UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

DAVID TAUBENFELD, Individually, and On Behalf of Himself and All Others Similarly Situated,

Plaintiff,

vs.

CAREER EDUCATION CORPORATION, JOHN M. LARSON and PATRICK K. PESCH,

Defendants.

Case No. 03 C 8884
Honorable Joan H. Lefkow

CLASS ACTION

THIRD AMENDED CONSOLIDATED COMPLAINT FOR VIOLATION OF THE FEDERAL SECURITIES LAWS

Demand For Jury Trial

Lead Plaintiff, Thomas Schroder ("Lead Plaintiff"), individually and on behalf of all other persons similarly situated, by his undersigned attorneys, alleges the following based upon personal knowledge as to himself, and information and belief as to all other matters based upon, *inter alia*, the investigation of Lead Plaintiff's counsel, which included a review of United States Securities and Exchange Commission ("SEC") filings by Career Education Corp. ("CEC" or the "Company"), as well as securities analysts' reports concerning the Company, Department of Education audits of CEC schools, press releases, media reports, other public statements issued by the Company, documents and e-mails prepared by the Company, and interviews with dozens of confidential witnesses, including the 27 former employees of the Company cited herein.

This Complaint directly addresses the matters raised in the Court's Memorandum Opinion and Order dated March 28, 2006. Among other things, it (a) adds as a named representative an individual who purchased shares of CEC stock shortly before the close of the Class Period (as defined below) (*see* paragraph 19); (b) incorporates significantly greater detail from many of the confidential witnesses as compared to the Second Amended Complaint, in many cases

based on further interviews of such witnesses; (c) incorporates more than a dozen additional internal corporate documents evidencing the wrongdoing set forth herein; (d) adds allegations of wrongdoing at 8 CEC schools based on audits conducted by the Department of Education; (e) extends the Class Period to incorporate additional fraudulent statements and acts; (f) adds allegations by new confidential witnesses (including Witnesses 5, 7, 27 and 28); and (g) deletes allegations made by three confidential witnesses whose statements referred to specific examples of wrongdoing at CEC schools rather than to acts that were far more widespread.

I

NATURE OF THE ACTION AND SUMMARY OF ALLEGATIONS

1. This is a federal class action on behalf of persons who purchased the securities of CEC between April 22, 2002 and February 15, 2005, inclusive (the "Class Period"), who have suffered damages thereby, seeking to pursue remedies under the Securities Exchange Act of 1934 (the "Exchange Act").

2. CEC is a provider of private, for-profit post-secondary education. During the Class Period it had between 51 and 78 campuses, including two online campuses, throughout the United States, and in Canada, France and the United Kingdom. CEC owns and operates schools (collectively, the "schools") in the following career-related fields: Visual Communication and Design Technologies, Information Technology, Business Studies, Culinary Arts, and Health Education. It also operates colleges and "universities."

3. As set forth in the Company's 2005 Form 10-K, CEC's United States schools are divided into six divisions; Academy, Colleges, Culinary, Gibbs, Health Education, and University.

4. The Company's business is highly regulated by federal, state and private accrediting agencies, including the Accrediting Council for Independent Colleges and Schools ("ACICS").

5. Throughout the Class Period, the Company publicly lauded its business and financial performance in its press releases, SEC filings and conference calls with analysts. During this time, CEC consistently reported (a) "record" financial results, including revenues, earnings and bad debt expense to revenue ratios that were comparable or superior to its competitors, and (b) improved student-related information, including steadily increasing figures for total student population and starts (*i.e.*, the number of students per semester who pay an enrollment fee, are fully packaged for tuition and sit for the first week of class) and excellent job placement rates for its graduates of approximately 95 percent. Indeed, the Company was touted as "never missing," and usually surpassing, analysts' projections of its operations (*see*, *e.g.*, May 15, 2003 CIBC Analyst Report p. 7.)

6. In fact, the defendants consistently lied about their financial and business successes. Revenue and earnings were overstated, and bad debt expense was understated through a variety of accounting manipulations, which were in violation of Generally Accepted Accounting Principles ("GAAP"). Similarly, important criteria measuring the success of the Company's schools, including starts, enrollment and job placement figures (all key business metrics that were important to analysts and investors), were based upon falsified records and fraudulent practices.

7. The reporting of false financial and business information was directed by defendants Larson and Pesch (the "Individual Defendants"). These defendants set goals that could not be achieved by legitimate means and then demanded that the goals be met "at any cost." They instructed CEC employees to "pull out all of the stops" to achieve those objectives. This message was delivered through regular, weekly and sometimes daily telephone conference calls and meetings

between the Individual Defendants, or their designated corporate representatives, and representatives of the constituent schools. The message to CEC employees was crystal clear: the public reporting of key financial and business results below levels projected by the Company "would have severe financial implications" and was simply "unacceptable."

8. Unfortunately for the investing public, CEC's employees, acting at the request of the defendants, falsified the Company's financial and business information so that CEC's publicly reported results equaled, or in most instances exceeded, its projected results. As expected, stock analysts acted with near adulation, and the Company's stock price soared. This inflated stock price enabled the Individual Defendants to sell their personally-held CEC stock at artificially inflated prices, reaping aggregate proceeds of more than $46 million. It also enabled the Company to use CEC stock as currency to fund its growth by acquiring more schools in stock-for-stock acquisitions. Inflated business metrics regarding job placements also allowed the Company to avoid running afoul of federal laws regulating the industry, which might have foreclosed the Company from being eligible to receive necessary Title IV funding (the source of more than 58% of its revenues).

9. When word began to seep out regarding its troubled business and financial condition, the Company promptly sought to "set the record straight." Thus, beginning at the end of 2003, CEC, ever desirous of maintaining its image as a Wall Street stalwart, promptly (and falsely) denied a series of reports which alleged that certain of its schools falsified student records or otherwise acted improperly.

10. The Company's stock price reacted negatively to these disclosures even though the defendants sought to minimize these stock drops by denying the accuracy of the disclosures or minimizing their importance and by continuing to report false financial and student information regarding the Company's ongoing operations.

11. Finally, on February 15, 2005, the close of the Class Period, CEC announced that it would (i) restate its previously reported financial results for 2000 through 2004 to reduce revenues and earnings for these periods; and (ii) take a $19 million charge in the 2004 fourth quarter to increase its estimate of its allowance for doubtful accounts. At the same time, the Company also announced that it would write off an astounding $92 million in bad debts. On this news, the price of CEC stock fell further, from a closing price on February 15, 2005 of $39.21, to close at $37.19 on February 16, 2005. The stock continued to fall as analysts became further aware of the extent of the Company's problems, closing on March 15, 2005 at $32.74 per share.

12. The Company has disclosed that it is the subject of inquiries by the U.S. Department of Justice as well as the Pennsylvania Attorney General. In addition, it is a defendant in eight consumer lawsuits which charge, *inter alia*, that its Allentown Business School Ltd., The Katherine Gibbs Corp.—New York and Melville, Ultrasound Technical Services, Inc., American Inter-Continental University ("AIU"), Sanford Brown College, Brooks College, and Brooks Institute of Photography School all misrepresented the student loan process, job placement rates, student retention rates and other student-related information at those schools.

13. The U.S. Department of Education ("DOE") also notified the Company in June 2005 that it is reviewing CEC's Restatement issued in February 2005 (described below) and annual compliance opinions for the years 2000-2003 and is evaluating pending school program reviews that have taken place at three CEC schools, including Brooks College in Long Beach, California, and the Pennsylvania Culinary Institute in Philadelphia ("PCI"). The DOE indicated that

until these matters are addressed to its satisfaction, it will not approve any new applications by CEC for pre-acquisition review or change of ownership, or for any additional branch campuses.[1]

II

JURISDICTION AND VENUE

14. The claims asserted herein arise under and pursuant to Sections 10(b) and 20(a) of the Exchange Act [15 U.S.C. §§ 78j(b) and 78t(a)] and Rule 10b-5 promulgated thereunder by the SEC [17 C.F.R. § 240.10b-5].

15. This Court has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. §1331 and §1337, and Section 27 of the Exchange Act.

16. Venue is proper in this District pursuant to Section 27 of the Exchange Act and 28 U.S.C. §1391(b). Many of the acts charged herein, including the preparation and dissemination of materially false and misleading information, occurred in substantial part in this District and CEC maintains its headquarters in this District.

17. In connection with the acts alleged in this complaint, Defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including, but not limited to, the mails, interstate telephone communications and the facilities of the national securities markets.

III

PARTIES

18. Lead Plaintiff, as set forth in the Amended Certification previously filed with this Court, purchased the common stock of CEC at artificially inflated prices during the Class Period and has been damaged thereby.

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[1] In February 2006 the DOE notified the company that it was reviewing its 2004 compliance opinions and that most of the restrictions set forth in the June 2005 letter would continue to apply, though it would consider applications by CEC to acquire two new campuses.

19. Additional Plaintiffs Nicholas J. Margaritas, Gordon W. MacKinney and Vivian Oh also purchased the common stock of CEC during the Class Period at artificially inflated prices and have been damaged thereby. Vivian Oh's Certification, indicating that she purchased CEC stock on January 25, 2005, is attached hereto as Exhibit A.

20. Defendant CEC is a corporation organized under the laws of Delaware with its principal executive offices located at 2895 Greenspoint Parkway, Suite 600, Hoffman Estates, IL 60195.

21. (a) Defendant John M. Larson ("Larson") was CEC's Chief Executive Officer, President and Chairman of the Board throughout the Class Period. Larson has served in these capacities since CEC's inception in 1994. In 2002, Larson received a salary of $600,000 and a bonus of $1,043,550. In 2003, Larson received a salary of $750,000 and a bonus of $762,500. The bonus component of Larson's annual compensation is based upon annual quantitative and qualitative performance targets established by the Board of Directors which considers, *inter alia*, net income, pre-tax income, EBITDA, operating income, earnings per share and other financial benchmarks, which, as described below, were artificially inflated by defendants' actions. In 2004, Larson received a salary of $900,000 and a bonus of $900,000. In April and September 2002 Larson sold 200,000 shares of CEC stock for $9 million, and in April, July and August 2003 and April 2004, ***Larson sold 800,000 CEC shares for $36.5 million***. These stock sales were made at a time that Larson and the other defendants were engaged in fraudulent acts; further they were far higher than his pre-class period sales and therefore suspicious in nature.

(b) From 1989 until 1993, Larson served as the Senior Vice President of College Operations of Phillips Colleges, Inc., ("Phillips") a nationwide system of 58 schools. During the period of his tenure at Phillips, that institution was repeatedly cited in Student Financial Assistance Proceedings for failing to provide documentation to support the award of government

financial aid. Moreover, in 1994 and 1995, the DOE effectively put Phillips out of business after it prohibited all of Phillips' schools from participating in Title IV funding; Phillips ultimately sold its portfolio of schools. The DOE determined that Phillips had widespread and massive mismanagement of financial aid and repeated regulatory violations, including: withholding student refunds; failing to notify lenders of student withdrawals; making improper financial aid disbursements; routinely changing student files to avoid repaying financial aid; utilizing false and misleading advertising; admitting students who failed to meet admission requirements; and lacking documentation for high school diplomas or GEDs as required by federal law. Phillips still owes defrauded students a $10 million judgment in Los Angeles, as well as many unpaid refunds.

22. Defendant Patrick K. Pesch ("Pesch") was CEC's Chief Financial Officer, Treasurer and Secretary throughout the Class Period. Pesch has been a director of CEC since 1995. He was an audit manager with Arthur Young & Company prior to his employment at CEC, and thus has extensive accounting and auditing experience. In 2002, Pesch received a salary of $300,000 and a bonus of $360,000. Pesch received a salary and bonus in 2003 of $360,000 and $366,000 respectively. In 2004, Pesch received a salary of $400,000 and a bonus of $240,000. Like Larson, the bonus component of Pesch's annual compensation is directly tied to achievement of specified performance related criteria, including, *inter alia*, revenues, operating income and earnings per share, which benchmarks were artificially inflated by defendants' actions. In April and May 2002, Pesch sold a total of 64,000 CEC shares for a total of $2.9 million. In April and August 2003, he sold a total of 292,000 CEC shares for $11.2 million. These stock sales were made a time when Pesch and the other defendants were committing fraudulent acts and were also far higher than pre-Class Period sales. Accordingly, they are suspicious in timing and amount.

23. Defendants Larson and Pesch are referred to herein as the "Individual Defendants."

24. During the Class Period, and as described in great detail below, the Individual Defendants, as senior executive officers and/or directors of CEC, were privy to confidential and proprietary information concerning CEC, its operations, and its financial condition and results. This access to non-public information was obtained from, *inter alia*, the following sources:

25. (a) **Periodic communications with Divisional or School representatives.** Both Larson and Pesch obtained non-public information from their daily participation in conference calls with lower level CEC employees. For example, CEC Corporate representatives, including the Individual Defendants, held daily conference calls with a variety of representatives from the schools, wherein critical issues such as student population numbers, retention rates, allowances for bad debts and bad debt reserves ratios would be discussed. CEC also held periodic "cash collection calls," in which Pesch, other corporate executives and Finance Managers and School Presidents participated, wherein specific collection efforts related to individual students were discussed, according to Witnesses 2, 5, 27, and 28 who participated in these calls.[2]

(b) **Access to a centralized computer system**: According to Witnesses 1 and 18 (both controllers), as of the beginning of the Class Period, the Campus 2000 information systems at CEC corporate headquarters had the access and ability to "drill down" to the student level in terms of having direct and immediate access to key financial information, including the amounts of money owed to CEC by individual students and the length of time that these balances were outstanding. In fact, as stated by Witness 1, CEC Corporate, including defendant Pesch, could do the close for a particular school without the assistance of the Controller for that particular school.

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[2] Descriptions of the Confidential Witnesses, whose statements are relied upon in this Complaint, are set forth in paragraph 30.

(c) **Periodic Reports**: The Campus 2000 System was used to generate multiple reports to the Individual Defendants and other corporate representatives regularly, and sometimes on a daily basis, during the Class Period. These reports reflected, *inter alia*, to what extent a particular school was above or below projected results, *e.g.*, whether a school had achieved projected revenues and bad debt ratios for a particular quarter. Pesch, and at times Larson, would also receive copies of communications sent by other CEC corporate representatives to school representatives indicating to what extent a particular school was achieving goals set by corporate. For example, prior to the end of a quarter, Pesch, and at times Larson, would be sent copies of reports sent by corporate manager Jason Licar to school representatives indicating to what extent the school's bad debt reserve ratio was over the amount set by Corporate for that school. As described below, school representatives would then take steps to artificially depress the school's bad debt ratio in order to meet Corporate's projected results, including encouraging current and former students to make minimal payments of $25 or less that would – in violation of GAAP – result in thousands of dollars *per student* being removed from bad debt and being re-classified as "current receivables." As set forth in CEC's own documents, on a school wide basis, this artificially lowered reported bad debt by more than $14 million in June 2003.

(d) **Weekly Flash Reports**. Each CEC school prepared a "Weekly Flash Report" which covered a variety of topics, and which, despite its title, were generated daily by most schools and were printed at CEC Corporate. The Weekly Flash Report contained "Sources of Leads, Enrollments and Starts," which were broken down further by each admission representative. These reports would also estimate anticipated future students and starts. According to Witness 20 (a former Vice President of Academic Affairs), who received copies of these reports, the Flash Reports were reviewed in conference calls with Witness 20 and Corporate, including Larson at times, with

the most important issue discussed being the number of student starts. (A Consolidated Flash Report by Region for the week of August 10, 2003, is attached as Exhibit B.)

Weekly Flash Reports for each school also included a "Packaging Summary" which calculated which students had complete packages of tuition and financial aid. Witness 20 indicated that this "Packaging Summary" was the primary responsibility of each school's VP of Finance, and that Larson would "jump" on the Finance VPs if "their numbers were not right." In addition, the Weekly Flash Report had a section entitled "Population Summary" to calculate student population, which listed additions to population, reduction to population, and "temporary reductions to population." The Weekly Flash Report also tracked cash collected, expected cash flow and past due receipts. Based upon these Reports, the Individual Defendants, or other Corporate employees acting on their behalf, would direct school officials to take particular acts, including fraudulent acts, to enable CEC schools to achieve goals set by Corporate, *e.g.* to keep the bad debt ratio below 4 percent.

26. The Individual Defendants, because of their positions with the Company, controlled the contents of its reports, press releases and SEC filings. Further, throughout the Class Period they made presentations to securities analysts on at least a quarterly basis. Thus, the Individual Defendants had the opportunity and means to issue the false and misleading statements alleged herein.

27. As senior executive officers and/or directors and as controlling persons of a publicly-traded company whose stock was, and is, registered with the SEC pursuant to the Exchange Act, and was traded on the Nasdaq National Market ("Nasdaq") and governed by the federal securities laws, the Individual Defendants had a duty to promptly disseminate accurate and truthful information with respect to CEC's financial condition and performance, growth, operations, financial statements, business, earnings and present and future business prospects, and to correct

any previously issued statements that had become materially misleading or untrue, so that the market price of CEC's securities would be based upon truthful and accurate information. The Individual Defendants' misrepresentations and omissions during the Class Period violated these specific requirements and obligations.

28. The Individual Defendants are liable as participants in a fraudulent scheme and course of conduct that operated as a fraud or deceit on purchasers of CEC's securities by disseminating materially false and misleading statements and by concealing materially adverse facts. The scheme deceived the investing public regarding CEC's business, financial results and operations and the intrinsic value of CEC's securities, and caused Lead Plaintiff and members of the Class to purchase CEC's securities at artificially inflated prices.

29. In addition, the Individual Defendants, by reason of their status as senior executive officers and/or directors were "controlling persons" within the meaning of Section 20 of the Exchange Act, and had the power and influence to cause the Company to engage in the unlawful conduct complained of herein. Because of their positions of control, the Individual Defendants were able to and did, directly or indirectly, control the conduct of CEC's business and the substance of its disclosures and filings with the investing public and the SEC.

IV

CONFIDENTIAL WITNESSES

30. Lead Plaintiff interviewed the following former employees of CEC and its schools:

(a) Witness 1 was a former Controller/Finance Vice President at Gibbs College in Vienna, Virginia from April 2000 through June 2003. Witness 1's duties included overseeing and managing all financial reporting functions; designing and implementing policies and procedure to facilitate timely reporting of financial information; performing forensic analysis and

correcting accounting records; overseeing the Student Accounts Department; and billing students and collecting funds.

(b) Witness 2 was a former Student Account Manager and Finance Manager at Gibbs College in Boston, Massachusetts from April 2002 through June 2003. Witness 2's duties included arranging financing for students, preparing budgets, and overseeing collections of receivables from students.

(c) Witness 3 was a former Director of Tuition Planning and Admissions at Pennsylvania Culinary Institute in Pittsburgh, Pennsylvania from May 2001 through May 15, 2003. Witness 3 managed a staff of seven Tuition Planners who explained the financial aid process and collected all the required paperwork from students for financial aid.

(d) Witness 4 was a former Director of Financial Aid at the International Academy of Design & Technology in Orlando, Florida from June 2003 through February 2004. Witness 4 reported to the Controller of the school. Witness 4's duties included ensuring that incoming students had sufficient financial aid and loans to cover the cost of tuition.

(e) Witness 5 was the Provost at Katherine Gibbs School in New York from February 4, 2002 until March 2003, at which time she was promoted to President of the School. She left Gibbs in September 2003. As a result of her administrative duties, she had direct knowledge regarding admissions irregularities, including hundreds of "phantom students" included in reported starts at her school, and bad debt issues. She spoke directly to Larson regarding the phantom student issue and had monthly calls with Larson and all 75 school presidents regarding starts, admissions practices, bad debt, and other issues. She also spoke directly to Pesch regarding the bad debt issues.

(f) Witness 6 was a former Employer Relations Manager at CEC corporate employed from October 2003 through February 2004. Witness 6's duties were to assist

students from CEC's online schools – American Inter-Continental University and Colorado Technical University – to find employment upon graduation by helping prepare resumes and cover letters for prospective employers and contact companies to introduce students.

(g) Witness 7 was a senior accounting executive at CEC Corporate in Hoffman Estates throughout the Class Period. Witness 7 was responsible for the Company's consolidating internal and external financial statements and financial reporting. Witness 7 was in frequent contact with CEC controllers by phone conference and, at times, communicated directly with Pesch regarding accounting matters at CEC.

(h) Witness 8 was a former Admissions Representative at Missouri College in St. Louis, Missouri, employed from 1997 through February 2004. Witness 8 was responsible for recruiting new students to the school.

(i) Witness 9 was a former Training Department Coordinator, then Regional Director of Admissions, based at CEC headquarters in Hoffman Estates employed from April 2001 through September 2002. Witness 9's duties included interviewing candidates for staffing of 44 colleges for various positions; creating and implementing a tracking system to monitor sales staff for CEC; creating sales training manuals and videos for sales representatives; and overseeing the performance of 208 employees at 7 CEC institutions.

(j) Witness 10 was a former Student Services Representative at Le Cordon Bleu College of Culinary Arts in Mendota Heights, Minnesota, employed from October 2003 through April 2004. Witness 10's duties included the retention of students by addressing issues that arose concerning disciplinary matters, financial aid problems and other situations.

(k) Witness 11 was a former Director of Career Services at AIU Los Angeles, in Los Angeles, California, employed between February 2003 and September 2003. Witness 11 attempted to place students in jobs after graduation from AIU Los Angeles; in that

capacity, Witness 11 also input data on the purported placement of graduates into reports provided to CEC Corporate.

(l) Witness 12 was a former Vice President of Finance employed at AIU Dunwoody in Georgia from December 2001 through February 2003. Witness 12 reported to the school President and to the Divisional Controller at Hoffman Estates.

(m) Witness 13 was a former Finance Manager employed at Gibbs College in Norwalk, Connecticut from August 2002 through February 2003. Witness 13's duties were to manage cash flow; reduce bad debt expense and meet bad debt ratio goals as set by CEC corporate; manage a staff of accounts receivable and student accounts representatives; and coordinate journal entries and post cash receipts. Witness 13 participated in weekly conference calls between his school and personnel from Hoffman Estates (*i.e.* Corporate) regarding how the school was doing towards meeting various performance goals, including admissions and collections on student accounts.

(n) Witness 14 was a former instructor at a culinary school in Florida employed from December 2004 through February 2005.

(o) Witness 15 was a former Controller at the Pennsylvania Culinary Institute in Pittsburgh, Pennsylvania, employed from 2001 through February 2003. Witness 15 was responsible for the school's financial reporting, budgeting and student accounts.

(p) Witness 16 was a former Director of Admissions at the Scottsdale Culinary Institute in Scottsdale, Arizona. Witness 16 was employed from January 2002 through June 2004 and oversaw the student admission process. This witness participated in conference calls with corporate on at least a weekly basis regarding enrollments and starts;

(q) Witness 17 was a former Retention Coordinator at the Texas Culinary Academy in Austin, Texas. Witness 17 was employed from June 2002 through September

2004. Witness 17's role was liaison with the school's student population and ensuring that students regularly attended classes in order to graduate. In this capacity, Witness 17 regularly kept track of the student population, both personally and in written reports and had full access to all school information through access to the Campus 2000 computer system.

(r) Witness 18 was a former CEC Divisional Controller for the Colleges Division employed from February 2002 to September 2003. Witness 18's duties were to serve as a liaison between the schools and CEC corporate, as well as assume the controller function for schools that might not have a controller and in particular, assist in the closing process for schools in the division. Initially, Witness 18 oversaw 10 or 11 schools but in early 2003, as a result of a restructuring, oversaw 5 West Coast schools.

(s) Witness 19 was a former Director of Career Services and Education employed at the International Academy of Design & Technology campus in West Virginia (now closed), from November 1999 through July 2003. Witness 19's duties were to develop curricula for the school with a focus on student retention.

(t) Witness 20 was a former Vice President of Academic Affairs employed from March 2003 through February 2004 and (concurrently) Vice-President of Student Affairs from September 2003 through February 2004 at AIU Los Angeles, in Los Angeles, California. As VP of Academic Affairs, Witness 20 established and approved curricula for the school, and hired and trained faculty. As VP of Student Affairs, Witness 20 interfaced with the admissions department to assist in student related issues and ensured that the school met its retention goals (*i.e.*, keeping students enrolled).

(u) Witness 21 was a former Vice President of Student Finance at the Katherine Gibbs school in New York, employed from February 2002 to September 2004. Witness 21 oversaw a staff that discussed financial options with students and reviewed students'

qualifications. Witness 21 is a CPA who was formerly employed by a large accounting firm and was familiar with the bad debt issues at the Katherine Gibbs school in New York and spoke directly with defendant Pesch about them.

(v) Witness 22 (intentionally deleted)

(w) Witness 23 was a former Director of Student Services at Missouri College in St. Louis, Missouri, employed from September 2002 through November 2003. Witness 23's duties included: counseling students on academic probation; creating academic plans; and re-enrolling students who dropped out. Witness 23 met weekly with the school President to discuss students and was told by the President not to drop students who should have been dropped.

(x) Witness 24 was a former Director of Admissions for AIU Online who worked in admissions for AIU for at least two years, ending in late 2003. Witness 24's duties were related to qualifying prospective students for admission to the Online University.

(y) Witness 25 was employed by CEC from December 2001 until April 2004 as Admissions Associate, Associate Director of Admissions and Director of Admissions at the Katherine Gibbs school in New York, New York. Witness 25's responsibilities as an Admissions Associate was to interview possible students and attempt to enroll them. As an Associate Director, Witness 25 supervised a team of other employees as they attempted to enroll students; as Director of Admissions, Witness 25 supervised a staff of approximately 10-12 admission associates.

(z) Witness 26 was a registrar at Brooks Institute of Photography in California from 2000 through September 2003. Witness 26's responsibilities included reviewing student files (both before and after the student was admitted). Witness 26 was aware of issues related to enrollment and retention of students.

(aa) Witness 27 was Vice President of Administration and Marketing for CEC's Katherine Gibbs Schools on the East Coast from 2002 to 2004. In that capacity, Witness 27

oversaw 9 Katherine Gibbs schools and frequently met with Larson and other top CEC management with respect to issues relating to, *inter alia*, starts, enrollment and bad debt.

(bb) Witness 28 worked as a CEC executive at Hoffman Estates throughout the Class Period. During that time Witness 28 had a variety of executive titles including Vice President of Admissions for all of CEC. ***Throughout the Class Period, Witness 28 met in person with Larson at least twice a week and met in person with Pesch at least once a week.***

V

CLASS ACTION ALLEGATIONS

31. Lead Plaintiff brings this action as a class action pursuant to Federal Rule of Civil Procedure 23(a) and (b)(3) on behalf of a Class, consisting of all those persons or entities who purchased the securities of CEC between April 22, 2002 and February 15, 2005, inclusive, and who were damaged thereby (the "Class"). Excluded from the Class are Defendants, members of their immediate families and their legal representatives, heirs, successors or assigns and any entity in which Defendants have or had a controlling interest.

32. The members of the Class are so numerous that joinder of all members is impracticable. Throughout the Class Period, there were approximately 100 million shares of CEC common stock actively traded on the Nasdaq (after the Company's stock split 2:1 on August 25, 2003). 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 that there are, at a minimum, thousands of members in the proposed Class.

33. Lead Plaintiff's claims are typical of the claims of the members of the Class as all members of the Class are similarly affected by Defendants' wrongful conduct in violation of federal law that is complained of herein.

34. 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.

35. Common questions of law and fact exist as to all members of the Class and predominate over any questions solely affecting individual members of the Class. Among the questions of law and fact common to the Class are: i) whether the federal securities laws were violated by Defendants' acts as alleged herein; ii) whether statements made by Defendants to the investing public during the Class Period misrepresented material facts about the business and financial results of CEC; and iii) to what extent the members of the Class have sustained damages and the proper measure of damages.

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

VI

SUBSTANTIVE ALLEGATIONS

A. Falsification of Financial Data

37. In order to achieve the projected levels of financial results that the Company periodically provided to analysts and the investing public, the Defendants falsified, or caused to be falsified, at least four critical elements of CEC's financial performance: (i) allowance for bad debt, (ii) bad debt ratios, (iii) revenues, and (iv) earnings.

1. <u>Understatement of Allowance for Doubtful Accounts</u>

38. During the Class Period, the Company disclosed to the investing public, on a quarterly basis, an allowance for doubtful accounts with respect to tuition receivables (the "allowance" or "bad debt reserve") and a bad debt to revenues ratio ("bad debt ratios").

39. Analysts and investors were particularly concerned with these figures because CEC students typically owed the Company thousands of dollars or more for tuition and fees. However, CEC students, graduates and drop outs rarely had good-paying jobs and therefore were frequently unable to pay their debt.

40. The importance of bad debt to CEC was made crystal clear in a memo from CEC Corporate to all School Presidents disseminated in 2002 or 2003 (as stated by Witness 28). The memo states in relevant part as follows:

> **Why Do We Care About Bad Debt?**
>
> - As a publicly traded company, it is the duty of all employees to maximize shareholder value.
> - Bad debt plays a pivotal role in describing the overall financial health of our organization
>
> . . .
>
> - Investors are savvy as to the impact of bad debt on future earnings and correlated stock prices ….
> - **Part of your bonus is based on YTD actual bad debt vs. budgeted bad debt expense. (emphasis and red color in original).**

41. In advising the college presidents on what they should do to improve bad debt, the memo stated, *inter alia*, as follows:

> "***Getting a past due student "current" on a payment plan (i.e., paid anything w/in the past 30 days) is key to reducing bad debt expense!!!***" (Emphasis added).

42. Another internal document showing the importance of bad debt is an internal e-mail dated June 6, 2003 from Ron Andersen, Vice President and Managing Director of the

University Division to Defendant Larson and others. The e-mail (attached as Exhibit C) references a recent call that Defendant Larson had made to the Presidents regarding their responsibility in the areas of unpackaged students, past due cash and bad debt. The e-mail notes that in the past, the School Presidents were able to discuss with CEC Corporate such issues and that corporate would at least take a look at the issue. The e-mail then states:

> WE DO NOT GET MUCH OF THIS NOW. WHAT WE GET, EVEN FROM MANAGING DIRECTORS, IS SILENCE. WHAT HAS CHANGED?

43. This e-mail confirms Larson's direct involvement in pressuring the School Presidents to lower their school's reported bad debt by holding them personally responsible for reported results.

44. Another internal e-mail, dated August 10, 2003, from David Ruggieri, a managing director at CEC to the Presidents of the Gibbs Schools, shows the importance of bad debt to CEC and the pressure that CEC Corporate put on its School Presidents:

> In 5 schools our bad debt is out of control, and I need it brought back into control with all efforts running at 110%. Bad debt is a major benchmark used to evaluate both a schools management and a corporate oversight….
>
> This is your first priority when you turn the key and open the door. Any other management issues you have on your agenda need to take a second seat to managing this bad debt. So get in early because there are other issues too. Daily accountability, daily management, daily focus will be the order of the day until your school get at, or below budget."

See Exhibit D, attached.

CEC Corporate Required All CEC Controllers to Use a "Template" <u>to Improperly Reduce Its Reported Bad Debt Allowance and Bad Debt Ratio</u>

45. Throughout the Class Period, CEC's reported allowance for bad debt was determined by use of a spreadsheet or template (the "template") designed at CEC Corporate under the supervision of the Individual Defendants. Pursuant to this template, an allowance would be

established whenever a particular tuition receivable was outstanding in excess of a specified period of time. However, when any minimal payment was made by a student, even a few dollars, the student's account would be considered current.

46. In an internal CEC memo entitled "Bad Debt Improvement Strategies" the Company wrote:

> Getting a past due student "current" on a payment plan is key to reducing bad debt expense!!! Collecting the full outstanding past due balance in cash is always preferable. HOWEVER, collecting a current substantive installment of an existing or new payment plan changes the "past due tier" to a lower reserve requirement, and thus reduces bad debt expenses immediately.

See Exhibit E, attached. The Company's use of the quotation marks around the word "current" is telling. The small payments accepted by CEC on a company-wide basis (less than $25 on overdue student accounts that were thousands of dollars or even tens of thousands of dollars) were not substantive and did not, in any real sense, make the student "current."[3]

47. This is supported by the witnesses representing at least 11 of CEC's campuses and also witnesses who worked at Corporate headquarters at Hoffman Estates. As explained by Witnesses 1, 2, 3, 5, 7, 18 and 28, the amount of the allowance for doubtful accounts would be based upon a percentage of the amount of the receivables, with the percentage increasing as the aging of the receivables increased. In addition, as explained by Witness 18 and 28, the amount of the allowance would differ depending on whether the student was or was not still attending the school (a higher allowance would, absent manipulation, be recorded for out-of-school students than in-school students.

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[3] Although Exhibit E is undated, based on the text and the names of four members of the Corporate Divisional Finance Team listed on page 3 of the memo, Witness 28 was able to confirm that the memo was written in 2002 or 2003. Witness 28 states that this memo was distributed to school presidents, school and regional financial officers and others.

48. Witness 18 further explained that tuition and fees related to CEC students would be booked as revenue as long as the student was enrolled at a school on the add/drop date. However, this is in violation of GAAP in view of the known, serious collectibility issues with respect to many CEC students. For example, Witness 5 stated that collectibility at the Katherine Gibbs New York school was so bad that the internal bad debt reserves for loans was 50%. *See* SAB 1 (revenue is recognized when "…collectibility is reasonably assured.").[4]

49. Witness 7 stated that he first learned about this manipulation in reported bad debt in a conference with school controllers in November or December of 2002 and immediately reported this to Bob Nachtcheim, CEC's Vice President/Controller, but Nachtcheim stated that he already knew all about it.[5]

50. Witness 1 stated that in 2003, the reported bad debt ratio at the witness' Katherine Gibbs school was reported as approximately 5%. In fact, absent the manipulation, the bad debt ratio at that time was approximately 9-12%. Witness 1 further stated that the reported bad debt ratios for the seven Gibbs schools in the region at that time was reported as less than 5%, when in reality their bad debt ratios were at the 6% to 9% level. Witness 1 was aware of this as a result of preparing the "regional" Gibbs bad debt reports and compared the witness' school results to other Gibbs schools.[6]

51. Witness 1 further stated that in 2003, all CEC schools had "bad debt problems" and that most CEC schools were not reaching their "starts," bad debt targets, net income targets and growth rate targets. She learned about the above through conversations with other CEC

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[4] *See* paragraphs 49 to 87, *infra*, for discussion of collectibility issues at other schools.

[5] Witness 7 also learned that CEC employees (including school Presidents) at Katherine Gibbs Schools and at other CEC schools used the schools' petty case fund to make minimal payments for students in order to reduce reported bad debt.

[6] Witness 1 advised that Gibbs-Vienna's bad debt rates were higher than at Gibbs Schools in Boston or Providence, RI, because those schools were located in more affluent areas.

division controllers and school controllers who she met at annual conferences and meetings, and through reading monthly consolidated "Flash Reports."[7]

52. Likewise, Witness 18 stated that the publicly reported allowance was significantly understated because all CEC school controllers were directed by Corporate to use the template for calculating each school's bad debt, and that template allowed old, past due accounts to be treated as current. According to the template, depending on how old a particular account receivable was, a certain percentage of the amount owed should have been allocated to the allowance. However, if even a minimal payment was made on the account – no matter how large the outstanding balance – CEC would count the account as current and there would not be an allowance for bad debt on that student's account. Witness 18 also stated that CEC corporate, including Pesch and Larson, knew what the proper bad debt allowance should be because reports were generated showing the bad debt allowance *prior* to any partial payments being applied to these accounts.

53. Witness 13 confirmed that bad debt expense was critically understated, due to the practice of collecting minimal partial payments from delinquent students, sometimes as little as $1 or $2, in order to consider the account "current." At the end of the first fiscal quarter 2003,

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[7] Witness 1 further explained that these flash reports listed budgeted bad debt (set in October of every year at 3% or below), forecasted bad debt (a rolling forward looking 12 month budget), and **actual** bad debt statistics. She noted that the bad debt numbers listed in the "Flash Reports" were always fudged and manipulated so schools could meet Company goals, and that these reports, including bad debt issues, were discussed during follow-up conference calls about the "Flash Reports."

Witness 1 further explained that the "Flash Reports" came out at least weekly, and that they were followed-up by weekly and monthly telephone conference calls. She participated in weekly conference calls held between "regional" managers on Tuesdays, with Corporate personnel "dropping in." The monthly conference calls were scheduled, after the books were closed, between school managers, regional managers and corporate executives like Pesch, Larson or Bob Natcheim.

Witness 1 further stated that she is confident that corporate personnel were aware of how "bad debts" were being manipulated because they used the Campus 2000 software systems to see that very small amounts were paid to keep accounts current. Further, the Gibbs regional mangers were all aware of the bad debt manipulation (they were told about it by the school controllers), and she is certain that this was reported to Corporate.

Witness 13's school had $12 million in accounts receivables, which represented monies owed by students no longer attending the school. However, the reported bad debt expense for the school, utilizing the corporate template for that same quarter, was approximately $50,000 to $60,000. This was a "skewed number" because it was clear (both to Witness 13 and to CEC Corporate) that many of the accounts shown as "current" were never going to be collected. Based on his knowledge that accounts were counted as "current" based upon minimal payments by out of school students, Witness 13, in his professional opinion, believed that the bad debt expense at his school should have been *at least* 10 times greater than the reported amount -- *i.e. at least* $500,000. Witness 13 advised his superiors regarding these matters, and further advised them that at the then current rate, the school's actual bad debt expense would be $1.5 million to $2 million by the end of 2003.

54. Witness 12 also confirmed that CEC utilized a "template" to calculate bad debt reserves. The spreadsheet required a user to fill in fields regarding the specific payments made on each student's account. Thus, personnel at CEC's headquarters, including Pesch and Larson, knew on a daily basis exactly how much had been paid, including payments by the individual students. As such, it would be clear to anyone looking at the spreadsheet that many students were making miniscule partial payments and had large outstanding balances, the reported bad debt reserve for a given school notwithstanding.[8]

55. Witness 12 said that in December 2002, his school hired four people to contact students who had dropped out in order to collect one-time payments of $40 or $50 per person so the accounts could be considered "current" for year end 2002. Witness 12 stated that for the year ended December 2002 (which figures were included in CEC's January 2003 press release)

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[8] Indeed, Witness 1 stated that she received calls from CEC Corporate questioning individual student payments at Gibbs-Vienna. Corporate personnel (including Kim Stanley) were using the Campus 2000 system to conduct "spot checks" of individual student payment records, and called her to discuss payment problems.

the school only reported approximately $2.5 million in bad debt, when, in his professional opinion, it should have been closer to $4 million.[9]

CEC Corporate Insisted that the Company's Bad Debt Ratio Stay Below Four Percent

56. Throughout the Class Period, the amount of the allowance and bad debt ratios, by school, would be periodically calculated by the Company's Campus 2000 computer system based upon the template formula; would be reviewed by representatives at CEC Corporate, who would compare the actual results to date with corporate projected quarter ending levels; and senior CEC executives would then communicate to the school's representatives how "off" they were from projected levels, and whether further "efforts" would be required to achieve projected levels. As noted by Witnesses 1, 18 and 28, Pesch and Larson would take part in the communications from CEC corporate to school representatives.

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[9] Likewise, according to Witnesses 1, 2, 3 and 4, all past due accounts in which payment had not been received within 90 days were sent to a third-party collection agency. However, if even a single penny was paid during a 90-day window, then the account was considered "current" and would not be sent to collections. Witness 15 confirmed that any small payment would entitle the account to be "current."

According to Witness 2, the use of such miniscule partial payments to calculate the bad debt was set forth in a spreadsheet disseminated from CEC Corporate, and located and maintained at CEC Corporate. Witness 2 further stated that when a student account was given to a collection agency, if the student made a partial payment of any kind to the collection agency, the student's account would be taken back from the collection agency and returned as an active account on the school's books.

Witness 5 stated that the Katherine Gibbs New York school did not appropriately account for outstanding loans. She gave an example where a 180-day outstanding loan of $15,000 was made current (0-30 days) with a $50 dollar payment. She stated that Corporate was aware of this occurring. In fact, she stated that CEC employees received up to $20,000 yearly bonuses to bring down bad debt and she was told that some CEC employees used cash from other sources to make minimal payments on behalf of students.

Witness 15 indicated that in September or October, 2002 he discovered that the bad debt template had a "glitch"; if a former student never made a payment, the template did not record any debt. By contrast, if a former student made a payment, but failed to do make an additional payment after 90 days, the template recorded a percentage of outstanding balance as bad debt. Witness 15 advised his superior at the school, and Julia Brooks at CEC Corporate about this matter. In December, 2002, Ms. Brooks advised Witness 15 how much she wanted the school to record for bad debt. This amount understated the school's bad debt by approximately $50,000. This corporate-mandated bad debt amount was part of the information set forth in CEC's January, 2003 press release.

57. The reporting of acceptable bad debt ratios was essential to the defendants to foster the illusion of CEC meeting Wall Street's expectations. Jason Licar, CEC's Corporate Manager, stated in a March 28, 2003 e-mail sent to controllers at CEC's schools, regarding the rise of bad debt ratios in the first quarter of 2003 as follows:

> ***Our organization has never previously surpassed the 4.0% bad debt threshold, and I know that I speak for everyone when I say that we must ensure that we do everything in our power to come well below that mark.*** Not only will this unprecedented bad debt level have severe financial implications from a profitability standpoint (think of bad debt as reversing revenue that you have previously recognized), but ***the public perception and impact on our presence in the marketplace could be compromised.*** To the outside world, bad debt is a clear indicator of how well one run's the business.

(Emphasis added.) Thus, as noted in Licar's e-mail, it seemed inevitable on March 28, 2003, that absent some "corrective" action, the Company's allowance for doubtful accounts and bad debt ratio would rise to unacceptable levels. This was the inevitable result of the Company's aggressive efforts to increase revenues and earnings by extending loans to high-risk students who would not otherwise be able to pay CEC's high tuition.

58. In response, the defendants devised a strategy to hide the actual bad debt exposure and make it appear that the Company's bad debt ratio was within acceptable industry standards. As set forth below, this was accomplished in at least three ways.

(a) The Licar E-Mail Directs CEC Controllers to "Pull Out All the Stops" to Reduce the Bad Debt Ratio

59. During each quarter, CEC schools would periodically report the amount of their bad debt allowance, mathematically determined by use of the Company's template, to CEC's corporate managers, including Mr. Licar. The corporate managers, acting under guidelines established by, *inter alia*, the Individual Defendants, would then direct the schools to take

"corrective" steps to reduce their allowances so as to insure that CEC corporate projected allowance for bad debt and bad debt ratios were achieved.

60. As described above, this was accomplished in large part by school representatives reaching out to delinquent students and pressing them to contribute a nominal amount, generally under $25, the payment of which would, under the template, eliminate most or almost all of the otherwise required allowance for bad debt, regardless of how large the receivable was or how long it had been outstanding.[10]

61. To facilitate this process, the Company's Campus 2000 computer system maintained student profiles indicating the name of the student, the number of days since his/her last payment, the receivable balance, how much the bad debt would be reduced by even a "token," or in CEC's words, "a good faith" payment. *See*, *e.g.*, "OOS Grad Status Bad Debt Improvement Report," dated as of June 23, 2003, attached hereto as Exhibit F. Thus, once CEC Corporate indicated to a particular school that it had to reduce its bad debt ratio to meet projected levels, school representatives could review this type of report and target those delinquent students who

[10] Witness 1 stated that if, for example, a student graduated on December 31 owing CEC $10,000, in the first quarter of the ensuing year, 10% of the $10,000 should have been reported as bad debt expense for this out-of-school student. If $10,000 was still owed going into the second quarter, then 50% of the $10,000 should have been reported as bad debt; if the amount was still owed in the third quarter, then 75% of the $10,000 should have been reported as bad debt. However, as long as a student paid $1 in the second quarter, then only 10% of the remaining $9,999 was reported as part of bad debt (instead of 50% if nothing was paid). Thus payments of $1 or even 1 cent were common at the school. This practice was confirmed by Witness 12, who indicated these minimal payments made accounts current even if ultimately uncollectible and also helped CEC report a profit in connection with its 2002 financial results. Witnesses 13, 15 and 18 similarly confirmed this practice was employed to bolster CEC's 2002 financial results.

In one incident at the end of 2002, when personnel were attempting to collect on student accounts, Witness 13 saw the President of the school present a "wad of cash" to the collectors and instruct them to apply the money to past-due accounts they had unsuccessfully tried to collect, so the accounts could be counted as current. Similarly, Witness 1 stated that during that time period her school and other Gibbs schools used the school's petty cash fund to make minimal payments on behalf of delinquent students. This affected CEC's reported bad debt allowance and bad debt ratio on its financial statements in the first quarter of 2003.

should be asked to make a nominal payment in order to promptly maximize the amount of the bad debt allowance that could be eliminated.

62. For example, CEC's corporate manager Jason Licar realized in late March 2003 that the Company's bad debt ratio for the first quarter of 2003 might exceed 4%. He considered this an unacceptable level, and he promptly reached out to each of the CEC school comptrollers and demanded that they "pull out all the stops" so that the reported level would fall below 4%:

> I want to bring to everyone's attention some information pertaining to the current status of our Q1 (2003) BAD DEBT. With 3 full days left (Saturday to Monday) we still have significant opportunity to achieve our desired bad debt goal. ***Based on a "worst-case" scenario that we have been running on a daily basis, we as an organization are trending to report a 4.0%+ bad debt amount for Q1. I must stress that this cannot be allowed to come to fruition***. . . . I know, through talking with many of you over past few weeks, that you have put your blood and sweat in to this cause - we are truly grateful for the achievements made thus far. Please realize that the effort is not over - we still have the weekend as well as Monday to make a significant impact on this month's bad debt. Please rely on all resources necessary to work the phones day and night, ask any temps you have to come in over the weekend, offer incentives to those out of school hard cases. We have been through all our potential strategies in the past. Please ***pull out all of the stops*** by March 31st.

(Emphasis added.) (Attached as Exhibit G.)

63. Hearing Mr. Licar's call, school representatives did in fact, "pull out all the stops", and on April 22, 2003, the Company issued a press release which reported a bad debt ratio of only 3.8%.

Internal Reports from Six CEC Schools Show
Manipulation of Bad Debt by Improper Classification of Loans

64. Defendants also artificially depressed the amount of allowances and bad debt ratios by improperly classifying loans as having been made to "in school" rather than to "out of school" students. As noted above, the template used in creating allowances distinguished between

these two types of students: thus, assuming both an in-school student and out-of-school student had the same amounts of loans outstanding for the same amounts of time, the template would create a larger allowance for the out-of-school student (since the Company assumed there was a greater risk of not being paid by students no longer attending classes).

65. In order to artificially depress the amount of allowance and bad debt ratio, CEC would direct the schools to improperly classify loans to students who had already stopped attending classes, for whom larger allowances should have been created, and instead treat them like loans to current students. This had a significant impact in understating allowance and bad debt expense.

66. Indeed, in internal memos, CEC's auditors recorded serious weaknesses in internal controls in reports dated (i) June 30, 2003 pertaining to Collins College; (ii) July 31, 2003 pertaining to Brooks College-Long Beach; (iii) July 31, 2003, Allentown Business School (now known as Lehigh Valley College); and (iv) September 30, 2003 pertaining to Katherine Gibbs School-Norwalk; (v) August 31, 2003 pertaining to Briarcliffe College-Patchogue; and (vi) August 31, 2003 pertaining to Briarcliffe College-Bethpage. (Copies of these reports are attached hereto as Exhibits H, I, J, K, L and M.)

67. Included in the findings at all sites were material failures to adequately provide for uncollectible accounts receivable.

68. At Brooks College-Long Beach, the internal auditors stated as follows:

> We noted 49 students who were recorded as dropped shortly after the audit period end. In all cases, the last date of attendance was prior to the audit period end. If these students had been included in the out of school allowance calculation, bad debt expense would have been negatively impacted by $211,483.
>
> We also reviewed payments of $25 or less received during July and calculated the impact these payments had on the allowance calculation. If these payments had not been considered in the in

> school and out of school allowance calculations, bad debt expense would have been negatively impacted by $72,144.

69. Likewise, at Collins College, the internal auditors noted the following problems:

> We noted 35 students who were recorded as dropped shortly after the audit period end. If these students had been included in the out of school allowance calculation, bad debt expense would have been negatively impacted by $45,717.
>
> We also reviewed payments of $25 or less received during June and calculated the impact these payments had on the allowance calculation. If these payments had not been considered in the in school and out of school allowance calculations, bad debt expense would have been negatively impacted by $24,743.

70. In addition, in classifying student account balances exceeding $8,000 at Collins College and $10,000 at Brooks College, the internal auditors identified $47,656 and $333,127, respectively, or an aggregate $380,783 of accounts that were being sent to collection agencies. If a collection rate of 50% were applied to accounts sent out for collection (typically collection amounts reduced by collection agency fees are substantially lower than 50%), the additional bad debt expense to be provided on the Collins College and Brooks College accounts to be sent for collection would be 50%,[11] or $190,391.

71. Likewise, at the Allentown Business School, internal auditors "noted 41 students who were recorded as dropped shortly after the audit period end. In all cases, the last date of attendance was prior to the audit period end. If these students had been included in the out of school allowance, calculation, bad debt expense would have been negatively impacted by $47,839."

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[11] Such 50% loss rate takes into consideration the likelihood that some portion of the general allowance that had already been recorded pertains to these accounts.

72. In addition, the auditors found that if the Allentown Business School had not used minimal payments of $25 by students to reduce bad debt, then in ***July 2003 alone***, the "bad debt expense would have been negatively impacted by $24,956."

73. Likewise, at the Katherine Gibbs School-Norwalk, internal auditors "noted 23 students who were recorded as dropped shortly after the audit period end. In all cases, the last date of attendance was prior to the audit period end. If these students had been included in the out of school allowance calculation, bad debt expense would have been negatively impacted by approximately $101,603."

74. Also, the auditors found that if the Katherine Gibbs School had not used minimal payments of $25 by students to reduce bad debt, then ***in September 2003 alone*** (55 students), the "bad debt expense would have been negatively impacted by approximately $215,320."

75. Likewise, at Briarcliffe College-Patchogue, internal auditors "noted 19 students who were recorded as dropped shortly after the audit period end. In all cases, the last date of attendance was prior to the audit period end. If these students had been included in the out of school allowance calculation, bad debt expense would have been negatively impacted by approximately $55,532."

76. Also, the auditors found that if Briarcliffe College-Patchogue had not used minimal payments of $25 by students to reduce bad debt, then ***in August 2003 alone***, the "bad debt expense would have been negatively impacted by approximately $19,352."

77. So, too, at Briarcliffe College-Bethpage, internal auditors "noted 11 students who were recorded as dropped shortly after the audit period end. In all cases, the last date of attendance was prior to the audit period end. If these students had been included in the out of school allowance calculation, bad debt expense would have been negatively impacted by $33,282."

78. Finally, the auditors found that if Briarcliffe College-Bethpage had not used minimal payments of $25 by students to reduce bad debt, then ***in August 2003 alone***, the "bad debt expense would have been negatively impacted by approximately $9,739."

79. In sum, internal audits at six CEC schools in five different divisions and in four different states between June and September 2003 show reported bad debt expenses being manipulated in an identical manner, with an aggregate effect of reducing reported bad debt by more than $1,050,000. (As set forth in its Forms 10-Q, CEC's write offs for bad debt for the second and third quarters of 2003 for the entire Company was only $25 million. Thus, these amounts were clearly material.)

80. Moreover, Witness 18 stated that the improperly reduced bad debt figures from the Brooks, Collins and Katherine Gibbs schools, referenced above, would have been sent to Corporate and incorporated into the Company-wide bad-debt figures for the second quarter of 2003.

81. Further, an internal CEC document shows that in June 2003, the Company used so-called "good faith" payments by out of school students ("OOS") to reduce its reported bad debt by $14,089,359.24. *See* Exhibit N, Divisional Summary: Bad Debt Improvement for OOS Students Sorted by: Bad Debt Improvement $ Via "Good Faith" Payment.

82. Furthermore, Exhibit O shows that in June 2003, the Company used these "good faith" payments to reduce bad debts by nearly $200,000 at Brooks College alone.

83. Likewise, another internal CEC document shows that in June 2003 the Company used so-called "good faith" payments by Upcoming Grads to reduce its reported bad debt by at least $1,886,654.90. *See* Exhibit P, Divisional Summary, Bad Debt Improvement for Upcoming Grads (within the next 60 days) Sorted By: Bad Debt Improvement Via Payment.

84. Furthermore, Exhibit Q shows that in June 2003, the Company used these "good faith" payments to reduce bad debts for upcoming grads at Brooks College alone by nearly $100,000.

Internal CEC Report Shows that Lack of Internal Controls at the School Level Increases Risk that Bad Debt Is Not Accurately Reported

85. In addition, an internal CEC document entitled Briarcliffe-Patchogue, NY Internal Control Process Findings states, *inter alia*, that "The Director of Financial Aid has not been completing Pell/RFMS reconciliations on a quarterly basis during the 2002-03 award year." The report explained that "failure to return payments to ineligible students could result in Department of Education (ED) findings and sanctions." *See* Exhibit R, attached.

86. The same document also notes that "the school has not effectively repackaged students beginning their second academic year. We noted that only 32% of students who had started prior to January 2002 had been fully packaged at the time of our audit…." The Company admitted that this "lack of process may result in the school losing the opportunity to assure collection of amounts due…."

87. The document also states that "Controls over student payment plans are not effective. We reviewed all student files with payment plans 48 months or greater (16 files) and noted that none included a note signed by the student. We also noted several plans did not meet the corporate requirements for maximum balance and/or minimum monthly payments, and three plans had terms longer than 10 years (120 months)." The Company admitted that due to these failings, "***There is an increased risk that these students will not satisfy their obligation, and that the school's true bad debt exposure is not accurately assessed or stated.***"

(b) Improper Classification of Loans

88. The result of the improper practices described in paragraphs 38 to 87 above was to delay or avoid the creation of allowances for bad debt, thereby artificially depressing

allowances and bad debt ratios reported during the Class Period. In February 2005, the Company finally began to recognize the true level of its bad debt. On February 15, 2005, the close of the Class Period, the Company issued a press release which stated, *inter alia*, that it was taking an $18.9 million "charge" so as to increase its allowance for doubtful accounts by that amount. The Company's explanation for taking this "charge" defies credulity; in fact, the Company had historically understated its allowance, thereby making inevitable its need to belatedly increase its allowance or write off its bad receivables.

89. Moreover, in its 2004 10-K, the Company noted that it had ***written off an extraordinary $92 million of its receivables***, a huge amount compared to its historical write-off experience. The sheer magnitude of this write off, which is nearly double the size of CEC's allowance for bad debt at the beginning of 2004 ($47.5 million) and more than double the Company's 2003 write off ($39 million) even though the Company's gross accounts receivable actually declined slightly during 2004, strongly supports Lead Plaintiff's other evidence that the Company historically failed to timely and accurately report the amount of its allowance and bad debt expense.

90. The combined effect of the understatement of bad debt expense by (a) providing an insufficient allowance for doubtful accounts, (b) failing to stretch revenue recognition through the completion of externships, and (c) overstating revenue by improperly accounting for recourse loans was an understatement of CEC's bad debt expense ratio that was material to securities analysts and to investors. In other words, in February 2005 the Company finally decided to clean house and get rid of tens of millions of dollars in bad debt that had been accumulating on its books for years, though it was never disclosed to investors.

91. Moreover, the reporting of false bad debt figures by CEC schools was well known to Larson. Witness 27 stated that in early to mid 2003, he attended a meeting in the CEC

training room at Hoffman Estates where Mark Tobin, Vice President of Student Finance and Regulatory Compliance, began a presentation refuting official CEC performance numbers. Witness 27 stated that when Tobin placed a spreadsheet on an overhead projector comparing CEC's official performance numbers with respect to bad debt with numbers Tobin himself had researched and analyzed, Defendant Larson quickly ended the presentation and took down the spreadsheet. Larson then pulled Tobin aside for a private conversation and moved onto a completely different subject, never returning to Tobin's presentation. Witness 27 recalls that with respect to one school that was listed on the spreadsheet, the reported bad debt number was 4% whereas the actual bad debt number was 6%.

92. Likewise, Witness 28, a Vice President of Admissions who attended weekly executive committee meetings with Larson and Pesch where bad debt issues were frequently discussed, stated that beginning in 2002, Larson and Pesch were well aware of the use of minimal payments by students to reduce reported bad debt. When the issue came up in executive meetings, they would ignore it.

93. As a result of the foregoing, it is clear that reported allowances and bad debt reserve ratios reported in press releases, conference calls and quarterly and annual reports issued by defendants during the Class Period materially understated CEC's allowances and bad debt reserve ratios.

CEC's Restatement Did Not Properly Allocate Bad Debt to Prior Periods

94. In its 2004 10-K, CEC set forth a "new methodology" for calculating an allowance for bad debts effective December 31, 2004. However, this new methodology did not indicate that the Company first provides a specific reserve for student loans receivables known to be uncollectible (*i.e.*, a specific allowance) before calculating a general allowance applicable to all remaining such receivables (*i.e.*, a general allowance). Nor did CEC disclose in its previously issued

financial statements that it provided specific reserves in earlier periods. Therefore, it is reasonable to assume that CEC did not provide a specific reserve for accounts known to be uncollectible in years prior to 2004, which, under these circumstances, resulted in an understatement of its allowance, bad debt expense and bad debt ratios.

95. In its 2004 10-K, CEC justifies its additional bad debt provision of $18.9 million recorded in the fourth quarter of 2004 as a change in accounting estimate (*i.e.* adoption of an improved methodology for calculating the allowance for uncollectible accounts as of December 31, 2004). However, most if not all of that $18.9 million charge would have been recorded in earlier periods if CEC had properly provided for bad debt expense by conforming with GAAP.

96. GAAP requires losses to be charged against earnings for both (1) known losses (*i.e.*, uncollectible receivables that existed on a given balance sheet date, and (2) estimated losses (*i.e.* losses that are probable of incurrence). Loss estimates must be based on reasonable assumptions (*i.e.* historical loss experience adjusted, if applicable, to account for current conditions). Therefore, for all quarters of 2002 through 2004, CEC should have (a) provided a specific allowance against student loan receivables it knew or should have known to be uncollectible, and (b) also provided a general allowance based on the true aging of its student loans receivable (*i.e.*, rather than on falsified agings that made old receivables current when negligible collections were made.)

97. CEC violated GAAP by (a) recklessly ignoring facts, thereby resulting in its failure to provide for specific losses, and (b) understating general losses through falsification of its agings, including misclassification of students. Lead Plaintiff believes that the fourth quarter charge was principally necessitated by the intentional fraud committed in earlier periods, correction of which should have been treated as an accounting error. GAAP requires material errors to be corrected through restatement of previously issued financial statements. It is incomprehensible how

a refinement of a routine calculation could produce such a dramatic one-time catch up adjustment in the absence of a significant change in CEC's business.

(c) CEC Overstated Revenue by Understating Risks in Recourse Loans

98. In 2004, CEC artificially overstated its revenue by improperly under-reporting probable loan losses incurred in connection with complex recourse loan agreements with Sallie Mae, Wachovia Bank and Stillwater Bank. These recourse loan arrangements provided funding to high credit risk students and gave the banks the right to require CEC to repurchase from 14% to 100% of defaulted loans.

99. Upon loan creation, Sallie Mae and Wachovia Bank withheld 14% to 20% of the loan amounts (to be used by them to effect repayment from CEC for defaulted loans they required CEC to repurchase). The aggregate amounts withheld and retained by them were caps on the total amount of loans that these financial institutions could require CEC to repurchase. At each loan's inception, CEC recorded the amounts withheld by Sallie Mae and Wachovia as "deposits," as if they were CEC's assets. CEC also recorded deferred revenue equal to 100% of the face amount of the loan.

100. CEC took the deferred revenue into income ratably over the expected period of tuition. It amortized the withheld deposit over the same period, but charged the expected loss to an operating expense account rather than reducing revenue. This had the effect of overstating revenue, which was an important metric to CEC. Through this methodology, and despite the very high risk that CEC's repurchase of defaulted loans would deplete the amounts withheld by Sallie Mae and Wachovia Bank, CEC improperly based the amount of revenue it would recognize on the full amount of the loans even though it was not reasonably assured that it would receive the full amount of the loans. Therefore, CEC violated GAAP by recognizing revenue attributable to the withheld fundings. Furthermore, charging costs of education through amortization of the deposits

is inconsistent with CEC's reduction of revenue when amortizing the deposits retained by Stillwater Bank, as discussed below.

101. Through December 31, 2004, $0.8 million of the $44.3 million of the Sallie Mae loans had been repurchased, but CEC remained exposed to repurchase 20%, or over $8 million of such loans. In 2005, CEC did, in fact, repurchase over $8 million of such loans.

102. Although the Wachovia fundings ended in 2003, through December 31, 2004, CEC had repurchased $10.5 million of the $70.7 million of the loans made by Wachovia. The fact that total repurchases were at or very close to the cap limits on each arrangement is evidence that the credit risks on these loans were high and that there was no assurance from their outset that CEC would collect more than the guaranteed amounts thereunder (*i.e.*, 86% and 80% of the loan amounts).

103. Unlike Sallie Mae and Wachovia, CEC's possible loss on Stillwater's loans to students has no ceiling. **100% of each loan was at risk, not just the 50% deposit retained by Stillwater**. In 2004, the first year of the arrangement, CEC already repurchased $2.9 million of the $8.4 million of student loans funded by Stillwater. Although CEC reduced revenue by $1.5 million of the $2.9 million of repurchased loans as an estimate of probable loan losses, it made no similar revenue reduction for its 50% exposure on the $5.5 million of student loans that remain outstanding as of December 31, 2004. In 2005, CEC was compelled to purchase an additional $13.9 million (including accrued interest) of student loans from Stillwater. By December 31, 2005, of the $19.5 million of loans made through Stillwater, CEC had repurchased $16.8 million (including accrued interest). Because of the high degree of risk to which it was exposed in connection with the Stillwater loans, CEC was not reasonably assured that it would realize the full amount of these loans.

104. In fact, of the $8.4 million in Stillwater loan money that CEC recognized as income in 2004, at least $5.8 million (and probably more) was eventually written off. Therefore, the

revenue related to the Stillwater loans should have been recognized only on a cash basis, as required by GAAP under such circumstances. *See* Staff Accounting Bulletin ("SAB") 101, Section A(1).

Overstatement of Revenues and Earnings

105. During the Class Period, analysts and investors unquestioningly accepted the Company's ability to continuously generate increased revenues and earnings; indeed, these reported results often exceeded analysts' projections for the Company, and prompted sharp increases in the Company's stock price. For example, when the Company announced record second quarter 2003 revenues and earnings on July 22, 2003, a July 23, 2003 William Blair & Company report noted:

> This was a quarter to remember for Career Education. It was one that we believe will be remembered for having vaulted the Company onto a short list of truly great emerging growth companies in the United States.

Not surprisingly, the Company's stock price rose from $36.49 to $41.055, or 13% in response to this news.

106. However, the Company's reported revenues and earnings for its 2003 second quarter, as well as all other quarters reported during the Class Period, were artificially inflated in at least two respects. First, as described above, the Company improperly accounted for its loan agreements with Wachovia, Sallie Mae and Stillwater.

107. Second, CEC also overstated revenues and earnings as a result of the erroneous manner in which it reported results from its Culinary and Health Education programs. Specifically, these programs require students to complete externships upon conclusion of in-school instruction in order to satisfy graduation requirements. As a result, pursuant to Staff Accounting Bulletin No. 104, Revenue Recognition, revenues, and associated earnings, related to these programs should have been recognized over the length of the entire program (including externship); instead CEC propped up revenues and earnings by recognizing such results entirely during the in-school instruction.

108. In 2004, CEC restated its 2000 - 2004 financial statements to stretch the period over which it recognized certain tuition revenue to include externships. The restatement reduced previously reported tuition and registration fee revenue by $9,340,000 and $10,622,000 in 2002 and 2003, respectively.

109. This had a material impact upon the revenues and earnings it reported during the Class Period. Specifically, as a result of this accounting error, there were the following overstatements of revenues and earnings:

Year	Revenues	Revenues as Restated	Net Income	Net Income Restated
2002	$780,059,000	$770,719,000	$67,472,000	$61,819,000
2003	$1,188,609,000	$1,177,987,000	$119,168,000	$112,804,000

2. <u>Additional Improper Accounting Practices</u>

110. According to numerous former employees, including Witnesses 1 and 3, CEC Corporate imposed on the schools absolutely unrealistic growth/EBIDTA expectations. Personnel at the subordinate schools had no choice but to commit to these unattainable goals if they wanted to keep their jobs. At the end of the quarter, if actual performance did not conform to the expectations imposed by CEC corporate, school controllers were told to "go and find" the monies necessary to meet the goals. The only way this could be done was by deviating from GAAP, which Witness 1 was directed to do by her superiors. Such GAAP deviations included manipulating accrual accounts to achieve budgeted or desired results. Witness 18 stated that the school controller she substituted for in 2003 had said that the marketing funds were being used as "slush funds". GAAP requires an income statement to reflect the actual amounts of expenses incurred, not the amounts of expenses that were budgeted or were necessary to meet management goals.

111. According to Witness 2, who was employed at CEC from April 2002 to June 2003, the Controller of the school told her on several occasions that she (*i.e.* the Controller) had been told to "fudge numbers and make up stuff."

112. In other cases, CEC schools inflated reported income by withholding refunds of Title IV funds that should have been returned to the government. On February 24 through February 28 and March 5, 2003, a program review was conducted of the Title IV Federal student assistance programs at Collins College in Tempe, Arizona by a representative of the DOE. The findings of the review were presented in a report to defendant Larson on or about July 14, 2004 ("Collins DOE Report"). In the Collins DOE Report, a random sampling of 15 students who were recipients for awards in each of years 2000-2001, 2001-2002 and 2002-2003 were selected, as well as 15 students who received funds in the enrollment period in which they withdrew from Collins.

113. The Collins DOE Report concluded that Collins and CEC, implemented accounting procedures to effectively distort its reported cash basis revenue in determining Collins' continuing eligibility to receive funds. In fact, the Collins DOE Report stated:

> ***Evidence suggesting a coordinated subterfuge to under-report the effect of Title IV revenues in the 90/10 attestations reported in footnotes to the CEC financial statements is described in the following observations and interviews*** of witnesses during the review.

114. The Collins DOE Report went on to state that student ledgers indicate that Collins improperly inflated its non-Title IV revenues by characterizing credit balance payments to students as "cash" received from tuition, fees and other institutional charges. The Collins DOE Report indicated this activity occurred in 14 of the 45 files within the regular sample.[12] Copies of the relevant pages are attached hereto as Exhibit S.

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[12] In addition, the DOE representative requested that CEC direct its auditors, Ernst & Young LLP ("E&Y") to provide him with copies of audit workpapers in connection with Collins' 90/10 attestation. E&Y

(continued ...)

3. CEC's GAAP Violations

115. The defendants' issuance of materially false and misleading statements, and failure to disclose material information regarding CEC's financial condition and improper applications of accounting practices as described above violated GAAP, as well as SEC reporting requirements.

116. GAAP is recognized by the accounting profession and the SEC as the uniform rules, conventions and procedures necessary to define accepted accounting practices and principles at a particular time. SEC Regulation S-X requires that publicly traded companies present their annual financial statements in accordance with GAAP. 17 C.F.R. § 210.401(a)(1). In addition, Regulation S-X requires that interim financial statements also comply with GAAP, with the exception that interim financial statements may omit disclosures which would substantially duplicate those disclosures in the annual financial statements. 17 C.F.R. § 210.10.01(a). Financial statements filed with the SEC that are not prepared in compliance with GAAP are presumed to be false and misleading.

117. 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 states:

> Financial reporting should provide information about an enterprise's financial performance during a period. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investments and credit decisions reflect investors' and creditors' expectations about future enterprise

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(... continued)
would only do so if the DOE would sign a release of confidentiality and hold harmless E&Y for any claims in connection with its attestation. Upon advice of counsel, the DOE did not sign the release. Mark Tobin Vice President of Government Relations at CEC was notified of this.

> performance, those expectations are commonly based at least partly on evaluations of enterprise performance.

Additionally, Section 13 of the Exchange Act requires, in part, that companies:

> (i) devise and maintain a system of internal controls sufficient to provide reasonable assurances that –
>
> * * *
>
> (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets.

118. 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 its business practices, CEC did not provide useful information in the Company's financial statements.

119. 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, earnings, allowances and bad debt ratios that were distorted by fraudulent business practices, defendants did not present fairly 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.

120. Furthermore, CEC improperly recognized revenue where the timing or amount of revenue was not recorded in accordance with GAAP. Staff Accounting Bulletin ("SAB") 101 expresses the SEC's Staff's views regarding the application of GAAP to revenue recorded in the financial statements. SAB 101 states that revenue is generally realized or realizable and earned when all of the following criteria are met:

(a) persuasive evidence of an arrangement exists,

(b) delivery has occurred or services have been rendered,

(c) the seller's price to the buyer is fixed or determinable, and

(d) collectibility is reasonably assured.

See SAB 101, Section A(1).

121. As described above, CEC improperly recognized revenues in connection with the recourse loans when, due to the high-risk nature of the student borrowers, collectibility of those revenues was not reasonably assured.

122. In addition, as CEC admitted in its February 15, 2005 press release, as well as in the subsequently filed 2004 10-K, both prior to and during the Class Period, CEC improperly recognized revenues with respect to its Culinary and Health Education programs in violation of SAB No. 104, Revenue Recognition. As required by the aforementioned accounting bulletin, CEC was required to recognize revenue related to these programs on a straight line basis over the length of the entire program, including the externship program, not just during the in-school instruction.

123. CEC violated GAAP by failing to adequately provide for losses on its student loan receivables although it knew that its student loans receivable were heavily populated with amounts due from individuals having a high credit risk. CEC failed to make adequate provision for loan losses by intentionally calculating a lower allowance for doubtful accounts than was reasonable under the facts and circumstances or indeed, as more fully detailed hereinafter, by individuals who were not even students. This resulted from, *inter alia*, applying unreasonably low reserve rates to its aging reports and falsifying the aging reports by considering a loan balance to be fully current if any amount was received, rather than aging the balance from the date the payment was due.

124. GAAP addresses materiality in Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information* ("CON 2"), as follows:

> Magnitude by itself, without regard to the nature of the item and the circumstances in which the judgment has to be made, will not generally be a sufficient basis for a materiality judgment. The Board's present position is that no general standards of materiality can be formulated to take into account all the considerations that enter into an experienced human judgment….
>
> The essence of the materiality concept is clear. The omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item. (¶132)

125. In August 1999, the SEC Staff issued Staff Accounting Bulletin 99 ("SAB 99"), *Materiality*, which further emphasized the need by preparers of financial statements to consider qualitative factors in assessing the materiality of a misstatement.

126. SAB 99 discusses circumstances that may cause a quantitatively small misstatement to be qualitatively material, including whether the misstatement hides a failure to meet analysts' consensus expectations for the enterprise. It further states:

> an assessment of materiality requires that one views the facts in the context of the 'surrounding circumstances,' as the accounting literature puts it, or the 'total mix' of information, in the words of the Supreme Court. In the context of a misstatement of a financial statement item, while the 'total mix' includes the size in numerical or percentage terms of the misstatement, it also includes the factual context in which the user of financial statements would view the financial statement item. The shorthand in the accounting and auditing literature for this analysis is that financial management and the auditor must consider both 'quantitative' and 'qualitative' factors in assessing an item's materiality. Court decisions, Commission rules and enforcement actions, and accounting and auditing literature have all considered 'qualitative' factors in various contexts.

127. GAAP for providing bad debt expense on student loan receivables is set forth in Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies* ("SFAS 5") and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss* ("FIN 14").

128. SFAS 5 states as follows:

> For purposes of this Statement, a contingency is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain … or loss … that will ultimately be resolved when one or more future events occur or fail to occur … (¶ 1.)
>
> Examples of loss contingencies include collectibility of receivables … (¶ 4.)
>
> An estimated loss from a loss contingency … shall be accrued by a charge to income if *both* of the following conditions are met:
>
> a. Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired … at the date of the financial statements …
>
> b. The amount of loss can be reasonably estimated. (¶ 8.)
>
> The assets of an enterprise may include receivables that arose from credit sales, loans, or other transactions. The conditions under which receivables exist usually involve some degree of uncertainty about their collectibility, in which case a contingency exists as defined in paragraph 1. Losses from uncollectible receivables shall be accrued when both conditions in paragraph 8 are met. Those conditions may be considered in relation to individual receivables or in relation to groups of similar types of receivables. If the conditions are met, accrual shall be made even though the particular receivables that are uncollectible may not be identifiable. (¶ 22.)
>
> FIN 14 indicates that if the reasonable estimate of a loss that has probably been incurred is a range, and if no one amount of loss within the range is a better estimate than any other amount within the range, the loss shall be recorded based on the minimum amount in the range. (¶ 8.)

B. <u>Falsification of Student-Related Information</u>

129. During the Class Period, the defendants also issued a series of false and misleading statements concerning certain critical business metrics of the Company, including its "starts," total student population, and job placement rates. As noted above, this information was of great interest to analysts and investors.

130. Throughout the Class Period, CEC reported enrollment numbers, start numbers and student population numbers to analysts and investors. For example, in its April 22,

2002 press release, CEC reported that for the first quarter of 2002, CEC's new starts were 10,550, up from 8,150. By April 22, 2003, the Company reported 14,600 first quarter 2003 new starts. By April 2004, CEC was touting first quarter new starts as 26,700.

131. Moreover, this information must be reported accurately for several reasons: one, CEC's very existence is directly dependent on its eligibility to participate in Title IV funding programs and its ability to maintain its accreditation. In order to participate in Title IV Programs, CEC schools must comply with the standards set forth in the Higher Education Act of 1965, as amended ("HEA") and the regulations promulgated by the Department of Education ("DOE"). Similarly, CEC is subject to extensive and varying regulations in each of the states in which it operates a school and in other states in which it recruits students. If a school loses its accreditation, it will be ineligible to participate in Title IV programs. Failure to accurately report the student-related information described above can lead to loss of accreditation and other penalties.

132. However, CEC did not report how many students left their schools prior to graduation (often shortly after their supposed "start"). An internal CEC document (Exhibit T, attached) indicates the drop rate for each CEC brick and mortar school for the first quarter, including the reasons for the drops, such as financial, personal, school dismissal or work conflict. Astonishingly, ***the number of drop outs amounts to 96,388 students***. This number far exceeds the reported student enrollment in all of CEC schools for any year in the Class Period. Touting student starts while failing to report student drop outs of this magnitude is a material omission.

133. The HEA 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 ***in an occupation sufficiently related to their course of study***. 34 C.F.R. § 668.8(g).

134. High placement rates are used to recruit new students. As discussed below, CEC admissions employees from various schools would tell prospective students that 90% or more of graduates would get high paying jobs related to their field of study.

135. Further, in its 2002 and 2003 Forms 10-K, CEC states that its overall placement rate was 95% in both years and this number was also disseminated by CEC in analyst conferences during that time period.

136. Where investors see these high job placement rates, they reasonably believe that (1) the Company schools are meeting their requirements under DOE regulations and (2) the Company will continue to grow because the high placement rates will attract new students willing to pay CEC's high tuition costs. However, these placement numbers are grossly inflated.

137. Defendants also had strong reasons to report inflated numbers concerning CEC's total student population, and "starts." During the Class Period, analysts and the investing public closely followed the Company's reported student population and starts, and the increase in those metrics helped fuel the Company's popularity among the investing public, and concomitantly, the rise in its stock price. (Generally, if start numbers and student population numbers rise at any given time, reported revenues at the end of the quarter will also rise.)

1. To Comply With DOE Regulations, CEC Had a Uniform Policy Governing Enrollment

138. According to a memorandum circulated by Jon R. Coover, Senior Vice President Marketing-Admissions for CEC, effective March 10, 2003, the Start Criteria at each CEC school is as follows:

Start Criteria

1. A student who has enrolled full-time in a program with the intent to graduate the program.

2. Student is determined to be in attendance and in good standing (in accordance with school policies) through the **5th school day of the term** (excludes Sat. and Sun.).

3. Prior cancels, DNE's, Reverse starts, and No Shows who re-enroll and meet the start criteria are considered a new start.

4. Prior Graduates who re-enroll and meet the start criteria are considered a start

5. Prior Drops who re-enroll after 364 days have elapsed from their Drop date and who meet the start criteria are considered a start.

6. Students who change programs and have not officially graduated from the respective program, regardless of program, and are without attendance interruption are defined as a program transfer and are not calculated as drops or starts.

7. Students who start but have not met the entrance requirement of a high school diploma or GED, but have taken the exam and are awaiting official outcomes of pass or fail are considered a start in a GED pending status. ***Students who have not taken the GED exam prior to classes starting must be enrolled for the next start date (no exceptions). Those students who successfully receive their GED and submit their GED to their school within thirty days from the date of their first class will continue to be classified as a start. Those student [sic] who do not successfully receive their GED within thirty days of starting school will be treated as a Reverse Start and discharged from the school.*** This is the only condition in which the classification of Reverse Start will be applied and subsequently reflected within the 30 day period as a negative start on the school's Flash Report. Schools do not earn on students in a GED pending status until such time as the student provides original proof of passing their GED and thereby meet the schools entrance requirement as published in the school's official catalog.

Note: All students who are counted as new starts are expected to be eligible to be charged tuition.

Admissions may continue to enroll students into the current start ONLY through the calendar day prior to the first day of class for the student's program in accordance with their official class schedule. Enrollments after that day must be for the next start date.

Cancels

1. Students who do meet satisfactory class attendance their first full week of classes of a particular start will not be considered a start. As [sic] example of this would be:

- The term begins on a Monday
- Student attends a majority of their [sic] scheduled classes during the first week.
- Academics and Admissions together must conduct attendance audits during the week and, after all avenues of servicing our student expectations have been exhausted and verified, recommend cancellation of any students who are not planning to continue to the President of the school.
- The audit must be completed and all enrollment statuses updated on the Flash to either Active or Cancel at the end of the business day in which the school's flash report is calculated for the week and submitted to the corporate office.
- In the case of defining a student status not covered by this policy, the DOA, DOE and DSM will each present their perspective to the President who will make the final decision.
- A baseline to manage your start would be a maximum of 3% attrition your start would be a maximum of 3% attrition on the final forecast start number at [sic] it applies to the start of the current, new start classes. A maximum of 2% attrition is also experienced by many during the first week of classes of a new start period. Our objective is to experience better than these benchmarks. Our Start Policy is designed to provide clear parameters for meeting our student's [sic] expectations and those of the school. This policy is enforced in the spirit of supporting of S.O.S., Saving Our Students. Students come first.

See Exhibit U, attached.

139. Unfortunately, CEC ignored this policy in reporting inflated starts to investors.

2. CEC Corporate Exerted Enormous Pressure on CEC Employees to Meet Start Goals That Could Not Be Achieved Through Legal Means

140. The pressure to meet student start numbers set by, *inter alia*, the Individual Defendants, was intense. Witness 9, a former Regional Director of Admissions based at corporate headquarters in Hoffman Estates, indicated that if a school failed to meet performance goals, defendants Larson and Pesch would closely question school officials as to why goals had not been met.

141. Moreover Witness 28, a Vice President of Admissions who worked at Hoffman Estate and met with Larson twice a week during the Class Period, stated that in 2002 and 2003, Larson instructed CEC Directors of Admissions to submit reports on those admissions representatives who did not meet their enrollment goals and these admissions representatives would quickly be terminated. Between April 2002 and early 2003 alone, on weekly phone conference calls held near the end of a start period, Larson told CEC admissions representatives who had not met their enrollment goals that they would be fired within a week if they did not meet those goals. At least 15 – 20 admissions representatives were fired at one time in 2002 pursuant to Larson's instructions and approximately 75 admissions representatives were fired between April 2002 and early 2003 pursuant to Larson's policy.

142. Indeed, an April 10, 2003 e-mail from Nicole A. Rocco, Regional Director of Marketing & Admissions, warns that "Any Presenter [i.e. a CEC admissions representative who would make presentations to high school seniors] who does not meet their monthly goal will be put on a PIP!" Witness 28 explained that PIP stood for "personal improvement plan" and was a euphemism for being given notice that the person would be fired in one or two weeks.

143. Witness 28 further explained that although CEC policy required students to have proof of high school graduation, this policy was not enforced. Witness 28 stated that ***between***

2002 and 2004, approximately 20% of the students who were counted as starts at CEC did not have proof of graduation or a GED.

144. Witness 28 further stated that Larson, Pesch, and other CEC executives knew about this and that Witness 28 had attended executive committee meetings with Larson and Pesch where this issue was discussed. Larson and Pesch were informed by Steve Sotraidis (Executive V.P. Administration) and/or by one of the internal audit teams visiting the various schools. (A major school with this problem was American Intercontinental University, Dunwoody, Georgia.) Discussions regarding lack of proof of graduation at various schools was discussed on numerous occasions during the Class Period at CEC's weekly Executive Committee Meetings, the "War Room Meetings" and on conference calls between Corporate and the Regional/Divisional Teams. These calls included Larson and/or Pesch, and in most cases Sotraidis.

145. Moreover, during the Class Period, Witness 28 stated that thousands of CEC's reported starts were false starts, where students who started during a later time period were counted as if they had started in the previous start period so that the admissions representatives could make their numbers for the earlier period and preserve their jobs. As one example of this type of fraudulent activity, in December 2002/January 2003 two hundred students at the Gibbs school in New York were moved from one start period to another so that Pat Martin, a close associate of Larson, could make her start numbers. Witness 28 stated that Larson was definitely aware of that.

146. Witness 9 also indicated that Larson and Pesch both received accurate "non-scrubbed" data about the financial status and financial aid packaging status of each and every enrolled and prospective student, as well as "scrubbed" (*i.e.* inaccurate) data about the same students; thus, the disparity in the numbers was obvious. This information was set forth in Weekly Flash Reports, which were disseminated prior to and during the Class Period according to Witnesses 18 and 20.

147. Witness 9 participated in making a presentation relating to student enrollment at a shareholder meeting shortly after the start of the Class Period. Witness 9 knew at the time of the presentation that the information pertaining to the number of students enrolled, admitted and currently attending classes in Witness 9's division was not correct, because she was aware that certain students were being counted as active when, in fact, they had dropped out. Thus, Witness 9 tempered the information by prefacing it with words to the effect "this is the best information I have right now, but it is not the most up-to-date information." Following the meeting, Witness 9 was told that defendant Larson was furious that she had not been "more affirmative" in reporting the numbers, and that Witness 9 would no longer be allowed to report results.

148. According to Witness 13, his school held weekly conference calls with corporate headquarters in which both Larson and Pesch periodically participated, wherein starts and collections on performance goals, including admissions, financial aid packaging for new entrants, collections on student accounts and other line items were discussed. Witness 13 directly participated in these calls. During these conference calls, the corporate personnel, particularly Pat Martin who was "in charge" of the Gibbs schools at the corporate level, would tell school officials to "do whatever it takes" to meet start goals and bad debt goals set by corporate.

3. <u>False Disclosures Regarding Placement Rates</u>

149. The 2002 and 2003 Forms 10-K disseminated during the Class Period contained specific representations about CEC's student placement rate. A 70% placement rate is required by federal law for institutions to remain eligible to receive certain Title IV funding. 34 C.F.R. § 668.8. However, defendants falsely misrepresented the placement rates at their schools by, as discussed below, improperly including a wide variety of student jobs unrelated to their studies as "placements."

150. CEC's 2002 10-K boasted that "approximately 93% of our [traditional colleges] and 97% of our Online Education Group segment graduates . . . have found employment in their fields of study, or related fields of study. This same representation was made in the 2003 10-K.

151. The importance of these placement metrics is also reflected in their prominent treatment in quarterly conference calls with equity analysts covering CEC. In the call discussing results for the fourth quarter of 2003, for example, defendant Larson emphasized:

> We had a record number of starts in 2003. People were attracted by the opportunities available to them upon graduation. Fourth quarter starts were up 74% over last year. Another exciting highlight is that we achieved great placement rates of 94% for our onsite group and 98% for the online group.

CCBN.com, *Event Transcript, CECO – Q4 2003 Career Education Earnings Conference Call*, at 2 (Feb. 4, 2004).

152. These placement figures held out by CEC are false and misleading. Numerous Witnesses confirmed that CEC regularly provided inflated job placement numbers to student applicants.

153. An internal CEC document (*see* Exhibit V, attached) titled "ACICS – As of May 12, 2002: Reporting Period of July 1, 2002 to April 25, 2003" indicates the number of graduates at 17 CEC schools. It also had columns for, *inter alia*, waivers, graduates available for employment and number employed in area trained. Even before June 2003 graduates would be counted (which would increase the number of graduates needing jobs by 3,939 (more than 200%), CEC only claimed to have a 68% placement rate for these 17 schools. Even assuming, *arguendo*, that CEC's numbers in this document did not improperly include jobs unrelated to the students' area of training, not a single one of these 17 schools was reporting numbers anywhere near the 95% placement rate that the Company was touting.

154. The document also shows that CEC needed to make 3,929 placements by August 30 to get up to a 95% placement rate for these 17 schools. Witness 28 stated that the goal of finding so many jobs for these CEC students in that time period was "impossible to achieve."

155. Witness 25 indicated that her admissions representatives would always tell prospective students that Katherine Gibbs had a 90% placement rate and that they would receive good paying jobs in their chosen field after graduation. She indicated that this 90% placement number was trumpeted by CEC corporate and repeated by the VP of Admissions (Steven Weinstein and Joy Wallace) and the Regional VP (Michael Gall). Witness 25 stated that all nine Katherine Gibb campuses utilized this placement percentage. Witness 25 further stated that this 90% job placement figure was significantly inflated but could not quantify the real percentage rate.

156. According to Witness 6, a former Employer Relations Manager who worked at CEC Corporate from October 2003 through February 2004 and was responsible for student placements at the online divisions of American Inter-Continental University and Colorado Technical University, CEC touted a 98% placement rate for graduates during her tenure at her schools. However, this placement rate was only achieved by counting *any* job as "related." Shockingly, Witness 6 indicated that during her tenure she could not confirm that a single student in her schools had been successfully placed by CEC with an employer. Witness 6 spoke to other Career Services Advisors at CEC to try to identify employers who hired students from her schools in the past, but was advised that no graduating student had been placed in a job as a result of CEC's efforts.

157. Witness 24, who was employed as an Admissions Officer at CEC from 2002 until late 2003, stated that CEC very much overstated and misrepresented its graduate job placement success, and senior management was aware of that. He said that CEC would consider any kind of employment as a successful job placement and would include it as part of the job placement statistic. As such, even part-time employment, military enlistments, or jobs like babysitting would be counted

by CEC as job placements. Moreover, job placement assistance in which CEC/AIU actually placed students into jobs following graduation was "almost nonexistent." [13]

158. Likewise, Witness 26, a registrar at Brooks from 2000 through September 2003, confirmed that students at Brooks Institute of Photography were given false information about job placement rates. Admission representatives would tell prospective students that the school had a 96% placement rate when in reality the placement rate was less than half of that (between 25% and 50%) for graduates who got jobs in photography related fields. The witness knew this because she spoke to the director of placement (Aldridge).

159. Further, Witness 26's statement is consistent with the findings of the California Bureau for Private Post-Secondary and Vocational Education, which found, in December 2004, that Brooks Institute of Photography's " advertisement and promotion is false and misleading, as it depicts job titles and salaries that are considerable, particularly when juxtaposed to the small sampling of the graduates."

160. Witness 11, a director of Career Services at an AIU school in Los Angeles, California from February 2003 to September 2003, stated that in order to claim "credit" for placement services, the President of the school directed his executive assistant to call graduated students in or about September 2003 and offer them $50 plus a shirt if the former students provided information on their employment so that the school could claim credit for the "placement," despite the fact that the school had provided absolutely no services for such placement. According to Witness 11, the placement rate at the school thereby increased from 69% to 85%.

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[13] Admissions officers at CEC consulted with placement officers on a regular basis, as the figures provided by placement assisted admissions officers in getting prospective students to sign up for CEC programs. Further, the issue of placements was discussed in the weekly phone conferences with Corporate that admissions officers participated in.

60 Minutes Broadcast Showed CEC Employees Lying About Job Placement

161. On January 30, 2005, the CBS News program, *60 Minutes*, broadcast an expose on CEC. Much of the story focused on fraudulent measures used by CEC to boost starts and student population, including providing false information to students regarding job placement rates.

162. The broadcast included an interview with three Brooks College graduates (the school offers training in fashion and design), Brook Chauaberg, Amanda Harris, and Shanee Thurston who all call the school "Crooks College" because everything told to them by CEC was a lie. In particular, ***the students state that the school had represented that it has a 98% job placement success rate for its graduates*** and that they could expect a starting salary of $30,000 per year.

163. In fact, none of these three witnesses (who graduated near the top of their class) got a job in fashion, nor did CEC make any attempt to find them a job. When they were interviewed for the *60 Minutes* program a year after they graduated, "none had been able to find the kind of jobs they were supposedly trained for." Brook was managing a telephone store, Amanda was unemployed and Shanee was selling T-shirts.

164. CBS reporter Steve Kroft interviewed Barry Ross and Eric Shannon, who used to work at Brooks College as admissions representatives:

KROFT: What was your title?

Mr. BARRY ROSS: Admissions representative.

Mr. ERIC SHANNON: Right, but we're really sales people.

KROFT: Selling?

Mr. ROSS: Selling the dream, basically.

KROFT: Sell me the dream.

> Mr. SHANNON: We're selling you that you're going to have a 95 percent chance that you're going to have a job paying $35,000-$40,000 a year by the time they're done in 18 months.
>
> KROFT: Is that true?
>
> Mr. SHANNON: No. No. We later found out it's not true at all.
>
> Mr. ROSS: Yeah, we later found out--yeah--it wasn't true at all.

165. Kroft also explained that "government-backed student loans are crucial to the entire industry. In 2003, they made up nearly 60 percent of CEC's revenues. And in order to be eligible for that money, CEC is required to provide students with accurate information about job placement."

166. Kroft also explained that "until she was fired a few months ago, ***Tami Hanson was the national manager in charge of student placement for all of Career Education Corporation's campuses in the United States***. She's one of more than 50 current or former employees we spoke with at more than a dozen schools, all of whom told us variations of the same story." Ms. Hanson explained that CEC tried to find its graduates any kind of job:

> KROFT: (Voiceover) But getting students any job they could did not necessarily mean getting them jobs they were trained for, and ***she says that job placement could mean just about anything***.
>
> Ms. HANSON: It may be that, you know, they end up placing them folding T-shirts at the Gap in a fashion--as a fashion grad, which is fine, but not what they were promised in the beginning.

167. This broadcast, which took place during the Class Period, provides additional evidence from CEC employees that CEC lied to its students regarding placement rates in order to boost starts and that it had a corporate-wide policy of inflating placement numbers by counting as "placements" jobs that were unrelated to the students' training.

4. False Disclosures Regarding Student Population and Starts

168. Each of the press releases, conference calls and Forms 10-K issued during the Class Period heralded CEC's ever-increasing total student population, and the press releases and conference calls also touted CEC's increasing starts. However, these representations were false and misleading when issued because CEC improperly counted as starts (a) students who were not fully packaged and thus were likely to drop out; (b) students who never showed up for class but for whom CEC continued to report as active in order to continue receiving federal financial aid, and thus, continue to record revenue; (c) students admitted without high school diplomas or GEDs who were, under federal financial aid rules, ineligible to receive aid; (d) students who did not satisfy the criteria to attend CEC schools and receive federal financial aid because they could not read, were illiterate, homeless, or otherwise unqualified; and (e) students for whom records were falsified. Thus, at all times during the Class Period, CEC misrepresented student starts and total student population by material amounts.

169. Lead Plaintiff's representatives have interviewed dozens of former CEC employees at CEC schools located throughout the United States. These witnesses describe a remarkably consistent pattern of "fudging" student population and start numbers. Numerous Witnesses indicated that CEC Corporate set impossible performance objectives to enroll new students each semester and, as stated by Witness 3, advised CEC employees, "I don't care how you do it, just get it done." (CEC's unrealistic start and student population goals and the heavy-handed pressure from Corporate to meet those goals are supported by Witnesses 4, 8, 9, 10, 12 16, 17, 18, 19, 20, 21 and 26.)

170. For the convenience of the Court, the following chart identifies the witnesses and the CEC Divisions where they worked.

CONFIDENTIAL WITNESSES REVEAL CEC FALSIFIED ENROLLMENTS AND STUDENT POPULATION AT ALL SIX OF ITS UNITED STATES DIVISIONS

Division	Allegations (source)
All	Witness 1 (¶ 51) (conversations with other division and school controllers; consolidated "Flash Reports") Witness 28 (¶ 143) (start numbers were inflated by at least 20% on a Company-wide basis by including students without high school diplomas)
Academy	Witness 4 (¶¶ 191, 193) (direct knowledge of school where employed (Orlando, FL)) Witness 19 (¶¶ 191, 194) (direct knowledge of school where employed (WV)) (now closed)
Colleges	Witness 9 (¶¶ 140, 147, n. 15, 196) (division wide, personal knowledge) Witness 26 (¶¶ 177, 219) (direct knowledge of school where employed (Brooks Institute of Photography), conversation with staff at second school (Brooks College)) Witness 18 (¶ 181) (direct knowledge, Brooks College, San Jose (now Sunnyvale), CA) California Bureau report (¶ 176) (Brooks College)
Culinary	Witness 10 (¶¶ 179, 195, 197) (direct knowledge of school where employed (MN)) Witness 16 (¶ 180) (direct knowledge of school where employed (AZ)) Witness 17 (¶ 198) (direct knowledge of school where employed (TX))
Gibbs	Witness 13 (¶¶ 148, 196) (direct knowledge of school where employed (Norwalk, CT)) Witness 1 (¶¶ 172, 191, 218) (direct knowledge of school where employed (VA)) Witness 2 (¶¶ 172, 191, 192, 196, 201, 214, 215) (direct knowledge of school where employed (MA)) Witness 21 (¶¶ 173, 183) (direct knowledge of school where employed (NY))
Health Education	Witness 8 (¶ 187) (direct knowledge of school where employed (Missouri College)) Witness 23 (n. 16, ¶ 189, n. 18 (direct knowledge of school where employed (Missouri College))
University	Witness 12 (¶ 196) (direct knowledge of school where employed (AIU–Dunwoody)) Witness 20 (¶¶ 199, 184, 213) (direct knowledge of school where employed (CA))

CEC Schools Changed Start Dates to Allow More Students to Be Counted as Starts

171. Witness 1 confirmed that "starts" was one of CEC's critical metrics for measuring its success. Once the five-day start period expires, as described in the March 10, 2003

Coover memo, *supra*, if a student drops out, it is considered an "education problem" as opposed to an admissions shortcoming (and therefore the student is included in the Company's calculation for the period regarding the number of starts, even if the student fails to show up for any classes after day 5).

172. Witnesses 1 and 2 explained that CEC allowed its schools considerable "flexibility" regarding enforcing the start period. For example, if starts for a semester were below CEC's goal, the "five day" date would be pushed out by one or two weeks so that additional students could be considered "starts" despite the fact that these students would have missed the first two weeks of the semester. In fact, Witness 2 confirmed that for every quarter during her tenure at the CEC school (April 2002 – June 2003), the start date was extended by at least seven days.[14]

173. Likewise, Witness 21, a former Vice President of Student Finance from February 2002 through September 2004, indicated that Gibbs New York had a rule that new starts could not be admitted two weeks after a semester began. However, if the school did not meet its corporate–budgeted "start" numbers, Gibbs New York would open up admissions for another week. This was significant, as the school starts often coincided with the time that CEC issued its preliminary quarterly financial results, and Gibbs New York was one of CEC's larger institutions. Further, approximately 30-40% of the starts dropped out of the Gibbs School within the first month, so that they would be a "start" at the end of one quarter, but a drop (rather than a cancel, which would not be counted as a start) at the beginning of the next quarter.[15]

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[14] Witness 2 knew this because she was responsible for "registration billing" to the students, which could not be done until after the add/drop date. The Director of Admissions would tell her when to run the registration billing.

[15] Likewise, Witness 9, who worked at CEC until September 2002, stated that CEC overstated the cumulative number of "starts" for any given period across the board by 10-20%, with the larger CEC schools particularly overstated. In order to report as many "starts" as possible, CEC would admit students to classes long after a semester began even though the students would have missed 20-25% of the semester's classes.

(a) Students Without High School Diplomas or GEDs Were Regularly Admitted to CEC Schools in Order to Inflate Starts

174. Governmental investigations, CEC's own internal audits, and confidential witnesses confirm that CEC regularly admitted large numbers of students who did not have high school diplomas or GED's or were otherwise unqualified to take the courses being offered. This was done in order to inflate the student start numbers that were reported to investors.

175. Moreover, CEC Corporate was fully aware of all of the unqualified students being admitted. Witness 26 confirmed that by late 2002 or early 2003, a new computer system had been installed so that information regarding the status of all CEC student files (including whether the file was missing proof of high school graduation) could be accessed by Corporate on an individual basis, a school wide basis, or a Company wide basis.

176. In December 2004, the California Bureau for Private Postsecondary and Vocational Education ("California Bureau") did an investigation in connection with an application for re-approval of Brooks College and found multiple violations. The December 1, 2004 report indicated that the California Bureau made an on site inspection at the college on November 8 and 9, 2004 and after reviewing 162 randomly selected records, found numerous violations of California Education Code. Among the violations found are the following:

> (2) ***numerous student files were missing*** (thirty of the fifty withdrawn of canceled student files did not have a written notice of cancellation or one that was signed by the student. Also, there were ***no records of attendance in the files*** and ***someone other than the student filled out several of the 'withdrawal forms***.'; … (4) … the institution is not in compliance with Title 5, CCR section 71770(a), which require that '***the institution shall not admit any student who is obviously unqualified*** or does not appear to have a reasonable prospect of completing the program; … and (6) "***The institution's advertisement and promotion is false and misleading*** as it depicts job titles and salaries that are considerable, particularly when juxtaposed to the small sampling of the graduates."

See Exhibit W, attached (emphasis added).

177. Witness 26, as a registrar, would receive student files near the beginning or at the end of a term; Witness 26 would review new student files to see if there was a high school diploma or equivalent and check to verify that the student had a grade point average of 2.5 or above as required by the school. During the first and second quarters of 2003, Witness 26 indicated that 40 – 50% of the student files she reviewed at the Brooks Institute of Photography (approximately 500 files per semester) were missing proof of high school graduation or a GED or indicated that the student's high school GPA was below 2.5 and therefore was not qualified for admission. Although Witness 26 voiced her concerns about these unqualified students to her supervisor in mid 2003, no student was ever removed from school for this reason. Instead, the school (through the Dean) granted "waivers" in all such cases.

178. Witness 26 also visited Brooks College in September 2003 and spoke to the registrar there and concluded that Brooks College had the same problem with student files missing proof of high school graduation and unqualified students being admitted.

179. Similarly, at the end of 2003, Witness 10 personally undertook a project given by the school's assistant dean, which entailed going through every file of the "current" student population to ensure that each file contained all the necessary documents to be in "compliance", according to the assistant dean. Witness 10 was required to review records for diplomas, transcripts, immunization records, among other things. Based on her firsthand knowledge, having undertaken the review, Witness 10 stated that at least 25% of the 775 files she reviewed were missing required documentation.

180. Likewise, Witness 16, a Director of Admissions from January 2002 through June 2004, estimated that 30-40 students who were counted as "starts" in each class of 160-200 students during his tenure had no high school diploma or GED, in violation of CEC's own policy as well as federal laws. 34 C.F.R. § 668.32.

181. In July 2003, according to Witness 18, the Brooks San Jose school reported total starts of 114 students. As of August 5, 2003, only 53 students had the proof of high school graduation/GED documentation required by federal law.

182. Witness 5 stated that in the Spring of 2002, she participated in an audit of students at Katherine Gibbs New York School and determined that 250 of the students there were "phantom" students who had been counted as starts by the admissions department (and that number was reported to Corporate), but were not attending school. She personally told Larson about this at an in-person meeting in New York on May 13, 2002.

183. Similarly, Witness 21 confirmed that the Katherine Gibbs New York school performed an audit of active student records and found that more than 200 of its students did not graduate from high school or have a GED.

184. In January 2004, according to Witness 20, 260 students at AIU's Los Angeles campus were listed as starts, and as of January 16, 2004 were considered "active." Of those 260 students, 140 had no file containing proof of graduation or GED; 7 other students had "requested" their high school file.[16]

185. Witness 16 stated that during his tenure between 2002 and June 2004, 30 to 40 starts in each class of 160-200 students (classes began every six weeks) had no high school diploma or GED.

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[16] Many of the students that CEC admitted were clearly unqualified to take classes on a post-high school level. Witness 14 stated that in one class of 20 students he taught between December 2004 and February 2005, at least 8 students could not read; another student would have to read aloud to these 8 after class.

Witness 23 indicated that on one of the weekly conference calls with CEC corporate, she expressed concerns about the quality of students and the school's policy on dropping students (which the school president told Witness 23 was *not* to happen). Those weekly conference calls were with MaryAnn Pelligrino, Corporate VP for Student Services, and would include other CEC executives.

186. Witness 29, Vice President of Admissions, stated that 20 – 25% of starts during the Class Period were the result of accepting students who did not have proof of graduation or a GED or were simply "made up" in order to meet start goals.

(b) Students Who Were Not Fully Packaged Were Regularly Admitted to CEC Schools in Order to Inflate Starts

187. During the Class Period, CEC schools improperly and regularly held on to millions of dollars in Title IV federal funds provided for students who CEC knew had dropped out. The schools did this so they could meet the quarterly income goals set by Corporate.

188. According to Witness 8, who was employed by CEC until February 2004, Missouri College counted as starts students who were not fully packaged and subsequently dropped out of school as a result. Witness 8 was told by an employee in financial aid that the school held onto the government money for as long as six months to combat the reality that monthly start goals were not being met. Witness 8 was unable to quantify the amount, but indicated that in early 2004, at least 50 files, representing $2,000 to $3,000 per student, were being processed by the financial aid employee for return to the government. This lengthy delay in returning federal monies was improper, as federal guidelines require that an institution receiving Title IV funds must return federal loans no later than 30 days after an institution determines a student withdrew (defined as when the institution is officially notified, or when the institution becomes aware the student ceased attending). 34 C.F.R. § 668.22.

189. Witness 23, employed at the same institution, confirmed Witness 8's statements and further stated that the school president told Witness 23 "The shareholders love us and as long as they do, we can do anything we want to."

190. Witness 28 stated that the following CEC schools held onto funds for much longer then they were supposed to: Gibbs (Montclair, Providence, Philadelphia, Norwalk and New York), Sanford Brown (Ft. Lauderdale, Springfield and New York City), AIU (Dunwoody,

Buckhead), College West, Brooks-Long Beach, Collins College, Missouri College and McIntosh College. Witness 28 stated that the total amount improperly withheld on a quarterly basis during the Class Period was, conservatively, at least $10-12 million. Witness 28 further stated that this procedure violated Title IV and inflated CEC's reported quarterly earnings.

191. In addition, numerous former CEC employees, including Witnesses 1, 2, 4 and 19, each employed at different CEC institutions, admitted that although students entering CEC schools were supposed to be "fully packaged," in many cases, this was simply not true. According to Witness 1, only 70 - 80% of the new students who started each quarter in 2002 were fully packaged. Of the 20-30% of students who were unpackaged, 42% would drop out in the ensuing quarter.

192. A similar story is recited by Witness 2, employed at CEC between April 2002 and June 2003, who stated that of the 200– 250 new students who started each quarter, 30-40% were not fully packaged. Of this unpackaged group, approximately 20% received loans from CEC, while the remaining 80% would drop out.

193. Likewise, according to Witness 4, who was employed at CEC from June 2003 through February 2004, at the start of a given quarter only about 70% of all new students were "fully packaged." Witness 4 indicated that financial aid staff would attempt to package the remaining 30% during the ensuing quarter, but if unsuccessful, the student would be withdrawn. This was significant, as these unpackaged students were all counted as "starts" for purposes of student enrollment, even though the Company knew that a high percentage of unpackaged starts would ultimately drop out. Witness 4 indicated that in the third quarter of 2003, 273 students "started" at his school, but only 35 were fully packaged. Although Witness 4 could not quantify the amount, he stated that many of the unpackaged students ended up dropping out for financial reasons.

194. Witness 19, who was employed at CEC until July 2003, stated that during her tenure, the school typically admitted 40-65 new students during each start period, 20% of whom were not packaged for financial aid, had "no ability" to get financial aid and thus would not complete their education at the school. She understood this from her discussions with the financial aid department personnel at the school as well as participation in monthly and quarterly conference calls with CEC Corporate wherein part of the discussion involved the performance of the school.

195. Witness 10, who was employed at CEC between October 2003 and April 2004, also stated that in any given quarter while Witness 10 was employed at the school, only about 70% of the new students were fully packaged. This information came from her participation in meetings prior to a class start where lists were circulated of students who were not packaged.

196. CEC Corporate received accurate student status reports from the schools, according to Witnesses 2, 9, 12 and 13, and thus Corporate knew the number of "starts" that were not fully packaged. Corporate also knew that many, if not most, of these students would ultimately drop out. In fact, one of the periodic reports generated by CEC schools was "FA Status Report – Short Version." (A copy of one for Brooks College generated June 30, 2003 is attached hereto as Exhibit X.)

(c) Students Who Did Not Attend Class Were Regularly Included in CEC Student Enrollment Figures

197. Witness 10 indicated that at the end of 2003, the student body count at Witness 10's school was officially about 775 students, but Witness 10 states that the number of students who were active and attending classes was, in fact, closer to 650 students. Witness 10 had personal knowledge of this fact, as she was given the project of ensuring that each student's file contained all necessary documentation to be in compliance with Federal regulations, such as transcripts and diplomas. Based upon her first-hand knowledge of this task, Witness 10 indicated

that at least 25% of the 775 files were missing critical documents. Witness 10 sought to locate the students to obtain the missing paperwork; approximately 125 students could not be found.

198. In mid-2004, Witness 17 downloaded directly from the school's Campus 2000 computer system a list of 216 students, who were deemed starts between 2002 and July 2004, which list contained their respective last date of attendance ("LDA"), start date, drop date, and the difference between (i) the drop date and start date; (ii) the LDA and start date; and (iii) the drop date and the LDA. The list, from which Witness 17 expunged names, has been reviewed by counsel herein. As explained by Witness 17, pursuant to state law, if a student did not attend classes for 5 consecutive days, the student was required to be withdrawn. However, as indicated in the spreadsheet, for all but 8 students out of 216, the number of days between their LDA and drop date range from 15 to 298 days, meaning that the student was considered "active" even though their last date of attendance may have been almost a year prior to the drop date. Thus, at this one school alone, more than 200 students in a two and one half period were improperly counted as part of the total student population, as announced in CEC press releases and Forms 10-K on a company-wide basis. Witness 17 indicated that while employed there, the maximum student population in a year was 1,200 students, so the number of improperly counted student at that school is significant on a percentage basis.

199. According to Witness 20, the add/drop date at her school was supposed to be on the fifth school day of a new start period. However, in virtually every start period during her tenure, the add/drop date was extended by at least "a couple of days and in a couple instances by as much as another complete week." Witness 20 said the extension of the add/drop dates got "much worse" from Spring 2003 onward with the arrival of a new VP of Admissions. In a January 22, 2004 document titled "January Start" from a CEC institution on the West Coast, of the 395 students listed as a January Start, 14 were cancelled. Of the remaining 381 students, according to this

document, 59 students *never* showed up for Days 1 and 2 of class, but were counted as starts; and another 83 students only attended Day 1 of the class, but not Day 2. Thus, 142 of the 381 students (or over 37%) were improperly counted as a "start" for this school, even though they were not attending classes during the first week of the start period.

200. Witnesses 1 and 5 also confirmed that in 2002 and 2003, the add/drop dates were frequently extended at their schools by one to two weeks in order to allow for more students to be reported as starts.[17]

201. Witness 2, who worked at CEC from April 2002 through June 2003, indicated that 4-6% of the students in every quarter during her tenure should not have been counted as active students (*i.e.*, included as starts), as they were not attending classes. Witness 2 went to the classrooms to find these "enrolled" students and would be told by the teacher that the student had never shown up, but nonetheless was being counted as an active student.[18]

202. Likewise, the Collins DOE Report (*see supra*) found that in 25 of the 45 student files in the regular sample, students did not complete 80% of the scheduled classes in one or more of the classes as required by school policy requirements.

Department of Education Audits at Seven CEC Schools Show a Pattern of Failing to Keep Appropriate Records of Student Enrollment

203. Department of Education audits of CEC schools show a remarkable pattern of failing to keep appropriate records of student enrollment. This was an inevitable result of the fraudulent acts related to reported starts and enrollment at these schools.

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[17] Witness 1 also stated that 50% - 60% of the students who started at her school would later drop out of the program.

[18] Likewise, Witness 23 met with the school president weekly in 2003 to discuss how to get students back in class. Witness 23 also held weekly retention meetings with students who had not been attending 20 consecutive classes in order to convince them to sit for at least one class to avoid listing the student as a drop (and thereby avoid the 30 consecutive days of non-attendance, which would require the return of federal funds).

204. The Collins DOE Report states that of 45 sample student recipients who did not withdraw, 11 students of those students had actually withdrawn, and an additional approximate $20,000 should have been returned to the government. The Collins DOE Report determined that Collins' method for determining the timing and extent of refunds was "fundamentally flawed" in three main areas: (1) The College delays the withdrawal process despite the fact it knows (or should have known) a student has withdrawn under its attendance policy and procedures; (2) Collins used a period of enrollment to coincide with its billing cycles instead of the period for which Title IV awards are intended; and (3) Collins does not include all of its institutional charges in determining how much unearned Title IV is due from Collins.

205. The Collins DOE Report also issued a finding that Collins' reported enrollment data was inconsistent with institutional records. The DOE found that 20 of the 45 regular sample student files "contained errors or discrepant information that distorts its students' enrollment statuses."[19]

206. Similar findings were made at other CEC schools. For example, the DOE also issued a final audit determination for American Intercontinental University in Atlanta, Georgia for the year ended December 31, 2002. In that Report, 48 of 131 student files reported incorrectly or untimely on students' enrollment status. Copies of the relevant pages are attached hereto as Exhibit Y.

207. So, too, in a November 6, 2003 review of compliance with federal loan requirements at the California Culinary Academy in San Francisco, California conducted by auditors acting for the DOE, the auditors found that enrollment status was incorrectly reported for 54 of the 112 students tested. Copies of the relevant pages are attached hereto as Exhibit Z.

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[19] The Collins DOE Report also noted that Collins failed to report a change in student status within the required timeframe for 37 of the 45 of the files tested.

208. In a similar review prepared for Gibbs College, Montclair, New Jersey encompassing the 2003 fiscal year, the auditor for the DOE concluded that in a sample of 40 student files, 16 files either reported the student's enrollment status late or incorrectly. Copies of the relevant pages are attached hereto as Exhibit AA.

209. The DOE also determined that the International Academy of Design and Technology in Pittsburgh Pennsylvania inaccurately reported student enrollment status for the 2003 fiscal year. In the auditors report, of 57 files tested, the auditor determined that 36 of the 57 files inaccurately or untimely reported the students' enrollment status. Copies of the relevant pages are attached hereto as Exhibit BB.

210. The DOE also concluded that McIntosh College inaccurately reported student enrollment status during 2003. In a review which sampled 70 student files, the enrollment status of 34 students were not timely reported to the federal agencies. Copies of the relevant pages are attached hereto as Exhibit CC.

211. In a review of the Texas Culinary Academy in Austin, Texas for the 2003 fiscal year, the DOE concluded that in a sample of 110 student files, the students' enrollment status in 49 of those files were reported incorrectly or untimely. Copies of the relevant pages are attached hereto as Exhibit DD.

212. This Company-wide pattern of failing to keep proper records of student enrollment status is a direct and inevitable result of the Company's fraudulent acts with respect to inflating student start numbers as discussed *supra*.

5. <u>Falsification of Records</u>

213. An e-mail received by Witness 20 from a CEC employee shortly after Witness 20 left CEC indicates that in July 2004, AIU commenced an internal review into the school's operations and found that admissions counselors had been holding onto a "significant

number of files" which were not signed by the students. In addition, none of the files had letters regarding their unsatisfactory academic progress ("SAP"), *so one employee spent an entire Friday producing SAP letters and backdating them*. Witness 20 stated that Steve Targalini, President of AIU in Los Angeles, ordered that students be put in the books in more classes than the students were enrolled in. When Witness 20 (and others) complained about this practice, they were told that such complaints could cost them their jobs.

214. Witness 2 confirmed that the school would falsify student records to show as still enrolled students who had dropped out, but whose financial aid applications had not been completed prior to the student dropping out. CEC did this in order to obtain the financial aid to cover the students' tuition. Although a school is eligible to receive government money for a student who drops out and for whom tuition is owed, it is improper to falsify records to create the appearance that the student was still enrolled.

215. Witness 2 indicated that her school kept government monies for up to two terms (approximately six months) before returning it to students who dropped out; it was Witness 2's understanding that CEC did this "for the stock" so CEC could report more students being enrolled than was actually the case. Witness 2, who previously supervised a staff of 29 employees in government responsible for disbursing student loans, had disputes with the Financial Aid Director on this issue, and told the Director that such monies could not be kept when it is known a student dropped out. In fact, HEA clearly states that federal loan money is to be returned within 30 days of the institution determining that the student had ceased attending; thus, failure to timely return funds was in clear violation of federal laws. Section 668.173.

216. In a June 11, 2004 report on compliance prepared by an auditor for the DOE regarding CEC's Cooking and Hospitality Institute of Chicago for the 2003 fiscal year, the auditor sampled 25 student files to determine whether refunds of federal funds were made within 30

days of the student's withdrawal from the program. The auditor concluded that payments were not timely made for 9 out of the 25 students. The auditor then expanded the sample of 59 additional students, which revealed 14 additional situations where refunds were not timely made. Copies of the relevant pages are attached hereto as Exhibit EE.

217. In connection with a review of Gibbs College, Boston Massachusetts conducted by an auditor for the DOE to determine the institution's compliance with laws and regulations governing the program, the auditor chose a sample of 291 students from the 2002/2003 award year and 290 students from the 2003/2004 award year. The review determined that for 77 students in the 2002/2003 and 76 students in the 2003/2004 award year, the institution failed to return unearned federal assistance within the required timeframe, ranging from 12 to 598 days late. The auditor concluded that this finding represented a "significant lapse of fiduciary duty and is suggestive of impaired administrative capability." Copies of the relevant pages are attached hereto as Exhibit FF.

218. Similarly, Witness 1 was personally aware of the school being unable to locate records of students who had purportedly graduated. The school's Director of Placement simply typed up phony records in order to satisfy the compliance auditors.

219. Finally, Witness 26 noted that where a student was absent, Brooks employees would change the records to mark the student present or tardy in order to meet retention goals. This happened approximately 20% of the time. Witness 26 was told this by the student advocate, Amanda Hill, who changed some of the records. Other records were changed by Nate Flint, the Dean of the school.

VII

DEFENDANTS' FALSE AND MISLEADING STATEMENTS

The First Quarter of 2002

220. On April 22, 2002, the beginning of the Class Period, CEC issued a press release reporting "record results" for the first quarter ended March 31, 2002, its 17th consecutive quarter of record results including net revenues, net income and earnings per share. First quarter 2002 net revenues were $169.9 million, an increase of 42% from $119.7 million for the same period in the prior year. First quarter 2002 net income was $12.0 million or $0.26 per diluted share, an increase of 90 and 86 percent, respectively, from the first quarter 2001 net income of $6.3 or $0.14 per diluted share.

221. With respect to bad debt expense, the April 22 press release stated:

> Bad debt expense was 3.6 percent for the quarter ended March 31, 2002, compared with 2.8 percent for the quarter ended March 31, 2001 and 3.7 percent for the quarter ended December 31, 2001.

222. In addition, CEC highlighted the student population results, stating:

> First quarter 2002 new students starts rose 29 percent to approximately 10,550, up from the approximately 8, 150 for the same period last year. Total student population on April 30, 2002 is expected to be approximately 40,800, up 24 percent from approximately 32, 800 on April 30, 2001.

223. In the April 22 press release, defendant Larson applauded the Company's performance, stating "Career Education Corporation began 2002 with accelerating momentum in virtually every aspect of our operations".

224. On May 14, 2002, CEC filed its quarterly report on Form 10-Q for the first quarter of 2002 with the SEC (the "1Q02 Report"). The 1Q02 Report reiterated the financial information contained in the April 22, 2002 press release relating to 2002 first quarter revenues, earnings and bad debt ratios. The 1Q02 Report was signed by the Individual Defendants.

225. In the 1Q02 Report in a section entitled "Basis of Presentation", the Company represented that the financial information contained therein was prepared in accordance with GAAP and fairly presented CEC's results, stating as follows in relevant part:

> The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. …In the opinion of management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included.

226. The representations contained in the April 22 press release and the 1Q02 Report regarding the Company's financial results and business for its first quarter of 2002 were false and misleading because of the following reasons:

(a) Overstatement of Revenues and Earnings

(i) As noted, the Company improperly inflated revenues and earnings generated by its Culinary and Health Education programs in violation of GAAP. The precise amount of the overstatement of revenues for this quarter is within the sole possession of defendants, and subject to further discovery.

(b) The bad debt expense as a percentage of revenue was understated based upon the understatement of allowances as of that time.

(c) By virtue of the false financial information described above, the Company's representation in the 1Q02 Report that the financial statements " . . . have been prepared in accordance with generally accepted accounting principles . . ." and that " . . . all adjustments considered necessary for a fair presentation have been included . . ." were false and misleading.

(d) The defendants falsified student and other records so as to overstate the reported starts and the total student population, the precise amount of such overstatements being within the exclusive knowledge of the defendants, and is subject to discovery.

The Second Quarter of 2002

227. On July 22, 2002, CEC issued a press release announcing its 18th consecutive quarter of "record results" in the second quarter of 2002. The Company reported that second quarter 2002 net revenues were $172.0 million, up 42 percent from $121.3 million for the same period in the prior year. Second quarter 2002 net income was $10.3 million or $0.22 per diluted share, more than double the prior year's net income of $5 million or $0.11 per diluted share. For the six months ended June 30, 2002, net revenues were $341.9 million an increase of 42% from $241.0 million for the same period last year. Net income for the first half of 2002 nearly doubled to $22.3 million or $0.47 per diluted share, from $11.2 million or $0.25 per diluted share.

228. In the July 22, 2002 press release, the Company represented as follows with respect to bad debt ratio:

> Bad debt expense was 3.6 percent for the quarter ended June 30, 2002, compared with 2.7 percent for the quarter ended June 30, 2001 and 3.6 percent for the quarter ended March 31, 2002.

229. With respect to starts and student population, the July 22, 2002 press release stated that:

> Second quarter 2002 new student starts rose 32 percent to approximately 8,700, up from approximately 6,600 for the same period last year. Total student population on July 31, 2002 is expected to be approximately 40, 650, up 29 percent from approximately 31,600 on July 31, 2001.

230. Market reaction to the July 22 press release was overwhelming. On July 23, 2002, CEC's stock price closed at $19.05 per share, up from the prior day's closing price of $16.625.

231. On August 13, 2002, the Company filed its quarterly report on Form 10-Q for the second quarter of 2002 with the SEC (the "2Q02 Report"). The 2Q02 Report reiterated the financial information contained in the July 22, 2002 press release regarding revenues, earning and the bad debt ratio. The 2Q02 Report was signed by defendants Larson and Pesch.

232. In the section of the 2Q02 Report titled "Basis of Presentation", the Company again represented that the financial information contained therein had been prepared in accordance with GAAP and fairly presented the Company's results.

233. The representations contained in the July 22, 2002 press release and the 2Q02 Report regarding the Company's financial results and business for its second quarter were false and misleading for the following reasons:

(a) The bad debt expense as a percentage of revenue was understated as a result of the understatement of allowances described in paragraphs 38 to 87, above.

(b) Defendants falsified student and other records in order to overstate the reported starts and total student population.

(c) The precise amount of the overstatement of revenues, earnings, starts, and student population, and the understatement of the bad debt ratio, which is within the exclusive knowledge of defendants, and is subject to discovery.

234. By virtue of the false financial information described above, the Company's representation in the 2Q02 Report that the financial statements "have been prepared in accordance with generally accepted accounting principles . . ." and that "all adjustments considered necessary for a fair presentation have been included . . ." was materially false and misleading.

<u>The Third Quarter of 2002</u>

235. On October 21, 2002, CEC reported yet another "record" quarter, its 19th consecutive quarter since becoming a public company. The Company reported that third quarter 2002 net revenues were $189.4 million, up 42% from $133.0 million for the same period in the prior year. Third quarter 2002 net income was $14.2 million or $0.30 per diluted share, up 81% from the prior year's reported net income of $7.8 million or $0.17 per diluted share. For the nine months ended September 30, 2002, net revenues were $531.3 million, an increase of 42% from $374.0

million for the same period last year. Net income for the first nine months of 2002 was $36.5 million or $0.77 per diluted share up 91% from $19.1 million or $0.42 per diluted share.

236. In the October 21 press release the Company provided the following information on bad debt ratio for the quarter:

> Bad debt expense was 3.9 percent for the quarter ended September 30, 2002, compared with 3.6 Percent for the quarter ended September 30, 2001.

237. With respect to student starts and population, the October 21 press release stated:

> Third quarter 2002 new student starts rose 19 percent to approximately 15,100, up from approximately 12,700 for the same period last year. Summer and fall (July through October) new student starts are expected to rise 19 percent to approximately 26,700, up from approximately 22,500 a year ago. Total student population on October 31, 2002 is expected to be approximately 50,400, up 23 percent from approximately 41,100 on October 31, 2002.

238. Market reaction to the October 22, 2002 press release was muted however, as analysts downgraded CEC stock due to a perception that growth at the Company was slowing. Thus, on October 23, 2002, CEC stock closed at $22.305 per share, compared to the prior day's closing price of $21.995 per share.

239. On November 13, 2002, CEC filed its quarterly report on Form 10-Q for the third quarter of 2002 with the SEC (the "3Q02 Report"). The 3Q02 Report reiterated the financial information contained in the October 22, 2002 press release regarding revenues, earnings and bad debt ratio and was signed by defendants Larson and Pesch. Moreover, the Individual Defendants certified that the 3Q02 Report did not contain any untrue statements of material fact or omit to state material facts necessary to make the statements made, in light of the circumstances under which they were made, not misleading; and that the financial statements and other financial information included in the 3Q02 Report fairly presented in all material respects the financial conditions, results of operations and cash flows of CEC (the "certification").

240. The 3Q02 Report, in the section entitled "Basis of Presentation", represented that the Company had prepared the financial information contained therein in accordance with GAAP and fairly presented the Company's results.

(a) The representations in the October 22, 2002 press release and the 3Q02 Report regarding the Company's financial result and business for its 2002 third quarter were false and misleading for the following reasons:

(i) As noted, the Company improperly inflated revenues and earnings generated by its Culinary and Health Education programs in violation of GAAP.

(b) The bad debt expense as a percentage of revenue was understated as a result of the understatement of allowances described in paragraphs 38 to 87, above.

(c) Defendants falsified student and other records in order to overstate the reported starts and total student population.

(d) The precise amount of the overstatement of revenues, earnings, starts, and student population, and the understatement of the bad debt ratio, which is within the exclusive knowledge of defendants, and is subject to discovery.

241. By virtue of the false financial information described above, the Company's representation in the 3Q02 Report that the financial statements "have been prepared in accordance with generally accepted accounting principles . . ." and that "all adjustments considered necessary for a fair presentation have been included . . ." was materially false and misleading.

Fourth Quarter And Year-End 2002

242. On January 28, 2003, the Company issued a press release announcing "record results," including record net revenues, net income and student population for the fourth quarter and year ended December 31, 2002, purportedly its twentieth consecutive quarter of record results since becoming a public company. Fourth quarter 2002 net revenues were $219.7 million, up

42% from $155.2 million for the same period last year. Fourth quarter 2002 net income was $31.0 million, or $0.65 per diluted share, an increase of 61% from the prior year's fourth quarter net income of $19.3 million, or $0.42 per diluted share. Full year 2002 net revenues were $751.0 million, up 42% from $529.2 million a year earlier. Full year 2002 net income was $67.5 million, or $1.42 per diluted share, up 76% from $38.4 million, or $0.85 per diluted share.

243. In the January 28, 2003 press release, defendants also provided information with respect to CEC's bad debt ratio:

> Bad Debt Expense was 3.7 percent for the quarter ended December 31, 2002, compared with 3.7 percent for the quarter ended December 31, 2001.

244. The Company further stated that January 2003 new student starts rose 28% to approximately 10,550, up from approximately 8,250 for the same period last year, and fourth quarter 2002 new students starts rose 18% to approximately 13,100, up from approximately 11,100 for the same period last year. Total student population on January 31, 2003 was reported at approximately 51,100, up 21% from approximately 42,100 on January 31, 2002.

245. Commenting on the Company's "record" results, defendant Larson stated, among other things:

> Career Education Corporation had an outstanding 2002, achieving record growth and profitability and becoming the world's largest on-campus provider of private, for-profit postsecondary education in terms of revenue . . . .

246. During a January 29, 2003 conference call with analysts, Larson reiterated the financial results regarding revenues, earnings, starts and total student population and Pesch reported the results regarding the bad debt reserve ratio referred to above.

247. The market reacted strongly to the January 28, 2003 press release, with CEC stock increasing from its closing price on January 28, 2003 of $20.055 per share, to close at $23.22 per share on January 29, 2003.

248. On March 10, 2003, the Company filed its annual report with the SEC on Form 10-K for the fiscal year ended December 31, 2002 ("2002 10-K"). The Company's 2002 10-K signed by the Individual Defendants, reaffirmed its previously-announced financial results regarding revenues, earnings, bad debt reserve ratio, and student population and start numbers set forth in the January 28, 2003 press release described above.

249. The 2002 10-K also addressed certain of the Company's accounting policies. Under "Critical Accounting Policies":

> **Critical Accounting Policies.**
>
> Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, ***which have been prepared in accordance with accounting policies generally accepted in the United States.***
>
> * * *
>
> **Allowance for Doubtful Accounts**
>
> Based upon past experience and judgment, we establish an allowance for doubtful accounts with respect to tuition receivables. In establishing our allowance for doubtful accounts, we consider, among other things, a student's status (in-school or out-of-school), whether or not additional financial aid funding will be collected from Title IV Programs or other sources, whether or not a student is currently making payments, and overall collections history. Changes in trends in any if these areas may impact the allowance for doubtful accounts. The receivable balances of withdrawn students with delinquent obligations are fully reserved in our allowance for doubtful accounts.
>
> Our historical bad debt expense as a percentage of gross school revenue for the years ended December 31, 2002, 2001, and 2000 was 3.7%, 3.3%, and 2.8%, respectively.

2002 10-K, pp. 36-37. (Emphasis added.)

250. As noted elsewhere in the 2002 10-K:

> Bad debt expense increased $11.2 million or 63%, from $17.8 million in 2001 to $29.1 million in 2002, and bad debt expense as a percentage of gross school revenue increased from 3.3% during 2001 to 3.7% during 2002. This anticipated increase in bad debt expense

> as a percentage of gross school revenue is primarily attributable to a greater number of students taking higher priced programs, which results in lower government funding for students as a percentage of cash receipts.

251. In the 2002 10-K, CEC emphasized that the placement of its graduates was critical to attract new students. Thus, the 2002 10-K noted:

> ***Emphasizing Employment of Graduates.*** We believe that the high rates of employment for graduates of our schools enhance the overall reputation of the schools as well as their ability to attract new students. High placement rates also lead to low student loan default rates, which are necessary to allow our schools to continue to participate in federal student financial aid programs. We consider student placement a high priority, and 94.1 percent of our graduates who were available for employment for the academic year ended June 30, 2002, had found employment relating to their fields of study within six months of graduation. We are committed to maintaining or improving these graduate employment rates, and newly acquired or opened schools will be expected to meet similar graduate employment success standards.
>
> (2002 10-K, p. 7)
>
> * * *
>
> Based on survey information received from graduating students and employers, we believe that of the 16,366 students graduating from our schools during the academic year ended June 30, 2002, ***94.1% of the 14,426 available graduates***, which excludes students who are continuing their education, in active military service or deceased, as well as students from foreign countries who are legally ineligible to work in the U.S., ***obtained employment in fields related to their programs of study***. This represents a 2.1 percentage point increase from our placement rate for the academic year ending June 30, 2001, of 92.0% (2002 10-K, p. 13) (emphasis added).

252. CEC also noted in its financial statements under "Other Data" the total approximate student population at its schools as of October 31, 2002 was 50,400, versus 41,100 and 29,000, respectively for the same period in 2001 and 2000, respectively.

253. The representations contained in the January 28, 2003 press release and 2002 10-K regarding the Company's financial results and business for its 2002 fourth quarter and year-end results were false and misleading, for the following reasons:

(a) Reported revenues and earnings were overstated. As noted in paragraph 331, below, the Company improperly inflated revenues generated by its Culinary and Health Education programs in violation of GAAP. On February 15, 2005, the Company disclosed that it was restating revenues and earnings as a result of the erroneous manner in which it treated revenue generated from these programs; that in fact it did not generate 2002 revenues and earnings of $780,059,000 and $67,472,000, respectively, as reported in the January 28, 2003 press release, January 29, 2003 analysts' conference call and 2002 10-K, but only revenues and earnings of $770,719,000 and $61,819,000, respectively.

(b) The Company's erroneously reported inflated revenues and earnings in connection with its Culinary and Health Education Programs described above, so its representation in the 2002 10-K that its financial statements had been prepared "in accordance with accounting policies generally accepted in the United States" were false, as the statements were not prepared in accordance with GAAP.

(c) By means of the acts described in paragraphs 129 to 219 and 242 to 252 above, the reported starts, total student population, and job placement rates were overstated, the precise amount of which is presently unknown but can be ascertained through discovery.

254. On March 26, 2003, the Company announced that it had entered into a definitive merger agreement with Whitman Education Group, Inc. ("Whitman") under which CEC agreed to acquire all of the shares of Whitman for a combination of cash and CEC stock. The transaction was designed to significantly enhance CEC's position in the rapidly-growth health education field. Under the terms of the agreement, Whitman's shareholders would receive $6.00 in

cash and $8.25 in CEC common stock (for a combined consideration of $14.25) for each share of Whitman stock. The stock portion of the consideration was subject to adjustment based on CEC's average share price during a specified period prior to closing. Thus, the Whitman acquisition provided defendants with the motive to maintain the trading price of CEC securities.

The First Quarter of 2003

255. On April 22, 2003, CEC issued a press release, headlined "Career Education Corporation Posts Record First Quarter Results," marking its "21st consecutive quarter of record results since becoming a public company." The Company summarized its results for the first quarter of 2003 as follows:

> First quarter 2003 revenues were $245.6 million, up 39 percent from $176.3 million for the same period last year. First quarter 2003 net income was $19.2 million, or $0.40 per diluted share, up 61 percent and 54 percent, respectively, from first quarter 2002 net income of $12.0 million, or $0.26 per diluted share.
>
> Effective January 1, 2003, bad debt expense is classified as a component of general and administrative expense; previously such expense was classified as a component of net revenue. The change was made to improve comparability of income statement amounts to the Company's peer group which classify bad debt in this way. If bad debt expense was still classified as a component of net revenue, first quarter 2003 net revenues would have been $236.2 million and the first quarter 2003 increase in net revenues would have remained at 39 percent.

256. With respect to accounts receivables and bad debt expense, the April 22 press release stated:

> Bad debt expense was 3.8 percent as a percent of revenue for the quarter ended March 31, 2003, compared with 3.6 percent for the quarter ended March 31, 2002 and 3.7 percent for the quarter ended December 31, 2002.

257. In addition, CEC reported a purported increase in starts and student population:

> First quarter 2003 new starts rose 38 percent to approximately 14,600, up from approximately 10,550 for the same period last year.
>
> Total CEC student population on April 30, 2003 is expected to be approximately 54,400, up 33 percent from approximately 40,800 on April 30, 2002. On a same school basis, student population is expected to show an increase of approximately 21 percent during these periods.

258. In the press release, defendant Larson touted the Company's results, attributing CEC's seeming success to the reputation of its schools and track record of finding jobs for students after graduation. In addition, Larson reiterated that the Company signed a definitive merger agreement to acquire Whitman Education Group Inc. earlier in the quarter, stating as follows in relevant part:

> "Career Education Corporation had an outstanding first quarter, delivering outstanding organic growth and enhanced operating margins," said John M. Larson, Chairman, President and Chief Executive Officer. "We also completed a nine-campus acquisition in France with the INSEEC Group and announced a definitive merger agreement with Whitman Education Group, Inc. that will significantly enhance CEC's platform in health education."

259. During an April 23, 2003 conference call with analysts, Larson reaffirmed the financial results and student information results regarding 2003 first quarter revenue, net income, starts, and student population, as described above . Analysts and the market reacted positively to CEC's April 22, 2003 press release. An April 23, 2003 U.S. Bancorp Piper Jaffrey report noted CEC had "another blowout quarter," and reiterated a strong buy rating of its stock . The Company's stock increased from its closing price of $26.355 per share on April 22, to close at $28.965 per share on April 23, 2003.

260. On May 15, 2003, CEC filed its quarterly report on Form 10-Q for the first quarter of 2003 with the SEC (the "1Q03 Report"). The 1Q03 Report reiterated the financial information contained in the April 22, 2003 press release referred to above relating to 2003 first quarter revenues, earnings, allowances, and bad debt ratios.

261. In addition, in a section of the 1Q03 Report entitled "Basis of Presentation," the Company represented that the financial information contained therein was prepared in accordance with GAAP and fairly presented the Company's results, stating as follows in relevant part:

> The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. . . . In the opinion of management, all adjustments considered necessary for a fair presentation have been included.

262. The 1Q03 Report was signed and certified by Defendants Larson and Pesch.

263. The representations contained in the April 22, 2003 press release, April 23, 2003 conference call, and 1Q 03 Report regarding the Company's financial results and business for its first quarter of 2003 were false and misleading, because of the following reasons:

(a) Overstatement of Revenues and Earnings

(i) As noted, the Company improperly inflated revenues and earnings generated by its Culinary and Health Education programs in violation of GAAP. The precise amount of the overstatement of revenues for this quarter is within the sole possession of defendants, and subject to further discovery.

(ii) Revenues generated by the Company's recourse loans made to high risk students pursuant to loan agreements with Sallie Mae and Wachovia were overstated. CEC recognized revenues in connection with the full amount of these recourse loans, even though, due to their high risk nature, collectibility of those revenues was not reasonably assured. The precise amount of the resulting overstatement of revenues and earnings is subject to further discovery.

(b) The bad debt expense as a percentage of revenue, reported at 3.8%, was understated based upon the understatement of allowances as of that time. As indicated in the Licar email referred to in paragraph 62, above, the bad debt ratio was then 4.0% or more.

(c) By virtue of the false financial information described above, the Company's representation in the 1Q03 Report that the financial statements " . . . have been prepared in accordance with generally accepted accounting principles . . . " and that " . . . all adjustments considered necessary for a fair presentation have been included . . . " were false and misleading.

(d) The defendants falsified student and other records so as to overstate the reported starts and the total student population, the precise amount of such overstatements being within the exclusive knowledge of the defendants, and is subject to discovery.

The Second Quarter of 2003

264. On July 1, 2003, CEC announced that it had acquired Whitman Education Group, Inc. in a combination cash and share exchange transaction valued at $245 million. Under the terms of the offer, "Whitman's shareholders will receive $6.00 in cash and 0.138 shares of CEC common stock for each share of Whitman common stock." The Company's plan to acquire Whitman was touted as an important strategic acquisition for CEC. In the July 1, 2003 press release, defendant Larson stated that "[t]his strategic combination will allow us to significantly enhance our position in the rapidly-growing health education field, while further expanding our leadership in information technology and business studies."

265. On July 22, 2003, CEC issued a press release announcing its 22nd consecutive quarter of "record" results in the second quarter of 2003. The Company also announced a 2-for-1 one stock split. The Company summarized its performance in the quarter and the first six months of 2003 as follows:

> Second quarter 2003 revenues were $256.1 million, up 44 percent from $178.4 million for the same period last year. Second quarter 2003 net income was $19.6 million, or $0.40 per diluted share, nearly double last year's net income of $10.3 million, or $0.22 per diluted share.
>
> For the six months ended June 30, 2003, revenues were $501.6 million, up 41 percent from $354.7 million for the same period last

> year. Net income for the first half of 2003 was $38.8 million, or $0.80 per diluted share, up 74 percent from $22.3 million, or $0.47 per diluted share.

266. In addition, CEC provided information related to its bad debt ratio as follows:

> Bad Debt Expense was 3.9 percent of total revenue for the quarter ended June 30, 2003, compared with 3.6 percent for the quarter ended June 30, 2002 and 3.8 percent for the quarter ended March 31, 2003.

267. With respect to starts and total student population, the July 22, 2003 press release stated that:

> Second quarter 2003 new student starts rose 46 percent to approximately 12,700, up from approximately 8,700 for the same period last year. The campuses related to the INSEEC and Whitman acquisitions did not contribute to CEC's second quarter 2003 new student starts.
>
> Total CEC student population on July 31, 2003 is expected to be approximately 63,000, up 55 percent from approximately 40,650 on July 31, 2002. …On a same school basis, total CEC student population is expected to increase year-over-year by approximately 30 percent.

268. Defendant Larson attributed the reportedly record results to the "excellent reputation" of CEC's schools, among other factors, stating as follows in relevant part:

> "As the record second quarter and first half results demonstrate, 2003 is another defining year for Career Education Corporation," said John M. Larson, chairman, president and chief executive officer. "Every element of our multi-pronged growth strategy is working as we continue to deliver enhanced operating results.
>
> "We are achieving high organic growth rates as record numbers of high school graduates and adult students seek high quality career programs at all degree levels," Mr. Larson said. "CEC schools have excellent reputations in the high-demand career fields of visual communication and design, IT, business, culinary arts and health education. Our broad geographic reach, full range of degree options and targeted marketing programs make our educational programs highly accessible to motivated students looking to succeed in their career field."

269. During a conference call with analysts on July 23, 2003, Larson reaffirmed the second quarter results regarding revenues, earnings, starts and the student population and Pesch reaffirmed second quarter revenue, earnings and bad debt ratio.

270. Analysts practically swooned in response to the news: "This was a quarter to remember for Career Education" (July 23, 2003 William Blair & Co. report); "Houston, We Have Liftoff All Systems Go." (July 23, 2003 Credit Suisse First Boston Report).

271. Moreover, the Company's July 22, 2003 press release had a dramatic impact on CEC's stock price, which increased from its closing price of $36.49 per share on July 22 to close at $41.055 per share on July 23, 2003.

272. On August 13, 2003, the Company filed its quarterly report on Form 10-Q for the second quarter of 2003 with the SEC (the "2Q03 Report"). The 2Q03 Report reiterated the financial information contained in the July 22, 2003 press release regarding revenues, earnings and the bad debt ratio. The 2Q03 Report was signed and certified by defendants Larson and Pesch.

273. In a section of the 2Q03 Report titled "Basis of Presentation," the Company represented that the financial information contained therein was prepared in accordance with GAAP and fairly presented the Company's results, stating as follows in relevant part:

> The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. . . . In the opinion of management, all adjustments considered necessary for a fair presentation have been included.

274. The representations contained in the July 22, 2003 press release, July 23, 2003 conference call and 2Q 03 Report regarding the Company's financial results and business for its second fiscal quarter were false and misleading for the following reasons:

(a) Reported revenues and earnings were overstated.

(i) As noted, the Company improperly inflated revenues and earnings generated by its Culinary and Health Education programs in violation of GAAP.

(ii) Revenues generated by the Company's recourse loans made to high risk students pursuant to loan agreements with Sallie Mae and Wachovia were overstated. CEC recognized revenues for the full amount of these recourse loans, even though due to their high risk nature, collectibility of the full amount of the loan revenues was not reasonably assured.

(b) The bad debt expense as a percentage of revenue was understated as a result of the understatement of allowances described in paragraphs 38 to 87, above.

(c) Defendants falsified student and other records in order to overstate the reported starts and total student population.

(d) The precise amount of the overstatement of revenues, earnings, starts, and student population, and the understatement of the bad debt ratio, which is within the exclusive knowledge of defendants, and is subject to discovery.

275. By virtue of the false financial information described above, the Company's representation in the 2Q03 Report that the financial statements "have been prepared in accordance with generally accepted accounting principles . . ." and that "all adjustments considered necessary for a fair presentation have been included . . ." was materially false and misleading.

The Third Quarter of 2003

276. On October 21, 2003, CEC reported yet another quarter of "record" results, its 23rd record quarter as a publicly-traded company. The Company summarized its performance for the third quarter and nine months of 2003 as follows:

> Third quarter 2003 revenues were $315.7 million, up 60 percent from $197.2 million for the same period last year. Third quarter 2003 net income was $26.9 million, or $0.26 per diluted share, up 90 percent from last year's net income of $14.2 million, or $0.15 per diluted share. For the nine months ended September 30, 2003, revenues were $817.3 million, up 48 percent from $551.8 million for the same

> period last year. Net income for the first nine months of 2003 was $65.8 million, or $0.66 per diluted share, up 80 percent from last year's net income of $36.5 million, or $0.39 per diluted share.

277. In the October 21 press release, CEC provided information on the bad debt ratio as follows:

> Bad Debt Expense was 4.8 percent of total revenues for the quarter ended September 30, 2003, compared with 3.9 percent for the quarters ended September 30, 2002 and June 30, 2003.

278. With respect to starts and total student population, the October 21 press release stated:

> Third quarter 2003 new student starts rose 73 percent to approximately 26,100, up from approximately 15,100 for the same period last year. Summer and fall (July through October) new student starts are expected to rise 6.3 percent to approximately 43,400, up from approximately 26,700 a year ago.
>
> Total CEC student population on October 31, 2003 is expected to be approximately 79,500, up 58 percent from approximately 50,400 on October 31, 2002. Of the expected total CEC student population on October 31, 2003, approximately 10,400 students are attributable to the Whitman Education Group acquisition. On a same school basis, total CEC student population is expected to increase year-over-year by approximately 26 percent.

279. Defendant Larson attributed the record results to the Company's successful business plan, stating as follows:

> Career Education Corporation continues to deliver record results, with the third quarter serving as a clear demonstration of the vitality and scalability of our business model. Third quarter results were driven by significant revenue and profitability gains in our online business, continued strong organic growth in our on-campus operations, and better than expected results from the recently acquired, former Whitman and INSEEC campuses. All of these factors helped drive our quarterly margin improvement of 210 basis points year-over-year.
>
> As the results demonstrate, CEC is delivering on all fronts. The growth of our online business continues to outperform expectations and was the primary contributor to our exceeding third quarter revenue and earnings guidance. Our Online Education Group

> generated approximately $44 million in revenues during the third quarter and is on course to generate more than $140 million in revenues in 2003. This estimate is significantly higher than our 2002 revenues of $20 million.

280. On an October 22, 2003 conference call with analysts, defendant Larson reaffirmed CEC's reported revenues, earnings, starts and student population and defendant Pesch reaffirmed reported third quarter revenues, earnings and bad debt ratio. In addition, Pesch sought to explain why the Company's bad debt ratio had increased to 4.8% from 3.9% from the prior comparable period in 2002 as follows:

> With respect to DSOs and bad debt, we did make some changes in our cash collection practices and adjusted some of our credit standards during the quarter which resulted in a significant improvement in our cash collections, as demonstrated by our year-over-year DSO performance and growth in our deferred tuition revenue balances. Those more aggressive collection practices were instituted in an effort to improve our working capital management and also to improve on a long term basis our bad debt performance. In the short term, these more aggressive practices have some impact on our bad debt.
>
> . . . .
>
> In terms of basic timing, you know, bad debt has been the subject of kind of intense focus and scrutiny throughout the industry for a period of time and, you know, we've always looked at our collection experience and our results there as being an important aspect to the operations. (Emphasis added).

281. In response, analysts praised the Company for a "superb quarter" (October 22, 2003 CIBC World Markets Report). CEC's stock price increased from $46.15 per share, its closing price on October 21, to close at $49.50 per share on October 22, 2003.

282. On November 13, 2003, the Company filed its quarterly report on Form 10-Q for the third quarter of 2003 with the SEC (the "3Q03 Report"). The 3Q03 Report reiterated the financial information contained in the October 21, 2003 press release regarding revenues, earnings, and bad debt ratio, and was signed and certified by defendants Larson and Pesch.

283. In addition, in the 3Q03 Report, the Company represented that the financial information contained therein was prepared in accordance with GAAP and fairly presented the Company's results, stating as follows in relevant part:

> The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X . . . . In the opinion of management, all adjustments considered necessary for a fair presentation have been included.

284. The representations contained in the October 21, 2003 press release, October 22, 2003 conference call, and 3Q 03 Report regarding the Company's financial results and business for its 2003 third quarter were false and misleading, for the following reasons:

(a) Reported revenues and earnings were overstated.

(i) As noted, the Company improperly inflated revenues generated by its Culinary and Health Education programs in violation of GAAP.

(ii) Revenues and earnings generated by the Company's recourse loans made to high risk students pursuant to loan agreements with Sallie Mae and Wachovia were overstated. CEC recognized revenues in connection with the full amount of these recourse loans, even though due to their high risk nature, collectibility of the full amount of those revenues was not reasonably assured.

(b) The bad debt expense as a percentage of revenue was understated as a result of the understatement of allowances described in paragraphs 38 to 87 above.

(c) The precise amount of the overstatement of CEC's revenues, earnings, starts and student population, and understatement of its bad debt ratio is within the exclusive knowledge of defendants and is subject to discovery.

(d) Defendants falsified student and other records in order to overstate reported starts and total student population as described in paragraphs 129 to 219 above;

(e) By virtue of the false financial information described above, the Company's representation in the 3Q03 Report that the financial statements " . . . have been prepared in accordance with generally accepted accounting principles . . . " and that " . . . all adjustments considered necessary for a fair presentation have been included . . . " were false and misleading.

The Rumblings Begin About CEC – CEC Quickly and Falsely Denies Allegations of Wrongdoing

285. On November 11, 2003, the *Bergen Record*, a local New Jersey newspaper, reported that a former director of CEC's Gibbs College in New Jersey had alleged in a wrongful termination action that the school routinely conferred degrees on students who did not complete required courses or attend mandatory internships. The former director alleged that she was terminated after repeatedly complaining to her supervisors about the fraudulent business practices she regularly witnessed at the school.

286. On November 17, 2003, the Company issued a press release denying the allegations, stating that "[t]he company believes the lawsuit is without merit and intends to vigorously defend itself." The Company's stock price plummeted on the news, falling from $52.70 per share on November 14, 2003 to $42.56 per share on November 17 (the next trading day), a one-day drop of 19.2%. However, CEC's stock price rebounded over the next few weeks as the market shrugged off the allegations in the lawsuit as isolated and unlikely to have a materially negative impact the Company's overall operations, consistent with the Company's representations regarding the matter.

287. Then, on December 3, 2003, *Bloomberg News* reported that a former registrar at CEC's Brooks Institute of Photography charged that officials at that school acted improperly to inflate enrollment and pass regulatory reviews. The Company promptly issued a strongly worded rebuttal denying the allegations. Nevertheless, the Company's shares quickly dropped from $54.76 on December 2, 2003 to $39.48 on December 3, 2003. Shortly after this disclosure, the first of the

lawsuits alleging that defendants violated the securities laws (and which have been consolidated into this action) was filed.

Fourth Quarter and Year End 2003

288. On February 3, 2004, CEC issued a press release again announcing "record" financial results for the fourth quarter and 2003 fiscal year ended December 31, 2003. In that release, CEC reported fourth quarter revenue of $371.3 million, up 63% from $228.2 million for the 2002 fourth quarter, with 2003 fourth quarter net income of $53.4 million or $.51 per diluted share, up 72% from 2002 fourth quarter net income of $31 million or $.32 per diluted share. CEC reported 2003 revenue of $1.19 billion, an increase of 52% from 2002 revenue of $780.1 million, with 2003 full year net income of $119.2 million or $.19 per share, up 77% from 2002 net income of $67.5 million or $.71 per diluted share.

289. In the February 3, 2003 press release, the Company also reported:

> Bad Debt Expense was 5.1 percent of total revenue for the quarter ended December 31, 2003, compared with 4.8 percent for the quarter ended September 30, 2003 and 3.7 percent for the quarter ended December 31, 2002.

290. In the February 3, 2004 press release, CEC also reported fourth quarter 2003 new student starts of 22,750, an increase of 74% from 13,100 for the same period in the prior year. Total student population on January 31, 2004 was reported at approximately 83,200, up 63% from approximately 51,100 on January 31, 2004.

291. In the February 3, 2004 press release, defendant Larson stated:

> We are very pleased with our fourth quarter and year-end 2003 results. Our marketing message continues to reach students throughout our global network, as demonstrated by our strong population growth and our strong fourth quarter lead flow, which was up more than 70 percent compared to the same period last year.

292. During a conference call with analysts on February 4, 2004, defendant Larson reported the 2003 fourth quarter and year-end revenues, earnings, starts, and total population numbers, and defendant Pesch repeated the reported bad debt ratio.

293. Analysts reacted positively to these disclosures. A February 4, 2004 Credit Suisse First Boston report noted that the Company "reported strong fourth quarter results." The market reaction to the disclosures was strong. CEC stock, which closed at $48.59 per share on February 3, 2004, closed at $52 on February 4, 2004.

294. On March 12, 2004, CEC filed its Form 10-K for the period ended December 31, 2003 ("2003 10-K"). The 2003 10-K reiterated the financial and other information contained in the February 3, 2004 press release regarding revenues, earnings, and bad debt ratios, and was certified as being in compliance under the Sarbanes-Oxley Act by defendants Larson and Pesch.

295. Under the section of the 2003 10-K labeled "Critical Accounting Policies," defendants made the following representations:

> **Revenue Recognition**
>
> Critical Accounting Policies
>
> Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting policies generally accepted in the United States.
>
> **Allowance for Doubtful Accounts**
>
> Based upon past experience and judgment, we establish an allowance for doubtful accounts with respect to tuition receivables. In establishing our allowance for doubtful accounts, we consider, among other things, a student's status (in-school or out-of-school), whether or not additional financial aid funding will be collected from Title IV Programs or other sources, whether or not a student is currently making payments, and overall collections history. Changes in trends in any of these areas may impact the allowance for doubtful accounts.

> Our historical bad debt expense as a percentage of revenue for the years ended December 31, 2003, 2002, and 2001 was 4.5%, 3.7%, and 3.3%, respectively.

296. As noted also in the 2003 10-K:

> Bad debt expense, which is included in general and administrative expense, increased $11.3 million or 63.5%, from $17.8 million in 2001 to $29.1 million in 2002, and bad debt expense as a percentage of revenue is primarily attributable to a greater number of students taking higher priced programs, resulting in a decrease in government funding available for students as a percentage of cash receipts. The increasing gap between program costs and available financial aid funding requires many of our students to enter into payment arrangements with larger monthly payments and terms that may extend beyond their scheduled graduation dates. In addition, a higher rate of attrition caused a larger portion of our receivables to be due from students who did not complete their programs. These students represent a greater risk than do those who complete their programs.

297. As with the 2002 10-K, CEC emphasized that the placement of graduates was critical to attract new students, and further stated:

> Based on information collected by us from graduating students and employers, we believe that of the 23, 488 CSU students and 885 OEG students who graduated from our schools during the academic year beginning July 1, 2002 and ended June 30, 2003, 92.8% and 97.3%, respectively, of the 20,903 CSU available graduates and 847 OEG available graduates obtained employment in their fields of study, or in related fields of study. This excludes students who are continuing their education, in active military service, are medically unable to work, are deceased or incarcerated, and students from foreign countries who are legally ineligible to work in the U.S. Our CSU placement results include the effect of our 2003 acquisition of Whitman Education Group, Inc. (*Id.* at 16).

298. The 2003 10-K also disclosed that on January 7, 2004, the Company was informed that the SEC was conducting an inquiry concerning the Company.

299. The representations contained in the February 3, 2004 press release, February 4 conference call with analysts, and 2003 10-K, regarding the Company's financial results and

business for its 2003 fourth quarter and year-end results were false and misleading, because of the following reasons:

(a) Reported revenues and earnings were overstated.

(i) As noted in paragraph 331, below, the Company improperly, and in violation of GAAP, inflated revenues and earnings generated by its Culinary and Health Education programs. On February 15, 2005, the Company disclosed that it was restating revenues and earnings as a result of the erroneous manner in which it treated revenue generated from these programs; that in fact it did not generate 2003 revenues and earnings of $1,186,609,000 and $119,168,000 as reported in the February 3, 2004 press release and 2002 Form 10-K, but only revenues and earnings of $1,177,987,000 and $112,804,000, respectively.

(ii) Revenues and earnings generated by the Company's recourse loans made to high risk students pursuant to loan agreements with Sallie Mae and Wachovia were overstated. CEC recognized revenues for the full amount of these recourse loans, even though due to their high risk nature, collectibility of those loans was not reasonably assured. The precise amount of the resulting overstatement of revenues and earnings is subject to further discovery.

(b) The bad debt expense ratio was understated as a result of the understatement of allowances described in paragraphs 38 to 87 above;

(c) By virtue of the false financial information described above, the Company's representation in the 2003 10-K that the financial statements " . . . have been prepared in accordance with accounting principles generally accepted in the United States . . . ."

(d) The defendants had falsified student and other records so as to overstate the reported starts, total student population, and placement ratio, the precise amount of overstatement of reported starts, total student population, and placement rates, and understatement

of bad debt ratio is within the exclusive knowledge of defendants and subject to further discovery, the precise amount of such overstatements and understatement being subject to further discovery.

The First Quarter of 2004

300. On April 20, 2004, CEC issued a press release announcing its "record" financial results for the 2004 first quarter ended March 31, 2004. In the April 20, 2004 press release, CEC reported revenue of $402.8 million and net income of $41.8 million or $.40 per diluted share, compared to revenue of $245.5 million and net income of $19.2 million or $.20 per share for the 2003 first quarter.

301. In the April 20, 2004 press release, defendant Larson stated: "[CEC] is off to a great start in 2004. We achieved significant growth in student population, and lead flow more than doubled, compared to last year's first quarter."

302. The April 20, 2004 press release also noted:

> Bad Debt Expense was 4.9 percent of total revenue for the quarter ended March 31, 2004, compared with 3.8 percent for the quarter ended March 31, 2003 and 5.1 percent for the quarter ended December 31, 2003.

303. CEC stated in the April 20, 2004 press release that first quarter 2004 new student starts rose 83% to approximately 26,700, up from approximately 14,600 for the same period in 2003. Total student population was expected to be 85,300 on April 30, 2004, up 57% from approximately 54,400 on April 30, 2003, of which 12,100 students were attributable to the Whitman acquisition.

304. During an April 2004 conference call with analysts, Larson reaffirmed reported first quarter revenues, earnings, starts, and student population, and Pesch reaffirmed the reported bad debt ratio.

305. Analysts expressed delight with these results: "Holy Outperformance Batman; 1Q Blowout" (April 21, 2004 Credit Suisse First Boston Report); "Magna Cum Laude

Earnings Distinction" (April 21, 2004 Jefferies & Company Report). The market price of CEC's stock again rose dramatically, from its closing price of $62.50 on April 20, 3004, to $70.66 on April 21, 2004.

306. On May 7, 2004, CEC filed its Form 10-Q for the first quarter ended March 31, 2004 ("1Q04 Report") which reiterated the financial information contained in the April 20, 2004 press release regarding revenues, earnings, and bad debt ratios. The 1Q04 Report was signed and certified by defendants Larson and Pesch.

307. The 1Q 04 also contained the following representation:

> The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X . . . . In the opinion of management, all adjustments considered necessary for a fair presentation have been included.

308. The representations contained in the April 20, 2004 press release, April 2004 conference call with analysts, and 1Q 04 Report regarding the Company's financial results and business for its 2004 first quarter were false and misleading, because of the following reasons:

(a) Reported revenues are earnings were overstated.

(i) As noted, the Company improperly inflated revenues and earnings generated by its Culinary and Health Education programs in violation of GAAP.

(ii) Revenues and earnings generated by the Company's recourse loans made to high risk students pursuant to loan agreements with Sallie Mae, Wachovia and Stillwater were overstated. CEC recognized revenues in connection with the full amount of those recourse loans, even though due to their high risk nature, collectibility of the full amount of the loans was not reasonably assured.

(b) The bad debt expense as a percentage of revenue was understated as a result of the understatement of allowances for the reasons described in paragraphs 38 to 87, above.

(c) By virtue of the false financial information described above, the Company's representation in the 1Q04 Report that the financial statements " . . . have been prepared in accordance with generally accepted accounting principles . . ." and that " . . . all adjustments considered necessary for a fair presentation have been included . . ." were false and misleading.

(d) Defendants falsified student and other records so as to overstate the reported starts, and total student population.

(e) The precise amount of the overstatement of the revenues, earnings, starts, total student population and understatement of bad debt ratio is subject to further discovery.

The Second Quarter of 2004

309. On July 27, 2004, CEC issued a press release announcing "record" results for the 2004 second quarter ended June 30, 2004. The Company reported revenue of $409.4 million and net income of $39.7 million or $.38 per diluted share, compared to revenue of $256.1 million and net income of $19.6 million or $.20 per diluted share for the same quarter in 2003 (adjusting for a 2-for-1 stock split in August 2003).

310. In the July 27, 2004 press release, CEC also reported:

> Bad Debt Expense was 5.1 percent of total revenue for the quarter ended June 30, 2004, compared with 3.9 percent for the quarter ended June 30, 2003 and 4.9 percent for the quarter ended March 31, 2004.

311. According to the July 27, 2004 press release, second quarter 2004 new student starts rose 61% to approximately 20,500, up from approximately 12,700 for the same period in the prior year. Total student population on July 31, 2004 was expected to be approximately 81,000, up 31% from approximately 62,000 on July 31, 2003.

312. During a July 28, 2004 conference call with analysts, Larson reaffirmed reported second quarter revenues, earnings, starts, and student population and Pesch reaffirmed the bad debt reserve ratios.

313. However, in the July 27 press release, CEC indicated that third quarter 2004 results would fall short of the $428 million estimated by Wall Street. Thus, the market price of the Company's stock dropped from $44.50 on July 27 to close at $33.63 on July 28. Analysts nonetheless generally reacted positively to the disclosure of second quarter results, and minimized the resulting drop in the Company's stock price ("Q2 Results Solid Overall; Sell-Off is Overdone," maintained a July 28, 2004 Piper Jaffrey & Co. Report).

314. On August 9, 2004, CEC filed its Form 10-Q for the second quarter ended June 30, 2004 ("2Q04 Report"), which reiterated the financial information regarding revenues, earnings, and bad debt ratios contained in the July 27, 2004 press release. The 2Q04 Report was certified and signed by defendants Larson and Pesch.

315. The 2Q 04 Report represented that:

> The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10Q and Article 10 of Regulations S-X . . . . In the opinion of management all adjustments considered necessary for a fair presentation have been included and are of a normal recurring nature.

316. The representations contained in the July 27, 2004 press release, July 2004 conference call with analysts and 2Q 04 Report regarding the Company's financial results and business for its 2004 second quarter were false and misleading, because of the following reasons:

(a) Reported revenues are earnings were overstated.

(i) As noted above, the Company improperly inflated revenues and earnings generated by its Culinary and Health Education programs in violation of GAAP.

(ii) Revenues and earnings generated by the Company's recourse loans made to high risk students pursuant to loan agreements with Sallie Mae, Wachovia and Stillwater were overstated. CEC recognized revenues for the full amount of these recourse loans,

even though due to their high risk nature, collectibility of the entire amount of the loans was not reasonably assured.

(b) The bad debt expense as a percentage of revenue was understated as a result of the understatement of allowances for the reasons stated in paragraphs 38 to 87, above.

(c) By virtue of the false financial information described above, the Company's representation in the 2Q04 Report that the financial statements " . . . have been prepared in accordance with generally accepted accounting principles . . . " and that " . . . all adjustments considered necessary for a fair presentation have been included . . . " were false and misleading.

(d) Defendants falsified student and other records so as to overstate the reported starts, and total student population.

317. The precise amount of the overstatement of revenues, earnings, starts and student population, and understatement of bad debt ratio is within the exclusive knowledge of defendants and subject to further discovery.

318. On September 28, 2004, CEC announced that its Board of Directors had formed a special committee on June 30, 2004 to conduct a "thorough and independent investigation" of allegations of securities laws violations made against the Company. The Special Committee ultimately concluded that no improprieties had been committed by "senior Company management."

319. On September 2, 2004, CEC announced that the U.S. Justice Department was investigating the Company.

The Third Quarter of 2004

320. On October 26, 2004, CEC issued a press release announcing "Quarterly Revenue up 39% and Net Income Up 60%; 3Q Starts Up 28%; Total October Student Population Up 22%; Online Population Up 125%." Specifically, for the third quarter ended September 30,

2004, the Company reported revenue of $438.7 million and net income of $43 million or $.41 per diluted share, compared to revenue of $315.7 and net income of $26.9 million or $.26 per diluted share for the same period in the prior period.

321. In the October 26, 2004 press release, CEC also noted:

> Bad Debt Expense was 5.5 percent of total revenue for the quarter ended September 30, 2004, compared to 4.8 percent for the quarter ended September 30, 2003 and 5.2 percent for the quarter ended June 30, 2004.

322. The October 26, 2004 press release further reported third quarter 2004 new student starts at approximately 33,500, up 28% from approximately 26,100 for the same period in the prior year; and that total student population on October 31, 2004 was expected to be approximately 97,300, up 22.4% from approximately 79,500 on October 31, 2003.

323. During a conference call with analysts on October 26, 2004, defendant Larson repeated the previously reported revenues, earnings, starts and total student population, and defendant Pesch repeated the previously reported bad debt ratio.

324. Analysts viewed third quarter results as "strong" (October 27, 2004 JP Morgan Report) or "solid" (October 27, 2004 William Blair & Co. Report), and CEC stock rose from its closing price on that day of $27.94 per share, to close at $31.10 on October 27, 2004.

325. CEC's third quarter financial results were reiterated in a Form 10-Q filed on November 3, 2004 ("3Q04 Report"). The 3Q04 Report was certified and signed by defendants Larson and Pesch and represented it had been prepared in accordance with GAAP.

326. The 3Q04 Report also made the following representations:

> The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions of Form 10Q and Article 10 of Regulation X-X . . . . In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included.

327. The representations contained in the October 26, 2004 press release, October 26 conference call and 3Q 04 Report regarding the Company's financial results and business for its third quarter of 2004 were false and misleading, because of the following reasons:

(a) Reported revenues are earnings were overstated.

(i) As noted above, the Company improperly inflated revenues and earnings generated by its Culinary and Health Education programs in violation of GAAP.

(ii) Revenues and earnings generated by the Company's recourse loans made to high risk students pursuant to loan agreements with Sallie Mae, Wachovia and Stillwater were overstated. CEC recognized revenues for the full amount of these recourse loans, even though due to their high risk nature, collectibility of the full amount of the loans revenues was not reasonably assured.

(b) The bad debt expense as a percentage of revenue was understated as a result of the understatement of allowances for the reason described above.

(c) By virtue of the false financial information described above, the Company's representation in the 3Q04 Report that the financial statements " . . . have been prepared in accordance with generally accepted accounting principles . . . " and that " . . . all adjustments considered necessary for a fair presentation have been included . . . " were false and misleading.

(d) Defendants falsified student and other record so as to overstate the reported starts and total student population.

328. The precise amount of the overstatement of revenues, earnings, starts, and student population, and the understatement of the bad debt ratio is subject to further discovery.

DEFENDANTS FINALLY ADMIT THAT CEC OVERSTATED REVENUES AND EARNINGS AND REPORT AN $18.9 MILLION "CHARGE" TO ALLOWANCES

The Fourth Quarter and Year End of 2004

329. On February 15, 2005, CEC issued a press release announcing its financial results for the 2004 fourth quarter and year ended December 31, 2004. The Company announced fourth quarter revenue of $485.9 million and net income of $59.8 million or $.57 per diluted share compared to revenue of $366.4 million (restated) and net income of $50.7 million or $.49 per diluted share.

330. The February 15, 2005 press release indicated that CEC's financial results included: i) a restatement due to a change in CEC's method of revenue recognition related to its Culinary and Health education externships for the financial periods 2000 through 2004; and ii) what the Company labeled a 2004 fourth quarter "charge" of $18.9 million for its estimate of the allowance for doubtful accounts, which represented $.11 per diluted share in the quarter.

331. With respect to the externships restatement, CEC stated in the February 15, 2005 press release that it had:

> . . . changed its method of revenue recognition related to its Culinary and Health Education externships. These student externships are required to be taken at the end of certain academic programs, following the conclusion of in-school instruction, in order to satisfy graduation requirements. The new revenue recognition method recognizes tuition revenue through the end of the student's externship period, while the prior practice recognized revenue only over the period of in-school academic instruction. This change, as shown in the attached financial tables, results in a restatement of the company's financial statements for 2000 through 2004. The full-year and fourth quarter 2004 restatement resulted in a non-cash reduction of $11.5 million and $3.4 million in revenue and $0.06 and $0.02 per diluted share after taxes, respectively. This revenue will be earned and recognized in subsequent periods net of student refunds.

332. In connection with the $18.9 million "charge," defendants maintained as follows:

> In connection with reporting its results for the fourth quarter of 2004, the company increased its estimates for its allowance for doubtful accounts. The company periodically evaluates its receivables and establishes the allowance for doubtful accounts based on methodologies and assumptions, which the company reviews and modifies based on emerging information. The company recently analyzed its receivables collection rates together with change in financial aid funding sources and improved analytical tools, and determined it should increase its estimate for its allowance for doubtful accounts. As a result, the company recorded a non-cash, pre-tax charge for the change in accounting estimate of its allowance for doubtful accounts of approximately $18.9 million in the fourth quarter of 2004. This change in estimate does not affect prior period financial statements. This additional charge, included in General and Administrative expense, less the related tax benefit of $7.6 million, represented $0.11 per diluted share in the quarter.

333. Even on its stated terms, the "charge" and restatement disclosed in the Company's February 15 press release are material. The effect of the restatement is to reduce 2004 net income by $6.9 million, or $0.06 per share; reduce 2003 net income by $6.4 million, or $0.07 per share; and to reduce 2002 net income by $5.7 million, or $0.06 per share. The combined effect of the "charge" and the restatement is to reduce 2004 net income by $18 million, or $0.17 per share.

334. On this news, CEC stock fell from a closing price of $39.21 on February 15, 2005, to close at $37.19 on February 16, 2005 and as of March 2, 2005, closed at $34.78.

335. On March 16, 2005, the Company filed its 2004 10-K. The 2004 10-K repeated the information described above regarding the Company's 2004 financial results; the "charge" and restatement; and the present status of various investigations, including the US Attorney investigation.

336. The 2004 10-K also noted that CEC has written off an astounding *$92 million* of its receivables, an extraordinary amount compared to its historical write-off experience. The immense magnitude of the write off, which is almost double the size of CEC's report allowance at the beginning of 2004, and more than double the 2003 write off even though gross accounts

receivable actually declined slightly during 2004, supports the fact that CEC historically failed to timely and accurately report the amount of its allowances and bad debt ratios.

337. The 2004 10-K also provided an update on the various accreditation and regulatory problems facing the Company, including: (a) on March 11, 2005, the Accrediting Commission of Career Schools and College of Technology directed the Company's Le Cordon Bleu College of Culinary Arts Atlanta to show cause why its accreditation should not be withdrawn on the basis of its untimely filing a Program Advisory Committed Report requested by the regulatory agency; (b) in June 2004, the Accrediting Commission for Community and Junior Colleges of the Western Association of Schools and Colleges ("ACCJC") advised Brooks College that, following its reaccredidation review, Brooks was placed on Probation. In January 2005, ACCJC continued the Probation status for Brooks College; (c) in February 2004, the Accrediting Bureau of Health Education Schools ("ABHES") conducted an unannounced visit of Sanford Brown Institute ("SBI"). In October 2004, ABHES notified Sanford Brown that as a result of concerns identified during the September site visit, SBI was directed to show cause why its current grant of accreditation should not be withdrawn.

338. In addition, in June 2004, the Commission on Colleges of the Southern Association of Colleges and Schools ("SACS") placed American InterContinental University of Atlanta, Georgia, on Warning status for six months after finding failure to comply with Comprehensive Standard 3.3.1 of SACS's Principles of Accreditation.

339. In December 2005, SACS placed AIU on Probation status for one year. SACS defines Probation, in part, as

> the Commission's most serious sanction, short of loss of membership, and can be imposed on an institution for failure to correct deficiencies of significant non-compliance with the Core Requirements or the Comprehensive Standards of the *Principles of Accreditation* of the Commission, failure to make timely and significant progress toward correcting the deficiencies, or failure to comply with

> Commission policies and procedures. The imposition of Probation is an indication of the gravity of non-compliance with the *Principles*.

340. In its December 14, 2005 Disclosure Statement Regarding the Status of American InterContinental University, SACS listed fifteen Principles with which AIU had failed to comply, beginning with the Prologue to the Principles ("***Integrity of student academic records and accuracy in recruiting and admission practices***") and including standards covering program content, governance and administration, information to consumers, student complaint procedures, and ***accuracy in recruitment materials and presentations***.

SCIENTER ALLEGATIONS

341. As alleged herein, defendants acted with scienter in that they knew that the statements or representations made in the press releases, public filings, meetings with analysts issued or disseminated in the name of the Company were materially false and misleading; knew that such statements 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 or documents as primary violations of the federal securities laws. As set forth elsewhere herein in detail, defendants, by virtue of their receipt of information reflecting the true facts regarding CEC, their control over, and/or receipt and/or modification of the Company's allegedly materially misleading misstatements and/or their associations with the Company which made them privy to confidential proprietary information concerning CEC, participated in the fraudulent scheme alleged herein.

342. As described in greater detail above, and as reflected in the March 28, 2003 Licar e-mail as well as statements made by Witnesses 1, 2, 3, 4, 12, 13 and 18, the defendants devised a system whereby school representatives would be informed by the CEC prior to the end of a quarter that their particular school was then reporting bad debt ratios in excess of the amounts projected by the Company for that particular quarter; corporate representatives would then work

with the schools to take steps that certain students make nominal payments so that, under the Company's template, allowances for doubtful accounts would be reduced or eliminated. These steps included obtaining nominal payments from students to eliminate or reduce reported allowances, and improperly classifying students as "in school" to minimize reported allowances. These steps were taken so as to intentionally understate allowances and bad debt ratios in order to maximize profitability and to insure that the public perception of the Company in the marketplace would not be compromised. These actions were taken under the supervision of the Individual Defendants; as noted above, Pesch, and in certain instances, Larson, would receive copies of the communications between corporate and school executives which reflected these actions being taken. In addition, corporate internal audit reports reflecting the overstatement of allowances and these reports were made available to the Individual Defendants.

343. The allegations based on Witnesses described above contain multiple indicators of scienter:

(i) The sheer number of improper operational and accounting manipulations employed during the Class Period.

(ii) The duration over which the allegations of improper accounting were perpetrated.

(iii) The types of accounting manipulations employed – as detailed herein, the alleged accounting improprieties did not occur as a result of good faith differences in accounting judgments, or interpretations of complicated or vague accounting rules. The alleged violations of accounting rules and precepts violated by CEC were long established, basic accounting standards and concepts, such as the most basic rule of recording revenue or creating allowances.

(iv) Improper accounting and internal control weaknesses were widespread, pervasive, systemic, and not limited to one educational center.

(v) Experienced accounting managers directed the alleged improper accounting – CEC's financial officers knew what they were doing. They were experienced and seasoned financial professionals.

344. As noted in the 2004 10-K, the Larsen and Pesch had admitted that ". . . a material weakness existed in our internal control over financial reporting as of the date of this Report and, to this extent, our disclosure controls and procedures were not effective to provide reasonable assurance that (i) information required to be disclosed by us in this Report was recorded, processed, summarized and reported within the time periods required to be disclosed by us is in this Report where recorded, processed summarized and reported within the time periods specified in the SEC's rules and forms . . ." *Id.* at 75. The Individual Defendants' conclusion that there was a material weakness in the internal controls supports the inference that these defendants, at a minimum, acted recklessly in reporting financial and business reports to the investing public during the Class Period.

345. In addition, the Individual Defendants were strongly motivated to commit the wrongdoing alleged herein in order to sell their own shares of the Company's common stock at artificially inflated prices. As is illustrated by the following chart, the Individual Defendants sold a total of 1,092,000 shares of CEC common stock during the Class Period, reaping gross proceeds in excess of $47.7 million. Other than the exercise of options, the Individual Defendants made no purchases of CEC common stock. The following insider trading data is adjusted to reflect the 2:1 stock split effective August 25, 2003:

John M. Larson (CEO, President, Chairman):

Date	# of Shares	Price Per Share ($)	Total Value ($)
4/25/02	6,000	$22.30	$133,800
4/25/02	6,000	$22.27	$133,620
4/25/02	90,000	$22.25	$2,002,500
4/25/02	20,000	$22.40	$447,900
4/25/02	37,000	$22.38	$827,875
4/25/02	15,000	$22.39	$335,775
4/26/02	26,000	$22.18	$576,680
9/6/02	100,000	$22.65	$2,265,000
9/6/02	50,000	$22.58	$1,128,750
9/6/02	50,000	$22.50	$1,125,000
4/25/03	10,000	$28.03	280,300.01
4/25/03	10,000	$28.03	280,250.00
4/25/03	20,000	$28.05	560,999.98
4/25/03	11,000	$28.25	310,750.00
4/25/03	16,000	$28.28	452,399.99
4/25/03	3,000	$28.28	84,840.00
4/28/03	20,000	$28.11	562,200.01
4/28/03	30,000	$28.26	847,800.01
4/28/03	4,000	$28.33	113,300.00
4/28/03	15,000	$28.40	425,999.99
4/28/03	5,000	$28.41	142,025.00
4/28/03	16,000	$28.42	454,640.01
4/28/03	20,000	$28.56	571,100.01
4/28/03	10,000	$28.60	286,000.00
4/28/03	10,000	$29.00	290,000.00
7/25/03	10,000	$40.99	409,900.02
7/25/03	10,000	$40.97	409,700.01
7/25/03	2,000	$41.26	82,520.00
7/25/03	44,000	$41.15	1,810,600.07
7/25/03	4,000	$41.13	164,500.00
7/25/03	20,000	$41.12	822,300.03
7/25/03	10,000	$41.11	411,100.01
7/25/03	50,000	$41.10	2,054,999.92
7/25/03	10,000	$41.08	410,750.01
7/25/03	40,000	$41.07	1,642,799.99
8/19/03	200,000	$45.75	9,150,000.00
4/23/04	200,000	$67.40	13,480,000.31
Total	**1,200,000**		**$45,488,675.38**

Patrick K. Pesch (CFO, Treasurer, Secretary):

Date	# of Shares	Price Per Share ($)	Total Value ($)
4/30/02	10,000	$22.51	$225,050
5/3/02	20,000	$22.80	$456,000
5/3/02	25,000	$22.79	$569,625
5/3/02	15,000	$22.78	$341,625
5/3/02	5,000	$22.65	$113,250
5/3/02	3,000	$22.63	$67,875
5/3/02	10,000	$22.50	$225,000
5/3/02	20,000	$22.58	$451,500
5/3/02	2,000	$22.55	$45,100
5/6/02	18,000	$22.17	$398,970
4/25/2003	36,800	$28.50	1,048,800.00
4/25/2003	10,000	$28.55	285,500.00
4/25/2003	1,200	$29.00	34,800.00
4/28/2003	16,000	$28.50	456,000.00
4/28/2003	10,000	$28.63	286,250.00
4/28/2003	10,000	$29.00	290,000.00
4/28/2003	10,000	$29.15	291,500.00
4/28/2003	5,000	$29.05	145,250.00
4/28/2003	5,000	$29.08	145,375.00
4/28/2003	5,000	$29.13	145,625.00
4/28/2003	3,000	$29.10	87,300.00
8/14/2003	160,000	$44.38	7,100,000.00
8/14/2003	20,000	$44.50	890,000.00
Total	**420,000**		**$14,100,395.00**

346. These sales were suspicious in nature, in that they generally followed false and misleading statements issued by the Individual Defendants that artificially inflated the market price of the Company's securities. For example:

(a) On April 22, 2003, the Company issued a press release announcing record setting results for its first quarter of 2003, and Larson and Pesch held a meeting with analysts on that day confirming these results. These disclosures were false and misleading for the reasons set forth in paragraph 226 above. The market price of the Company's stock increased from $26.35 to $28.96, or over 9%.

(b) On April 25 and 28, Larson sold 200,000 shares for over $5,662,605, and on April 25 and April 28, 2003, Pesch sold 112,000 shares for $3,216,400.

(c) On July 22, 2003, the Company issued a press release announcing record results for its second quarter of 2003 , and Larson and Pesch held a meeting with analyst held a meeting with analysts on that day confirming these results. These disclosures were false and misleading for the reasons set forth in paragraph 233 above. The market price of the Company's stock increased from $36.49 to $41.05, or 11%.

(d) On July 25, Larson sold 200,000 shares for over $8,219,170.

(e) On August 18, 2003, *The Wall Street Journal* published an interview with Larson, where he projected record 2003 revenues, referred to the Company's excellent placement rate, sharp increase in the market price of its stock and generally praised the Company. The stock, which had been trading at $44.10 on August 15, rose to $46.35 on August 19.

(f) On August 19, Larson sold 200,000 shares for $9,150,000.

(g) On April 20, 2004, the Company issued a press release announcing record financial results for the fiscal year end 2003. These disclosures were false and misleading for the reasons set forth in paragraph 308 above. The price of the Company's stock increased from $62.50 to $70.66 on April 21, 2004, or almost 12%.

(h) On April 23, 2004, Larson sold 200,000 shares at a price of $67.40 per share, for total proceeds of over $13,480,000.

347. In addition, Nick Fluge, the Company's president of the on-line division, sold 104,000 shares of CEC stock in 2003 (mostly on July 29, 2003) for proceeds of $7,833,798. In 2004, he sold 193,000 shares for proceeds of $8,503,681, mostly on May 27 and May 28, 2004, just weeks before the filing of the amended complaint in this action. (On May 27, 2004, he sold 101,000

shares for proceeds of $6,674,627 and on May 28, 2004, he sold 27,500 shares for proceeds of $1,829,294.)

348. Indeed, in the two-month period leading up to the filing of the Complaint, "ten [CEC] insiders sold a total of about a million shares" for an average price of $66.16 per share. T. Cooke, *Career Education Insiders Shed a Million Shares*, The Wall Street Journal, June 23, 2004 (Exh. F attached). "[T]he ten insiders [including Larson] received proceeds of about $58 million after paying the exercise price for their options." *Id.* Mr. Cooke noted that "[i]nsiders at [CEC] appear as eager to get out of their company's stock as students are to leave on the last day of class." *Id.* Moreover, an analyst who follows the Company stated that "the sellers left themselves with relatively few shares. 'Something has caused them to decide that now is the time to get out.'" *Id.*

349. The foregoing reveals a clear pattern whereby the Individual Defendants would sell huge blocks of their CEC shares shortly after disclosure by them of false information regarding the Company which artificially inflated the market price of those shares.

350. The insiders' fears were well-founded. When the public learned the breadth and detail of the allegations set forth in the Complaint, CEC stock plummeted from $69.52 per share to $56.24 per share in two days (and by June 30, 2004, closed at $45.60 per share).

351. Defendants were further motivated to artificially inflate the Company's results and stock price so that the Company could complete the strategic acquisition of Whitman Education Group, Inc. using its stock as currency. Pursuant to the merger agreement, Whitman shareholders received $6 in cash and 0.138 shares of CEC common stock for each share of Whitman Stock. At this time, CEC stock was trading at the mid-$30 range. The fraud therefore allowed the Company to execute this large acquisition on July 1, 2003 for $245 million, more favorable terms than if the truth about its business practices were known.

352. In addition, the Individual Defendants were motivated to inflate reported financial results so that they could maximize the amount of any bonus received. As set forth in CEC's Schedule 14A, filed on April 20, 2004, at page 14, "Discretionary bonuses for executive officers are directly tied to achievement of specified goals of CEC." These goals included, *in part*, net income, operating income and earnings per share, all of which were artificially inflated by virtue of the defendants' fraud. Indeed, in 2003, the Individual Defendants received bonus compensation which actually *exceeded* their base salary compensation, and was based upon false revenue and earnings that had been disseminated to the investing public.

353. Moreover, the Company is presently subject to ongoing investigations by the U.S. Attorney, the DOE, and other governmental agencies.

CEC Stock Declines During the Class Period
as a Result of Disclosures of the Fraud

354. The market for CEC's common stock was open, well-developed and efficient at all relevant times. As a result of these materially false and misleading statements and failures to disclose, CEC common stock traded at artificially inflated prices during the Class Period. Lead Plaintiff and other members of the Class purchased or otherwise acquired CEC's common stock relying upon the integrity of the market price of the Company's common stock and market information relating to CEC, and have been damaged thereby.

355. During the Class Period, defendants materially misled the investing public, thereby inflating the price of CEC common stock, by publicly issuing false and misleading statements and omitting to disclose material facts necessary to make defendants' statements, as set forth herein not false and misleading, these statements and omissions were materially false and misleading in that they failed to disclose material adverse information and misrepresented the truth about the Company, its business, operations and financial results, as detailed herein. Partial disclosures made by or relating to the Company during the Class Period did not fully disclose the

extent of the Company fraud; indeed, and as noted above, CEC frequently issued strong public denials of information adverse to its interests.

356. At all relevant times, the material misrepresentations and omissions particularized in this Complaint directly or proximately caused or were a substantial contributing cause of the damages sustained by Lead Plaintiff and other members of the Class. During the Class Period, defendants made or caused to be made a series of materially false or misleading statements about CEC's business, financial performance, and results. These material misstatements and omissions created in the market an unrealistically positive portrayal of CEC and its operations and prospects, thus causing the Company's common stock to be overvalued and artificially inflated at all relevant times. Defendants' materially false and misleading statements during the Class Period resulted in Lead Plaintiff and other members of the Class purchasing the Company's common stock at artificially inflated prices, thus leading to their losses when the truth was revealed, and the market was able to accurately value the Company. Among the disclosures that caused CEC stock to decline are the following:

357. On November 11, 2003, the *Bergen Record*, a local New Jersey newspaper, reported that a former director of CEC's Gibbs College in New Jersey had alleged that the school routinely graduated students who did not complete required courses or attend mandatory internships. These allegations were made in a wrongful termination action filed by a former Director of Career Services of Gibbs College Montclair in the Superior Court of New Jersey on November 5, 2003. The former director alleges that she was terminated after repeatedly complaining to her supervisors about the fraudulent business practices she regularly witnessed at the school. The fraudulent practices included the falsification of academic records in colleges operated by CEC in order to continue to receive State of New Jersey and federal funding; and the conferring of degrees upon students who did not complete required courses of study, and in the some cases,

who did not attend classes. Because the story appeared in a local New Jersey daily with very limited circulation, it was not digested by the market and did not immediately affect the Company's stock price.

358. However, on November 17, 2003, the Company issued a press release announcing the filing of the wrongful termination action. In a press release, the Company denied the allegations, stating that "[t]he company believes the lawsuit is without merit and intends to vigorously defend itself." The Company's stock price plummeted on the news, falling from $52.70 per share on November 14, 2003 to $42.56 per share on November 17 (the next trading day), a one-day drop of 19.2%.

359. CEC's stock price rebounded over the next few weeks, apparently accepting the Company's representations regarding the matter.

360. On December 3, 2003, the market learned that additional accusations of wrongdoing had been leveled by a highly-placed employee of a different CEC school in California. On December 3, 2003, *Bloomberg News* reported that the former registrar of CEC's Brooks Institute of Photography in Santa Barbara, California filed a complaint with ACICS alleging that the school falsified student records to ensure that the school passed inspections by accreditation auditors and to increase enrollment. *Bloomberg News* quoted the former registrar as alleging that "***Many staff members have been asked by management to commit forgery, fraud, perjury or whatever is necessary to pass audit inspections.***" (Emphasis added). On December 4, 2003, The Street.com quoted the former registrar as stating that "***officials at the school acted illegally and improperly to inflate enrollment and boost the bottom line.***" (Emphasis added).

361. In reaction to this latest revelation, CEC's stock price plummeted again, falling from $54.76 per share on December 2, 2003 to $39.48 on December 3, 2003, a one-day drop

of 28%, on trading volume of 18.2 million shares -- more than nine times the Company's three month daily average.

362. On June 18, 2004, the Amended Complaint in this action was filed, citing interviews with former employees of CEC schools. The amended complaint, which included statements by more than a dozen former employees, alleged that CEC tampered with student records and manipulated data. Newspaper reports indicated that the new disclosures in this suit caused CEC stock to fall 16%.

363. CEC stock, which closed at $67.03 on June 17, closed at $56.24 per share on record volume of 31,588,000 shares (compared with volume of 5,341,100 on the prior day).

364. On June 22, 2004 after the close of the market, CEC announced that the Midwest Regional Office of the SEC issued a formal order of investigation.

365. On June 23, 2004, CEC stock closed at $44.11 per share, compared with the prior day's closing price of $58.58 per share.[20]

366. In the face of intense public scrutiny, on July 24, 2004, CEC issued a press release after market close in July 27, 2004 announcing its financial results for the second quarter ended June 30, 2004. In the press release, CEC announced that second quarter profit had more than doubled, but that revenue guidance for the third quarter would be lower than previously projected.

367. On this news, CEC stock fell from a closing price of $44.50 per share on July 27, 2004 to close at $33.63 per share on July 28, 2004, with volume in excess of 38 million shares.

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[20] Recently, the Midwest Regional Office of the SEC announced that it was recommending that no enforcement action against the Company be taken. However, this does not constitute a finding on the merits.

368. On September 28, 2004, after market close, CEC announced it formed a special committee to investigate allegations of securities laws violations. The following day, CEC stock closed at $29.02, compared with the prior day's closing price of $27.90.[21]

369. On February 15, 2005, again after market close, CEC issued a press release announcing financial results for the fourth quarter and fiscal year end of 2004. In this press release, CEC announced it would be taking a charge of $18.9 million to increase its estimate for doubtful accounts. In addition, CEC restated financial statements for 2000 through 2004 for improperly recognizing revenue related to Culinary and Health Education externships and it announced a $92 million write off of bad debt.

370. On this news, CEC stock fell from a closing price on February 15 of $39.21 per share to close at $37.19 per share on February 16, and continued to decline for days after.

Applicability of Presumption of Reliance:
<u>Fraud-on-the-Market Doctrine</u>

371. At all relevant times, the market for CEC's securities was an efficient market for the following reasons, among others:

(i) CEC stock actively traded on the Nasdaq National Market, a highly efficient and automated market;

(ii) As a regulated issuer, CEC filed periodic public reports with the SEC and the Nasdaq;

(iii) CEC regularly communicated with public investors via established market communication mechanisms, including through the regular dissemination of press releases on the national circuits of major newswire services and through other wide-ranging

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[21] Although the Special Committee ultimately found no wrongdoing by senior management, it did find improper acts by lower level employees.

public disclosures, such as communications with the financial press and other similar reporting services; and

(iv) CEC was followed by numerous securities analysts employed by major brokerage firms who wrote reports which were distributed to the sales force and certain customers of their respective brokerage firms. Each of these reports was publicly available and entered the public marketplace.

372. As a result of the foregoing, the market for CEC's securities promptly digested current information regarding CEC from all publicly available sources and reflected such information in CEC's stock price. Under these circumstances, all purchasers of CEC's securities during the Class Period suffered similar injury through their purchase of CEC's securities at artificially inflated prices and a presumption of reliance applies.

No Safe Harbor

373. The statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the allegedly false statements pleaded in this complaint. The specific statements pleaded herein were not identified as "forward-looking statements" when made. To the extent there were any forward-looking statements, there were no meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the purportedly forward-looking statements. Alternatively, to the extent that the statutory safe harbor does apply to any forward-looking statements pleaded herein, defendants are liable for those false forward-looking statements because at the time each of those forward-looking statements was made, the particular speaker knew that the particular forward-looking statement was false, and/or the forward-looking statement was authorized and/or approved by an executive officer of CEC who knew that those statements were false when made.

FIRST CLAIM

Violation of Section 10(b) of
The Exchange Act and Rule 10b-5
Promulgated Thereunder Against All Defendants

374. Lead Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

375. During the Class Period, CEC and the Individual Defendants, and each of them, carried out a plan, scheme and course of conduct which was intended to and, throughout the Class Period, did: (i) deceive the investing public, including Lead Plaintiff and other Class members, as alleged herein; (ii) artificially inflate and maintain the market price of CEC's securities; and (iii) cause Lead Plaintiff and other members of the Class to purchase CEC's securities at artificially inflated prices. In furtherance of this unlawful scheme, plan and course of conduct, defendants, and each of them, took the actions set forth herein.

376. Defendants (a) employed devices, schemes, and artifices to defraud; (b) made untrue statements of material fact and/or omitted to state material facts necessary to make the statements not misleading; and (c) engaged in acts, practices, and a course of business which operated as a fraud and deceit upon the purchasers of the Company's securities in an effort to maintain artificially high market prices for CEC's securities in violation of Section 10(b) of the Exchange Act and Rule 10b-5. All defendants are sued either as primary participants in the wrongful and illegal conduct charged herein or as controlling persons as alleged below.

377. CEC and the Individual Defendants, individually and in concert, directly and indirectly, by the use, means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct to conceal adverse material information about the business, operations and future prospects of CEC as specified herein.

378. These defendants employed devices, schemes and artifices to defraud, while in possession of material adverse non-public information and engaged in acts, practices, and a course of conduct as alleged herein in an effort to assure investors of CEC's value and performance and continued substantial growth, which included the making of, or the participation in the making of, untrue statements of material facts and omitting to state material facts necessary in order to make the statements made about CEC and its business operations and future prospects in the light of the circumstances under which they were made, not misleading, as set forth more particularly herein, and engaged in transactions, practices and a course of business which operated as a fraud and deceit upon the purchasers of CEC's securities during the Class Period.

379. The Individual Defendants' primary liability, and controlling person liability, arises from the following facts: (i) the Individual Defendants were high-level executives and/or directors at the Company during the Class Period; (ii) the Individual Defendants were privy to and participated in the creation, development and reporting of the Company's internal budgets, plans, projections and/or reports; and (iii) the Individual Defendants were aware of the Company's dissemination of information to the investing public which they knew or recklessly disregarded was materially false and misleading.

380. The 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 such facts, even though such facts were available to them. Such defendants' material misrepresentations and/or omissions were done knowingly or recklessly and for the purpose and effect of concealing CEC's operating condition and future business prospects from the investing public and supporting the artificially inflated price of its securities. As demonstrated by defendants' overstatements and misstatements of the Company's business, operations and earnings throughout the Class Period, defendants, if they did not have actual

knowledge of the misrepresentations and omissions alleged, were reckless in failing to obtain such knowledge by deliberately refraining from taking those steps necessary to discover whether those statements were false or misleading.

381. As a result of the dissemination of the materially false and misleading information and failure to disclose material facts, as set forth above, the market price of CEC's securities was artificially inflated during the Class Period. In ignorance of the fact that market prices of CEC's publicly-traded securities were artificially inflated, and relying directly or indirectly on the false and misleading statements made by defendants, or upon the integrity of the market in which the securities trade, and/or on the absence of material adverse information that was known to or recklessly disregarded by defendants but not disclosed in public statements by defendants during the Class Period, Lead Plaintiff and the other members of the Class acquired CEC securities during the Class Period at artificially high prices and were damaged thereby.

382. At the time of said misrepresentations and omissions, Lead Plaintiff and other members of the Class were ignorant of their falsity, and believed them to be true. Had Lead Plaintiff and the other members of the Class and the marketplace known of the true financial condition and business prospects of CEC, which were not disclosed by defendants, Lead Plaintiff and other members of the Class would not have purchased or otherwise acquired their CEC securities, or, if they had acquired such securities during the Class Period, they would not have done so at the artificially inflated prices which they paid.

383. By virtue of the foregoing, defendants have violated Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder.

384. As a direct and proximate result of defendants' wrongful conduct, Lead Plaintiff and the other members of the Class suffered damages in connection with their respective purchases and sales of the Company's securities during the Class Period.

SECOND CLAIM

Violation of Section 20(a) of
The Exchange Act Against the Individual Defendants

385. Lead Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

386. Each of the Individual Defendants acted as a controlling person of CEC within the meaning of Section 20(a) of the Exchange Act as alleged herein. By virtue of their high-level positions, and their ownership and contractual rights, participation in and/or awareness of the Company's operations and/or intimate knowledge of the statements filed by the Company with the SEC and disseminated to the investing public, the Individual Defendants had the power to influence and control and did influence and control, directly or indirectly, the decision-making of the Company, including the content and dissemination of the various statements which Lead Plaintiff contends are false and misleading. The Individual Defendants were provided with or had unlimited access to copies of the Company's reports, press releases, public filings and other statements alleged by Lead Plaintiff to be misleading prior to and/or shortly after these statements were issued and had the ability to prevent the issuance of the statements or cause the statements to be corrected, as set forth more fully herein.

387. In particular, the Individual Defendants had direct and supervisory involvement in the day-to-day operations of the Company and, therefore, and had the power to control or influence the particular transactions giving rise to the securities violations as alleged herein, and exercised the same.

388. As set forth above, CEC and the Individual Defendants each violated Section 10(b) and Rule 10b-5 by their acts and omissions as alleged in this Complaint. By virtue of their position as a controlling person, the Individual Defendants are liable pursuant to Section 20(a) of the Exchange Act. As a direct and proximate result of CEC's and the Individual Defendants'

wrongful conduct, Lead Plaintiff and other members of the Class suffered damages in connection with their purchases of the Company's securities during the Class Period.

WHEREFORE, Lead Plaintiff prays for relief and judgment, as follows:

A. Determining that this action is a proper class action, and certifying Lead Plaintiff as a class representative under Rule 23 of the Federal Rules of Civil Procedure and Lead Plaintiff's counsel as Class Counsel;

B. Awarding compensatory damages in favor of Lead Plaintiff and the other Class members against all defendants, jointly and severally, for all damages sustained as a result of defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;

C. Awarding Lead Plaintiff and the Class their reasonable costs and expenses incurred in this action, including counsel and expert fees; and

D. Such other and further relief as the Court may deem just and proper.

JURY TRIAL DEMANDED

Lead Plaintiff hereby demands a trial by jury.

Dated: May 1, 2006

/s/ Norman Rifkind

Norman Rifkind
Leigh Lasky
LASKY & RIFKIND, LTD.
350 N. LaSalle Street, Suite 1320
Chicago, Illinois 60610
(312) 634-0057
Fax: (312) 634-0059

Local Counsel for Lead Plaintiff

Jonathan M. Plasse
Louis Gottlieb
Emily C. Komlossy
Christopher J. Keller
LABATON SUCHAROW & RUDOFF LLP
100 Park Avenue
New York, New York 10017-5563
(212) 907-0700

Counsel for Lead Plaintiff and Gordon W. MacKinney

Andrei Rado
MILBERG WEISS BERSHAD & SCHULMAN LLP
One Pennsylvania Plaza
New York, New York 10119
(212) 594-5300

Counsel for Nicholas J. Margaritis

Eric J. Belfi
MURRAY, FRANK & SAILER LLP
275 Madison Avenue
New York, New York 10016
(212) 682-1818

Counsel for Vivian Oh

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