

**UNITED STATES DISTRICT COURT**  
**NORTHERN DISTRICT OF ILLINOIS**  
**EASTERN DIVISION**

AMY COOK, derivatively on behalf of  
CAREER EDUCATION CORP.,

Plaintiff,

v.

GARY E. MCCULLOUGH, STEVEN H.  
LESNIK, LESLIE T. THORNTON, DENNIS  
H. CHOOKASZIAN, DAVID W.  
DEVONSHIRE, PATRICK W. GROSS,  
GREGORY L. JACKSON, MICHAEL J.  
GRAHAM, THOMAS B. LALLY, BRIAN R.  
WILLIAMS, THOMAS G. BUDLONG, and  
THOMAS A. MCNAMARA,

Defendants

-and-

CAREER EDUCATION CORP.,  
a Delaware corporation,

Nominal Defendant.

) Case No.

) **VERIFIED SHAREHOLDER**  
) **DERIVATIVE COMPLAINT FOR:**

- ) **(1) BREACH OF FIDUCIARY DUTY**  
) **(2) ABUSE OF CONTROL**  
) **(3) GROSS MISMANAGEMENT**  
) **(4) UNJUST ENRICHMENT**

) **DEMAND FOR JURY TRIAL**

Plaintiff Amy Cook, derivatively on behalf of Career Education Corporation (“CEC” or the “Company”), files this Verified Shareholder Derivative Complaint against Individual Defendants Steven H. Lesnik, Leslie T. Thornton, Dennis H. Chookaszian, David W. Devonshire, Patrick W. Gross, Gregory L. Jackson, Thomas B. Lally, Thomas A. McNamara, Thomas G. Budlong, and Brian R. Williams (collectively, the “Individual Defendants”) for breaches of their fiduciary duties as directors and/or officers of CEC, gross mismanagement, abuse of control, and unjust enrichment. In support thereof, Plaintiff hereby alleges as follows:

### **NATURE OF THE ACTION**

1. This is a shareholder derivative action which seeks to remedy wrongdoing committed by Career Education Corporation’s senior directors and officers between April 2007 and the present (the “Relevant Time Period”). During this time, the Individual Defendants breached their fiduciary duties as officers and directors of CEC by causing the Company to violate federal and state law regarding the Company’s compliance with Title IV, recruitment of students, representations made by CEC to students and the public regarding student repayment rates and job placement. The defendants also breached their fiduciary duties by falsely representing that CEC maintained adequate internal controls when, in fact, the defendants knew that such controls were materially deficient. The lack of adequate internal controls has caused the Company to violate federal and state law governing operation of the Company’s schools, payment of wages to its employees, and accreditation of its schools. These violations of federal and state law have cost the Company millions of dollars and subjected it to multiple lawsuits.

2. In addition, beginning in November 2010, the Individual Defendants caused the Company to make false and misleading statements to the investing public. CEC’s officers and directors caused the Company to misrepresent that CEC’s student enrollment, revenues, and profits were all growing. But the positive statements were materially false and misleading when made because CEC’s officers and directors failed to disclose that the Company’s purported growth and profits were achieved through an improper course of conduct, including misleading students into enrolling in CEC’s scholastic and educational programs and engaging in other manipulative recruiting tactics. The defendants’ public statements also concealed the material

fact that such recruiting and enrollment violations posed a material risk to accreditation of the Company's schools. Without proper accreditation, CEC's revenues and profits would plunge.

3. Career Education is a Delaware corporation with its principal place of business in Schaumburg, Illinois. It is a publicly-traded company and its stock trades on the NASDAQ Exchange under the ticker "CECO." CEC is one of the largest publicly-traded companies offering "for-profit" educational services to students, primarily through "online" Internet schools. According to the Company's most recent Form 10-Q filed with the SEC on November 9, 2011, CEC has over 100,000 current students enrolled at its schools, which include American InterContinental University ("AIU"); Brooks Institute; Colorado Technical University ("CTU"); Harrington College of Design; INSEEC Group ("INSEEC") Schools; International University of Monaco ("IUM"); International Academy of Design & Technology ("IADT"); Istituto Marangoni; Le Cordon Bleu North America ("LCB"); and Sanford-Brown Institutes and Colleges.

4. The federal government, through Title IV of the Higher Education Act, 20 U.S.C. § 1070 *et seq.* ("Title IV"), administers billions of dollars in student financial assistance to students at both non-profit and for-profit educational institutions. When students default on the federal student loans, the federal government and the U.S. taxpayers are responsible for the bill. While students at for-profit institutions represent only 9% of all college students, they receive roughly 25% of all Federal Pell Grants and Loans, and are responsible for 44% of all student loan defaults. Based on the disproportionate percentage of student loan defaults associated with for-profit educational institutions, the federal government instructed the United States General Accounting Office ("GAO") to investigate for-profit colleges.

5. Institutions receiving Title IV funding are required to meet certain regulations, including a limit on the ratio of government loan funds to cash revenue (the "90/10 Rule"), limits on the percentage of their student borrowers who default on these loans (the "Cohort Default Rate"), and other regulatory requirements on how prospective students are recruited. Institutions that violate these requirements risk losing their Title IV accreditation.

6. On August 3, 2010, the GAO issued a report concluding that for-profit educational institutions, like CEC, had engaged in an illegal and fraudulent course of action designed to recruit students and over-charge the federal government for the cost of such education.

7. On August 13, 2010, the DOE released data showing estimated student loan repayment rates. Under the DOE's proposed "gainful employment" rule, for-profit educational providers would fully qualify for federal aid in one of two ways: either more than 45% of their former students are paying off principal on loans, or the debt burden of former students is below 8% of total income or below 20% of discretionary income. Accordingly, schools are eligible for federal loans if they prepare their students for "gainful employment in a recognized profession" under the Higher Education Act of 1965. However, schools lose eligibility if repayment rates are below 35% or debt burden is above 12 percent of total income and 30 percent of discretionary income.

8. For CEC, the DOE data showed that many of CEC's schools had loan repayment rates of less than 20%, and at other campuses the rates were less than 10%. As a result, analysts downgraded CEC's securities to "hold" from "buy" citing the Company's "lower-than-feared" repayment rates.

9. On August 16, 2010, Bloomberg published an article entitled "Corinthian, For-Profit Stocks Drop on Repayment Data, Downgrades." The article stated:

*"Colleges owned by Career Education Corp., Corinthian Colleges Inc. and Washington Post Co. have campuses where fewer than 20 percent of federal student loans are being repaid, according to the U.S. Department of Education, which wants to use the data to determine whether programs can remain eligible for aid.*

Nationally, for-profit colleges have a 36 percent student- loan repayment rate, compared with 54 percent at public universities and 56 percent at private nonprofits, according to an analysis of the Education Department data by the Institute for College Access & Success, an Oakland, California nonprofit research and advocacy group.

*The repayment rate at Career Education's Sanford Brown College-Hazelwood in Missouri was 9 percent, according to the data posted on the Education Department website."*

10. Following the GAO's August 3, 2010 report, a Congressional Committee launched an investigation of such practices. The U.S Department of Education ("DOE") released data showing that the loan repayment rates for CEC enrollees were well below the level required for federal loan program eligibility. Further, the Company disclosed that its enrollee default rates had significantly increased. When this news surfaced in a DOE report on August 13, 2010, the Company's stock fell over 6% from \$18.79 on Friday, August 13, 2010 to \$17.64 on Monday, August 16, 2010.

11. The professional schools operated by CEC derive greater than 80% of their tuition revenue from federal Title IV programs. In order for institutions of higher education to be eligible to receive Title IV funding, among other things, they must be accredited. To maintain their accreditation, certain of CEC's schools must place 65% of their graduating students in the jobs that their studies ostensibly prepared them for. As a result, if one of these schools fails to place 65% or more of students in such jobs, it faces loss of accreditation. Loss of accreditation means loss of Title IV funding and the loss of CEC's principal stream of revenue.

12. According to the CEC, if any one of its campuses were to lose eligibility for Title IV funding, the school would likely have to be closed.

13. In August 2011, following an investigation of CEC's post-graduate employment statistics in the Company's 49 Health Education and Art & Design institutions, all of which had previously represented levels of post-graduate job placement that were 65% or greater, it was reported that 36 of the 49 institutions placed less than 65% of graduates in jobs in their fields.

14. On November 21, 2011, the Company filed a Form 8-K with the SEC disclosing that:

"On November 14, 2011, the Company received a letter from ACICS directing the Company, on behalf of 49 of its ACICS-accredited institutions in the Health and Art & Design segments (the "Institutions"), to show cause at ACICS' December 2011 meeting as to why the Institutions' current grants of accreditation should not be withdrawn by way of suspension. The show cause directive relates to the adequacy of the administrative practices and controls relative to the Company's reporting of placement rates to ACICS. According to ACICS *Accreditation Criteria*, a show-cause directive is not a negative or conditioning action. Rather, it is issued to an institution for it to come forward and demonstrate that a negative or conditioning action should not be taken."

15. In the Form 8-K, CEC admitted that: “the failure by the Company to satisfactorily resolve the show cause directive could have a material adverse effect on the Company’s business, reputation, financial position, cash flows and results of operations.”

16. A loss of accreditation at any of its schools would materially damage CEC. Moreover, CEC has already been damaged because the breaches of fiduciary duty committed by the Individual Defendants have exposed the Company to a multitude of lawsuits and resulted in lower profit margins, declining enrollment, and a tarnished reputation.

17. In response to these events, CEC initiated an investigation (the “Internal Investigation”) and retained the law firm of Dewey & LeBoeuf LLP to provide legal advice with respect to the investigation.

18. The Company has now disclosed that the Internal Investigation, which involved the review of records, statistical sampling, and verification calls with former students, confirmed the existence of improper placement determination practices at certain of the Company’s Health Education segment schools, and, for the Company’s Health Education and Art & Design segment schools, Dewey & LeBoeuf identified certain placements that lacked sufficient supporting documentation or otherwise did not meet applicable placement guidelines established by the Company. In accordance with their annual reporting schedule, the Company’s Health Education and Art & Design segment schools recently reported 2010-2011 placement rates to their accreditor, the Accrediting Counsel for Independent Colleges and Schools (“ACICS”), taking into account Dewey & LeBoeuf’s findings. The ACICS placement rate standard is 65%. Placement rates below this minimum standard may subject an institution to increased accreditation oversight, which may include increased reporting requirements, a requirement that the institution submit a corrective action plan or undergo an on-site evaluation, or restrictions on the addition of new locations or programs. ACICS may also initiate accreditation proceedings such as a show-cause directive, an action to defer or deny action related to an institution’s application for a new grant of accreditation or an action to suspend an institution’s accreditation if it fails to meet this standard. Based on their recently reported 2010-2011 placement rates, 13 of the Company’s 49 ACICS-accredited Health Education and Art & Design segment schools met

ACICS' 65% minimum placement rate standard for the 2010-2011 reporting period. ACICS could determine that additional schools do not meet its minimum placement rate standard. Dewey & LeBoeuf's review of the placement rate determination practices of the Company's other domestic campuses, including its AIU, CTU and Culinary schools, is ongoing.

19. Moreover, the Company has limited the Internal Investigation to only a statistically valid sample of graduates of schools in CEC's Health Education and Art & Design programs. As a result, the investigation does not encompass all graduates of all schools in all segments, and the Company therefore has failed to fully investigate the wrongdoing or adopt measures that will prevent the same problems from occurring in other areas of its business.

#### **JURISDICTION AND VENUE**

20. Jurisdiction is conferred by 28 U.S.C. § 1332. There is complete diversity among the parties and the amount in controversy exceeds the sum or value of \$75,000, exclusive of interest and costs.

21. Venue is proper in this district pursuant to 28 U.S.C. § 1391 because CEC maintains its principal executive offices in this district, one or more of the Defendants resides in this district, a substantial portion of the transactions and wrongs complained of herein—including the Individual Defendants' primary participation in the wrongful acts—occurred in this district, and Defendants have received substantial compensation in this district by doing business here and engaging in numerous activities that had an effect in this district.

#### **THE PARTIES**

22. Plaintiff Amy Cook is a current shareholder of CEC. Plaintiff has been a shareholder of CEC since April 2, 2007, and has continuously held her CEC stock at all relevant times. Plaintiff is a citizen and resident of California.

23. Nominal Defendant CEC is a Delaware corporation with its principal place of business located at 231 North Martingale Road, Schaumburg, Illinois 60173. CEC's stock is listed and traded on the NASDAQ Exchange under the ticker "CECO." CEC is a citizen of the States of Delaware and Illinois.

24. Defendant Gary E. McCullough was, until he was forced to resign on October 31, 2011, President, Chief Executive Officer and a Board member. McCullough is a citizen of the State of Illinois.

25. Defendant Steven H. Lesnik (“Lesnik”) has been a Director of the Company since 2006, Chairman of the Board since 2008, and was appointed President and Chief Executive Officer (“CEO”) of the Company in November 2011. Lesnik is a citizen of the State of Illinois.

26. Defendant Leslie T. Thornton (“Thornton”) has been a Director of CEC since 2005. Thornton is the Chairperson of the Compliance Committee. Thornton is a citizen of Washington, D.C.

27. Defendant Dennis H. Chookaszian (“Chookaszian”) has been a Director of CEC since 2002. Chookaszian is the Chairperson of the Audit Committee and a member of the Compliance Committee. Chookaszian is a citizen of the State of Illinois.

28. Defendant Michael J. Graham (“Graham”) is, and at relevant times was, Chief Financial Officer (“CFO”) and Executive Vice President of Career Education. Graham is a citizen of the State of Illinois.

29. Defendant David W. Devonshire (“Devonshire”) has been a Director of CEC since 2008. Devonshire is a member of the Audit Committee and the Compensation Committee. Devonshire is a citizen of the State of Illinois.

30. Defendant Patrick W. Gross (“Gross”) has been a Director of CEC since 2005. Gross serves as Chairperson of the Compensation Committee and also serves on the Audit Committee and Nominating and Governance Committee. Gross is a citizen of the State of Virginia.

31. Defendant Gregory L. Jackson (“Jackson”) has been a director of CEC since 2008. Jackson serves on the Compensation Committee and the Compliance Committee. Jackson is a citizen of the State of Utah.

32. Defendant Thomas B. Lally (“Lally”) has been a Director of CEC since 1998. Lally serves as Chairperson of the Nominating and Governance Committee and is a member of the Compensation Committee. Lally is a citizen of the State of Illinois.



33. Brian R. Williams is a former executive of CEC. During the Relevant Period, and until Q4 2011, Williams was the Senior Vice President of Culinary Arts. Williams allegedly left the Company for “personal” reasons, but was really forced out due to his involvement in the wrongdoing alleged herein. Williams served as the Senior Vice President Culinary Arts from September 2008 until October 2011, having joined the Company in 1999. His experience encompasses culinary training, management positions in the culinary field and business operations and strategy in the educational services field. He served Culinary Arts as Vice President of Operations from February 2008 through September 2008. He previously was Vice President of Admissions for American InterContinental University Online from 2006 to 2008, special assistant to the school’s chief executive officer from 2005-2006, President of Western Culinary Institute from 2003 to 2005, Regional Vice President of the College Division West in 2003, and Vice President and Managing Director for American InterContinental University from 2000 to 2003. He served as Vice President of the College Division from 1999 to 2000 and joined the Company as President of the Scottsdale Culinary Institute in 1999. Prior to joining the Company in 1999, Mr. Williams held various management positions with Promus Hotels’ Red Lion, Doubletree and Embassy Suites hotels. Mr. Williams holds a Master in Business Administration from American InterContinental University, a Bachelor of Science in Marketing from the University of Phoenix, and an Associate of Occupational Studies, Culinary Arts from Western Culinary Institute. Due to his experience with the Company, and specifically his tenure as special assistant to the school’s chief executive officer from 2005-2006, Williams was instrumental in devising and implementing the wrongful business practices employed by the Individual Defendants during the Relevant Period. Williams is a citizen of the State of Illinois.

34. Thomas G. Budlong is a former executive of CEC. During the Relevant Period, and until October 2011, Budlong was the Senior Vice President of International and Chief Administrative Officer left the Company. Budlong allegedly left the Company for “personal” reasons, but was really forced to resign due to his involvement in the wrongdoing alleged herein. Budlong served as Senior Vice President, Chief Administrative Officer and Chief of Staff from November 2010 until October 2011, as Senior Vice President, Head of International Operations

and Chief Administrative Officer from January 2009 through November 2010, and as Senior Vice President, Organizational Effectiveness and Administration from August 2007 to January 2009. From 1984 until joining the Company, Mr. Budlong served in a variety of positions with the Wm. Wrigley Jr. Company, a then-public manufacturer and seller of confections with global sales in excess of \$4 billion, most recently as Senior Human Resources Director of Global Commercial Operations and Corporate Groups and as a member of Wrigley's Global Commercial Leadership Team and Human Resources Leadership Group. Prior to that, he served as the Senior Human Resources Director for Global Commercial Operations, Human Resources Director for the Americas, and Human Resources Director for Asia/Pacific. Mr. Budlong received a Bachelor of Science in Business Administration, with a specialization in human resource management, from Marquette University. Budlong is a citizen of the State of Illinois.

35. Thomas A. McNamara is a former executive of CEC. During the Relevant Period, he was Senior Vice President of Art & Design. McNamara allegedly left the Company in October 2011 to pursue another professional opportunity but really left the Company because of his involvement in the wrongdoing alleged herein. McNamara served as the Senior Vice President Art & Design from November 2010 until October 2011. He joined the Company in February 2001 as Controller and Director of Operations for the International Academy of Design and Technology ("IADT") in Chicago. He served in a variety of financial and operations positions, including Divisional Controller for the Academy Division (consisting of nine campuses) from March 2002 to January 2004, Vice President of Finance for the Company's Start-up Division from January 2004 to January 2005, Vice President of Operations of that Division from January through October 2005, and Vice President and Managing Director of the Division from October 2005 through March 2008. He became Vice President of Operations of IADT in March 2008 and Senior Vice President of IADT in January 2009. Prior to joining the Company, Mr. McNamara worked as Controller for the Irish Dairy Board, a multinational dairy cooperative, and as an auditor for PricewaterhouseCoopers in Dublin, Ireland. Mr. McNamara holds a Bachelor of Business Studies from the Waterford Institute of Technology, Waterford, Ireland and a Master of Business Studies (Finance) from Dublin City University, Dublin, Ireland.

He is a fellow of the Institute of Chartered Accountants in Ireland. McNamara is a citizen of Ireland.

**FIDUCIARY DUTIES OF THE DEFENDANTS**

36. By reason of their positions as officers, directors and/or fiduciaries of CEC and because of their ability to control the business and corporate affairs of the Company, the Individual Defendants owe CEC and its shareholders fiduciary obligations of trust, loyalty, good faith and due care, and were and are required to use their utmost ability to control and manage CEC in a fair, just, honest and equitable manner. The Individual Defendants were and are required to act in furtherance of the best interests of the Company and its shareholders so as to benefit all shareholders equally and not in furtherance of their personal interest or benefit.

37. Each director and officer of the Company owes to CEC and its shareholders the fiduciary duty to exercise good faith and diligence in the administration of the affairs of the Company and in the use and preservation of its property and assets, and the highest obligations of fair dealing.

38. The Individual Defendants, because of their positions of control and authority as directors and/or officers of CEC, were able to and did, directly and/or indirectly, exercise control over the wrongful acts complained of herein.

39. To discharge their duties, the officers and directors of CEC were required to exercise reasonable and prudent supervision over the management, policies, practices and controls of the affairs of the Company. By virtue of such duties, the officers and directors of CEC were required to, among other things:

(a) ensure that the Company complied with its legal obligations and requirements;

(b) conduct the affairs of the Company in an efficient, business-like manner so as to make it possible to provide the highest quality performance of its business, to avoid wasting the Company's assets, and to maximize the value of the Company's stock;

(c) remain informed as to how CEC conducted its operations, and, upon receipt of notice or information of imprudent or unsound conditions or practices, to make reasonable inquiry in connection therewith, and to take steps to correct such conditions or practices; and

(d) ensure that the Company was operated in a diligent, honest and prudent manner in compliance with all applicable federal, state and local laws, rules and regulations.

40. Each Individual Defendant, by virtue of his or her position as a director and/or officer, owed to the Company and to its shareholders the highest fiduciary duties of loyalty, good faith and the exercise of due care and diligence in the management and administration of the affairs of the Company, as well as in the use and preservation of its property and assets. The conduct of the Individual Defendants complained of herein involves a knowing and culpable violation of their obligations as directors and officers of CEC, the absence of good faith on their part, and a reckless disregard for their duties to the Company and its shareholders that the Individual Defendants were aware or should have been aware posed a risk of serious injury to the Company. The conduct of the Individual Defendants who were also officers and/or directors of the Company has been ratified by the remaining Individual Defendants who collectively comprised all of CEC's Board at all relevant times.

41. At times relevant hereto, defendants were the agents of each of the other defendants and were at all times acting within the course and scope of such agency.

#### CONTROL, ACCESS, AND AUTHORITY

42. The Individual Defendants, because of their positions of control and authority as directors and/or officers of CEC, were able to and did, directly and/or indirectly, exercise control over the wrongful acts complained of herein, as well as the contents of the various public statements issued by CEC.

43. Because of their advisory, executive, managerial, and directorial positions with CEC, each of the Individual Defendants had access to adverse, non-public information about the

financial condition, operations, and improper representations of CEC, including information regarding the student admissions rate and future growth rate.

44. At all times relevant hereto, each of the Individual Defendants was the agent of each of the other Individual Defendants and of CEC, and was at all times acting within the course and scope of such agency.

REASONABLE AND PRUDENT SUPERVISION

45. To discharge their duties, the officers and directors of CEC were required to exercise reasonable and prudent supervision over the management, policies, practices and internal controls of the Company. By virtue of such duties, the officers and directors of CEC were required to, among other things:

(a) refrain from acting upon material inside corporate information to benefit themselves;

(b) ensure that the Company complied with its legal obligations and requirements, including acting only within the scope of its legal authority and disseminating truthful and accurate statements to the investing public;

(c) conduct the affairs of the Company in an efficient, business-like manner so as to make it possible to provide the highest quality performance of its business, to avoid wasting the Company's assets, and to maximize the value of the Company's stock;

(d) properly and accurately guide investors and analysts as to the true financial condition of the Company at any given time, including making accurate statements about the Company's financial results;

(e) remain informed as to how CEC conducted its operations, and, upon receipt of notice or information of imprudent or unsound conditions or practices, make reasonable inquiry in connection therewith, and take steps to correct such conditions or practices and make such disclosures as necessary to comply with securities laws; and

(f) ensure that CEC was operated in a diligent, honest, and prudent manner in compliance with all applicable laws, rules, and regulations.

BREACHES OF DUTIES

46. Each Individual Defendant, by virtue of his or her position as a director and/or officer, owed to CEC and to its shareholders the fiduciary duty of loyalty and good faith and the exercise of due care and diligence in the management and administration of the affairs of CEC, as well as in the use and preservation of its property and assets. The conduct of the Individual Defendants complained of herein involves a knowing and culpable violation of their obligations as directors and officers of CEC, the absence of good faith on their part, and a reckless disregard for their duties to CEC and its shareholders that the Individual Defendants were aware or should have been aware posed a risk of serious injury to CEC.

47. The Individual Defendants each breached their duty of loyalty and good faith by allowing Defendants to cause, or by themselves causing, the Company to make false and/or misleading statements and or failing to disclose: (1) the Company overstated its growth prospects by engaging in illegal and improper recruiting activities, which also artificially inflated the Company's reported results and future growth prospects; (2) the Company's financial results were overstated because the Company's colleges inflated tuition costs and its student loan repayment rates and placement rates were well below levels required for participation in federal loan programs; (3) the Company failed to maintain adequate systems of internal operational and financial controls; and (4) the Individual Defendants lacked a basis for their positive statements about the Company's prospects and growth. In addition, as a result of the Individual Defendants' illegal actions and course of conduct, the Company is now the subject of class action lawsuits that allege violations of the federal securities laws. As a result, CEC has expended, and will continue to expend, significant sums of money to rectify the Defendants' wrongdoing.

CONSPIRACY, AIDING AND ABETTING, AND CONCERTED ACTION

48. In committing the wrongful acts alleged herein, the Individual Defendants have pursued, or joined in the pursuit of, a common course of conduct, and have acted in concert with

and conspired with one another in furtherance of their wrongdoing. The Individual Defendants further aided and abetted and/or assisted each other in breaching their respective duties.

49. During all times relevant hereto, the Individual Defendants collectively and individually initiated a course of conduct that was designed to and did conceal the fact that: (1) the Company overstated its growth prospects by engaging in illegal and improper recruiting activities and misrepresenting its default and placement rates, which also artificially inflated the Company's reported results and future growth prospects; (2) the Company's financial results were overstated because the Company's student loan repayment rates and its student job placement rates were well below levels required for participation in federal loan programs; (3) the Company failed to maintain adequate systems of internal operational and financial controls; and (4) the Individual Defendants lacked a basis for their positive statements about the Company's prospects and growth. In furtherance of this plan, conspiracy, and course of conduct, the Individual Defendants collectively and individually took the actions set forth herein.

50. The Individual Defendants engaged in a conspiracy, common enterprise, and/or common course of conduct. During this time, the Individual Defendants caused the Company to issue false financial results based upon inflated tuition costs and student loan repayment rates that were well below levels required for participation in federal loan programs.

51. The purpose and effect of the Individual Defendants' conspiracy, common enterprise, and/or common course of conduct was, among other things, to: (i) disguise the Individual Defendants' violations of law, including breaches of fiduciary duty and unjust enrichment; and (ii) disguise and misrepresent the Company's future business prospects.

52. The Individual Defendants accomplished their conspiracy, common enterprise, and/or common course of conduct by causing the Company to falsely represent that the Company had adequate internal controls in place, and by purposefully, recklessly, or negligently causing the Company to release improper statements. Because the actions described herein occurred under the authority of the Board, each of the Individual Defendants was a direct, necessary, and substantial participant in the conspiracy, common enterprise, and/or common course of conduct complained of herein.

53. Each of the Individual Defendants aided and abetted and rendered substantial assistance in the wrongs complained of herein. In taking such actions to substantially assist the commissions of the wrongdoing complained of herein, each Individual Defendant acted with knowledge of the primary wrongdoing, substantially assisted the accomplishment of that wrongdoing, and was aware of his or her overall contribution to and furtherance of the wrongdoing.

### **FACTUAL ALLEGATIONS**

54. Career Education is a publicly-traded company. Its directors are elected by stockholders and obligated to act in the best interests of such stockholders, not further their own interests. CEC's Corporate Governance Guidelines state: "Career Education Corporation's ("CEC" or the "Company") business is managed under the direction of its Board of Directors (the "Board"), which is elected by the stockholders. *The basic responsibility of the Board is to exercise its business judgment to act in what it believes to be the best interest of CEC's stockholders.*"

55. CEC's Corporate Governance Guidelines also state that: "CEC's Board represents stockholders' interest in perpetuating a successful business and *optimizing long-term financial returns* in a manner consistent with applicable legal requirements and ethical considerations. The Board is responsible for identifying and taking reasonable actions to help assure that CEC is managed in a way designed to achieve this result. Consistent with the importance of the Board's responsibilities, *each director is expected to review the Company's business and public disclosures (including its filing with the Securities and Exchange Commission), to review in advance of Board meetings all related materials distributed to the Board and to attend and participate in meetings of the Board, meetings of any committee of which such director is a member and the Company's annual meeting of stockholders.*"

56. Founded in 1994, CEC is a for-profit provider of education services in the United States and Europe. The Company offers doctoral, master's, bachelor's and associate degrees, and diploma and certificate programs at more than 90 campuses. Nearly 40% of CEC's approximately 100,000 students attend the web-based virtual campuses of American



Intercontinental University (“AIU”), Colorado Technical University (“CTU”), International Academy of Design & Technology and Le Cordon Bleu North America.

57. CEC’s business is divided into four segments: i) University: schools offering regionally and nationally accredited academic programs in various career-oriented disciplines; ii) Health Education: offering programs in career-oriented disciplines of health education; iii) Culinary Arts: offering culinary programs in career-oriented disciplines of culinary arts, baking and pastry arts, and hotel and restaurant management; and iv) International: offering programs from schools located in France, Italy, the United Kingdom and Monaco.

THE INDIVIDUAL DEFENDANTS’ FAILURE TO ENSURE ADEQUATE INTERNAL CONTROLS AT THE COMPANY HAVE SUBJECTED THE COMPANY TO MULTIPLE LAWSUITS ALLEGING VIOLATION OF LABOR AND OVERTIME LAW

58. CEC is a significant employer, employing thousands of individuals across the United States. Thus, it is imperative that the Company maintain adequate internal controls to ensure that the Company complies with all applicable federal and state laws regarding wages and labor issues.

59. Indeed, in light of the importance of wages to individuals, most States have laws which are highly protective of individuals’ rights to promptly receive all wages to which they are entitled.

60. During the Relevant Period, the Individual Defendants failed to ensure that CEC had adequate internal controls regarding compliance with federal and state laws governing wages and labor law.

61. As a result, CEC has been named as a defendant in multiple class action lawsuits alleging violation of federal and state labor laws.

THE INDIVIDUAL DEFENDANTS’ WRONGDOING HAS SUBJECTED THE COMPANY TO MULTIPLE LAWSUITS ALLEGING ILLEGAL AND FRAUDULENT RECRUITMENT PRACTICES

62. The Company received from the Attorney General of the State of New York (“NYAG”) a Subpoena Duces Tecum (“Subpoena”) dated May 17, 2011, relating to the NYAG’s investigation of whether the Company and certain of its schools have complied with

certain New York state consumer protection, securities, finance and other laws. Pursuant to the Subpoena, the NYAG has requested from the Company and certain of its schools documents and detailed information on a broad spectrum of business practices, including such areas as marketing and advertising, student recruitment and admissions, education financing, training and compensation of admissions and financial aid personnel, programmatic accreditation, student employment outcomes, placement rates of graduates and other disclosures made to students. The documents and information sought by the NYAG in connection with its investigation cover the time period from May 17, 2005 to the present. The Company has reported the preliminary results of its internal investigation of placement rate determination practices to the NYAG as they relate to the Company's New York-based ground schools.

63. The Florida campuses of Sanford-Brown Institute received a notice on November 5, 2010 from the State of Florida Office of the Attorney General that it has commenced an investigation into possible unfair and deceptive trade practices at these schools. The notice includes a subpoena to produce documents and detailed information for the time period from January 1, 2007 to the present about a broad spectrum of business practices at such schools. The Florida campuses of Sanford-Brown Institute have responded to the subpoena and are cooperating with the Florida Attorney General in the investigation. The Florida Attorney General's website indicates that the Attorney General is conducting similar investigations of several other postsecondary education companies operating schools located in Florida.

64. On February 11, 2008, a class action complaint was filed in the Circuit Court of Madison County, Illinois, naming as defendants Career Education Corporation and Sanford-Brown College, Inc. Plaintiffs filed amended complaints on September 5, 2008 and September 24, 2010. The five plaintiffs named in the amended complaint are former students who attended a medical assistant program at Sanford-Brown College located in Collinsville, Illinois. The class is alleged to be all persons who enrolled in that program since July 1, 2003.

The amended class action complaint asserts claims for alleged violations of the Illinois Private Business and Vocational Schools Act, for alleged unfair conduct and deceptive conduct under the Illinois Consumer Fraud and Deceptive Business Practices Act, as well as common law claims of fraudulent misrepresentation and fraudulent omission.

65. In the amended complaint filed on September 24, 2010, the plaintiffs allege that the school's enrollment agreements contained false and misleading information regarding placement statistics, job opportunities and salaries and that Admissions, Financial Aid and Career Services personnel used standardized materials that allegedly contained false and/or deceptive information. Plaintiffs also allege that the school misused a standardized admissions test to determine program placement when the test was not intended for that purpose; failed to provide allegedly statutorily required loan repayment information; and misrepresented the transferability of credits. Plaintiffs seek compensatory, treble and punitive damages, disgorgement and restitution of all tuition monies received from medical assistant students, attorneys' fees, costs and injunctive relief.

66. Defendants filed a motion to dismiss the amended complaint on October 20, 2010. On October 27, 2010 the Court granted defendants' motion with respect to plaintiffs' fraudulent omission claims. The Court denied the motion with respect to the statutory claims under the Private Schools Act and the Illinois Consumer Fraud Act and the common law fraudulent misrepresentation claim.

67. By Order dated December 3, 2010, the Court certified a class consisting of all persons who attended SBC in Collinsville, Illinois and enrolled in the Medical Assisting Program during the period from July 1, 2003 through November 29, 2010.

68. *Surrett, et al. v. Western Culinary Institute, Ltd. and Career Education Corporation*. On March 5, 2008, original named plaintiffs Shannon Gozzi and Megan Koehnen filed a complaint in Portland, Oregon in the Circuit Court of the State of Oregon in and for

Multnomah County. Plaintiffs filed the complaint individually and as a putative class action and alleged two claims for equitable relief: violation of Oregon's Unlawful Trade Practices Act ("UTPA") and unjust enrichment. Plaintiffs filed an amended complaint on April 10, 2008, which added two claims for money damages: fraud and breach of contract. Plaintiffs allege that Western Culinary Institute, Ltd. ("WCI") made a variety of misrepresentations to them, relating generally to WCI's placement statistics, students' employment prospects upon graduation from WCI, the value and quality of an education at WCI, and the amount of tuition students could expect to pay as compared to salaries they may earn after graduation. WCI subsequently moved to dismiss certain of plaintiffs' claims under Oregon's UTPA; that motion was granted on September 12, 2008. Shannon Gozzi subsequently withdrew as a named plaintiff and former named plaintiff Meghan Koehnen's claims have been dismissed. Jennifer Schuster became a plaintiff, and when Ms. Koehnen's claims were dismissed, she became the sole named plaintiff. The parties completed written discovery on class issues. On February 5, 2010, the Court entered a formal Order granting class certification on part of plaintiff's UTPA and fraud claims purportedly based on omissions, denying certification of the rest of those claims and denying certification of the breach of contract and unjust enrichment claims. The class consists of students who enrolled at WCI between March 5, 2006 and March 1, 2010, excluding those who dropped out or were dismissed from the school for academic reasons.

69. *Vasquez, et al. v. California School of Culinary Arts, Inc. and Career Education Corporation.* On June 23, 2008, a putative class action lawsuit was filed in the Los Angeles County Superior Court entitled *Daniel Vasquez and Cherish Herndon v. California School of Culinary Arts, Inc. and Career Education Corporation.* The plaintiffs allege causes of action for fraud, constructive fraud, violation of the California Unfair Competition Law and violation of the California Consumer Legal Remedies Act. The plaintiffs allege improper conduct in connection with the admissions process during the alleged class period. The alleged class is defined as

including “all persons who purchased educational services from California School of Culinary Arts, Inc. (“CSCA”), or graduated from CSCA, within the limitations periods applicable to the herein alleged causes of action (including, without limitation, the period following the filing of the action).” Defendants demurred to the constructive fraud claim and the Court dismissed it. Defendants also successfully demurred to plaintiffs’ claims based on alleged violations of California’s former Educational Reform Act.

70. The plaintiffs have filed a fourth amended complaint, in which they assert the same claims against CEC, but have added claims against approximately 15 student lenders. The plaintiffs allege the student lenders are contractually liable for damages incurred as a result of conduct by us by virtue of certain “holder clauses” included in their loan documents.

71. The parties are currently engaged in class discovery in the case. Plaintiffs filed a motion for class certification, and we filed an opposition on September 16, 2011. The Court allowed plaintiffs to take limited discovery in support of a reply brief, and has set the class certification hearing for January 31, 2012.

72. CEC filed a motion to compel arbitration of the claims asserted by the class representatives. The motion was denied after a hearing on October 21, 2011.

73. Plaintiffs’ counsel have filed four separate but related “mass actions” entitled *Banks, et al. v. California School of Culinary Arts*, Los Angeles County Superior Court; *Abrica v. California School of Culinary Arts*, Los Angeles County Superior Court, *Aguilar, et al. v. California School of Culinary Arts*, Los Angeles County Superior Court, and *Alday v. California School of Culinary Arts*, Los Angeles Superior Court. All four cases are being prosecuted on behalf of hundreds of individual former students. The allegations are the same as those asserted in the *Vasquez* class action case. The individual plaintiffs in these cases seek compensatory and punitive damages, disgorgement and restitution of tuition monies received, attorneys’ fees, costs and injunctive relief. All of these cases have been or are expected to be deemed related. Once

deemed related, they will be transferred to the Judge handling the *Vasquez* class action. Each case has been stayed or will be stayed upon transfer pending a ruling on class certification in the *Vasquez* case.

74. *False Claims Act Lawsuit.* On July 28, 2009, we were served with a complaint filed in the U.S. District Court for the Northern District of Georgia, Atlanta Division. The complaint was originally filed under seal on July 14, 2008 by four former employees of the Dunwoody campus of our American InterContinental University on behalf of themselves and the federal government. The case is captioned *United States of America, ex rel. Melissa Simms Powell, et al. v. American InterContinental University, Inc., a Georgia Corporation, Career Education Corp., a Delaware Corporation and John Doe Nos. 1-100.*

75. On July 27, 2009, the Court ordered the complaint unsealed and CEC was notified that the U.S. Department of Justice declined to intervene in the action. When the federal government declines to intervene in a False Claims Act action, as it has done in this case, the private plaintiffs may elect to pursue the litigation on behalf of the federal government and, if they are successful, receive a portion of the federal government's recovery. The action alleges violations of the False Claims Act, 31 U.S.C. § 3729(a)(1) and (2), and promissory fraud, including allegedly providing false certifications to the federal government regarding compliance with certain provisions of the Higher Education Act and accreditation standards. On September 1, 2009, CEC filed a motion to dismiss all of the claims which motion was denied by the Court in its Order of June 2, 2010. CEC filed its response on December 6, 2010, and the discovery phase of the lawsuit is presently underway.

76. As a result of the litany of lawsuits against the Company, the wrongdoing committed at CEC and its schools, and the lack of internal controls, the Company was forced in the fourth quarter 2011 to get rid of several high-level executives and directors who had been key participants in the wrongdoing. Effective October 31, 2011 Gary E. McCullough was forced to

resign as President, Chief Executive Officer and a Board member. The Board appointed Steven H. Lesnik as President and Chief Executive Officer, in addition to his role as Chairman of the Board of Directors. In addition, during the fourth quarter Brian R. Williams, Senior Vice President of Culinary Arts and Thomas G. Budlong, Senior Vice President of International and Chief Administrative Officer left the Company allegedly for “personal” reasons. Thomas A. McNamara, Senior Vice President of Art & Design left the Company to allegedly pursue another professional opportunity. The International business unit is now led by Michael J. Graham, Executive Vice President and Chief Financial Officer. The Culinary Arts and Art & Design teams will report to Mr. Lesnik while the Company continues its search for new leadership.

77. Rather than fire these individuals who actively participated in the harm caused to the Company, CEC agreed to pay unusually large severance agreements to these individuals. The Company estimates that additional expense of approximately ***\$6.0 million will be reflected within the fourth quarter 2011 results of operations related to the separation agreements for Mr. McCullough and Mr. Budlong.*** In response for these payments, the executives are precluded from testifying against the Company or providing any information to civil litigants.

THE INDIVIDUAL DEFENDANTS’ WRONGDOING HAS SUBJECTED THE COMPANY  
TO POTENTIAL LOSS OF FEDERAL FINANCIAL AID AND POSSILBE LOSS OF  
ACCREDITATION OF SOME OF ITS SCHOOLS

78. The majority of CEC’s students receive federally funded financial aid in order to finance the cost of tuition. As a result, CEC’s revenue stream is highly dependent on the ability of its students to secure federal tuition assistance.

79. One type of federal financial assistance are programs administered under Title IV of the Higher Education Act of 1965, 20 USCS §§ 1001 *et seq.* To participate in Title IV Programs, an institution must, among other things, be authorized to offer its programs of instruction by the relevant education agencies of the state in which it is located and be accredited by a recognized accreditation agency.

80. According to the Company's Form 10-K filed with the Securities and Exchange Commission ("SEC") on February 22, 2011 (the "2011 10-K"), as of December 31, 2010, approximately 18% of CEC's U.S. schools' cash receipts from tuition payments, in the aggregate, were derived from non-Title IV sources. Therefore, 82% of CEC's U.S. cash tuition receipts were derived from Title IV sources.

81. In the 2011 10-K, CEC reported tuition revenue for full year 2010 of \$2,042,383,000 and total revenue for its International segment of \$136,076,000. As a consequence, at a minimum, CEC's U.S. tuition revenue in 2010 was \$1,906,307,000, 82% of which, or \$1,563,171,740, was derived from Title IV sources.

82. Because a significant portion of CEC's revenues is derived from Title IV programs, the Individual Defendants know that it would be devastating for the Company and its shareholders if the Company were to lose a substantial amount of Title IV funding. As the 2011 10-K notes:

If any one of our campuses were to lose state authorization, it would be unable to offer educational programs, and students attending the campus would not be eligible to participate in Title IV Programs, and *the lack of Title IV eligibility would likely require us to close a campus* if it were to lose state authorization.

\* \* \*

*Any loss of institutional accreditation would result in a loss of Title IV Program funds for the affected school and its students.*

2011 10-K at 18, 35 (emphasis added).

83. The primary purpose for which students choose to attend a professional school is to obtain a job in their chosen field of study. As a result, CEC's schools, unlike traditional non-profit colleges and universities, derive most of its new student enrolment through advertising: in 2010, 79% of CEC's new student enrolment was generated from leads obtained through internet, television or print marketing. The 2011 10-K further stated:

**Student Recruitment and Admissions**

Our schools seek highly motivated, career-oriented students with both the desire and ability to complete their academic programs of choice. To promote



interest among potential students, each of our schools engages in a wide variety of marketing activities.

\* \* \*

We seek to increase enrollment at each of our schools through marketing programs designed to maximize each campus' market penetration.

2011 10-K at 7. Accordingly, CEC's business model depends to a large degree on the ability of CEC institutions to market themselves as effectively advancing the job prospects of their students. To this end, CEC's website (internet marketing was responsible for 71% of new student starts in 2010) prominently features post-graduate employment prospects as a reason to attend CEC. As a result, the attractiveness of CEC schools to potential students is dependent on the ability of the Company to place graduates in jobs. Any revelations that the Company is not successful placing graduates in jobs would directly undermine CEC's ability to obtain new student enrollments.

84. On November 5, 2010, CEC filed a Form 8-K with the SEC disclosing, among other things, that:

[T]he Florida campuses of Sanford Brown Institute [a CEC school,] received a notice on November 5, 2010 from the State of Florida Office of the Attorney General that it has commenced an investigation into possible unfair and deceptive trade practices at these schools.

Although the details of the Florida Attorney General's investigation have not been made public, the subject matter of the inquiry suggests that the conduct at issue is the same as in the investigation by the New York Attorney General begun in May 2011.

85. On May 24, 2011, CEC filed a Form 8-K with the SEC disclosing that:

Career Education Corporation has received from the Attorney General of the State of New York a Subpoena Duces Tecum dated May 17, 2011, relating to the Attorney General's investigation of whether the Company and certain of its academic institutions have complied with certain New York state consumer protection, securities, finance and other laws. Pursuant to the Subpoena, the Attorney General has requested from the Company and certain of its academic institutions documents and detailed information on a broad spectrum of business practices for the time period May 17, 2005 to the present.

**DEFENDANTS' FALSE AND MISLEADING  
STATEMENTS ISSUED DURING THE PERIOD NOVEMBER 3, 2010 TO NOVEMBER  
1, 2011**

86. On August 13, 2010, the U.S. Department of Education ("ED") released student loan repayment rates for institutions that receive federal loans under Title IV of the Higher Education Act.

87. On August 16, 2010, Career Education issued a release commenting on this data:

The company intends to work with ED to gain further clarity on its methodology and, where possible, obtain access to additional information. The "gainful employment" rule, as currently proposed, requires repayment rate information and salary information at a program level to determine eligibility to provide Title IV loans. . . .

As Career Education has previously communicated publicly, the information provided on August 13, 2010 combined with analysis from limited data related to the other parts of the proposed "gainful employment" test indicates directionally that the Company's Culinary and Art and Design segments would be more impacted than the Health and University segments.

\* \* \*

The colleges, schools and universities that are part of the Career Education Corporation ("CEC") family offer high-quality education to a diverse student population of over 104,000 students across the world in a variety of career-oriented disciplines.

88. By mid-October 2010, Career Education's stock was still trading below \$18 per share.

89. On November 2, 2010, after the market closed, the Individual Defendants caused Career Education to issue a press release announcing its third quarter 2010 financial results. The Company reported net income of \$26.1 million, or \$0.33 diluted EPS, and revenue of \$524.2 million for the third quarter of 2010. The release stated in part:

"Our performance in the third quarter was in line with our expectations and marked a continuation of our year-over-year improvement," said Gary E. McCullough, President and Chief Executive Officer. "While the third quarter brought intensified government and media scrutiny of our sector, I am particularly proud of the way that our company remained focused on enhancing the quality of education and student services in order to prepare students for success in their chosen careers."

90. Following the release, on November 3, 2010, Career Education hosted a conference call with investors, media representatives and analysts, during which defendants represented the following:

[McCULLOUGH:] We are maintaining and improving upon the compliance culture we developed over the past few years. This includes ensuring students had clear information including the demands of our programs, the range of potential outcomes, and their financial obligations. We're focused on continuing to enhance the educational quality and ensuring that our programs prepare students for success in their chosen field or career, and we continue to engage in activities that help identify students who are more likely to persisting graduate, thereby improving student outcomes.

\* \* \*

[GRAHAM:] Turning to Health Education, the student population grew by 24% over the third quarter last year and new student starts increased 18%. Revenue is 22% higher than last year. Operating income was \$13 million in the third quarter, and operating margin was 11.6%, which included \$5.8 million in operating losses from the start-up campuses. Operating losses for start-up campuses in third quarter of 2009 were only \$2.4 million. If you exclude start-up losses of both years, operating margin for Health Education would have been 18.3%.

As Gary mentioned with the addition of Skokie and Portland Oregon openings we now opened six new health start-ups 2010. We do not anticipate any additional openings this year in the fourth quarter, but expect to open at least three additional health schools next year. As of September 30, we are operating 38 health schools, 10 of which are classified as start-up schools. This does not include the Portland location, which opened in October.

91. Following these statements, Career Education's stock price began to increase, reaching nearly \$20 per share by mid-November 2010.

92. On February 17, 2011, Career Education issued a press release reporting its fourth quarter and full-year 2010 financial results. The Company reported net income of \$12.1 million, or \$0.15 diluted EPS, and total revenue of \$542.9 million for the fourth quarter of 2010. The Company further reported net income of \$157.8 million, or \$1.95 diluted EPS, and revenue of \$2.12 billion for the full-year 2010. In addition, defendant McCullough stated:

"Our financial performance both in the fourth quarter and in 2010 was in line with our expectations . . . . While private sector postsecondary education is in a period of heightened scrutiny and uncertainty, we view this as a period of opportunity in

which we will continue to enhance our programs, processes and systems to better meet the needs of our diverse student population.”

93. On April 6, 2011, Career Education’s stock reached a high, closing at \$24.72 per share.

94. On May 4, 2011, Career Education issued a press release reporting its first quarter 2011 financial results. The Company reported net income of \$73.0 million, or \$0.95 diluted EPS, and total revenue of \$543.4 million for the first quarter of 2011. In addition, defendant McCullough stated:

“Our performance continues to be in line with our expectations as we take steps to improve our programs, processes and systems to comply with new federal regulations . . . . We intend to emerge from this period of change among the leading providers of private sector education, serving our students better than ever before.”

95. On May 24, 2011, Career Education filed a Form 8-K with the SEC announcing that the Company had received a subpoena from the Attorney General of New York. The 8-K stated in part:

Career Education Corporation (the “Company”) has received from the Attorney General of the State of New York (“Attorney General”) a Subpoena Duces Tecum (“Subpoena”) dated May 17, 2011, relating to the Attorney General’s investigation of whether the Company and certain of its academic institutions have complied with certain New York state consumer protection, securities, finance and other laws. Pursuant to the Subpoena, the Attorney General has requested from the Company and certain of its academic institutions documents and detailed information on a broad spectrum of business practices for the time period May 17, 2005 to the present.

96. On August 3, 2011, Career Education issued a press release announcing its second quarter 2011 financial results and admitting that it had identified improper practices at certain of its health education segment campuses relating to the determination of reported placement rates. The release reported net income of \$55.4 million, or \$0.73 diluted EPS, and revenue of \$497.2 million for the second quarter of 2011, down 5.8% on a year-over-year basis, and stated in part:

**INTERNAL INVESTIGATION REGARDING PLACEMENT RATES**

Career Education Corporation has identified improper practices at certain of its health education segment campuses relating to the determination of reported placement rates. The company recently discovered these practices in preparing its

response to the previously disclosed subpoena issued to the company by the New York Attorney General on May 17, 2011. Career Education's Board of Directors has directed outside independent legal counsel Dewey & LeBoeuf to undertake a thorough investigation of these practices. In addition, independent counsel has been directed to review the determination of student placements at all of the company's domestic schools. The company will implement remedial measures based on the results of independent counsel's investigation. Results of the investigation will be reported to the New York Attorney General and other relevant accrediting and governmental bodies, as appropriate.

"The integrity of Career Education and its schools is paramount. I am greatly disappointed that some people within our organization have acted inappropriately and not lived up to the standards Career Education expects," said Gary E. McCullough, president and chief executive officer. "We will take all steps necessary to ensure we accurately determine and report placement rates in the future."

97. On this news, Career Education's stock dropped \$3.36 per share to close at \$18.51 per share on August 4, 2011, a one-day decline of 15%, and in the following days dropped to the \$16 per share range. However, even this drop did not reflect how egregious Career Education's practices had been in the past. Thus, Career Education's stock continued to be artificially inflated.

98. Then, on November 1, 2011, Career Education issued a press release announcing its third quarter 2011 financial results. The Company reported net income of \$10.6 million, or \$0.14 diluted EPS, and revenue of \$431.3 million for the third quarter of 2011, down 17.7 % on a year-over-year basis. In the pres release, the Company provided an update regarding its previous admission of improper practices, stating in part:

**UPDATE REGARDING INTERNAL INVESTIGATION RELATED TO  
THE DETERMINATION OF STUDENT PLACEMENT RATES**

\* \* \*

Counsel's investigation confirmed the existence of improper placement determination practices at certain of the Company's Health Education segment schools, and, for the Company's Health Education and Art & Design segment schools, Dewey [& LeBoeuf] identified certain placements that lacked sufficient supporting documentation or otherwise did not meet applicable placement guidelines established by the Company. In accordance with their annual reporting schedule, the Company's Health Education and Art & Design segment schools recently reported 2010-2011 placement rates to their accreditor, the Accrediting

Counsel for Independent Colleges and Schools (“ACICS”), taking into account Dewey [ & LeBoeuf’s] findings. The ACICS placement rate standard is 65%. Placement rates below this minimum standard may subject an institution to increased accreditation oversight, which may include increased reporting requirements, a requirement that the institution submit a corrective action plan or undergo an on-site evaluation, or restrictions on the addition of new locations or programs. ACICS may also initiate accreditation proceedings such as a show-cause directive, an action to defer or deny action related to an institution’s application for a new grant of accreditation, or an action to suspend an institution’s accreditation if it fails to meet this standard. Based on their recently reported 2010-2011 placement rates, 13 of the Company’s 49 ACICS-accredited Health Education and Art & Design segment schools met ACICS’ 65% minimum placement rate standard for the 2010-2011 reporting period. ACICS could determine that additional schools do not meet its minimum placement rate standard. The Company has scheduled a meeting with ACICS to address these reported rates.

At the direction of the Board of Directors, in the third quarter Career Education commenced corrective action and has implemented enhanced controls and procedures with respect to the determination of placement rates by its Health Education and Art & Design segment schools. As part of this effort, the Company has adopted new career services policies and procedures and trained all of the career services employees in its Health Education and Art & Design segment schools on those new policies and procedures.

#### **UPDATE REGARDING NYAG INVESTIGATION**

As also previously reported, Career Education received a subpoena from the Attorney General of the State of New York (“NYAG”) relating to the NYAG’s investigation of whether the Company and certain of its schools have complied with certain New York state consumer protection, securities, finance and other laws. The Company has reported the preliminary results of its internal investigation of placement rate determination practices to the NYAG as they relate to the Company’s New York-based ground schools. The Company continues to fully cooperate with the NYAG with a view towards satisfying their inquiries as promptly as possible.

99. Also, on November 1, 2011, defendant McCullough resigned from the Company.

100. These problems were specific to Career Education and were not attributed to the industry as a whole. As a Morgan Stanley analyst told *Barron’s*:

“CECO has a history of accreditation issues and in the current environment, in which accrediting bodies have been under pressure to better police the industry, we do not expect this to be handled with leniency. We note though that this issue appears to be CECO specific and while the whole group is likely to trade off, we would view this as a buying opportunity for companies with better records of regulatory compliance.”

101. As a result of this news, Career Education's stock dropped \$7.63 per share to close at \$8.32 per share on November 2, 2011, a one-day decline of nearly 48% on volume of nearly 22 million shares.

102. The true facts, which were known by the defendants but concealed from the investing public beginning in November 2010, were as follows:

(a) The Company failed to disclose that it had engaged in improper and deceptive recruiting practices and that, due to the government's scrutiny into the for-profit education sector, the Company would be unable to continue these practices in the future;

(b) The Company's practices included reporting unrealistic placement statistics; and

(c) The Company failed to maintain proper internal controls to prevent placement statistics from being improperly reported.

103. As a result of defendants' false statements and omissions, Career Education has been damaged. The Company's shares have been subjected to significant sales by investors shocked by the recent revelation of the true state of affairs at CEC, sending the shares down 66% recently.

104. While the Company's Internal Investigation has resulted in an admission of some of the wrongdoing perpetrated by the Individual Defendants, it has failed to identify 13 schools that were in jeopardy of losing their accreditation and the problems at the 36 schools the investigation did identify have persisted despite the supposed "enhanced controls."

105. On November 2, 2011, the Company conducted a third quarter 2011 earnings conference call with investors. During the call, the new CEO, defendant Lesnik stated:

During the third quarter, our revenue decreased 18% versus the third quarter 2010. We earned operating income of \$16 million. *Operating income for this third quarter reflected the pricing of \$11 million of charges related to various regulatory matters. First, approximately \$2 million in outside legal fees associated with responding to the New York Attorney General's subpoena requests. Second, roughly \$3 million in charges associated with conducting our internal placement rate review. And third, a reserve for \$5*

*million related to potential return of veterans affair funds, which I'll speak to later.* [Emphasis added].

106. In response to the November 2, 2011 revelations, CEC stock, which had not recovered from its drop in response to the August 2, 2011 disclosures, plummeted from \$15.95 per share on November 1, 2011 to \$7.37 per share at close on November 3, 2011, for a loss of \$8.58 per share, or a nearly 55%, in two days.

107. On November 18, 2011, *CaliforniaWatch.org*, a California news website operated by the Center for Investigative Reporting, published a report about the job placement rate issues at CEC in which it noted some of the deficiencies in the mandate for CEC's independent investigation:

Career Education officials disclosed earlier this month that an independent investigation by outside counsel found that most of its health and art and design campuses had inflated the 2010-11 job placement rates that were about to be reported to accreditors. The investigation was prompted by a subpoena from the New York attorney general's office.

\* \* \*

*It turns out that the independent investigators didn't examine employment information for every single graduate. They only reviewed - and corrected - a "statistically valid" sample. When they extrapolate their findings to the entire group of graduates, job placement rates fall below 65 percent for 45 out of the 49 colleges they investigated.* [Emphasis added].

108. On November 21, 2011, CEC filed a Form 8-K with the SEC in which it disclosed that all 49 of the Health Education and Art & Design institutions were in jeopardy of losing their accreditation due to the job placement misrepresentations:

On November 14, 2011, the Company received a letter from ACICS directing the Company, on behalf of 49 of its ACICS-accredited institutions in the Health and Art & Design segments (the "Institutions"), to show cause at ACICS' December 2011 meeting as to why the Institutions' current grants of accreditation should not be withdrawn by way of suspension. The show cause directive relates to the adequacy of the administrative practices and controls relative to the Company's reporting of placement rates to ACICS. *According to ACICS Accreditation Criteria, a show-cause directive is not a negative or conditioning action. Rather, it is issued to an institution for it to come forward and demonstrate that a negative or conditioning action should not be taken.*

In the letter ACICS has requested that the Company provide certain information to ACICS in advance of the meeting. The Company is



assembling the requested information and representatives of the Company will appear before ACICS at the December 2011 meeting. At the meeting, the Company will review with ACICS the actions the Company has taken to date to report accurate placement rates and the controls and procedures it has implemented to ensure the accurate determination and reporting of placement rates going forward.

The ACICS show-cause directive further demonstrates that the Internal Investigation is not sufficient to expose the true extent of the wrongdoing: the Internal Investigation concluded that only 36 of the 49 Health Education and Art & Design schools had misrepresented job placement statistics. However, ACICS issued the show-cause directive to all 49 schools. As a result, the supposed “enhanced controls” were inadequate because they were based on a flawed investigation and underestimated the scope of the problem.

109. The 49 CEC colleges implicated in the ACICS proceedings are highly material to CEC’s revenues and profits since they represent approximately 40% of CEC revenues.

#### **DAMAGES TO CEC**

110. Although the investigations of CEC in connection with possible loss of accreditation at 49 of the Company’s 90 schools are ongoing, CEC has been, and will continue to be, severely damaged and injured by the Individual Defendants’ misconduct. Further, as a direct and proximate result of the Individual Defendants’ conduct, CEC has expended and will continue to expend significant sums of money. Such expenditures include, but are not limited to:

(a) legal fees, settlements, and judgments in the litany of lawsuits filed against the Company for violations of labor law, the federal securities laws, federal and state laws and regulations, and the common law;

(b) legal fees, costs, and settlements and/or judgments relating to the investigations of the Attorneys General;

(c) declining enrollment at CEC’s colleges;

(d) loss of reputation and goodwill, and a “liar’s discount” that will plague the Company’s stock in the future due to the Individual Defendants’ false statements and lack of candor to the marketplace;

(e) amounts paid to outside lawyers, accountants, and investigators in connection with CEC's Internal Investigation;

(f) loss of revenues and profits due to any loss accreditation.

#### **DERIVATIVE ALLEGATIONS**

111. Plaintiff brings this action for the benefit of CEC to redress injuries the Individual Defendants as a result of the Individual Defendants' violations of law, as well as the aiding and abetting thereof. CEC is named solely as a nominal party in this action. This is not a collusive action to confer jurisdiction on this Court that it would not otherwise have.

112. Plaintiff is and has been a CEC shareholder since April 2, 2007. Plaintiff therefore will adequately and fairly represent the interests of CEC in enforcing and prosecuting its rights.

#### **DEMAND FUTILITY ALLEGATIONS**

113. A pre-suit demand on the CEC Board is futile, and therefore, excused. The current Board of CEC consists of the following seven individuals: Defendants Lesnik, Thornton, Chookaszian, Devonshire, Gross, Jackson and Lally.

114. Demand is futile as to Thornton, Chookaszian, Devonshire, Gross, Jackson and Lally because they all participated in October 2011 in the self-interested decision to give one of the chief persons responsible for the wrongdoing during the Relevant Period – Defendant McCullough – a huge severance package rather than firing him. They did so in order to buy McCullough's silence so that McCullough would not implicate the board in the wrongdoing and testify against them in civil lawsuits. Indeed, McCullough's settlement agreement precludes him from "disparaging" CEC in any way, including but not limited to testifying against the Company or any of its officers or directors. Defendant Lesnik was then appointed to fill McCullough's position as CEO so that a board "insider" would maintain day-to-day control at CEC rather than an outsider who could not be trusted to close ranks behind the board.

115. Indeed, due to the actual conduct of Thornton, Chookaszian, Devonshire, Gross, Jackson and Lally in not only refusing to bring suit against McCullough, but sending him off with a lavish severance agreement rather than firing him, there is no need to speculate as to

whether a demand on such defendants to bring suit against McCullough or themselves would be futile – they have already been presented with the opportunity to sue McCullough and they wrongfully refused to do so and instead paid him for his silence. There could be no more palpable evidence of the futility of a demand on Thornton, Chookaszian, Devonshire, Gross, Jackson and Lally.

116. Moreover, Thornton, Chookaszian, Devonshire, Gross, Jackson and Lally also wrongfully refused to bring suit against several other high-level executives who were Brian R. Williams, Senior Vice President of Culinary Arts and Thomas G. Budlong, Senior Vice President of International and Chief Administrative Officer left the Company allegedly for “personal” reasons. Thomas A. McNamara, Senior Vice President of Art & Design left the Company to allegedly pursue another professional opportunity. The International business unit is now led by Michael J. Graham, Executive Vice President and Chief Financial Officer. The Culinary Arts and Art & Design teams will report to Mr. Lesnik while the Company continues its search for new leadership.

117. Rather than fire these individuals who actively participated in the harm caused to the Company, CEC agreed to pay unusually large severance agreements to these individuals. The Company estimates that additional expense of approximately ***\$6.0 million will be reflected within the fourth quarter 2011 results of operations related to the separation agreements for Mr. McCullough and Mr. Budlong.*** In response for these payments, the executives are precluded from testifying against the Company or providing any information to civil litigants.

118. Defendants Chookaszian, Devonshire and Gross were responsible for reviewing and approving the Company’s financial statements. By authorizing the false financial statements and public statements alleged herein which were made beginning in November 2010, and failing to correct statements which Defendants McCullough and Graham caused the Company during such time, Chookaszian, Devonshire and Gross were active participants in breaches of candor and duty, and have subjected the Company to potential lawsuits claiming violations of the federal securities laws. As a result, any demand upon them to bring suit against themselves or Defendants McCullough and Graham would be a useless and futile act.

119. Defendants Chookaszian, Devonshire and Gross are the current members of the Audit Committee. The Audit Committee Charter states: “The purpose of the Audit Committee (the “**Committee**”) of the Board of Directors of Career Education Corporation (the “**Company**”) is to assist the Board of Directors in fulfilling its responsibility for oversight of the quality and integrity of the accounting, auditing and reporting practices of the Company, and such other duties as directed by the Board relating to the accounting, auditing, financial reporting and internal control functions of the Company.”

120. Pursuant to CEC’s Audit Committee Charter, Defendants Chookaszian, Devonshire, and Gross were specifically required to: “Review with financial management and the Independent Auditors the Company’s earnings releases prior to their dissemination, including any pro forma, adjusted or non-GAAP financial information included therein, and to the extent there are significant accounting matters in a quarter, discuss such matters with the Independent Auditors.”

121. During the Relevant Time Period, Defendants Chookaszian, Devonshire, and Gross had actual knowledge that CEC’s internal controls were inadequate and that CEC was violating various federal and state laws regarding federal financial aid, recruitment of students, and public representations about Cohort default rates and placement rates of graduates of the Company’s colleges. Nonetheless, Defendants Chookaszian, Devonshire, and Gross failed to institute sufficient processes for managing the business and financial risks created by the wrongdoing. They thus consciously abdicated their duties as directors of the Company. As a result of these defendants’ abdication of their duties, any demand upon them is futile.

122. The Compliance Committee is currently comprised of defendants Chookaszian, Jackson and Thornton. The Compliance Committee of the Board is generally responsible for overseeing CEC’s policies, programs and procedures to ensure compliance with applicable laws and regulations and advises the Board on the status of CEC’s compliance programs and ongoing developments relating to compliance matters, including education regulatory matters. Nonetheless, the Compliance Committee falsely represented that the Company had sufficient controls at a time when they had actual knowledge that this was not the case. By such

actions, Defendants Chookaszian, Jackson and Thornton abdicated their fiduciary duties. Thus, demand on defendants Chookaszian, Jackson and Thornton is futile.

123. The Individual Defendants ignored, consciously disregarded and/or were reckless in not establishing internal controls that would have been compliant with accreditation requirements and the underlying directives regarding books, records, and controls. As such, CEC did not (and could not) make and keep books, records, and accounts, which, in reasonable detail: (1) accurately and fairly reflected the job placement rates of CEC students; (2) provided reasonable assurances that CEC's schools were meeting accreditation requirements; and (3) demonstrated whether the documented job placement statistic problems at the Company's schools are indicative of systematic problems at CEC's schools in the United States. Thus, because the Individual Defendants were active participants in the alleged wrongdoing and failed to take corrective action, demand on the Board is futile, and therefore, excused.

124. The Individual Defendants have failed to take action against those who are responsible for conducting CEC's job placement statistic and accreditation reviews without implementing and maintaining internal controls for compliance with accreditation requirements, including themselves. The Individual Defendants have demonstrated their unwillingness and/or inability to act in compliance with their fiduciary obligations and/or to sue themselves and/or their fellow directors and allies in the top ranks for the corporation for the wrongdoing complained of herein. Because five of the seven Individual Defendants have served on the CEC board together for five years or more, they have developed professional relationships, are friends and have entangling financial alliances, interests and dependencies, and therefore, they are not able to and will not vigorously prosecute any such action. Thus, demand on the Board is futile, and therefore, excused.

125. The Individual Defendants' decision to deprive CEC of accreditation-compliant internal controls resulted in the inability to ensure that the representations made to students on CEC's behalf were accurately reflected in the Company's books and records. The fact that allegations of similar wrongdoing alleged herein have been lodged against the Company since 2005 (as detailed herein) and have not been corrected demonstrates that at all relevant times CEC

lacked internal controls to prevent such improper conduct and failed to take action to institute such controls even though the Individual Defendants were on notice of the problem. Moreover, the decision to operate a business that is entirely contingent upon continued accreditation without implementing and maintaining sufficient internal controls for compliance with accreditation guidelines is not a decision entitled to business judgment protection. Thus, demand on the Individual Defendants is futile, and therefore, excused.

126. As particularized herein, to properly prosecute this lawsuit, CEC directors would have to sue themselves and the other defendants, requiring them to expose themselves and their comrades to tens of millions of dollars in civil liability and/or sanctions. This they will not do. A majority of the defendants are exposed to potential liability for operating CEC without the internal controls for accreditation compliance that would have detected and prevented the improper misrepresentations that have occurred over an extended period of time. Thus, demand on the Individual Defendants is futile, and therefore, excused.

127. The Individual Defendants have benefited, and will continue to benefit, from the wrongdoing herein alleged and have engaged in such conduct to preserve their positions of control and the perquisites derived thereof, and are incapable of exercising independent objective judgment in deciding whether to bring this action. Likewise, these defendants have and will continue to receive substantial remuneration predicated upon CEC's results. The acts complained of herein have resulted in economic benefits to CEC - as well as to defendants through their increased and continuing compensation - without corresponding recognition or accounting for the correlated liability and risk that CEC was subject to as a result of its lack of internal controls. Individual Defendants, through their course of conduct to date, have demonstrated their unwillingness to seek appropriate relief for the overpayment of this compensation once the risk is accounted for and the penalties and costs are reconciled into CEC's balance sheet. Thus, demand on the Individual Defendants is futile, and therefore, excused.

128. CEC has been and will continue to be exposed to significant losses due to the wrongdoing complained of herein, yet, the Individual Defendants have not filed any lawsuits

against defendants or others who were responsible for the wrongful conduct to attempt to recover for CEC any part of the damages the Company suffered and will suffer thereby. Thus, demand on the Board is futile, and therefore, excused.

129. Demand on the Individual Defendants is futile because when given an opportunity to commence an internal investigation that would reveal the extent of the recruiting violations, and thus the potential harm to the Company's schools' accreditations, the Board so restricted the scope of the inquiry as to render it incomplete and ineffective. The Internal Investigation failed to identify that all 49 of the schools in the Health Education and Art & Design programs were in jeopardy of losing their accreditation, not only 36. There is no basis to believe that the recruiting system for CEC's other segments is materially more compliant with recruiting ethics and accreditation guidelines than the recruiting systems in the Health Education and Art & Design programs. Further, the investigation did not actually assess the true number of graduates employed, but relied on a sample to derive its findings. The Company has not disclosed how the sample was arrived at, or why the true number of graduates employed was not ascertained. Additionally, the supposed "enhanced controls" implemented in response to the flawed findings of the Internal Investigation were restricted to only the 49 Health Education and Art & Design institutions. Because, when given the opportunity to fully reveal the extent of wrongdoing and threat to accreditation at CEC's schools, the Individual Defendants instituted a needlessly restricted and ineffective investigation, demand is excused.

130. Furthermore, in 2005 the CEC Board formed a Special Committee to investigate, among other things, allegations relating to the reporting of CEC job placement statistics. In the Company's Form 10-K filed in March 2006 ("2006 10-K"), it reported:

We have undertaken a number of steps to improve our internal controls in the areas of finance and compliance, including the further development and expansion of our compliance, legal, and internal audit infrastructure processes. The Special Committee recommended additional improvements relating to our financial, compliance, and other controls. Our Board of Directors and senior management are continuing to evaluate the results and recommendations of the special committee. Coir Board of Directors has requested that the Special Committee and its counsel remain in place and available, as needed.

2006 Form 10-K at F-39. Due to the persistent nature of claims of wrongdoing relating to CEC's use of placement statistics and the fact that the last time the Company instituted an investigation into these claims it failed to correct the problem and institute sufficient controls, there is no reason to believe that the August 2011 investigation will be any more effective.

131. In light of CEC's long and troubled history of accreditation and recruiting issues, demand on the Board is futile. Since at least 2005, CEC has repeatedly been confronted with allegations that it made material misrepresentations about job prospects in its recruiting, has been investigated repeatedly by state and federal agencies and has been threatened with loss of accreditation due to conduct substantially similar to allegations herein. The company has repeatedly shown its unwillingness to take the allegations seriously as demonstrated by its consistent statements denying and/or claiming to have taken action to remedy the problem:

(a) On January 31, 2005, *60 Minutes* aired a report exposing CEC for lying to students about their job prospects. At the time, CEC's Chairman of the Board John Larson, responded to *60 Minutes* saying, "We'll investigate the situations cited in your report and take appropriate corrective action as violations are identified."

(b) In December 2005, one of CEC's largest schools, American InterContinental University, was placed on probation by its accrediting body, the Commission on Colleges of the Southern Association of Colleges and Schools, due to issues including recruitment materials, administrative competence, academic policies, program quality, transfer credit and academic record confidentiality.

(c) On January 13, 2006, the *Chronicle of Higher Education* ran an article called "Promises and Profits" the article stated in part:

The U.S. Justice Department and the Securities and Exchange Commission are investigating Career Education, based in Hoffman Estates, Ill., as are state officials in California, New Jersey, and Pennsylvania. Meanwhile, the U.S. Education Department has put a freeze on approving any new applications for campuses or acquisitions by Career Education while department investigators examine the company's financial records and compliance with federal financial-aid regulations.

\* \* \*



But critics say officials at some of the companies have engaged in aggressive and misleading recruiting and admissions tactics to inflate their enrollment numbers. The goals: to obtain student financial-aid money from the federal government, and to win favor with investors in order to drive up stock prices.

\* \* \*

Nonetheless, the company does appear to be taking the charges seriously and has been cleaning house at some of its institutions, including the Los Angeles campus of AIU, from which Mr. Tartaglini departed in November.

Over the last year, the company has also strengthened “the standards and procedures” that each of its campuses must follow in its admissions and recruiting policies, asserts Lynne Baker, a spokeswoman for the corporation, to deal with concerns that have been raised and to prevent any future abuses.

“In those rare and isolated cases where possible violations of policies and procedures have been brought to our attention, we have moved quickly,” says Ms. Baker, “to make any necessary changes to prevent potential reoccurrence and to ensure that our students are always treated fairly and appropriately.”

(d) On January 31, 2007, the *New York Times* reported that the New York State Education Department was threatening to close CEC’s Katherine Gibbs School in New York City if a number of deficiencies were not corrected. The article further stated:

Last summer, responding to a peer review that formed the basis of [the Education Department’s] findings, [Wynn F. Blanton, president of Gibbs New York] said he accepted many of the criticisms, but considered others “highly subjective, clearly unsubstantiated and objectionable.”

[Lynne Baker, a CEC spokesperson] said that since the summer, the College “has implemented substantial changes that directly address the concerns.”

(e) On June 6, 2007, *SF Weekly* published an article titled “Burnt Chefs” detailing the complaints of graduates of CEC’s California Culinary Academy (“CCA”) that they were misled about their job prospects after graduation. The article reported that as early as 2004, a former admissions counselor at CCA had sent a whistle-blowing letter to a California regulatory agency on the subject of misrepresentations about job prospects. The article further stated:

Two former admissions representatives who worked at CCA confirm that students were misled. The former employees say admissions reps preyed on

students' dreams of becoming celebrity chefs, and glossed over the painful economic realities of industry.

The two women describe a high-pressure sales environment where the reps were focused solely on meeting enrollment numbers, not finding students who would benefit from the program.

\* \* \*

Through 2005 and 2006, former students from eight different Career Education Corporation schools filed lawsuits. All but one of the suits against the company are still pending; a case in Missouri was settled out of court in May with an undisclosed payment to the former students. ***While the educations programs in question range widely -from medical billing to photography -the allegations in each case are strikingly similar. Each suit accuses a school of intentional misrepresentations and consumer fraud, and most specifically mention false statements regarding admission criteria and student job-placement rates. Career Education has denied the allegations made in the lawsuits.*** [Emphasis added].

132. Of the seven current members of the Board, five were members of the board between 2005 and 2007 when the Company was exposed for recruiting violations that were substantially the same as those it is currently confronting: Lally has served since 1998, Chookaszian since 2002, Gross and Thornton since 2005, and Lesnik since 2006. These five board members were on notice that the Company's recruiting apparatus was susceptible to ethics violations, they knew that the Company was exposed to significant risk as a result, and they failed implement sufficient controls so as to prevent the problems from recurring. As a result, these five defendants breached their fiduciary duties by failing to sufficiently monitor an area of the Company's business that they knew was in need of oversight. Because these Board members were previously given multiple opportunities to implement sufficient controls and to monitor and supervise the Company's recruiting processes and failed to do so, demand on these board members is a futile and useless act.

133. The CEC Board, with one insider, three members on the Audit Committee, and three members on the Compliance Committee, is dominated by persons who are specifically implicated in the wrongdoing and therefore cannot be expected to sue themselves.

134. According to the Company's May 19, 2011 Proxy Statement, current directors received the following compensation in 2010 for their service on the Board: Lesnik, \$585,691;

Chookaszian, \$501,960; Thornton, \$498,960; Devonshire, \$493,960; Gross, \$502,460; Jackson, \$495,460; and Lally, \$494,460. These compensation packages are unusually high compared to companies of similar sized market capitalization. Accordingly, the Individual Defendants are incapable of impartially considering a demand to commence and vigorously prosecute this action because they have an interest in safeguarding their substantial compensation.

135. CEC's officers and directors are protected against personal liability for their acts of mismanagement and breach of fiduciary duty alleged in this Petition by directors' and officers' liability insurance which they caused the Company to purchase for their protection with corporate funds, *i.e.*, monies belonging to the stockholders of CEC. However, due to certain changes in the language of directors' and officers' liability insurance policies in the past few years, the directors' and officers' liability insurance policies covering the defendants in this case contain provisions that eliminate coverage for any action brought directly by CEC against these defendants, known as, *inter alia*, the "insured versus insured exclusion." As a result, if these directors were to sue themselves or certain of the officers of CEC, there would be no directors' and officers' insurance protection and thus, they will not bring such a suit. On the other hand, if the suit is brought derivatively, as the action is brought, such insurance coverage exists and will provide a basis for the Company to effectuate a recovery. Thus, demand on the Individual Defendants is futile, and therefore, excused.

### **COUNT I**

#### **Against All Defendants for Breach of Fiduciary Duty**

136. Plaintiff incorporates by reference and realleges each and every allegation set forth above, as though fully set forth herein.

137. Each defendant owes and owed to the Company the duty to exercise candor, good faith, and loyalty in the management and administration of CEC's business and affairs, particularly with respect to issues fundamental to the Company's ongoing viability, such as accreditation.

138. Defendants' conduct set forth herein was due to their intentional, reckless, or negligent breach of the fiduciary duties they owed to the Company, as alleged herein.

Defendants intentionally, recklessly, or negligently breached or disregarded their fiduciary duties to protect the rights and interests of CEC.

139. As alleged herein, defendants willfully breached their fiduciary duties candor, care, and good faith.

140. As a direct and proximate result of defendants' breaches of their fiduciary obligations, CEC has sustained and continues to sustain significant damages. As a result of the misconduct alleged herein, defendants are liable to the Company.

## **COUNT II**

### **Against All Defendants for Abuse of Control**

141. Plaintiff incorporates by reference and realleges each and every allegation set forth above, as though fully set forth herein.

142. Defendants' misconduct alleged herein constituted an abuse of their ability to control and influence CEC, for which they are legally responsible.

143. As a direct and proximate result of defendants' abuse of control, CEC has sustained significant damages. As a direct and proximate result of defendants' breaches of their fiduciary obligations of candor, good faith, and loyalty, CEC has sustained and continues to sustain significant damages. As a result of the misconduct alleged herein, defendants are liable to the Company.

## **COUNT III**

### **Against All Defendants for Gross Mismanagement**

144. Plaintiff incorporates by reference and realleges each and every allegation contained above, as though fully set forth herein.

145. By their actions alleged herein, the Individual Defendants, either directly or through aiding and abetting, abandoned and abdicated their responsibilities and fiduciary duties with regard to prudently managing the assets and business of CEC in a manner consistent with the operations of a publicly held corporation.

146. As a direct and proximate result of the Individual Defendants' gross mismanagement and breaches of duty alleged herein, CEC has sustained significant damages.

147. As a result of the misconduct and breaches of duty alleged herein, the Individual Defendants are liable to the Company.

148. Plaintiff on behalf of CEC has no adequate remedy at law.

**COUNT IV**

**Against Defendants McCullough, McNamara, Williams, Budlong, and Graham for  
Unjust Enrichment**

149. Plaintiff incorporates by reference and realleges each and every allegation set forth above, as though fully set forth herein.

150. During the Relevant Period, Defendants received bonuses, stock options and/or similar such compensation from CEC that were tied to the financial performance of CEC. Defendants were unjustly enriched thereby. Defendant McCullough alone received \$4,576,923 in compensation in 2010.

151. Specifically, in CEC's Proxy Statement filed in 2011 CEC disclosed that Defendants McCullough, McNamara, Williams, Budlong, and Graham, as executive officers of CEC, received incentive-based compensation based on CEC's 2010 financial results. Specifically, CEC noted that: "In 2010, the Company's financial performance exceeded its business plan by 4% as measured by adjusted operating income. Achievement of Company and strategic business unit ("SBU") operating income targets and individual goals determine the amount of annual performance-based incentive awards to be paid. In aggregate, annual incentive payments (including those related to individual goals) to the named executive officers ranged from 101% to 125% of target opportunities. The Company's financial performance results for the 2008-2010 performance-based restricted stock cycle was 160% of target performance, resulting in award payouts equal to 200% of target awards. Named executive officers, including our Chief Executive Officer, received long-term incentives in the form of stock options and performance-based restricted stock, weighted 60% and 40% respectively, with vesting of performance-based restricted stock contingent upon attainment of operating income and revenue performance measures."

152. CEC's financial performance in 2010, however, was achieved at a time when CEC did not have adequate internal controls in place and was violating various federal and state laws. Had CEC complied with all applicable laws, and had proper internal controls in place, the defendants would not have received the incentive-based compensation that they did. The defendants, by causing the Company to violate the law, inflated the Company's short-term financial performance in order to realize short-term (*i.e.*, one year, 2010) profits, but at a significant cost – the long-term profitability, reputation, and operation of the Company. The Company's 2011 financial results have already suffered and the Company's 2012 results and beyond will be significantly impaired due to defendants' self-dealing and breach of the duty of loyalty. The Company has now been sued in dozens of lawsuits and is the subject of governmental investigations and Congressional hearings. As a result, the incentive-based compensation earned by defendants in 2010 was inequitable, defendants were unjustly enriched, and the incentive-based compensation should be returned to the Company.

153. Defendants McCullough, McNamara, Williams, and Budlong, however, are free for the time being from any repercussions. They left the Company in October 2011 and took with them their generous 2010 incentive-based compensation, and in addition unusually large and unmerited additional severance payments. The Company and its long-term shareholders are left holding the bag and paying the debts which the Company is saddled with as a result of defendants' disloyal conduct.

154. In January 2010, CEC was forced to adopt a "Compensation Recovery Policy" in order to comply with Dodd-Frank. However, the policy only mandates the return of executive pay if the Company restates its financial results. The policy is wholly deficient and does not require return of executive compensation where, as here, defendants have engaged in wrongful conduct that does not require a restatement of the Company's financial results.

155. To remedy Defendants unjust enrichment, this Court should order them to disgorge not only the gains they made from the bonuses and stock options which were based on inaccurately reported revenues of CEC, but also any such performance based compensation.

**PRAYER FOR RELIEF**

WHEREFORE, Plaintiff demands judgment in the Company's favor against all defendants as follows:

A. Declaring that plaintiff may maintain this action on behalf of CEC and that plaintiff is an adequate representative of the Company;

B. Declaring that the Individual Defendants have breached and/or aided and abetted the breach of their fiduciary duties to CEC;

C. Determining and awarding to CEC the damages sustained by it as a result of the violations set forth above from each of the defendants, jointly and severally, together with interest thereon;

D. Directing CEC and the Individual Defendants to take all necessary actions to reform and improve its corporate governance and internal procedures to comply with applicable laws and to protect CEC and its shareholders from a repeat of the damaging events described herein, including, but not limited to, putting forward for shareholder vote the following resolutions for amendments to the Company's By-Laws or Articles of Incorporation; and the following actions as may be necessary to ensure proper Corporate Governance Policies:

1. a proposal to strengthen the Board's supervision of operations and develop and implement procedures for greater shareholder input into the policies and guidelines of the Board;

2. a provision to permit the shareholders of CEC to nominate at least three candidates for election to the Board; and

3. a proposal to ensure the establishment of effective oversight of compliance with applicable laws, rules, and regulations;

E. Determining and awarding to CEC exemplary damages in an amount necessary to punish Individual Defendants and to make an example of defendants to the community according to proof at trial;

F. Awarding CEC restitution from defendants, and each of them;

G. Awarding Plaintiff the costs and disbursements of this action, including reasonable attorneys' and experts' fees, costs, and expenses; and

H. Granting such other and further equitable relief as this Court may deem just and proper.

**JURY DEMAND**

Plaintiff demands a jury trial.

Dated: December 21, 2011

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