waddles, and Modany signed Certifications annexed to the 2002 Form 10-K attesting (a) "this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;" and (b) "the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report."

100. On April 17, 2003, ITT issued a press release announcing financial results for the quarter ended March 31, 2003, that reported "EPS Increased 35.7 Percent in 2003 First Quarter." The press release further reported:

> [E]arnings per share ("EPS") in the first quarter of 2003 increased 35.7 percent to $0.19 compared to $0.14 in the first quarter of 2002. New student enrollment in the first quarter of 2003, excluding international enrollments and enrollments at two of its institutes that are gradually ceasing operations, increased 7.4 percent to 7,213 compared to 6,714 in the first quarter of 2002. As of March 31, 2003, total student enrollment, excluding international enrollments and enrollments at two of its institutes that are gradually ceasing operations, increased 4.7 percent to 31,966 compared to 30,528 as of March 31, 2002.
>
> Revenues in the first quarter of 2003 increased 13.8 percent to $122.4 million compared to $107.5 million in the first quarter of 2002. During the first quarter of 2003, operating income increased 38.7 percent to $13.7 million compared to $9.9 million in the same period of 2002. Operating margin increased 200 basis points in the first quarter of 2003 to 11.2 percent compared to 9.2 percent in the first quarter of 2002. Net income for the three months ended March 31, 2003 increased 35.5 percent to $8.7 million compared to $6.4 million in the same period of 2002.

101. Defendant Champagne specifically stated in the press release:

> Our strong financial performance in the first quarter of 2003 that resulted in a 35.7 percent increase in EPS demonstrates that we were able to successfully navigate the challenges posed by high unemployment, softness in the technology sector and the effects of the war in Iraq on the national economy and consumer confidence. Our ability to increase new student enrollment by 7.4 percent in the first quarter is a testament to our 10-point growth strategy and the effectiveness of our marketing campaign. Lead generation in the first quarter was strong and our lead conversion rate continued to improve.

102. Defendant Modany added "Operating margin increased 200 basis points to 11.2 percent in the first quarter, primarily due to increased student enrollment, a 7.4 percent increase in the average revenue per student and our ability to leverage overhead costs."

103. During the Company's quarterly conference call with analysts on April 17, 2003, Defendant Champagne remarked:

> EPS in the first quarter increased by a very strong 35.7 percent to 19 cents per share, compared to 14 cents in the first quarter of 2002 and compared to consensus estimates of 18 cents. This marks the tenth consecutive quarter that the company has exceeded consensus EPS estimates. This attractive EPS increase was achieved as a result of increased new student enrollment, a 7.4 percent increase in the average revenue per student in the first quarter, along with bottom line benefits of leveraging overhead cost structure.
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> * * *
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> Excluding our two colleges currently being phased out, new student enrollment increased by 7.4 percent in the first quarter. This new student enrollment increase marks the third consecutive quarter of relatively strong new student enrollment and confirms our ability to navigate the technology sector slowdown. Demand for our service expressed in the form of leads continues to be very strong. Total student enrollment in the first quarter increased seven – 4.7 percent compared to prior year.

104. On April 28, 2003, ITT filed its Form 10-Q for the quarter ended March 31, 2003, with the SEC. The 2003 1Q Form 10-Q repeated the financial and enrollment information announced in the press release and conference call referenced above, and stated: "We prepared the accompanying unaudited consolidated financial statements in accordance with generally accepted accounting principles for interim periods . . . . the financial statements contain all adjustments, consisting only of normal recurring adjustments, necessary to present fairly our financial condition and results of operations." The 2003 1Q Form 10-Q was signed by Defendant Modany.

105. Defendants Champagne, Waddles, and Modany signed Certifications annexed to the 2003 1Q Form 10-Q attesting (a) "this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading

with respect to the period covered by this quarterly report;" and (b) "the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report."

106. Defendants Champagne and Modany signed Certifications pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 attesting that: (a) "The [2003 1Q Quarterly] Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934"; and (b) "The information contained in the [2003 1Q Quarterly] Report fairly represents, in all material respects, the financial condition and results of operations of the Company."

107. On July 17, 2003, ITT issued a press release announcing financial results for the quarter ended June 30, 2003, that reported "50 Percent Increase in EPS in Second Quarter 2003, New Student Increase of 15.8 Percent." The press release further reported:

> [E]arnings per share ("EPS") in the second quarter of 2003 increased 50.0 percent to $0.21 compared to $0.14 in the second quarter of 2002. New student enrollment in the second quarter of 2003, excluding international enrollments and enrollments at two of its institutes that have stopped recruiting new students and are gradually ceasing operations, increased 15.8 percent to 8,665 compared to 7,485 in the same period of 2002. Total student enrollment as of June 30, 2003, excluding international enrollments and enrollments at the two institutes that are gradually ceasing operations, increased 6.6 percent to 33,153 compared to 31,113 as of June 30, 2002.

108. Defendant Champagne specifically stated in the press release:

> We experienced yet another strong financial performance in the second quarter of 2003 that resulted in a 50.0 percent increase in EPS. Our EPS of $0.21 in the second quarter of 2003 exceeded analysts' consensus estimates by 2 cents per share. This performance was driven primarily by increased total student enrollment, tuition increases and greater leveraging of the Company's operating costs. Lead generation in the second quarter remained strong and our lead conversion rate

> continued to improve, as evidenced by a 15.8 percent increase in new student enrollment. New student enrollment and total student enrollment in the first six months of 2003, excluding international enrollments and enrollments at the two institutes are gradually ceasing operations, increased 11.8 percent compared to the same period in 2002 and 5.9 percent respectively.

109. Defendant Modany added:

> In the second quarter of 2003, operating margin increased 310 basis points primarily as a result of our greater leveraging of overhead costs, increased student enrollment, tuition price increases and various cost containment projects . . . . Other key metrics to note in the second quarter of 2003 include a 10.5 percent increase in revenue per student and a 460 basis point improvement on our Return on Equity over the trailing twelve months.

110. During the Company's quarterly conference call with analysts on July 17, 2003, Defendant Champagne remarked:

> EPS in the second quarter increased 50 percent to 21 cents, 2 cents higher than consensus analysts' estimates. This achievement marks the 11th consecutive quarter that ITT Educational Services has exceeded consensus estimates in spite of the fact that both our internal goals and analysts' estimates have increased each of the eleven quarters.
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> * * *
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> New student enrollment in the first six months of 2003 has increased 11.8 percent compared to the same period in 2002. In addition, our total student enrollment increased 6.6 percent in the second quarter. And in the first six months of 2003, total student enrollment has increased 5.9 percent, in line with our full-year goal of 6 to 8 percent.

111. Defendant Modany added "We had a strong revenue increase of 15.2 percent in the second quarter, that was driven by increased student enrollment and a 10.5 percent increase in revenue per student."

112. Defendant Champagne later commented during the call:

> I believe it is apparent that we do not have a new student enrollment issue at ITT Educational Services. I say that based on new student enrollment increases over the last four quarters, commencing with the third quarter of '02, in which new students increased 6 percent; and Q4 '02, new students increased 11 percent; in the first quarter of '03, new

> students increased at 7 percent; and of course, in the second quarter of '03, we just reported a 15.8 percent increase. The average increase in new students over those four quarters was 9.8 percent. Now, obviously, we are well ahead of our internal goal of increasing new students in the range of 6 to 8 percent for the full year of 2003. We believe we have positive new student enrollment momentum going into the second half of 2003, and therefore, we are optimistic regarding our new student enrollment growth opportunities over the next several quarters … We believe the Company is well-positioned for a solid enrollment in growth and financial performance over the next 18 months.

113. Investors reacted favorably to the Company's financial results, causing ITT's stock price to surge $5.81 from $30.32 on July 16, 2003, to close at $36.13 on July 17, 2003. In a report dated July 18, 2003, Jefferies praised the Company's "outstanding Q2 results" which once again beat EPS estimates. Jefferies attributed this increase to an "upside surprise from enrollment demand" and noted that ITT's "operating environment seems to be improving, with apparent strengthening student demand . . . ."

114. On July 17, 2003, ITT filed its Form 10-Q for the quarter ended June 30, 2003, with the SEC. The 2003 2Q Form 10-Q repeated the financial and enrollment information announced in the press release and conference call referenced above, and stated: "We prepared the accompanying unaudited consolidated financial statements in accordance with generally accepted accounting principles for interim periods . . . . the financial statements contain all adjustments, consisting only of normal recurring adjustments, necessary to present fairly our financial condition and results of operations." The 2003 2Q Form 10-Q was signed by Defendant Modany.

115. Defendants Champagne, Waddles, and Modany signed Certifications pursuant to 15 U.S.C. § 7241 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 annexed to the 2003 2Q Form 10-Q attesting (a) "this report does not contain any untrue

statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;" and (b) "the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report."

116. Defendants Champagne and Modany signed Certifications pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 attesting that: (a) "The [2003 2Q Quarterly] Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934"; and (b) "The information contained in the [2003 2Q Quarterly] Report fairly represents, in all material respects, the financial condition and results of operations of the Company."

117. On October 16, 2003, ITT issued a press release announcing financial results for the quarter ended September 30, 2003, that reported "30.8 Percent Increase in EPS in Third Quarter 2003, New Student Increase of 20.7 Percent." The press release further reported:

> During the three months ended September 30, 2003, earnings per share ("EPS") increased 30.8 percent to $0.34 compared to $0.26 in the same period of 2002. EPS in the first nine months of 2003 increased to 38.9 percent to $0.75 compared to $0.54 in the comparable period of 2002. In the third quarter of 2003, new student enrollment (excluding international enrollments and enrollments at two of its institutes that are gradually ceasing operations) increased 20.7 percent to 12,690 compared to 10,518 in the same period of 2002. Total student enrollment as of September 30, 2003 (excluding international enrollments and enrollments at the two institutes that are gradually ceasing operations) increased 10.8 percent to 36,947 compared to 33,352 as of September 30, 2002.

118. Defendant Champagne specifically stated in the press release:

> Our strong enrollment and financial performance in the third quarter and first nine months of 2003 reflects the solid demand we have experienced for our programs of study.
>
> * * *
>
> Our third quarter EPS of $0.34 exceeded analysts' consensus estimates by 2 cents per share. Our strong financial and operating results in the quarter were primarily driven by increased total student enrollment, tuition increases and greater leveraging of the Company's operating costs. Lead flow resulting from our marketing efforts remained strong in the third quarter, and our student recruiters continued to improve their lead conversion rates during that period. In the first nine months of 2003, new student enrollment (excluding international enrollments and enrollments at the two institutes that are gradually ceasing operations) increased 15.6 percent compared to the first nine months of 2002. Demand for our programs of study has been strong to date in 2003. We are optimistic that demand can remain strong for the balance of 2003 and 2004.

119. Defendant Modany also commented:

> Operating margin in the third quarter of 2003 increased 280 basis points as a result of increased total student enrollment, tuition price increases, leveraging of overhead operating costs and various cost containment projects. Revenue per student in the third quarter of 2003 increased 7.7 percent compared to the same period in 2002. Net income increased 30.9 percent in the third quarter and 36.1 percent in the first nine months compared to the same periods last year. We continue to operate without debt and have $204.1 million of cash, short-term investments and investments. We are confident that we can achieve or exceed our internal financial goals for 2003.

120. During the Company's quarterly conference call with analysts on October 16, 2003, Defendant Champagne remarked:

> New student enrollment in the third quarter continued at a [low] rate of growth increasing by approximately 21% compared to the same period last year. As you know, we do not include international student enrollments in any of our domestic U.S. enrollment numbers. New student increases in the third quarter were primarily driven by robust growth in our associate degree programs offered at existing colleges. This attractive new student enrollment growth reflects the effectiveness of our marketing efforts which continued to generate strong lead flow and it also reflects continued improvement in lead flow conversions.
>
> * * *

> Turning now to total student enrollment, as of September 30, total enrollment increased 10.8%. For the first three quarters of 2003, total student enrollment has increased by an average of 7.4% compared to the first three quarters of 2002.
>
> * * *
>
> Our performance in the third quarter produced an increase of 30% in earnings per share to 34 cents compared to consensus estimates of 32 cents. This achievement marks the 12th consecutive quarter that we have exceeded consensus EPS estimates despite the fact that both our internal EPS goals and analysts' estimates have increased following the completion of each quarter. EPS in the first nine months of 2003 increased 38.9% to 75 cents compared to 54 cents in the same period of 2002.

121. In response, the Company's stock price increased $1.52 from $46.37 on October 15, 2003 to close at $47.89 on October 16, 2003. Commenting on the Company's results, JP Morgan wrote in its October 16, 2003 report that "ESI reported strong 3Q03 results, which we think should allay some concerns about poor performance from the for-profit postsecondary education group during the 3Q03 earnings season." JP Morgan pointed out new enrollment as a driver of this growth writing "New student starts and total enrollment showed *outstanding growth, significantly beating our estimates.*" (Emphasis added). Similarly, in an October 16, 2003 report, US Bancorp Piper Jaffray reported on "strong new student enrollment" which "beat expectations."

122. On October 17, 2003, ITT filed its Form 10-Q for the quarter ended September 30, 2003, with the SEC. The 2003 3Q Form 10-Q repeated the financial and enrollment information announced in the press release and conference call referenced above, and stated: "We prepared the accompanying unaudited consolidated financial statements in accordance with generally accepted accounting principles for interim periods . . . . the financial statements contain all adjustments, consisting only of normal recurring adjustments,

necessary to present fairly our financial condition and results of operations." The 2003 3Q Form 10-Q was signed by Defendant Modany.

123. Defendants Champagne, Waddles, and Modany signed Certifications pursuant to Rule 13a-14(a) of the Exchange Act attesting (a) "this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;" and (b) "the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report."

124. Defendants Champagne and Modany signed Certifications pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 attesting that: (a) "The [2003 3Q Quarterly] Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934"; and (b) "The information contained in the [2003 3Q Quarterly] Report fairly represents, in all material respects, the financial condition and results of operations of the Company."

125. On January 22, 2004, ITT issued a press release announcing financial results for the fourth quarter and year ended December 31, 2003, that reported "Record Enrollment and EPS for Fourth Quarter and Full Year 2003." The press release further reported:

> During the three months ended December 31, 2003, earnings per share ("EPS") increased 30 percent to $0.52 compared to $0.40 in the same period of 2002. EPS for its 2003 fiscal year increased 35.1 percent to $1.27 compared to $0.94 in 2002. In the fourth quarter of 2003, new student enrollment (excluding international enrollments and enrollments at two of its institutes that are gradually ceasing operations) increased 29.3 percent to 7,277 compared to 5,628 in the same period of 2002. Total student enrollment as of December 31,

> 2003 (excluding international enrollments and enrollments at the two institutes that are gradually ceasing operations) increased 14.6 percent to 36,901 compared to 32,197 as of December 31, 2002.

126. Defendant Champagne specifically stated in the press release:

> Strong enrollment growth throughout 2003 contributed to our ability to deliver a 2003 EPS of $1.27 that exceeded analysts' consensus estimates by four cents. Enrollment growth in each 2003 fiscal quarter not only exceeded the enrollment growth in the same quarter of 2002, it increased sequentially in each quarter of 2003. Considering that the average combined total program time that graduates of one or more of our programs were enrolled is 27 months, the 2003 enrollment growth positions the company well for meeting or exceeding its internal financial and operational goals in 2004 and 2005.

127. Defendant Modany added:

> Our strong financial results in the fourth quarter and year ending December 31, 2003 were driven by attractive increases in student enrollment, tuition price increases, continued leveraging of overhead operating costs and various cost containment projects. In the fourth quarter of 2003, revenues increased 17.7 percent, operating margin expanded by 380 basis points, net income increased 31.7 percent and EPS increased 30.0 percent compared to the fourth quarter of 2002. We had $254.2 million of cash and cash equivalents, restricted cash, and investments as of December 31, 2003. Deferred tuition revenue increased 26.6 percent on December 31, 2003 compared to December 31, 2002. Our days sales outstanding on December 31, 2003 were 6.0 days compared to 6.7 days on December 31, 2002, and our bad debt expense as a percent of revenues in the fourth quarter of 2003 was 0.8 percent compared to 1.2 percent in the fourth quarter of 2002. We continue to operate without debt.

128. During the Company's quarterly conference call with analysts on January 22, 2004, Defendant Champagne remarked:

> We're particularly pleased with the 29.3 percent increase in new students during the fourth quarter. … Equally as pleasing was the 14.6 percent increase in total enrollment as of 12-31-03, that has contributed to our revenue and earnings growth. … This marks the 13th consecutive quarter that we have exceeded analyst estimates.

129. The market reacted positively to this news, causing ITT's stock price to increase $1.40 from $51.90 on January 21, 2004 to close at $53.30 on January 22, 2004. JP Morgan, in its January 22, 2004 report, praised ITT for "solid results" and "strong enrollment growth," pointing out that "[n]ew student start growth of 29.3% YOY was well above our estimate of 9.9% and exceeded our most optimistic expectations."

130. On February 24, 2004, ITT filed its Form 10-K for the fiscal year ended December 31, 2003, with the SEC. The 2003 Form 10-K repeated the financial and enrollment information announced in the press release and conference call referenced above, and stated that the financials "have been prepared in conformity with generally accepted accounting principles." The 2003 Form 10-K was signed by Defendants Champagne, Waddles, Modany, Araskog, Dean, Miller, and Weadock.

131. Defendants Champagne, Waddles, and Modany signed Certifications pursuant to Rule 13a-14(a) of the Exchange Act attesting (a) "this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;" and (b) "the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report."

132. Defendants Champagne and Modany signed Certifications pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 attesting that: (a) "The [2003 Annual] Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934"; and (b) "The information contained in

the [2003 Annual] Report fairly presents, in all material respects, the financial condition and results of operations of the Company."

133. The representations made or contained in ¶¶ 86-89, 91-96, 98-112, 114-120, 122-128, 130-132, *supra*, were materially false and misleading when made because they failed, *inter alia*, to disclose and misrepresented the following material adverse facts:

(a) during the Class Period, ITT systematically falsified student records in order to increase start, enrollment, completion, attendance, placement, grades and graduation rates, and to conceal problems to help its institutes pass audits conducted by the ACICS and DOE, among other agencies;

(b) a material portion of ITT's reported revenues was improperly recognized because it was derived through fraudulent business practices, such as federal grants and financial aid payments made based upon records and representations that were falsified by Defendants;

(c) contrary to statements in its press releases, ITT's success was not attributable to the supposed strength of its business or its purported competitive advantages, but rather, a material portion of its results was attributable to fraudulent and prohibited business practices;

(d) ITT failed to disclose that it had falsified student records, thereby placing its accreditation at serious risk and jeopardizing significant revenue from federal funding, which would have a devastating impact on ITT's business, operations, revenues, and income;

(e) ITT's financial statements were not prepared and reported in accordance with GAAP and did not fairly present its actual financial results or condition; and

(f) Defendants failed to disclose the existence of the California Attorney General's investigation of the Company, which began in October 2002 and continued throughout the Class Period.

VI. THE REVELATIONS

134. On February 25, 2004, ITT shocked the market when it announced in a press release that federal agents, armed with search warrants issued by the United States Court for the Southern District of Texas, were seizing records at the Company's offices in Indianapolis, Indiana and at ten (10) of the 77 institutes run by ITT in Indiana, Texas, Virginia, Florida, Louisiana, Nevada, California, and Oregon. The Company disclosed that the search warrants and related grand jury subpoenas related to placement figures and rates, retention figures and rates, graduation figures and rates, attendance figures and rates, recruitment and admissions materials, student grades, graduate salaries and transferability of credits to other institutions.

135. In response to the revelations of the federal search warrants being served at ITT's headquarters and institutes related to the metrics used to support federal funding for the Title IV Programs, the price of ITT common stock plummeted 33% on February 25, 2004, falling from $57.40 per share on February 24, 2004 to a closing price of $38.50 per share on February 25, 2004.

136. On March 9, 2004, Defendants disclosed in the Company's 2004 Proxy filed with the SEC that, in addition to the information previously reported, the SEC had informed the Company that it was conducting an investigation parallel to the DOJ's investigation. Moreover, for the first time, the Company revealed that it has been under investigation by the California Attorney General's Office *since October 2002*:

> In October 2002, the Office of the Attorney General for the State of California ("CAG") informed us that the CAG had initiated an

> investigation of ITT Technical Institutes in California. We believe that the CAG's investigation is in response to one or more qui tam actions filed against us under the state and/or federal False Claims Acts. The CAG has not asserted any claims against us, and we have not been informed of the specific matters that the CAG is investigating. Based on the information that the CAG has requested, however, we believe that the CAG is investigating, among other matters, whether one or more of our California ITT Technical Institutes: (a) falsified records relating to student attendance, grades and academic progress; (b) falsified student grade point average calculations used to qualify students for financial aid under the State's Cal Grant Program; and (c) retaliated against employees who may have complained about those alleged acts . . . .

137. News of the disclosures contained in the Company's 2004 Proxy and filed with the SEC March 9, 2004 trickled into the market during the day and was not fully reported until the afternoon of March 9, 2004. After the market closed, Professor Hugh Friedman of the University of San Diego Law School was quoted on the *Bloomberg* newswire as saying, "Arguably the attorney general's investigation was material and should have been disclosed when the company learned of it."

138. During the trading day on March 9, 2004, the price of ITT common stock declined $2.22 from a closing price of $34.87 on March 8, 2004, to $32.65. On March 10, 2004, the price of ITT common stock lost an additional $2.20 per share to close at $30.45 per share. Over the next three trading days the price continued to fall until it bottomed out at $28.29 per share on March 15, 2004.

139. A March 15, 2004 *Bloomberg* article revealed that Defendants sold more than *$27 million* of ITT common stock in the 17 months between the time ITT learned of the CAG investigation and its first disclosure of the probe to the public. The article reported that Nancy Brown, a spokeswoman for ITT, admitted that "Officials at the Carmel, Indiana – based company were aware of the non-public state [California] probe before they sold their shares."

140. The *Bloomberg* article further reported that Defendant Araskog initially denied knowledge of the California investigation when he sold 223,900 shares of ITT common stock in February and October 2003 reaping in excess of $6.4 million: "In an initial phone interview, Araskog . . . said that he didn't know about the California allegations at the time he sold the stock." Indeed, Araskog pleaded, "'I was not aware of anything other shareholders weren't aware of. I was equal to other shareholders.'" However, the article noted that Araskog subsequently admitted the truth about his knowledge of the nonpublic California investigation when he sold his shares of ITT stock: "[i]n a subsequent conversation, he said that the California investigation was discussed at several board meetings." The article added that Araskog's new story was that directors were told the California investigation was not material, and that, "'I would not have received approval to sell if our corporate counsel thought it was material.'"

141. In fact, corporate counsel Defendant Elwood – who purportedly opined that the CAG investigation was immaterial – not only sold 161,600 shares of his own ITT common stock on January 29, 2003, for proceeds of $4,124,100, but was *one of the first* sales by an insider after the California investigation was disclosed to the Company in October 2002. As noted by Lynn Stout, a securities law professor at the University of California, Los Angeles in the *Bloomberg* article: "'It is certainly logical to infer that if insiders are dumping stock at a rapid clip after learning of a potentially adverse investigation, *that the investigation may be why they are selling and therefore material*.'" (Emphasis added). Indeed, Defendants collectively dumped more than $27 million worth of ITT common stock after learning of the investigation.

142. On April 27, 2004, ITT filed its Form 10-Q for the quarter ended March 31, 2004, with the SEC. In the 2004 1Q Form 10-Q, ITT signaled to investors the significance of the DOJ and SEC investigations and shareholder lawsuits by disclosing that it recorded a charge of $9.7 million in the first quarter "for estimated legal costs associated with the investigation of us being conducted by the DOJ, the inquiry initiated by the SEC into the allegations being investigated by the DOJ, and the securities class action and shareholder derivative lawsuits filed against us, certain of our current and former executive officers and each of our Directors (collectively, the "Actions")."

143. The Company also warned about the possible effects of the DOJ investigation, SEC inquiry and shareholder lawsuits, including a possibility that the Company may be forced to restate its financial results:

> The effects of the DOJ investigation of us could result in monetary fines or penalties or other sanctions imposed on us, including our loss of eligibility to participate in student financial aid programs, that could materially adversely affect our financial condition and operations. The results of the SEC inquiry into the allegations being investigated by the DOJ could result in the restatement of our financial statements, monetary fines or penalties or other sanctions that could materially adversely affect our financial condition and operations. The results of the securities class action and shareholder derivative lawsuits filed against us, if adversely determined, could have a material adverse effect on our financial condition and results of operations.

144. On July 23, 2004, ITT filed its Form 10-Q for the quarter ended June 30, 2004, with the SEC. The 2004 2Q Form 10-Q revealed that the Company increased its previously disclosed reserve for the DOJ and SEC investigations and shareholder lawsuits by $3 million:

> Consistent with our accounting policy for contingent liabilities (pursuant to which we accrue probable legal costs associated with a claim or a potential claim), we recorded a charge of $9,700,000 in the three months ended March 31, 2004 for estimated legal costs associated with the investigation of us being conducted by the U.S. Department of Justice ("DOJ"), the inquiry initiated by the SEC into the allegations

> being investigated by the DOJ, and the securities class action and shareholder derivative lawsuits filed against us, certain of our current and former executive officers and each of our Directors (collectively, the "Actions"), as described below in Note 10. As a result of our most recent review of this estimate, we recorded an incremental charge of $3,000,000 for legal costs associated with the Actions during the three months ended June 30, 2004. During the six months ended June 30, 2004, we were billed $8,410,000 for those legal costs. We believe that it is probable that we will incur at least $12,700,000 in legal costs related to these matters.
>
> * * *
>
> During the three months ended June 30, 2004, we incurred $2,606,000 of non-legal costs related to the Actions. Those costs were expensed as incurred and primarily included fees charged by our registered public accounting firm for the performance of extended audit procedures as a result of the Actions and other non-legal costs related to the Actions.

145. The 2004 2Q Form 10-Q also stated "[o]n March 4, 2004, our Board of Directors appointed a Special Committee of independent Directors to conduct an investigation into the facts and circumstances relating to the DOJ and CAG investigations and the securities class action lawsuits described above . . . . In late June 2004, the Special Committee reported on its investigation to our Board of Directors."

146. The 2004 2Q Form 10-Q further warned investors that the DOJ investigation "could result in monetary fines or penalties or other sanctions imposed on us, including our loss of eligibility to participate in student financial aid programs, that could materially adversely affect our financial condition and operations." The Company also cautioned that:

> [T]he SEC inquiry into the allegations being investigated by the DOJ could result in the restatement of our financial statements, monetary fines or penalties or other sanctions that could materially adversely affect our financial condition and operations. The results of the securities class action and shareholder derivative lawsuits filed against us, if adversely determined, could have a material adverse effect on our financial condition and results of operations.

147. The 2004 2Q Form 10-Q contained the Separation and General Release Agreement ("Separation Agreement") between ITT and Defendant Waddles. The Separation

Agreement provided that "on the conditions that Waddles remains employed by ITT through July 30, 2004 and ITT determines that he satisfactorily performed all assigned duties and responsibilities, (i) ITT shall make a separation payment to Waddles in an amount equivalent to five (5) months of Waddles' annual base salary (less taxes and other required deductions), (ii) ITT shall pay said separation payment in a lump sum as soon as practical after July 30, 2004."

VII. ADDITIONAL SCIENTER ALLEGATIONS

A. Defendants' Insider Trading Supports A Strong Inference Of Scienter

148. As alleged herein, Defendants acted with scienter in that they knew that the press releases, statements to analysts, and public filings issued or disseminated in the name of the Company were materially false and misleading; knew that such statements and/or documents would be issued or disseminated to the investing public; and knowingly and substantially participated or acquiesced in the issuance or dissemination of such statements and documents as primary violations of the federal securities laws. As set forth herein in greater detail, Defendants, by virtue of their receipt of information reflecting the true facts regarding ITT, their control over and/or modification of the Company's materially misleading statements, and their positions within the Company which made them privy to confidential proprietary information concerning ITT, participated in the fraudulent scheme alleged herein.

149. In addition, during the Class Period, several Defendants were strongly motivated to commit the wrongdoing alleged herein in order to allow them to sell ITT common stock from their own portfolios at artificially inflated prices and while in possession of material non-public information. As illustrated by the following chart, during the Class Period, Defendants sold a combined 826,166 shares of ITT common stock, reaping proceeds

of **$27,501,556**. The following chart shows the actual sales by Defendants during the Class Period:

	Date	Shares	Price	Total
Araskog, Rand V.	02/11/03	50,000	$26.6900	$1,334,500
	02/12/03	77,700	$26.3000	$2,043,510
	02/18/03	72,300	$26.5700	$1,921,011
	10/24/03	23,900	$48.9400	$1,169,999
	10/24/03	100	$48.8950	$ 4,895
		224,000		**$6,473,582**
Baugh, Gene A.	01/29/03	**67,500**	$25.6200	**$1,729,350**
Champagne, Rene R.				
	02/27/03	28,100	$26.5000	$ 744,650
	02/28/03	31,900	$26.7500	$ 853,325
	10/29/03	47,100	$50.7400	$2,389,854
	11/04/03	15,700	$50.6500	$ 795,205
	11/04/03	3,300	$50.2400	$ 165,792
	11/05/03	8,900	$50.0800	$ 445,712
		135,000		**$5,394,538**
Elwood, Clark D.	01/29/03	**161,600**	$25.5100	**$4,124,100**
Lauer, Thomas W.	02/13/03	40,000	$25.8600	$1,034,400
	08/13/03	38,800	$41.0000	$1,590,800
	08/13/03	1,200	$41.1100	$ 49,332
	02/02/04	1,200	$56.4400	$ 67,728
	02/02/04	38,800	$56.3400	$2,185,992
		120,000		**$4,928,252**
Miller, Harris N.	10/22/03	10,000	$49.0400	$ 490,400
	01/28/04	8,000	$55.5000	$ 444,000
		18,000		**$ 934,400**
Waddles, Omer E.	07/24/03	33,333	$38.7200	$1,290,654
	07/31/03	33,333	$39.0000	$1,299,987
	08/07/03	33,334	$39.8000	$1,326,693
		100,000		**$3,917,334**
Total Insider Sales		**826,166**		**$27,501,566**

150. These stock sales are suspicious in amount because:

- In the two years before the Class Period, Defendants Champagne, Elwood, Miller or Waddles *did not sell any* shares of ITT stock.
- Prior to his Class Period sales, Defendant Araskog had not sold any shares of ITT stock since August 2001.
- While Defendant Baugh did sell shares during February and May 2002, prior to the Class Period, it was on the heels of his retirement from the Company. Moreover, Defendant Lauer's March 2002 and December 2001 sales constituted less than half of his total sales during the Class Period.

151. All of Defendants' Class Period trades are suspicious in time because they occurred *after* Defendants learned in October 2002 that the California Attorney General was investigating fraud allegations at ITT's California institutes, but prior to revealing such material information to investors on March 9, 2004. Moreover, as detailed below, *each and every one* of Defendants' sales occurred subsequent to earnings announcements which consistently caused ITT's share price to increase:

Defendant Araskog:

- Araskog's February 2003 sales occurred shortly after the issuance of the Company's press release on January 23, 2003 announcing fourth quarter and full year 2002 results, which caused the stock price to increase over $0.70 between the time of the announcement and Araskog's sales.
- Araskog's October 2003 sales occurred eight days after the issuance of the Company's press release on October 16, 2003 announcing third quarter 2003 results, which caused the stock price to increase approximately $1.50 between the time of the announcement and Araskog's October 2003 sales.

Defendant Baugh:

- Baugh's January 2003 sale occurred six days after the issuance of the Company's press release on January 23, 2003 announcing fourth quarter and full year 2002 results, which caused the stock price to increase approximately $0.60 between the time of the announcement and Baugh's sales.

Defendant Champagne:

- Champagne's February 2003 sales occurred shortly after the issuance of the Company's press release on January 23, 2003 announcing fourth quarter and full year 2002 results and one day after the Company filed its Form 10-K for 2002 on February 26, 2003, which caused the stock price to increase over $0.45 after the filing of the 10-K and increase approximately $1.35 between the time of the announcement of year-end results and Champagne's sales.
- Champagne's October and November 2003 sales occurred shortly after the issuance of the Company's press release announcing third quarter results on October 16, 2003 and the filing of the Form 10-Q on October 17, 2003, which caused the stock price to increase over $3.30 between the time of the announcement and Champagne's October and November 2003 sales.

Defendant Elwood:

- Elwood's January 2003 sales occurred shortly after the issuance of the Company's press release on January 23, 2003 announcing fourth quarter and full year 2002 results, which caused the stock price to rise $0.67 between the time of the announcement and Elwood's sale.

Defendant Laurer:

- Laurer's February 2003 sales occurred shortly after the issuance of the Company's press release on January 23, 2003 announcing fourth quarter and full year 2002 results, which caused the stock price to increase over $0.20 between the time of the announcement and Laurer's sales.
- Laurer's August 2003 sales occurred shortly after the issuance of the Company's press release on July 17, 2003 announcing second quarter 2003 results, which caused the stock price to increase over $5.00 between the time of the announcement and Laurer's sales.
- Laurer's February 2004 sale occurred mere weeks before ITT institutes throughout the country were raided by federal investigators.

<u>Defendant Miller:</u>

- Miller's October 2003 sales occurred six days after the issuance of the Company's press release announcing third quarter 2003 results on October 16, 2003, which caused the stock price to increase $0.84 between the time of the announcement and Miller's October 2003 sales.
- Miller's January 2004 sale occurred mere weeks before ITT institutes throughout the country were raided by federal investigators.

<u>Defendant Waddles:</u>

- Waddles' July and August 2003 sales occurred shortly after the issuance of the Company's press release on July 17, 2003 announcing second quarter 2003 results, which caused the stock price to rise over $2.80 between the time of the announcement and Waddles' sales.

B. Defendants Were Also Motivated To Commit Fraud Because Their Compensation Was Tied To ITT's Performance

152. In addition, Defendants were motivated to inflate reported financial results so that they could maximize their bonus and other compensation. The basic calculation for determining annual bonuses did not change during the Class Period. According to the 2003 and 2004 Proxies, annual bonus awards were based on "corporate financial performance for the year compared to an annual performance goal established by the [Compensation] Committee and approved by the Board at the beginning of the year." Specifically, for 2002 and 2003, the goal was 2002 or 2003 earnings per share compared to targeted 2002 or 2003 earnings per share.

153. By manipulating students' records and statistics, Defendants were able to maintain and increase revenues received from Title IV Programs and state funding, which in turn artificially inflated the Company's revenues and earnings, giving the appearance that the Company had exceeded targeted earnings and increasing Defendants' bonuses.

154. Indeed, Defendants' course of conduct resulted in the award of the following bonuses to the Defendants in 2002 and 2003:

	2003 Bonus	2002 Bonus
Champagne, Rene R.	$1,100,000	$680,000
Waddles, Omer E.	$ 502,560	$360,000
Lauer, Thomas W.	$ 311,290	$248,000
Elwood, Clark D.	$ 243,804	$189,000
Modany, Kevin M.	$ 268,380	$ 95,000
Baugh, Gene A.	—	$242,000

155. Further, ITT's "Long-Term Incentives" awards were made by the Compensation Committee in the form of stock option awards which were "directly related to the performance of ITT/ESI Common Stock." The stock options awarded to Defendants during the Class Period "directly related to the performance of ITT Common Stock," which

was artificially inflated as a result of Defendants' course of conduct and material misstatements, were as follows:

	2003 Options	2002 Options
Champagne, Rene R.	135,000	110,000
Waddles, Omer E.	60,000	50,000
Lauer, Thomas W.	30,000	30,000
Elwood, Clark D.	30,000	30,000
Modany, Kevin M.	20,000	30,000
Baugh, Gene A.	___	30,000

156. The 2003 stock options have an exercise price of $23.70 per share, and the 2002 stock options have an exercise price of $17.25 per share.

C. Defendants Were Informed of The Fraudulent Activities

157. Witness interviews confirm that Defendants knew of, and/or recklessly disregarded the falsification of enrollment, grades and attendance rates at ITT institutes. As detailed above, in October 2002, ITT's Vice President of National Academic Affairs, Gary Carlson, the district manager of ITT and ITT's legal counsel met with an instructor at the ITT Technical Institute in Sylmar, California. Carlson reported directly to Defendant Laurer who reported to Defendant Waddles. At the meeting, the former instructor recounted specific instances of fraud at the Sylmar Institute and stated that documents had been turned over to the Office of Inspector General of the U.S. Department of Education.

158. Even prior to this October 2002 meeting, an attorney representing ITT was present at the deposition of a former instructor in the Hubbard Action where blatant and routine grade falsification at the Sylmar Institute was detailed.

159. Moreover, the former director of recruitment at the ITT Technical Institute in Bothell, Washington sent a letter directly to Defendant Champagne in September or October 2002 that alerted him to the fraud occurring at the Bothell ITT Institute.

D. The Magnitude and Pervasiveness of the Falsification of Student Information Supports A Strong Inference of Scienter

160. The sheer number of improper manipulations relating to enrollment, grades, placement, retention, the duration over which these improprieties were perpetrated and the multitude of manipulations employed further support a strong inference of scienter.

161. The fact that these violations did not occur at a few ITT institutes, but at numerous ITT institutes nationwide, supports that these were not isolated instances, but a widespread pattern of fraudulent activity. Moreover, that these manipulations were brought to Defendants attention and/or were accessible companywide through ITT's reporting system and management meetings is indicative that Defendants knew of or recklessly disregarded that falsification of student information was occurring at ITT institutes throughout the United States.

E. Defendants' Attempts to Conceal The California Attorney General Investigation Supports a Strong Inference of Scienter

162. Defendants' efforts to hide the California Attorney General investigation from investors for 17 months, all the while Defendants profited from illegal insider sales, raise a strong inference of scienter.

163. As discussed above, while Defendants have claimed that the CAG investigation was immaterial and did not warrant disclosure, upon learning of the probe, Defendants dumped large amounts of their personal holdings of ITT stock. Moreover, Defendant Araskog initially denied any knowledge of the California investigation when he made his stock sales, which he has since retracted. Similarly, Defendant Elwood, who purportedly opined on the materiality of the California investigation, was one of the first

insiders to sell stock following knowledge of the investigation and reaped millions of dollars from his sales.

164. Significantly, the fact that ITT's stock plummeted $4.42, or 12.5% upon disclosure of the California Attorney General probe to investors, dispels the notion that this investigation was anything but material, and supports the notion that Defendants chose to keep the investigation secret so they could continue to perpetrate their fraud.

165. Moreover, the document destruction recounted by witnesses at ITT's California and Memphis institutes just prior to government investigations, illustrates steps taken to conceal Defendants' fraud and further supports an inference of scienter.

VIII. GAAP VIOLATIONS

166. Throughout the Class Period, Defendants issued materially false and misleading statements and omitted to disclose material information concerning ITT's financial status and used improper accounting practices in violation of GAAP and SEC reporting requirements to falsely inflate and report revenues and earnings.

167. GAAP are those principles recognized by the accounting profession as the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. SEC Regulation S-X (17 C.F.R. §210.4-01(a)(1)) states that financial statements filed with the SEC which are not prepared in compliance with GAAP are presumed to be misleading and inaccurate, despite footnote or other disclosure. Regulation S-X requires that interim financial statements must also comply with GAAP. 17 C.F.R. §210.10-01(a).

168. As set forth in Financial Accounting Standard Board ("FASB") Statement of Financial Accounting Concepts ("SFAC") No. 1, one of the fundamental objectives of

financial reporting is to provide accurate and reliable information concerning an entity's financial performance during the period being presented. SFAC No. 1, ¶42.

169. SFAC No. 1 states that financial reporting, *i.e.*, financial statements and the related footnote disclosures, is intended to provide information that is useful to the users of the statements in making business and economic decisions. By presenting investors with financial information that did not reflect the true nature of fraudulent and inappropriate business practices, ITT did not provide useful information in the Company's financial statements.

170. Similarly, SFAC No. 1 states that "[f]inancial reporting is expected to provide information about an enterprise's financial performance during a period and about how management of an enterprise has discharged its stewardship responsibility to owners." By presenting revenues and expenses that were grossed up by fraudulent business practices, Defendants did not present the Company's actual financial performance. Results obtained through such business practices do not accurately reflect the Company's operations, are highly deceptive to investors, and are inherently unsustainable.

171. SFAC No. 2 describes the characteristics required to make accounting information useful to the people that use it. One of these characteristics is representational faithfulness, which is defined as "correspondence or agreement between a measure or description and the phenomenon that it purports to represent (sometimes called validity)."

172. Another characteristic defined in SFAC No. 2 is verifiability. Verifiability is "the ability through consensus among measurers to ensure that information represents what it purports to represent or that the chosen method of measurement has been used without error or bias."

173. ITT improperly recognized revenue where the timing or amount of revenue was not recorded in accordance with GAAP. Pursuant to SFAC No. 5, ¶¶ 83-84, revenue should not be recognized until it is "realized" or "realizable and earned." SFAC No. 5, paragraph 83(b) states that "an entity's revenue-earning activities involve delivering or producing goods, rendering services, or other activities that constitute its ongoing major or central operations, and revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues." Paragraph 84(a) continues "the two conditions (being realized or realizable and being earned) are usually met by the time product or merchandise is delivered or services are rendered to customers, and revenues from manufacturing and selling activities and gains and losses from sales of other assets are commonly recognized at time of sale (usually meaning delivery)." In addition, paragraph 84(d) states that "If services are rendered or rights to use assets extend continuously over time (for example, interest or rent), reliable measures based on contractual prices established in advance are commonly available, and revenues may be recognized as earned as time passes."

174. Staff Accounting Bulletin ("SAB") 101 also expresses the SEC Staff's views regarding the application of GAAP to revenue recognition in financial statements. SAB 101 states that revenue is generally realized or realizable and earned when all of the following criteria are met:

- persuasive evidence of an arrangement exists;
- delivery has occurred or services have been rendered;
- the seller's price to the buyer is fixed or determinable; and
- collectibility is reasonably assured.

See SAB 101, Section A(1).

175. ITT Quarterly Reports on Form 10-Q, referenced herein, identify the Company's Critical Accounting Policies as the recognition of tuition revenue on a straight-line basis over the period of instruction. ITT thus has overstated its tuition revenue during the Class Period by failing to have persuasive evidence of valid student enrollment or placements nor fully qualified financial aid to pay for them. In addition, ITT has recognized higher tuition revenue than GAAP permits when it falsified student records to confer degrees or to record the completion of classes, and falsely inflated student enrollment records and statistics. GAAP precludes the recognition of revenue until strong evidence demonstrates and supports the existence of an agreement between both parties. *See* SAB 101, Section A(2), Question 1, paragraph 2.

176. ITT also overstated tuition revenue by recognizing revenue prior to the completion of the "earnings process," where services, *i.e.* classes, have not been rendered to students. ITT did not notify government agencies when students dropped out of school; counted inactive students as active when the students were not attending classes; and regularly credited and billed students for courses they never attended. GAAP provides that revenue can be recorded only when ITT completes its obligations, *i.e.* to provide education to students in accordance with the terms of its contractual agreements, federal, state, and local government regulations, and accrediting agency standards. *See* SAB 101, Section A(1), footnote 4, and Concepts Statement 5, paragraphs 84(a), (b), and (d).

177. ITT also overstated tuition revenue by failing to appropriately account for initial concerns related to the collectibility of student receivables. GAAP precludes the immediate recognition or revenue when there is an initial concern about whether corresponding revenue can be collected. *See* SAB 101, Section A (1), footnote 6.

178. ITT's materially false and misleading financial statements resulted from a series of deliberate decisions by the Defendants, all senior managers of the Company, designed to conceal the truth regarding ITT's actual operating results. Defendants caused the Company to violate GAAP because Defendants knew or recklessly disregarded that ITT's revenues were grossly inflated during the Class Period, as a result of the employment of fraudulent business practices, such as the falsification of documents used to obtain federal financial aid grants, and the improper manipulation of the allowance for doubtful accounts and bad debt expense.

179. According to numerous former employees, Defendants imposed onto the institutes unrealistic growth and expectations. The only way these could be achieved was by deviating from GAAP.

180. The business practices described by ITT employees were not legitimate practices under GAAP. GAAP requires that revenues are not recognized until earned. SFAC No. 5, ¶¶ 83-84. By, among other things, falsifying student records, ITT improperly recognized revenue because financial aid payments made by the federal government in reliance on fraudulent records created by ITT is not convertible to known amounts of cash or claims to cash due to their illegitimate nature and risk of disgorgement.

181. SFAS No. 5 also requires that financial statements disclose contingencies when it is at least reasonably possible, *e.g.*, a greater that slight chance, that a loss may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss, a range of loss or state that such an estimate cannot be made. Thus, under GAAP, Defendants were required to disclose the California Attorney General's investigation as early as October 2002.

182. Moreover, ITT was grossly reckless in failing to maintain adequate internal accounting controls. The American Institute of CPA's Auditing Standards, AU 319.06, "Internal Control in a Financial Statement Audit," defines internal controls as "a process – effected by an entity's board of directors, management, and other personnel – designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations."

183. The pervasiveness of the aforementioned allegations involved in ITT's fraudulent operations and accounting practices suggest there are significant deficiencies, if not material weaknesses, in the Company's internal controls and disclosure controls. These deficiencies relate to:

(a) the structure and design of certain financial information reporting processes relating to the timing and magnitude of revenue recognition and bad debt expense by ITT:

(b) the inadequate or ineffective policies for documenting student enrollment transactions;

(c) inadequate documentation of policies and execution of processes related to accounting for transactions; and

(d) an internal control environment that has allowed fraudulent transactions and accounting manipulations to be recorded by ITT and the Defendants.

184. Due to these accounting improprieties, the Company presented its financial results and statements in a manner which violated GAAP, including the following fundamental accounting principles:

(a) The principle that interim financial reporting should be based upon the same accounting principles and practices used to prepare annual financial statements was violated (APB No. 28, ¶10);

(b) The principle that financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions was violated (FASB Statement of Concepts No. 1, ¶34);

(c) The principle that financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and effects of transactions, events and circumstances that change resources and claims to those resources was violated (FASB Statement of Concepts No. 1, ¶40);

(d) The principle that financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it was violated. To the extent that management offers securities of the enterprise to the public, it voluntarily accepts wider responsibilities for accountability to prospective investors and to the public in general (FASB Statement of Concepts No. 1, ¶50);

(e) The principle that financial reporting should provide information about an enterprise's financial performance during a period was violated. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance (FASB Statement of Concepts No. 1, ¶42);

(f) The principle that financial reporting should be reliable in that it represents what it purports to represent was violated. That information should be reliable as well as relevant is a notion that is central to accounting (FASB Statement of Concepts No. 2, ¶¶58-59);

(g) The principle that accounting information is reliable to the extent that users can depend on it to represent the economic conditions or events that it purports to represent (FASB Statement of Concepts No. 2, ¶62);

(h) The principle of completeness, which means that nothing is left out of the information that may be necessary to insure that it validly represents underlying events and conditions was violated (FASB Statement of Concepts No. 2, ¶79); and

(i) The principle that conservatism be used as a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered was violated. The best way to avoid injury to investors is to try to ensure that what is reported represents what it purports to represent (FASB Statement of Concepts No. 2, ¶¶95, 97).

185. Further, the undisclosed adverse information concealed by Defendants during the Class Period is the type of information which, because of SEC regulations, regulations of the national stock exchanges and customary business practice, is expected by investors and securities analysts to be disclosed and is known by corporate officials and their legal and financial advisors to be the type of information which is expected to be and must be disclosed.

IX. AUDIT COMMITTEE LIABILITY

186. During the Class Period, the Audit Committee was responsible for the oversight of (a) the integrity of ITT's financial statements and other financial information provided by ITT to any governmental body or the public; (b) ITT's compliance with legal and regulatory requirements; (c) ITT's systems of internal controls regarding finance, accounting, legal compliance and ethics that ITT management and the Board of Directors establish; (d) ITT's auditing, accounting and financial reporting process generally; (e) the qualifications, independence and performance of ITT's independent auditor; and (f) the performance of ITT's internal audit function.

187. During the Class Period, the Audit Committee was required to perform the following tasks:

(a) report regularly to the Board of Directors on significant matters within the Committee's scope of responsibility, including <u>any</u> issues that arise with respect to the quality or integrity of ITT's financial statements; ITT's compliance with legal and regulatory requirements; the performance and independence of ITT’s independent auditor; the performance of the Internal Audit Department;

(b) periodically review with ITT’s general counsel legal, regulatory and related governmental policy matters that may have a material impact on ITT’s financial statements, legal and regulatory compliance and programs;

(c) conduct or authorize investigations into any matters within the Committee’s scope of responsibility;

(d) provide such disclosures and reports as may be required of the Committee by the SEC in ITT’s proxy statement for its annual meeting of shareholders;

(e) establish procedures for the receipt, retention and treatment of complaints received by ITT regarding accounting, internal accounting controls or auditing matters; and confidential, anonymous submissions by ITT employees of concerns regarding questionable accounting or auditing matters;

(f) review the results of the Internal Audit Department’s annual audit of director and ITT officer expense accounts, management perquisites and management’s use of corporate assets; and monitoring of ITT’s compliance with the ITT Code of Business Conduct and Ethics;

(g) review management policies and programs relating to ITT’s compliance with legal and regulatory requirements, business ethics, business integrity, conflicts of interest and environmental matters; and

(h) perform such other functions as assigned by law, the New York Stock Exchange, ITT's Certificate of Incorporation or By-Laws or the Board of Directors.

188. During the Class Period, the Audit Committee was also required to inquire about, consider and review:

(a) ITT's annual and quarterly financial statements, including the Management's Discussion and Analysis of Financial Condition and Results of Operations;

(b) management's qualitative judgments regarding (the appropriateness of critical accounting principles and financial disclosure practices used, or proposed to be adopted, by ITT); clarity, consistency and completeness of the accounting information contained in ITT's financial statements and related disclosures;

(c) the effect of regulatory and accounting initiatives on ITT's financial statements;

(d) the type and presentation of information to be included in earnings press releases;

(e) financial information and earnings guidance provided to security analysts and rating agencies;

(f) ITT's risk assessment and risk management, including the guidelines and policies governing the process by which management assesses and manages ITT's exposure to risk; and ITT's major financial risk exposures and the steps taken by management to monitor and control those exposures;

(g) any significant adjustments, management judgments, accounting estimates, new or changed accounting policies, uncertainties, timing of transactions or timing of the recording of transactions;

(h) any items that have a significant impact on the representational faithfulness, verifiability, neutrality and consistency of the accounting information included in ITT's financial statements;

(i) ITT's independent auditor's rationale for accepting or questioning any significant estimates by management; and

(j) the adequacy of ITT's internal accounting and financial controls, including any significant deficiencies in the design or operation of the internal controls, any material weaknesses in the internal controls; and any fraud (whether or not material) that involves management or ITT employees who have a significant role in the internal controls.

189. The Audit Committee knowingly and/or recklessly failed to comply with its responsibilities and duties as defined by ITT's Charter of the Audit Committee of ITT's Board of Directors, and allowed the Company to issue earnings press releases and public filings with the SEC which contained materially false and misleading statements.

190. During the Class Period, ITT's Internal Audit Department was required to review the Company's institutes' compliance with Title IV Program requirements and conduct an annual compliance review of each of ITT's institutes. The review was required to address numerous compliance areas, including student tuition refunds and return of Title IV Program funds, student academic progress, student admission, graduate employment, student attendance, student financial aid applications, implementation of prior audit recommendations

and a general review of student recruiting practices relating to student presentations and the execution and completion of enrollment agreements.

191. The Internal Audit Department's review was necessary to insure that ITT's institutes were in compliance with the various external agencies, including the DOE, state agencies, guaranty agencies and the ACICS. If the DOE or another regulatory agency determined that one of ITT's institutes improperly disbursed Title IV Program funds or violated a provision of the HEA or the DOE's regulations, the Company could be required to repay such funds to the DOE or the appropriate state agency or lender and could be assessed an administrative fee. The DOE could also subject the funds to the reimbursement system, under which a school must disburse its own funds to students and document the students' eligibility for Title IV Program funds before receiving such funds from the DOE. Violations of Title IV Program requirements could also subject ITT to other civil and criminal penalties.

192. The Audit Committee, as defined pursuant to ITT's Charter of its Audit Committee, was a control person of the Internal Audit Department, and was specifically responsible to inquire about, consider, and review the Internal Audit Department's annual compliance review of each of ITT's institutes.

X. CLASS ACTION ALLEGATIONS

193. Lead Plaintiff brings this action as a class action pursuant to Federal Rules of Civil Procedure 23(a) and (b)(3) on behalf of the Class defined in ¶1 above. Excluded from the Class are Defendants, the Company's officers and directors, affiliates, legal representatives, heirs, predecessors, successors and assigns, and any entity in which the Company has a controlling interest or of which the Company is a parent or subsidiary.

194. The members of the Class are located in geographically diverse areas and are so numerous that joinder of all members is impracticable. As of February 15, 2004, the Company reported that it had 45,667,619 shares of its common stock outstanding. The Company's common stock trades under the symbol "ESI" on the New York Stock Exchange. While the exact number of Class members is unknown to Lead Plaintiff at this time and can only be ascertained through appropriate discovery, Lead Plaintiff believes there are, at a minimum, thousands of members of the Class who traded Company common stock during the Class Period.

195. Common questions of law and fact exist as to all members of the Class and predominate over any questions affecting solely individual members of the Class. Among the questions of law and fact common to the Class are:

(a) Whether Defendants engaged in acts or conduct in violation of the federal securities laws as alleged herein;

(b) Whether Defendants had a duty to disclose certain information;

(c) Whether Defendants acted knowingly or recklessly in making materially misleading statements during the Class Period;

(d) Whether Defendants acted knowingly or recklessly in omitting material information during the Class Period;

(e) Whether the market prices of the Company's securities during the Class Period were artificially inflated because of Defendants' conduct complained of herein; and

(f) Whether the members of the Class have sustained damages and, if so, the proper measure of damages.

196. Lead Plaintiff's claims are typical of the claims of the members of the Class as Lead Plaintiff and members of the Class sustained damages arising out of the Defendants' wrongful conduct in violation of federal laws as complained of herein.

197. Lead Plaintiff will fairly and adequately protect the interests of the members of the Class and has retained counsel competent and experienced in class and securities litigation. Lead Plaintiff has no interests antagonistic to or in conflict with those of the Class.

198. A class action is superior to other available methods for the fair and efficient adjudication of this controversy since joinder of all members of the Class is impracticable. Furthermore, because the damages suffered by individual Class members may be small relative to the expense and burden of individual litigation, it is impossible for the Class members individually to redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

199. Lead Plaintiff will rely, in part, upon the presumption of reliance established by the fraud-on-the-market doctrine in that:

(a) Defendants made material misstatements or failed to disclose material facts during the Class Period;

(b) the misleading statements and omissions were material;

(c) the securities of the Company traded under the symbol "ESI" on the New York Stock Exchange, an efficient and open market, and the Company was followed by numerous major analysts; and

(d) the misleading statements and omissions alleged would tend to induce a reasonable investor to misjudge the value of the Company's securities.

200. Lead Plaintiff and members of the Class purchased their Company stock between the time Defendants made misleading statements or failed to disclose material facts and the time the true facts were disclosed, without knowledge of the misrepresentations or omitted facts.

201. Based upon the foregoing, Lead Plaintiff and members of the Class are entitled to a presumption of reliance upon the integrity of the market price for the Company's securities.

XI. CAUSES OF ACTION

COUNT I
AGAINST ALL DEFENDANTS FOR VIOLATIONS OF § 10(b) OF THE EXCHANGE ACT AND RULE 10b-5 PROMULGATED THEREUNDER

202. Lead Plaintiff repeats and realleges each of the allegations set forth in the foregoing paragraphs.

203. This Count is asserted against all Defendants and is based upon Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder.

204. During the Class Period, Defendants, individually and in concert, directly, by the use, means and instrumentalities of interstate commerce, the United States mails, and the institutes of a national securities market, engaged in a unlawful course of conduct, pursuant to which Defendants knowingly or recklessly engaged in acts, transactions, practices, and courses of business to conceal adverse material information about the Company's financial condition which operated as a fraud and deceit upon Lead Plaintiff and the other members of the Class, and made various deceptive and untrue statements of material facts, and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading to Lead Plaintiff and the other members of the Class. The purpose and effect of said scheme, plan, and unlawful course of conduct was, among other things, to cause Lead Plaintiff and the other members of the Class to purchase the Company's securities during the Class Period at artificially inflated prices.

205. Specifically, the statements made by Defendants as set forth above were materially false and misleading and/or failed to disclose facts necessary to render what was said true and accurate because they failed, *inter alia*, to disclose and misrepresented the following material adverse facts alleged in this complaint, including:

(a) during the Class Period, ITT had systematically falsified student records in order to increase start, enrollment, continuing student, and graduation rates, and to conceal problems to help its institutes pass audits conducted by the ACICS and DOE, among other agencies;

(b) a material portion of ITT's reported revenues was improperly recognized because it was derived through fraudulent business practices, such as federal grants and financial aid payments made based upon records and representations that were falsified by Defendants;

(c) contrary to statements in its press releases, ITT's success was not attributable to the supposed strength of its business or its purported competitive advantages, but rather, a material portion of its results were attributable to fraudulent and prohibited business practices;

(d) ITT failed to disclose that it had falsified student records, thereby placing its accreditation at serious risk and jeopardizing the ability of its students to qualify for financial aid, which could have a devastating impact on ITT's business, operations, revenues, and income;

(e) ITT's financial statements were not prepared and reported in accordance with GAAP and did not fairly present its actual financial results or condition; and

(f) Defendants failed to disclose the existence of the California Attorney General's investigation of the Company, which began in October 2002 and continued throughout the Class Period.

206. Defendants, as Company officers and/or directors, are liable as direct participants in the wrongs complained of herein. As officers and directors of a publicly traded corporation, these Defendants had a duty to disseminate accurate and truthful information about the Company's operations and financial condition and results so that the market price of the Company's publicly traded securities would be based on truthful and accurate

information. Through their position of control and authority as officers and directors of the Company, these Defendants were able to and did control, directly or indirectly, the content of the financial statements and public statements disseminated by and through the Company. With knowledge of the falsity and/or misleading nature of the statements contained therein, or in reckless disregard of the true financial condition and prospects of the Company, these Defendants caused the heretofore complained of public statements to contain material misstatements and omissions of material facts as alleged above, in violation of their aforementioned duties and of the federal securities laws.

207. Defendants had actual knowledge of the misrepresentations and omissions of material facts set forth herein, or acted with reckless disregard for the truth in that they failed to ascertain and to disclose the true facts, even though such facts were available to them.

208. Defendants had a clear incentive to inflate ITT's financial results, and hence the price of its securities.

209. As a result of the dissemination of the false and misleading statements set forth above, the market price of the Company's securities was artificially inflated during the Class Period. In ignorance of the false and misleading nature of the statements described above, Lead Plaintiff and the other members of the Class relied, to their detriment, on the integrity of the market price of the securities in purchasing the Company's common stock. Had Lead Plaintiff and the other members of the Class known the truth, they would not have purchased said securities or would not have purchased them at the inflated prices that were paid.

210. Lead Plaintiff and the other members of the Class have suffered substantial damages as a result of the wrongs herein alleged in an amount to be proved at trial.

211. By reason of the foregoing, Defendants violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

COUNT II
AGAINST THE INDIVIDUAL DEFENDANTS
AND THE AUDIT COMMITTEE DEFENDANTS FOR
VIOLATIONS OF § 20(a) OF THE EXCHANGE ACT

212. Lead Plaintiff repeats and realleges each of the allegations set forth in the foregoing paragraphs.

213. This Count is asserted against the Individual Defendants and the Audit Committee Defendants, and is based upon Section 20(a) of the Exchange Act, 15 U.S.C. 78t(a).

214. The Individual Defendants and Audit Committee Defendants had the power and influence and exercised the same to cause the Company to engage in the illegal and improper conduct complained of herein. Because of their executive, managerial, and directorial positions at the Company, these Defendants had access to the non-public information alleged herein, and acted to conceal and/or omitted to disclose such information from Lead Plaintiff, the Class, and the investing public, and caused the price of the Company's common stock to become artificially inflated as more fully described herein.

215. By reason of the conduct alleged in Count I, the Individual Defendants and Audit Committee Defendants are liable for the aforesaid wrongful conduct, and are liable to Lead Plaintiff and to the other members of the Class for the substantial damages which they suffered in connection with their purchases of the Company's securities during the Class Period.

WHEREFORE, Lead Plaintiff on behalf of itself and the Class prays for judgment as follows:

A. Declaring this action to be a proper class action maintainable pursuant to Rule 23 of the Federal Rules of Civil Procedure and Lead Plaintiff to be a proper class representative;

B. Awarding Lead Plaintiff and the Class compensatory damages, together with appropriate prejudgment interest at the maximum rate allowable by law;

C. Awarding Lead Plaintiff and the Class their costs and expenses for this litigation including reasonable attorneys' fees and other disbursements; and

D. Granting such other and further relief as this Court deems to be just and proper.

DEMAND FOR TRIAL BY JURY

Pursuant to Rule 38(b) of the Federal Rules of Civil Procedure, Lead Plaintiff hereby demands trial by jury of all issues that may be so tried.

Dated: August 19, 2004

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Counsel for Lead Plaintiff and the Class

CERTIFICATE OF SERVICE

I hereby certify that on August 19, 2004 a copy of the foregoing Consolidated Class Action Complaint was filed electronically. Notice of this filing will be sent to the following parties by operation of the Court's electronic filing system. Parties may access this filing through the Court's system.

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I hereby certify that on August 19, 2004, a copy of the foregoing Consolidated Class Action Complaint was mailed by first class mail, postage prepaid and properly addressed to the following:

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