

CAREER EDUCATION CORP
Form 10-Q
November 02, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2010

OR

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

FOR THE TRANSITION PERIOD FROM TO

Commission File Number: 0-23245

CAREER EDUCATION CORPORATION

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)
2895 Greenspoint Parkway, Suite 600,

36-3932190
(I.R.S. Employer
Identification No.)

Hoffman Estates, Illinois
(Address of principal executive offices)

60169
(Zip Code)

Registrant's telephone number, including area code: (847) 781-3600

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

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

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

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

Indicate by check mark whether the registrant is a shell company, as defined in Rule 12b-2 of the Securities Exchange Act of 1934. Yes No

Number of shares of registrant's common stock, par value \$0.01, outstanding October 29, 2010: 81,259,251

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****CAREER EDUCATION CORPORATION AND SUBSIDIARIES****UNAUDITED CONSOLIDATED BALANCE SHEETS****(In thousands, except share and per share amounts)**

	September 30, 2010	December 31, 2009
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 283,515	\$ 284,473
Short-term investments	158,988	200,379
Total cash and cash equivalents and short-term investments	442,503	484,852
Student receivables, net of allowance for doubtful accounts of \$50,054 and \$34,963 as of September 30, 2010 and December 31, 2009, respectively	64,366	57,823
Receivables, other, net	5,514	5,256
Prepaid expenses	43,561	41,090
Inventories	11,078	11,271
Deferred income tax assets, net	12,983	12,983
Other current assets	7,810	9,442
Assets of discontinued operations	5,297	6,118
Total current assets	593,112	628,835
NON-CURRENT ASSETS:		
Property and equipment, net	335,836	306,279
Goodwill	383,821	377,515
Intangible assets, net	182,351	178,520
Student receivables, net of allowance for doubtful accounts of \$31,741 and \$18,394 as of September 30, 2010 and December 31, 2009, respectively	14,426	21,455
Deferred income tax assets, net	3,984	3,659
Other assets, net	36,099	23,178
Assets of discontinued operations	23,491	24,401
TOTAL ASSETS	\$ 1,573,120	\$ 1,563,842
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Current maturities of capital lease obligations	\$ 784	\$ 880
Accounts payable	47,613	51,108
Accrued expenses:		
Payroll and related benefits	62,571	88,439
Advertising and production costs	25,186	21,436
Income taxes	1,206	17,849
Earnout payments	17,061	18,009
Other	92,391	46,182
Deferred tuition revenue	210,618	184,411
Liabilities of discontinued operations	19,371	13,695

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Total current liabilities	476,801	442,009
NON-CURRENT LIABILITIES:		
Capital lease obligations, net of current maturities	1,336	2,262
Deferred rent obligations	105,011	91,725
Earnout payments	11,898	23,680
Other liabilities	13,140	19,124
Liabilities of discontinued operations	43,464	62,997
Total non-current liabilities	174,849	199,788
SHARE-BASED AWARDS SUBJECT TO REDEMPTION	160	521
STOCKHOLDERS EQUITY:		
Preferred stock, \$0.01 par value; 1,000,000 shares authorized; none issued or outstanding		
Common stock, \$0.01 par value; 300,000,000 shares authorized; 96,383,089 and 95,399,192 shares issued, 81,264,576 and 85,785,478 shares outstanding as of September 30, 2010 and December 31, 2009, respectively	964	954
Additional paid-in capital	262,040	244,992
Accumulated other comprehensive income	2,356	8,408
Retained earnings	1,035,090	889,057
Cost of 15,118,513 and 9,613,714 shares in treasury as of September 30, 2010 and December 31, 2009, respectively	(379,140)	(221,887)
Total stockholders equity	921,310	921,524
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 1,573,120	\$ 1,563,842

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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CAREER EDUCATION CORPORATION AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
REVENUE:				
Tuition and registration fees	\$ 497,172	\$ 434,932	\$ 1,516,181	\$ 1,271,207
Other	27,034	23,359	65,579	57,620
Total revenue	524,206	458,291	1,581,760	1,328,827
OPERATING EXPENSES:				
Educational services and facilities	159,104	149,822	477,419	444,899
General and administrative	308,627	251,935	830,421	706,566
Depreciation and amortization	17,843	15,908	51,813	48,399
Goodwill and asset impairment	354	2,500	354	2,500
Total operating expenses	485,928	420,165	1,360,007	1,202,364
Operating income	38,278	38,126	221,753	126,463
OTHER INCOME:				
Interest income	189	326	689	1,968
Interest expense	(30)	(10)	(75)	(32)
Miscellaneous income (expense)	760	62	(506)	(704)
Total other income	919	378	108	1,232
PRETAX INCOME	39,197	38,504	221,861	127,695
Provision for income taxes	12,304	11,626	73,842	43,351
INCOME FROM CONTINUING OPERATIONS	26,893	26,878	148,019	84,344
LOSS FROM DISCONTINUED OPERATIONS, net of tax	(762)	(6,086)	(2,348)	(33,805)
NET INCOME	\$ 26,131	\$ 20,792	\$ 145,671	\$ 50,539
NET INCOME (LOSS) PER SHARE BASIC:				
Income from continuing operations	\$ 0.34	\$ 0.32	\$ 1.85	\$ 0.97
Loss from discontinued operations	(0.01)	(0.07)	(0.03)	(0.39)
Net income per share	\$ 0.33	\$ 0.25	\$ 1.82	\$ 0.58
NET INCOME (LOSS) PER SHARE DILUTED:				
Income from continuing operations	\$ 0.34	\$ 0.32	\$ 1.82	\$ 0.97
Loss from discontinued operations	(0.01)	(0.07)	(0.03)	(0.39)

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Net income per share	\$ 0.33	\$ 0.25	\$ 1.79	\$ 0.58
WEIGHTED AVERAGE SHARES OUTSTANDING:				
Basic	78,919	83,120	80,206	86,570
Diluted	79,819	83,669	81,195	87,071

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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CAREER EDUCATION CORPORATION AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	For the Nine Months Ended September 30,	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 145,671	\$ 50,539
Adjustments to reconcile net income to net cash provided by operating activities:		
Goodwill and asset impairment	354	2,500
Depreciation and amortization expense	51,813	50,038
Bad debt expense	77,374	38,927
Compensation expense related to share-based awards	14,390	12,313
Loss on disposition of property and equipment	546	1,196
Changes in operating assets and liabilities	(72,633)	61,883
Net cash provided by operating activities	217,515	217,396
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available-for-sale investments	(229,771)	(464,163)
Sales of available-for-sale investments	271,035	502,383
Purchases of property and equipment	(81,944)	(50,329)
Acquisition of the rights to the Le Cordon Bleu brand	(12,729)	(25,000)
Business acquisition, net of acquired cash	(6,194)	
Other	81	(370)
Net cash used in investing activities	(59,522)	(37,479)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Purchase of treasury stock	(154,913)	(181,126)
Issuance of common stock	2,453	2,166
Tax benefit associated with stock option exercises	216	194
Payment of assumed loans upon business acquisition	(4,279)	
(Payments)/borrowings of capital lease obligations & other long term debt	(2,085)	1,214
Net cash used in financing activities	(158,608)	(177,552)
EFFECT OF FOREIGN CURRENCY EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS:		
	(942)	888
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS	(1,557)	3,253
DISCONTINUED OPERATIONS CASH ACTIVITY INCLUDED ABOVE:		
Add: Cash balance of discontinued operations, beginning of the period	599	2,004
Less: Cash balance of discontinued operations, end of the period		987
CASH AND CASH EQUIVALENTS, beginning of the period	284,473	242,854
CASH AND CASH EQUIVALENTS, end of the period	\$ 283,515	\$ 247,124

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The accompanying notes are an integral part of these unaudited consolidated financial statements.

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CAREER EDUCATION CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

1. DESCRIPTION OF THE COMPANY

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 more than 118,000 students across the world in a variety of career-oriented disciplines through online, on-ground and hybrid learning program offerings. The more than 90 campuses that serve these students are located throughout the United States and in France, Italy, the United Kingdom and Monaco, and offer doctoral, master s, bachelor s and associate degrees and diploma and certificate programs.

CEC is an industry leader whose institutions are recognized globally. Those institutions include, among others, 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. Through its schools, CEC is committed to providing high-quality education, enabling students to graduate and pursue rewarding career opportunities.

For more information, see CEC s website at www.careered.com. The website includes a detailed listing of individual campus locations and web links to CEC s colleges, schools, and universities.

As used in this Quarterly Report on Form 10-Q, the terms we, us, our, and CEC refer to Career Education Corporation and our wholly-owned subsidiaries. The terms school and university refer to an individual, branded, proprietary educational institution, owned by us and includes its campus locations. The term campus refers to an individual main or branch campus operated by one of our schools or universities.

2. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the financial statements do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments, including normal recurring accruals, considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2010, are not necessarily indicative of the results that may be expected for the year ending December 31, 2010.

The unaudited consolidated financial statements presented herein include the accounts of CEC. All inter-company transactions and balances have been eliminated.

On January 15, 2010, we realigned our resources to more effectively execute our strategic growth plan. We began the integration of our schools which previously comprised the Art & Design Strategic Business Unit (SBU) alongside AIU and CTU, within the University SBU. This realignment facilitates synergies between the programs in Art & Design and University, especially in the areas of fashion design, merchandising and interior design and technology. It also enabled the sharing of student-focused online platforms and expertise and aids IADT as it pursues its longer-term strategy of regional accreditation. Harrington College of Design, Collins College and Brooks Institute joined the IADT schools in the alignment of the Art & Design group into the University SBU. The realignment also shifted Brown College and Briarcliffe College into the Health Education SBU. We expect Briarcliffe s regional accreditation to be beneficial in providing greater opportunity for Sanford-Brown students to enroll in higher degree programs. This realignment resulted in new reportable segments, and prior period results have been revised to reflect these new reportable segments. See Note 14 Segment Reporting of the notes to our unaudited consolidated financial statements for further discussion.

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In addition to the realignment, we completed a detailed review of our shared service costs to determine which of these costs should be charged to the SBUs as well as how these shared service costs should be allocated. These services include legal, finance, human resources, marketing, certain academic functions and certain centralized activities related to student finance, including financial aid processing, student account posting and collections. These costs, recorded within Corporate and Other, were previously allocated to our SBUs based upon a percentage of revenue. Improved data and analytical capabilities have provided us insight into costs being incurred to support the SBUs versus costs being incurred to support the corporation as a whole. The new methodology allocates costs based on usage and consumption factors such as student population, employee headcount, advertising spend, number of financial aid recipients and revenue where appropriate. In the case of certain services which are shared evenly across the SBUs, we allocate evenly. The new methodology is intended to provide improved transparency into the costs of the shared services. The effect of these changes impacts the costs reported within each SBU and reduces the level of unallocated shared service costs. Results beginning in 2010 are presented under the new methodology and prior period results have been revised to be comparable to the current reporting.

3. BUSINESS ACQUISITION

On April 15, 2010, the Company acquired 100% of the issued and outstanding stock of International University of Monaco (IUM) for a purchase price of \$6.3 million plus assumption of \$4.3 million related to outstanding loans which were immediately paid after the acquisition closed. The purchase price was funded with cash generated from operating activities. IUM is a leading international business university located in Monte Carlo, offering bachelor s, master s and doctoral programs in such areas as finance, international business and luxury goods and services.

The following table summarizes the estimated fair values of assets acquired and liabilities assumed as of April 15, 2010 (dollars in thousands):

Current assets (including cash of \$79)	\$ 559
Property and equipment	524
Intangible assets not subject to amortization	
Trade names	2,383
Accreditation rights	740
Intangible assets subject to amortization	
Program curriculum (useful life of 15 years)	407
Covenant not to compete (useful life of 4 years)	62
Goodwill	8,360
Other assets	17
Total assets acquired	13,052
Assumed loans	4,279
Deferred tuition revenue	1,104
Other current liabilities	1,396
Total liabilities assumed	6,779
Net assets acquired	\$ 6,273

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Goodwill of \$8.4 million represents the premium the Company paid over the fair value of the net tangible and intangible assets it acquired. The Company paid this premium due to the strategic location and brand

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CAREER EDUCATION CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except per share amounts)

recognition that IUM contributes to its international operations. We do not expect any portion of this goodwill balance to be deductible for income tax reporting purposes. Acquisition costs of approximately \$0.8 million were incurred in conjunction with this acquisition and are recorded in general and administrative expense on our unaudited consolidated statements of operations. IUM's operating results are included in our unaudited consolidated financial statements from the date of acquisition.

Supplemental pro forma financial statement disclosures have not been included as this acquisition was not material to our unaudited consolidated financial position or results of operations.

4. RECENT ACCOUNTING PRONOUNCEMENTS

In July 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. This ASU is effective for disclosures as of the end of a reporting period for interim and annual reporting periods ending on or after December 15, 2010 and for disclosures about activity that occurs during a reporting period for interim and annual reporting periods beginning on or after December 15, 2010. Management is currently evaluating the impact that the adoption of ASU 2010-20 will have and does not believe the adoption will result in a material level of new disclosures.

In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. This ASU requires new disclosures regarding transfers within the fair value hierarchy and the Level 3 reconciliation, and clarifies existing disclosure requirements. This guidance is effective for interim and annual reporting periods beginning after December 15, 2009, except for the requirement to present the Level 3 roll forward on a gross basis, which is effective for fiscal years beginning after December 15, 2010. Management has fully considered this guidance when determining the fair value and related disclosures of our financial assets as of September 30, 2010 and our adoption did not have a material impact on our unaudited consolidated financial statements.

In October 2009, the FASB issued ASU No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements*, which provides guidance on whether multiple deliverables exist and how arrangement consideration should be measured and allocated to the separate units of accounting in the arrangement. ASU 2009-13, which is effective for fiscal years beginning on or after June 15, 2010, is effective for us on January 1, 2011. Management is currently evaluating the impact that the adoption of ASU 2009-13 will have on our financial condition, results of operations, and disclosures.

In January 2009, the Securities and Exchange Commission (SEC) issued Release No. 33-9002, *Interactive Data to Improve Financial Reporting*. The rule requires all companies to provide their financial statements and financial statement schedules to the SEC and on their corporate websites in interactive data format using the eXtensible Business Reporting Language (XBRL), which is an electronic language specifically for the communication of business and financial data. The intention of XBRL is to improve its usefulness to users and to automate regulatory filings and business information processing. Interactive data has the potential to improve efficiencies and the analyses of financial disclosures by investors and other users. The Company was required to adopt this rule by June 15, 2010. The Company elected to early adopt this rule in the first quarter of 2010 and has made the necessary filings.

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As of September 30, 2010, the results of operations for schools that have ceased operations or were sold are presented within discontinued operations. The Company expects to recognize approximately \$9.0 million in the fourth quarter 2010 of future remaining lease obligations upon the closure of our AIU - Los Angeles, CA campus. The results for this campus will be recast as a component of discontinued operations upon the completion of its teach out.

Results of Discontinued Operations

Combined summary unaudited results of operations for our discontinued operations for the three and nine months ended September 30, 2010 and 2009, are as follows:

	For the Three Months Ended September 30, 2010		For the Nine Months Ended September 30, 2010	
		2009		2009
	(Dollars in thousands)			
Revenue	\$	\$ 1,641	\$	\$ 9,263
Pretax loss	\$ (1,111)	\$ (9,261)	\$ (3,583)	\$ (51,628)
Income tax benefit	(349)	(3,175)	(1,235)	(17,823)
Loss from discontinued operations	\$ (762)	\$ (6,086)	\$ (2,348)	\$ (33,805)

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Assets and liabilities of discontinued operations on our unaudited consolidated balance sheets as of September 30, 2010 and December 31, 2009 include the following:

	September 30, 2010	December 31, 2009
	(Dollars in thousands)	
Assets:		
Current assets:		
Cash and cash equivalents	\$	\$ 599
Receivables, net	71	242
Prepaid expenses and other current assets	1,764	1,815
Deferred income tax assets	3,462	3,462
Total current assets	5,297	6,118
Non-current assets:		
Deferred income tax assets	21,474	21,474
Other assets, net	2,017	2,927
Total assets of discontinued operations	\$ 28,788	\$ 30,519
Liabilities:		
Current liabilities:		
Accounts payable	\$ 50	\$ 173
Accrued expenses	2,504	5,912
Deferred tuition revenue		44
Remaining lease obligations	16,817	7,566
Total current liabilities	19,371	13,695
Non-current liabilities:		
Remaining lease obligations	43,464	62,997
Total liabilities of discontinued operations	\$ 62,835	\$ 76,692

Remaining Lease Obligations

A number of the campuses that ceased operations in 2008 and 2009 have remaining lease obligations that expire during the years 2011 to 2019. A liability is recorded representing the fair value of the remaining lease obligation at the time in which the space is no longer being utilized. Changes in our future remaining lease obligations, which are reflected within current and non-current liabilities of discontinued operations on our unaudited consolidated balance sheets, for our discontinued operations for the three and nine months ended September 30, 2010 and 2009, were as follows:

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	Balance, Beginning of Period	Charges Incurred (1)	Net Cash Payments	Other (2)	Balance, End of Period
	(Dollars in thousands)				
For the three months ended September 30, 2010	\$ 62,707	\$ 930	\$ (3,356)	\$	\$ 60,281
For the three months ended September 30, 2009	\$ 25,941	\$ 2,954	\$ (2,128)	\$ 153	\$ 26,920
For the nine months ended September 30, 2010	\$ 70,563	\$ 1,627	\$ (11,909)	\$	\$ 60,281
For the nine months ended September 30, 2009	\$ 14,468	\$ 31,302	\$ (22,013)	\$ 3,163	\$ 26,920

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- (1) Includes charges for newly vacated spaces and subsequent adjustments for accretion, revised estimates, and variances between estimated and actual charges.
- (2) Includes existing deferred rent liability balances for newly vacated spaces that offset the losses incurred in the period recorded.

6. FINANCIAL INSTRUMENTS**Cash and Cash Equivalents and Investments**

Cash and cash equivalents and investments from our continuing operations consist of the following as of September 30, 2010 and December 31, 2009:

	Cost	September 30, 2010 (Dollars in thousands)		Fair Value
		Gross Unrealized Gain	(Loss)	
Cash and cash equivalents:				
Cash	\$ 202,380	\$	\$	\$ 202,380
Money market funds	80,867	268		81,135
Total cash and cash equivalents	283,247	268		283,515
Short-term investments (available-for-sale):				
U.S. Treasury bills	158,979	21	(12)	158,988
Total cash and cash equivalents and short-term investments	\$ 442,226	\$ 289	\$ (12)	\$ 442,503
Long-term investments:				
Municipal bonds auction rate securities	\$ 12,325	\$	\$ (423)	\$ 11,902

	Cost	December 31, 2009 (Dollars in thousands)		Fair Value
		Gross Unrealized Gain	(Loss)	
Cash and cash equivalents:				
Cash	\$ 180,571	\$	\$	\$ 180,571
Money market funds	103,530	372		103,902
Total cash and cash equivalents	284,101	372		284,473
Short-term investments (available-for-sale):				
U.S. Treasury bills	200,320	61	(2)	200,379
Total cash and cash equivalents and short-term investments	\$ 484,421	\$ 433	\$ (2)	\$ 484,852

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Long-term investments:

Municipal bonds	auction rate securities	\$ 12,325	\$	\$ (745)	\$ 11,580
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CAREER EDUCATION CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except per share amounts)

In the table above, unrealized holding losses as of September 30, 2010 relate to cash equivalents and short-term investments that have been in a continuous unrealized loss position for less than one year. The table also includes unrealized holding losses that relate to our long-term investments in municipal bonds, which are auction rate securities (ARS). When evaluating our investments for possible impairment, we review factors such as the length of time and extent to which fair value has been less than the cost basis, the financial condition of the investee, and our ability and intent to hold the investment for a period of time that may be sufficient for anticipated recovery in fair value. The decline in the fair value of our municipal bonds through September 30, 2010 is attributable to the continued lack of activity in the ARS market, exposing these investments to liquidity risk.

Included in cash and cash equivalents above are amounts related to certain of our European campuses that are operated on a not-for-profit basis. The cash and cash equivalents related to these schools have restrictions which require that the funds be utilized for these particular not-for-profit schools. The amount of cash and cash equivalents of our not-for-profit schools with restrictions was \$47.7 million and \$49.9 million at September 30, 2010 and December 31, 2009, respectively. Restrictions on cash balances have not affected our ability to fund operations.

Money market funds. Money market funds are mutual funds that invest in lower risk securities and generate low yields. Such funds maintain clear investment guidelines and seek to limit credit, market and liquidity risks.

Municipal bonds: Municipal bonds represent debt obligations issued by states, cities, counties, and other governmental entities, which earn federally tax-exempt interest. ARS generally have stated terms to maturity of greater than one year. We classify investments in ARS as non-current on our unaudited consolidated balance sheets within other assets. Auctions can fail when the number of sellers of the security exceeds the buyers for that particular auction period. In the event that an auction fails, the interest rate resets at a rate based on a formula determined by the individual security. The ARS for which auctions have failed continue to accrue interest and are auctioned on a set interval until the auction succeeds, the issuer calls the securities, or they mature. As of September 30, 2010, we have determined these investments are at risk for impairment due to the nature of the liquidity of the market over the past year. Cumulative unrealized losses as of September 30, 2010, amount to \$0.4 million and are reflected within other comprehensive income as a component of stockholders' equity. We believe this impairment is temporary, as we do not intend to sell the investments and it is unlikely we will be required to sell the investments before recovery of their amortized cost basis.

U.S. Treasury bills: Debt obligations issued by the U.S. government that pay interest at maturity. U.S. Treasury bills are traded at discounts to par value and mature in one year or less.

Fair Value Measurements

The fair value measure of accounting for financial instruments establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

As of September 30, 2010, our long term student receivables, net, balances are presented within non-current assets on the unaudited consolidated balance sheets. It is not practicable to estimate the fair value of these financial instruments, since observable market data is not readily available.

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As of September 30, 2010, we held investments that are required to be measured at fair value on a recurring basis. Investments (available-for-sale) consist of U.S. Treasury bills that are publicly traded and for which market prices are readily available.

As of September 30, 2010, we also held investments in auction rate securities, which are classified as available-for-sale and reflected at fair value. The auction events for these investments have failed for the past year. The fair values of these securities are estimated utilizing a discounted cash flow analysis as of September 30, 2010. These analyses consider, among other items, the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the expectation of the next time the security is expected to have a successful auction. These securities were also compared, when possible, to other observable market data with similar characteristics.

Investments measured at fair value on a recurring basis subject to the disclosure requirements issued by the FASB ASC under Topic 820 *Fair Value Measurements and Disclosures* at September 30, 2010 and December 31, 2009, were as follows:

	As of September 30, 2010 (Dollars in thousands)			Total
	Level 1	Level 2	Level 3	
Municipal bonds	\$	\$	\$ 11,902	\$ 11,902
U.S. Treasury bills	158,988			158,988
Totals	\$ 158,988	\$	\$ 11,902	\$ 170,890

	As of December 31, 2009 (Dollars in thousands)			Total
	Level 1	Level 2	Level 3	
Municipal bonds	\$	\$	\$ 11,580	\$ 11,580
U.S. Treasury bills	200,379			200,379
Totals	\$ 200,379	\$	\$ 11,580	\$ 211,959

The following table presents our assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in FASB ASC Topic 820 at September 30, 2010 (dollars in thousands):

Balance at December 31, 2009	\$ 11,580
Unrealized gain	322
Balance at September 30, 2010	\$ 11,902

Credit Agreement

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As of September 30, 2010, we had letters of credit totaling \$8.7 million outstanding under our \$185.0 million U.S. Credit Agreement. Credit availability under our U.S. Credit Agreement as of September 30, 2010, was \$176.3 million.

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(In thousands, except per share amounts)

7. RECEIVABLES**Student Receivables Valuation Allowance**

Changes in our short-term and long-term receivables allowance for the three and nine months ended September 30, 2010 and 2009 were as follows (dollars in thousands):

	Balance, Beginning of Period	Charges to Expense (1)	Amounts Written-off	Balance, End of Period
For the three months ended September 30, 2010	\$ 68,692	\$ 31,934	\$ (18,831)	\$ 81,795
For the three months ended September 30, 2009	\$ 49,447	\$ 14,238	\$ (13,827)	\$ 49,858
For the nine months ended September 30, 2010	\$ 53,357	\$ 77,865	\$ (49,427)	\$ 81,795
For the nine months ended September 30, 2009	\$ 47,895	\$ 39,158	\$ (37,195)	\$ 49,858

- (1) In the first and third quarters 2010, we increased the reserve rates applied to outstanding student receivables balances attributed to our student extended payment plans and our previously terminated recourse loan programs. We recorded pretax expense of \$8.1 million and \$8.3 million during the first and third quarters 2010, respectively. The bad debt reserve rates are continually reviewed for appropriateness based upon historical data as it becomes available.

Recourse Loan Agreements

Previously, we had recourse loan agreements with Sallie Mae and Stillwater National Bank and Trust Company (Stillwater) which required us to repurchase loans originated by them to our students after a certain period of time. Our recourse loan agreement with Stillwater was terminated on April 29, 2007. Our recourse loan agreement with Sallie Mae ended on March 31, 2008.

Outstanding net recourse loan receivable balances for continuing operations as of September 30, 2010 and December 31, 2009 were \$3.6 million and \$8.5 million, respectively. These receivables are reported under non-current assets as a component of student receivables, net within the unaudited consolidated balance sheets.

8. GOODWILL AND ASSET IMPAIRMENT

Changes in the carrying amount of goodwill for continuing operations for the nine months ended September 30, 2010, are as follows by segment (dollars in thousands):

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	University	Health Education	Culinary Arts	International	Transitional	Total
Goodwill balance at December 31, 2009	\$ 120,192	\$ 136,610	\$ 75,148	\$ 45,565	\$	\$ 377,515
Acquisition of IUM				8,360		8,360
Effect of foreign currency exchange rate changes				(2,054)		(2,054)
Goodwill balance at September 30, 2010	\$ 120,192	\$ 136,610	\$ 75,148	\$ 51,871	\$	\$ 383,821

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(In thousands, except per share amounts)

As a result of the realignment of our IADT schools, Harrington College of Design, Collins College and Brooks Institute into the University SBU as well as Briarcliffe College and Brown College into the Health Education SBU as of January 15, 2010, we reassigned the goodwill balances to each reporting unit in accordance with FASB ASC Topic 350 *Intangibles - Goodwill and Other*.

During the third quarter of 2010, we recorded a \$0.4 million asset impairment charge for one of our leased facilities. This noncash charge is reflected within University and relates to the repurposing of a facility. During the third quarter of 2009, we recorded a \$2.5 million asset impairment charge for one of our owned facilities, resulting from its carrying value exceeding its current fair value. This noncash charge is reflected within Corporate and Other.

9. COMMITMENTS AND CONTINGENCIES

Our estimated accrual for legal fees and settlements is presented within other current liabilities on our unaudited consolidated balance sheets. This accrual increased approximately \$40.9 million from \$3.8 million at December 31, 2009 to \$44.7 million at September 30, 2010. The Company recorded legal expenses of \$47.3 million in the third quarter 2010 resulting from the settlements of certain legal matters. Of this pretax amount, \$40.0 million was recorded within the Culinary Arts segment in connection with the settlement of the *Amador* and *Adams* actions described in Student Litigation below. The remaining \$7.3 million was recorded within the University segment.

Litigation

We are, or were, a party to the following legal proceedings that are outside the scope of ordinary routine litigation incidental to our business.

Student Litigation

Amador, et al. v. California Culinary Academy and Career Education Corporation; Adams, et al. v. California Culinary Academy and Career Education Corporation. On September 27, 2007, Allison Amador and 36 other current and former students of the California Culinary Academy (CCA) filed a complaint in the California Superior Court in San Francisco. Plaintiffs plead their original complaint as a putative class action and allege four causes of action: fraud; constructive fraud; violation of the California Unfair Competition Law; and violation of the California Consumer Legal Remedies Act. Plaintiffs contend that CCA made a variety of misrepresentations to them, primarily oral, during the admissions process. The alleged misrepresentations relate generally to the school's reputation, the value of the education, the competitiveness of the admissions process, and the students' employment prospects upon graduation, including the accuracy of statistics published by CCA.

On April 3, 2008, the same counsel representing plaintiffs in the Amador action filed the Adams action on behalf of Jennifer Adams and several other unnamed members of the Amador putative class. The Adams action also is styled as a class action and is based on the same allegations underlying the Amador action and attempts to plead the same four causes of action pled in the Amador action. The Adams action has been deemed related to the Amador action and is being handled by the same judge. The Adams action has been stayed.

Plaintiffs filed a Fourth Amended Complaint on or about March 19, 2010 alleging the same causes of action, but included a new claim based on violations of the California Education Code, which was recently reinstated by the California legislature. Defendants filed a motion to dismiss this new claim. The motion was taken under submission by the Court and has not been ruled on.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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In October 2010, the parties reached agreement on all the material terms of a settlement and executed a formal settlement agreement as of November 1, 2010. The settlement is subject to court approval. The monetary component of the settlement involves payment by the Company of approximately \$40.0 million to pay claims by all students who enrolled in CCA and/or graduated from CCA from September 28, 2003 through October 8, 2008. The payment includes plaintiffs' attorneys' fees and certain expenses to be incurred in connection with the implementation of the settlement. During the third quarter of 2010, the Company recorded a pretax charge of \$40.0 million which represents our best estimate of the loss related to this matter.

Lilley, et al. v. Career Education Corporation, et al. 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.

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.

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. Defendants' brief in opposition to plaintiffs' motion for class certification is expected to be filed on November 5, 2010. The Court has set a hearing on plaintiffs' motion for class certification for November 15, 2010.

Schuster, 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 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. On May 21, 2008, plaintiffs filed a second amended complaint in which they simply changed the statement "Claims Subject to Mandatory Arbitration" on the caption to "Claims Not Subject to Mandatory Arbitration" (emphasis added). WCI and CEC filed an answer on June 13, 2008 and WCI subsequently moved to dismiss certain of plaintiffs' claims under Oregon's Unlawful Trade Practices Act; that motion was granted on September 12, 2008. Shannon Gozzi subsequently withdrew as a named plaintiff and is now asserting claims merely as an absent class member, and

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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. Ms. Schuster filed a third amended complaint on November 20, 2008. Defendants filed an answer on December 5, 2008. Plaintiffs filed their most recent pleading, a fourth amended complaint, on September 2, 2009, and Defendants filed an answer on October 15, 2009. The parties completed written discovery on class issues. Plaintiffs filed their motion for class certification on August 31, 2009, and oral argument on the motion was heard on October 29, 2009. On February 5, 2010, the Court entered a formal Order granting class certification on part of the 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. On April 30, 2010, the Court addressed the issue of whether the class should include students who enrolled prior to March 5, 2006, provided that they were attending the school on or after March 6, 2006. Defendants argued that the class cannot include pre-March 6, 2006 enrollees (two years prior to the filing of the lawsuit, corresponding with the two year statute of limitations on the fraud claim) because of the individual questions associated with determining whether the statute of limitations may be tolled. The Court agreed with Defendants' position and limited the class as Defendants suggested. Because Ms. Schuster was not a member of the certified class (she enrolled before March 5, 2006), Plaintiff's counsel is proposing to substitute in a new class representative for her named Nathan Surrett. The parties are negotiating the terms of that potential substitution, allowing WCI the right to challenge whether the new class representative is adequate (with Plaintiff retaining the burden of proof on that issue). Class notice has not been sent due to the complications associated with the impending withdrawal of the named Plaintiff and potential substitution of a new plaintiff. The parties are currently engaged in merits discovery. The class will consist 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.

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 successfully demurred to the constructive fraud claim and the Court has dismissed it. The parties are engaged in class discovery. The Court has set a deadline of January 28, 2011 for plaintiffs to file their motion for class certification.

Due to the inherent uncertainties of litigation, we cannot predict the ultimate outcome of these matters. An unfavorable outcome of any one or more of these matters could have a material adverse impact on our business, results of operations, cash flows, and financial position.

False Claims Act

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*.

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On July 27, 2009, the Court ordered the complaint unsealed and we were 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, we timely filed a Motion to Dismiss all of the claims. It was denied by the Court in its Order of June 2, 2010. On June 16 and 17, 2010, we filed separate Motions for Reconsideration, for Certification for Interlocutory Appeal, and to Strike certain allegations in the complaint. Briefing on these Motions was completed on July 15, 2010. Discovery in the matter is stayed pending their resolution.

Telephone Consumer Protection Act Litigation

Fahey, et al v. Career Education Corporation; Rojas, et al v. Career Education Corporation. On August 4, 2010, a putative class action lawsuit was filed in the Circuit Court of Cook County, Illinois, by Sheila Fahey alleging that she had received an unauthorized text message advertisement in violation of the Telephone Consumer Protection Act. On September 3, 2010, CEC removed this case to the U.S. District Court for the Northern District of Illinois. On August 18, 2010, the same counsel representing plaintiffs in the Fahey action filed a similar lawsuit in the U.S. District Court for the Northern District of Illinois on behalf of Sergio Rojas containing similar allegations. Rojas, like Fahey, seeks class certification of his claims. The alleged classes are defined to include persons who received unauthorized text message advertisements from CEC. Rojas and Fahey seek an award trebling the statutory damages to the class members, together with costs and reasonable attorneys' fees.

Other Litigation

In addition to the legal proceedings and other matters described above, we are also subject to a variety of other claims, suits, and investigations that arise from time to time in the ordinary conduct of our business, including, but not limited to, claims involving students or graduates and routine employment matters. While we currently believe that such claims, individually or in aggregate, will not have a material adverse impact on our financial position, cash flows, or results of operations, the litigation and other claims noted above are subject to inherent uncertainties, and management's view of these matters may change in the future. Were an unfavorable final outcome to occur in any one or more of these matters, there exists the possibility of a material adverse impact on our business, reputation, financial position, cash flows, and the results of operations for the period in which the effect becomes probable and reasonably estimable.

Accrediting Body and Federal Regulatory Matters

AIU's accrediting agency, the Higher Learning Commission of the North Central Association of Colleges and Schools (HLC), commissioned an advisory team to visit AIU in January 2010. The advisory team conducted a review of AIU, with particular focus on program integrity. Based on the results of its review, the HLC advisory team did not cite AIU for any violations of any HLC accreditation criteria, including but not limited to those related to program length and credit hours, and did not recommend any sanction or limitation on AIU's accreditation status. The advisory team recommended a focused visit for 2011 or 2012 to evaluate AIU's transition to a new undergraduate credit structure which was introduced in February 2010. All new undergraduate students starting at AIU are enrolled in programs with this new credit structure. The recommended focused visit will supersede the focused visit concerning credit equivalence previously scheduled for 2010. The focused visit is currently scheduled for September 19-20, 2011.

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In accordance with HLC policy, the advisory team's recommendation that HLC conduct a focused visit to evaluate AIU's transition to a new undergraduate structure was subject to review and approval by the HLC Institutional Actions Council (IAC) and validation by the HLC Board of Trustees. The advisory team's recommendation was approved by the IAC on June 14, 2010, and the decision of the IAC was validated by the HLC Board of Trustees on June 23, 2010. AIU's updated Statement of Affiliation Status and Organizational Profile were posted to the HLC's website on Friday, July 9, 2010.

AIU has recently submitted new academic program applications to HLC, which are being reviewed by HLC in accordance with its regular practices.

Due to their participation in Title IV programs, our schools and universities are subject to periodic program reviews by the U.S. Department of Education (ED) for the purpose of evaluating an institution's compliance with Title IV requirements, identifying any liabilities to the ED caused by errors in compliance, and improving future institutional capabilities.

As previously disclosed, the ED conducted a program review of AIU in November 2009. On July 14, 2010, AIU received a copy of the ED's Program Review Report, which is a preliminary report of the ED's findings from its program review. The Program Review Report identified six findings, two of which were deemed to be systemic findings by the ED's program review team. These two findings relate to AIU's policy for determining student attendance in online courses for purposes of determining such students' enrollment status, withdrawal dates and associated timing respecting the return of unearned Title IV funds. AIU disagrees with these two findings and intends to contest the program review team's proposed determination of what constitutes appropriate documentation or verification of online academic activity. The remaining four findings were isolated and generally relate to processing errors. We believe the amounts involved in these four findings are immaterial. AIU intends to submit a response to the findings contained in the Program Review Report. After the ED receives AIU's response, it will issue a Final Program Review Determination letter that will specify any required corrective action and amounts owed to the ED, if any.

In addition, an ED program review report for Gibbs College - Livingston, New Jersey (school closed) and final determination letters for Briarcliffe College and Katharine Gibbs School - New York, New York (school closed) are currently pending. The program review report and/or final determination letter will, generally, cover a school's main campus and any branch campuses. We are committed to resolving all issues identified in connection with these program reviews to the ED's satisfaction and ensuring that our schools operate in compliance with all ED regulations.

Our schools and universities are also subject to periodic audits by various regulatory bodies, including the U.S. Department of Education's Office of Inspector General (OIG). The OIG audit services division commenced a compliance audit of CTU in June 2010, covering the period July 1, 2009 to June 30, 2010, to determine whether CTU has policies and procedures to ensure that CTU administers Title IV and other federal program funds in accordance with applicable federal regulations. The OIG audit is ongoing.

While we believe that our schools operate in substantial compliance with applicable statutes and regulations, we cannot predict the outcome of these matters, and any unfavorable outcomes could have a material adverse effect on our business, results of operations, cash flows and financial position.

10. INCOME TAXES

The determination of the annual effective tax is based upon a number of significant estimates and judgments, including the estimated annual pretax income in each tax jurisdiction in which we operate and the

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ongoing development of tax planning strategies during the year. In addition, our provision for income taxes can be impacted by changes in tax rates or laws, the finalization of tax audits and reviews, as well as other factors that cannot be predicted with certainty. As such, there can be significant volatility in interim tax provisions.

The following is a summary of our income tax provision and effective tax rate for continuing operations (dollars in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
Pretax income	\$ 39,197	\$ 38,504	\$ 221,861	\$ 127,695
Provision for income taxes	\$ 12,304	\$ 11,626	\$ 73,842	\$ 43,351
Effective tax rate	31.4%	30.2%	33.3%	33.9%

The increase in our effective tax rate for the three months ended September 30, 2010 as compared to the prior year quarter was primarily due to the recording of a higher tax benefit in the prior year resulting from the expiration of the statute of limitations periods on various uncertain tax positions. In addition, the current quarter results include lower levels of both non-profit income and tax-exempt interest as a percentage of pretax income.

The decrease in our effective tax rate for the nine months ended September 30, 2010 as compared to the prior year to date was primarily due to the recording of a \$4.2 million tax benefit in the second quarter 2010 resulting from a recently closed federal tax audit for credits associated with curriculum development. This tax credit reduced our effective tax rate by 1.9% for the nine months ended September 30, 2010. This reduction in the effective tax rate was partially offset by lower levels of both non-profit income and tax-exempt interest as a percentage of pretax income.

We estimate that it is reasonably possible that the liability for unrecognized tax benefits for a variety of uncertain tax positions will decrease by up to \$8.8 million in the next twelve months as a result of the completion of various tax audits currently in process and the expiration of the statute of limitations in several jurisdictions. The income tax rate for the three and nine months ended September 30, 2010 does not take into account the possible reduction of the liability for unrecognized tax benefits. The impact of a reduction to the liability will be treated as a discrete item in the period the reduction occurs. We recognize interest and penalties related to unrecognized tax benefits in tax expense. As of September 30, 2010, we had accrued \$3.4 million as an estimate for reasonably possible interest and accrued penalties.

Our tax returns are routinely audited by federal, state and foreign tax authorities and these audits are at various stages of completion at any given time. The Internal Revenue Service completed its examination of our U.S. income tax returns through our tax year ending December 31, 2007.

11. STOCK REPURCHASE PROGRAM

During the nine months ended September 30, 2010, we repurchased 5.4 million shares of our common stock for approximately \$154.9 million at an average price of \$28.56 per share. We did not repurchase shares of our common stock during the third quarter 2010.

As of September 30, 2010, approximately \$290.5 million was available under our authorized stock repurchase program to repurchase outstanding shares of our common stock. Stock repurchases under this program may be made on the open market or in privately negotiated transactions from time to time, depending on various factors, including market conditions and corporate and regulatory requirements. The stock repurchase

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program does not have an expiration date and may be suspended or discontinued at any time. The repurchase of shares of our common stock reduces the amount of cash available to pay cash dividends to our stockholders. We have never paid cash dividends on our common stock.

12. SHARE-BASED COMPENSATION

Overview of Share-Based Compensation Plans

On May 13, 2008, the stockholders of CEC approved the Career Education Corporation 2008 Incentive Compensation Plan (the 2008 Plan). The 2008 Plan authorizes awards of stock options, stock appreciation rights, restricted stock, restricted stock units, deferred stock, performance units, annual incentive awards, and substitute awards. Any shares of CEC common stock that are subject to awards of stock options or stock appreciation rights payable in shares will be counted as 1.0 share for each share granted for purposes of the aggregate share limit and any shares of CEC common stock that are subject to any other form of award will be counted as 1.67 shares for each share granted for purposes of the aggregate share limit. The 2008 Plan replaced our 1998 Employee Incentive Compensation Plan, as amended (the 1998 Employee Plan) and our 1998 Non-Employee Directors Stock Option Plan (the Directors Plan). As of September 30, 2010 there's.

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(b) \$100,000 Limitation. Notwithstanding the designation "Incentive Stock Option" in an Option Agreement, if and to the extent that the aggregate Fair Market Value of the Shares with respect to which Incentive Stock Options are exercisable for the first time by the Awardee during any calendar year (under all plans of the Company and any of its Related Corporations) exceeds \$100,000, such Options shall be treated as Nonstatutory Stock Options. An Incentive Stock Option is considered to be first exercisable during a calendar year if the Incentive Stock Option will become exercisable at any time during the year, assuming that any condition on the Awardee's ability to exercise the Incentive Stock Option related to the performance of services is satisfied. If the Awardee's ability to exercise the Incentive Stock Option in the year is subject to an acceleration provision, then the Incentive Stock Option is considered first exercisable in the calendar year in which the acceleration provision is triggered. For purposes of this Section 9(b), Incentive Stock Options shall be taken into account in the order in which they were granted. However, because an acceleration provision is not taken into account prior to its triggering, an Incentive Stock Option that becomes exercisable for the first time during a calendar year by operation of such provision does not affect the application of the \$100,000 limitation with respect to any Incentive Stock Option (or portion thereof) exercised prior to such acceleration. The Fair Market Value of the Shares shall be determined as of the Grant Date.

(c) Leave of Absence. For purposes of Incentive Stock Options, no leave of absence may exceed three months, unless reemployment upon expiration of such leave is provided by statute or contract. If reemployment upon expiration of a leave of absence approved by the Company or a Related Corporation is not so provided by statute or contract, an Awardee's employment with the Company shall be deemed terminated on the first day immediately following such three month period of leave for Incentive Stock Option purposes and any Incentive Stock Option granted to the Awardee shall cease to be treated as an Incentive Stock Option upon the expiration of the three month period following the date the employment relationship is deemed terminated.

(d) Transferability. The Option Agreement must provide that an Incentive Stock Option cannot be transferable by the Awardee otherwise than by will or the laws of descent and distribution, and, during the lifetime of such Awardee, must not be exercisable by any other person. Notwithstanding the foregoing, the Administrator, in its sole discretion, may allow the Awardee to transfer his or her Incentive Stock Option to a trust where under Section 671 of the Code and other Applicable Law, the Awardee is considered the sole beneficial owner of the Option while it is held in the trust. If the terms of an Incentive Stock Option are amended to permit

transferability, the Option will be treated for tax purposes as a Nonstatutory Stock Option.

(e) Exercise Price. The per Share exercise price of an Incentive Stock Option shall be determined by the Administrator in accordance with Section 8(b)(i) of the Plan.

(f) 10% Stockholder. If any Employee to whom an Incentive Stock Option is granted is a 10% Stockholder, then the Option term shall not exceed five years measured from the date of grant of such Option.

(g) Other Terms. Option Agreements evidencing Incentive Stock Options shall contain such other terms and conditions as may be necessary to qualify, to the extent determined desirable by the Administrator, with the applicable provisions of Section 422 of the Code.

10. Exercise of Option

(a) Procedure for Exercise; Rights as a Stockholder

(i) Any Option granted hereunder shall be exercisable according to the terms of the Plan and at such times and under such conditions as determined by the Administrator and set forth in the respective Award Agreement.

(ii) An Option shall be deemed exercised when the Company receives (A) written or electronic notice of exercise (in accordance with the Award Agreement) from the person entitled to exercise the Option; (B) full payment for the Shares with respect to which the related Option is exercised; and (C) with respect to Nonstatutory Stock Options, payment of all applicable withholding taxes.

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(iii) Shares issued upon exercise of an Option shall be issued in the name of the Participant or, if requested by the Participant, in the name of the Participant and his or her spouse. Unless provided otherwise by the Administrator or pursuant to this Plan, until the Shares are issued (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company), no right to vote or receive dividends or any other rights as a stockholder shall exist with respect to the Shares subject to an Option, notwithstanding the exercise of the Option.

(iv) The Company shall issue (or cause to be issued) such Shares as soon as administratively practicable after the Option is exercised. An Option may not be exercised for a fraction of a Share.

(b) Effect of Termination of Service on Options

(i) Generally. Unless otherwise provided for by the Administrator, if a Participant ceases to be a Service Provider, other than upon the Participant's death or Total and Permanent Disability, the Participant may exercise his or her Option within such period of time as is specified in the Award Agreement to the extent that the Option is vested on the date of termination (but in no event later than the expiration of the term of such Option as set forth in the Award Agreement). Notwithstanding the foregoing, so long as the issuance and sale of securities under this Plan require qualification under the California Corporate Securities Law of 1968, upon Participant's Termination of Service, other than due to death, Total and Permanent Disability, or cause, the Participant may exercise his or her Option (i) at any time on or prior to the date determined by the Administrator, which date shall be in compliance with the requirements set forth in Section 260.140.41 of Title 10 of the California Code of Regulations as in effect on the date of grant of the Option, and (ii) only to the extent that the Participant was entitled to exercise such Option on the termination date. In the absence of a specified time in the Award Agreement, the vested portion of the Option will remain exercisable for three months following the Participant's termination. Unless otherwise provided by the Administrator, if on the date of termination the Participant is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option will revert to the Plan. If after termination the Participant does not exercise his or her Option within the time specified by the Administrator, the Option will terminate, and the Shares covered by such Option will revert to the Plan.

(ii) Disability of Awardee. Unless otherwise provided for by the Administrator, if a Participant ceases to be a Service Provider as a result of the Participant's Total and Permanent Disability, the Participant may exercise his

or her Option within such period of time as is specified in the Award Agreement to the extent the Option is vested on the date of termination (but in no event later than the expiration of the term of such Option as set forth in the Award Agreement). Notwithstanding the foregoing, so long as the issuance and sale of securities under this Plan require qualification under the California Corporate Securities Law of 1968, in the event of Participant's Termination of Service due to his or her Total and Permanent Disability, the Participant may exercise his or her Option (i) at any time on or prior to the date determined by the Administrator, which date shall be in accordance with Section 260.140.41 of Title 10 of the California Code of Regulations as in effect on the date of grant of the Option (but which date determined by the Administrator shall in no event be later than the expiration date of the term of his or her Option), and (ii) only to the extent that the Participant was entitled to exercise such Option on the termination date. In the absence of a specified time in the Award Agreement, the Option will remain exercisable for twelve months following the Participant's termination. Unless otherwise provided by the Administrator, if at the time of disability the Participant is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option will immediately revert to the Plan on the date of the Participant's disability. If the Option is not so exercised within the time specified herein, the Option will terminate, and the Shares covered by such Option will revert to the Plan.

(iii) Death of Awardee. Unless otherwise provided for by the Administrator, if a Participant dies while a Service Provider, the Option may be exercised following the Participant's death within such period of time as is specified in the Award Agreement to the extent that the Option is vested on the date of death (but in no event may the Option be exercised later than the expiration of the term of such

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Option as set forth in the Award Agreement), by the Participant's designated beneficiary, provided such beneficiary has been designated prior to Participant's death in a form acceptable to the Administrator. Notwithstanding the foregoing, so long as the issuance and sale of securities under this Plan require qualification under the California Corporate Securities Law of 1968, in the event that the Participant dies prior to a Termination of Service, the Participant's Option may be exercised by the Participant's designated beneficiary (i) at any time on or prior to the date determined by the Administrator, which date shall be in accordance with Section 260.140.41 of Title 10 of the California Code of Regulations as in effect on the date of grant of the Option (but which date determined by the Administrator shall in no event be later than the expiration date of the term of his or her Option), and (ii) only to the extent that the Participant was entitled to exercise the Option at the date of death. If no such beneficiary has been designated by the Participant, then such Option may be exercised by the personal representative of the Participant's estate or by the person(s) to whom the Option is transferred pursuant to the Participant's will or in accordance with the laws of descent and distribution. In the absence of a specified time in the Award Agreement, the Option will remain exercisable for twelve months following Participant's death. Unless otherwise provided by the Administrator, if at the time of death Participant is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option will immediately revert to the Plan on the date of the Participant's death. If the Option is not so exercised within the time specified herein, the Option will terminate, and the Shares covered by such Option will revert to the Plan.

11. Stock Awards.

(a) Stock Award Agreement. Each Stock Award Agreement shall contain provisions regarding (i) the number of Shares subject to such Stock Award or a formula for determining such number, (ii) the purchase price of the Shares, if any, and the means of payment for the Shares, (iii) the performance criteria, if any, and level of achievement versus these criteria that shall determine the number of Shares granted, issued, retained and/or vested, (iv) such terms and conditions on the grant, issuance, vesting and/or forfeiture of the Shares as may be determined from time to time by the Administrator, (v) restrictions on the transferability of the Stock Award and (vi) such further terms and conditions in each case not inconsistent with this Plan as may be determined from time to time by the Administrator.

Notwithstanding the foregoing, so long as the issuance and sale of securities under this Plan require qualification under the California Corporate Securities Law of 1968, the purchase price for restricted Shares shall be determined by the Administrator and in accordance with Section 260.140.42 of Title 10 of the California Code of Regulations as in effect on the date of grant of the Award.

(b) Restrictions and Performance Criteria. The grant, issuance, retention and/or vesting of each Stock Award may be subject to such performance criteria and level of achievement versus these criteria as the Administrator

shall determine, which criteria may be based on financial performance, personal performance evaluations and/or completion of service by the Awardee. Notwithstanding the foregoing, so long as the issuance and sale of securities under this Plan require qualification under the California Corporate Securities Law of 1968, restricted stock awarded to anyone other than an Officer, Director or Consultant of the Company shall vest in accordance with Section 260.140.42 of Title 10 of the California Code of Regulations as in effect on the date of grant of the Award.

Notwithstanding anything to the contrary herein, the performance criteria for any Stock Award that is intended to satisfy the requirements for "performance-based compensation" under Section 162(m) of the Code shall be established by the Administrator based on one or more Qualifying Performance Criteria selected by the Administrator and specified in writing.

(c) Forfeiture. Unless otherwise provided for by the Administrator, upon the Awardee's Termination of Service, the Stock Award and the Shares subject thereto shall be forfeited, provided that to the extent that the Participant purchased any Shares, the Company shall have a right to repurchase the unvested Shares at the original price paid by the Participant, provided that for so long as the issuance and sale of securities under this

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Plan require qualification under the California Corporate Securities Law of 1968, the Company must exercise such right to repurchase in accordance with the conditions set forth in Sections 260.140.42 and 260.140.8 of Title 10 of the California Code of Regulations as in effect on the date of grant of the Award.

(d) Rights as a Stockholder. Unless otherwise provided by the Administrator, the Participant shall have the rights equivalent to those of a stockholder and shall be a stockholder only after Shares are issued (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company) to the Participant. Unless otherwise provided by the Administrator, a Participant holding Stock Units shall be entitled to receive dividend payments as if he or she was an actual stockholder.

12. Stock Appreciation Rights. Subject to the terms and conditions of the Plan, a SAR may be granted to a Service Provider at any time and from time to time as determined by the Administrator in its sole discretion.

(a) Number of SARs. The Administrator shall have complete discretion to determine the number of SARs granted to any Service Provider.

(b) Exercise Price and Other Terms. The per SAR exercise price shall be no less than 100% of the Fair Market Value per Share on the Grant Date. The Administrator, subject to the provisions of the Plan, shall have complete discretion to determine the other terms and conditions of SARs granted under the Plan.

(c) Exercise of SARs. SARs shall be exercisable on such terms and conditions as the Administrator, in its sole discretion, shall determine.

(d) SAR Agreement. Each SAR grant shall be evidenced by a SAR Agreement that will specify the exercise price, the term of the SAR, the conditions of exercise, and such other terms and conditions as the Administrator, in its sole discretion, shall determine.

(e) Expiration of SARs. A SAR granted under the Plan shall expire upon the date determined by the Administrator, in its sole discretion, and set forth in the SAR Agreement. Notwithstanding the foregoing, the rules of Section 10(b) will also apply to SARs.

(f) Payment of SAR Amount. Upon exercise of a SAR, the Participant shall be entitled to receive a payment from the Company in an amount equal to the difference between the Fair Market Value of a Share on the date of exercise over the exercise price of the SAR. This amount shall be paid in Shares of equivalent value.

13. Cash Awards. Each Cash Award will confer upon the Participant the opportunity to earn a future payment tied to the level of achievement with respect to one or more performance criteria established for a performance period.

(a) Cash Award. Each Cash Award shall contain provisions regarding (i) the performance goal(s) and maximum amount payable to the Participant as a Cash Award, (ii) the performance criteria and level of achievement versus these criteria which shall determine the amount of such payment, (iii) the period as to which performance shall be measured for establishing the amount of any payment, (iv) the timing of any payment earned by virtue of performance, (v) restrictions on the alienation or transfer of the Cash Award prior to actual payment, (vi) forfeiture provisions, and (vii) such further terms and conditions, in each case not inconsistent with the Plan, as may be determined from time to time by the Administrator. The maximum amount payable as a Cash Award that is settled for cash may be a multiple of the target amount payable, but the maximum amount payable pursuant to that portion of a Cash Award granted under this Plan for any fiscal year to any Awardee that is intended to satisfy the requirements for [performance based compensation] under Section 162(m) of the Code shall not exceed \$1,000,000.

(b) Performance Criteria. The Administrator shall establish the performance criteria and level of achievement versus these criteria which shall determine the target and the minimum and maximum amount payable under a Cash Award, which criteria may be based on financial performance and/or personal performance evaluations. The Administrator may specify the percentage of the target Cash Award that is intended to satisfy

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the requirements for [performance-based compensation] under Section 162(m) of the Code. Notwithstanding anything to the contrary herein, the performance criteria for any portion of a Cash Award that is intended to satisfy the requirements for [performance-based compensation] under Section 162(m) of the Code shall be a measure established by the Administrator based on one or more Qualifying Performance Criteria selected by the Administrator and specified in writing.

(c) Timing and Form of Payment. The Administrator shall determine the timing of payment of any Cash Award. The Administrator may specify the form of payment of Cash Awards, which may be cash or other property, or may provide for an Awardee to have the option for his or her Cash Award, or such portion thereof as the Administrator may specify, to be paid in whole or in part in cash or other property.

(d) Termination of Service. The Administrator shall have the discretion to determine the effect of a Termination of Service on any Cash Award due to (i) disability, (ii) retirement, (iii) death, (iv) participation in a voluntary severance program, or (v) participation in a work force restructuring.

14. Other Provisions Applicable to Awards.

(a) Non-Transferability of Awards. An Award may be exercised, during the lifetime of the Participant, only by the Participant, and may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will, by the laws of descent and distribution, to a revocable trust or as permitted by Rule 701; provided that so long as the issuance and sale of securities under this Plan does not require qualification under the California Corporate Securities Law of 1968, the Administrator may in each case determine otherwise. If the Administrator makes an Award transferable, either at the time of grant or thereafter, such Award shall contain such additional terms and conditions as the Administrator deems appropriate, and any transferee shall be deemed to be bound by such terms upon acceptance of such transfer.

(b) Qualifying Performance Criteria. For purposes of this Plan, the term [Qualifying Performance Criteria] shall mean any one or more of the following performance criteria, either individually, alternatively or in any combination, applied to either the Company as a whole or to a business unit, Affiliate or business segment, either individually, alternatively or in any combination, and measured either annually or cumulatively over a period of years, on an absolute basis or relative to a pre-established target, to previous years' results or to a designated comparison group, in each case as specified by the Committee in the Award: (i) cash flow; (ii) earnings (including gross margin, earnings before interest and taxes, earnings before taxes, and net earnings); (iii) earnings per share; (iv) growth in earnings or earnings per share; (v) stock price; (vi) return on equity or average stockholders' equity; (vii) total stockholder return; (viii) return on capital; (ix) return on assets or net assets; (x) return on investment; (xi) revenue; (xii) income or net income; (xiii) operating income or net operating income; (xiv) operating profit or net operating profit; (xv) operating margin; (xvi) return on operating revenue; (xvii) market share; (xviii) contract awards or backlog; (xix) overhead or other expense reduction; (xx) growth in stockholder value relative to the moving average of the S&P 500 Index or a peer group index; (xxi) credit rating; (xxii) strategic plan development and implementation; (xxiii) improvement in workforce diversity, (xxiv) EBITDA,

and (xxv) any other similar criteria. The Committee may appropriately adjust any evaluation of performance under a Qualifying Performance Criteria to exclude any of the following events that occurs during a performance period: (A) asset write-downs; (B) litigation or claim judgments or settlements; (C) the effect of changes in tax law, accounting principles or other such laws or provisions affecting reported results; (D) accruals for reorganization and restructuring programs; and (E) any extraordinary non-recurring items as described in Accounting Principles Board Opinion No. 30 and/or in management's discussion and analysis of financial condition and results of operations appearing in the Company's annual report to stockholders for the applicable year.

(c) Certification. Prior to the payment of any compensation under an Award intended to qualify as performance-based compensation under Section 162(m) of the Code, the Committee shall certify the extent to which any Qualifying Performance Criteria and any other material terms under such Award have been satisfied (other than in cases where such relate solely to the increase in the value of the Common Stock).

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(d) Discretionary Adjustments Pursuant to Section 162(m). Notwithstanding satisfaction of any completion of any Qualifying Performance Criteria, to the extent specified at the time of grant of an Award to covered employees within the meaning of Section 162(m) of the Code, the number of Shares, Options or other benefits granted, issued, retained and/or vested under an Award on account of satisfaction of such Qualifying Performance Criteria may be reduced by the Committee on the basis of such further considerations as the Committee in its sole discretion shall determine.

(e) Section 409A. Notwithstanding anything in the Plan to the contrary, it is the intent of the Company that all Awards granted under this Plan shall not cause an imposition of the additional taxes provided for in Section 409A(a)(1)(B) of the Code.

(f) Financial Information. For so long as the issuance and sale of securities under this Plan require qualification under the California Corporate Securities Law of 1968, and to the extent required by Section 260.140.46 of Title 10 of the California Code of Regulations, the Company shall at least annually provide financial statements to Participants.

15. Adjustments upon Changes in Capitalization, Dissolution, Merger or Asset Sale.

(a) Changes in Capitalization. Subject to any required action by the stockholders of the Company, (i) the number and kind of Shares covered by each outstanding Award, and the number and kind of shares of Common Stock which have been authorized for issuance under the Plan but as to which no Awards have yet been granted or which have been returned to the Plan upon cancellation or expiration of an Award, (ii) the price per Share subject to each such outstanding Award, and (iii) the Share limitation set forth in Section 3 of the Plan, shall be proportionately adjusted for any increase or decrease in the number or kind of issued shares resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Common Stock, or any other increase or decrease in the number of issued shares of Common Stock effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been effected without receipt of consideration. Such adjustment shall be made by the Administrator, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock subject to an Award.

(b) Dissolution or Liquidation. In the event of the proposed dissolution or liquidation of the Company, the Administrator shall notify each Participant as soon as practicable prior to the effective date of such proposed transaction. The Administrator in its discretion may provide for an Option to be fully vested and exercisable until ten days prior to such transaction. In addition, the Administrator may provide that any restrictions on any Award shall lapse prior to the transaction, provided the proposed dissolution or liquidation takes place at the time and in the manner contemplated. To the extent it has not been previously exercised, an Award will terminate immediately prior to the consummation of such proposed transaction.

(c) Change in Control. In the event there is a Change in Control of the Company, as determined by the Board or a Committee, the Board or Committee may, in its discretion, (i) provide for the assumption or substitution of, or adjustment to, each outstanding Award; (ii) accelerate the vesting of Options and SARs and terminate any restrictions on Stock Awards or Cash Awards; and (iii) provide for the cancellation of Awards for a cash payment to the Participant.

16. Amendment and Termination of the Plan.

(a) Amendment and Termination. The Administrator may amend, alter or discontinue the Plan or any Award Agreement, but any such amendment shall be subject to approval of the stockholders of the Company in the manner and to the extent required by Applicable Law.

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(b) Effect of Amendment or Termination. No amendment, suspension or termination of the Plan shall impair the rights of any Award, unless mutually agreed otherwise between the Participant and the Administrator, which agreement must be in writing and signed by the Participant and the Company. Termination of the Plan shall not affect the Administrator's ability to exercise the powers granted to it hereunder with respect to Awards granted under the Plan prior to the date of such termination.

(c) Effect of the Plan on Other Arrangements. Neither the adoption of the Plan by the Board or a Committee nor the submission of the Plan to the stockholders of the Company for approval shall be construed as creating any limitations on the power of the Board or any Committee to adopt such other incentive arrangements as it or they may deem desirable, including, without limitation, the granting of restricted stock or stock options otherwise than under the Plan, and such arrangements may be either generally applicable or applicable only in specific cases.

17. Designation of Beneficiary.

(i) An Awardee may file a written designation of a beneficiary who is to receive the Awardee's rights pursuant to Awardee's Award or the Awardee may include his or her Awards in an omnibus beneficiary designation for all benefits under the Plan. To the extent that Awardee has completed a designation of beneficiary such beneficiary designation shall remain in effect with respect to any Award hereunder until changed by the Awardee to the extent enforceable under Applicable Law.

(ii) Such designation of beneficiary may be changed by the Awardee at any time by written notice. In the event of the death of an Awardee and in the absence of a beneficiary validly designated under the Plan who is living at the time of such Awardee's death, the Company shall allow the executor or administrator of the estate of the Awardee to exercise the Award, or if no such executor or administrator has been appointed (to the knowledge of the Company), the Company, in its discretion, may allow the spouse or one or more dependents or relatives of the Awardee to exercise the Award to the extent permissible under Applicable Law.

18. No Right to Awards or to Service. No person shall have any claim or right to be granted an Award and the grant of any Award shall not be construed as giving an Awardee the right to continue in the service of the Company or its Affiliates. Further, the Company and its Affiliates expressly reserve the right, at any time, to dismiss any Service Provider or Awardee at any time without liability or any claim under the Plan, except as provided herein or in any Award Agreement entered into hereunder.

19. Legal Compliance. Shares shall not be issued pursuant to the exercise of an Award unless the exercise of such Award and the issuance and delivery of such Shares shall comply with Applicable Laws and shall be further subject to the approval of counsel for the Company with respect to such compliance. Notwithstanding anything in the Plan to the contrary, it is the intent of the Company that the Plan shall be administered so that the additional taxes provided for in Section 409A(a)(1)(B) of the Code are not imposed.

20. Inability to Obtain Authority. To the extent the Company is unable to or the Administrator deems that it is not feasible to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, the Company shall

be relieved of any liability with respect to the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

21. Reservation of Shares. The Company, during the term of this Plan, will at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan.

22. Notice. Any written notice to the Company required by any provisions of this Plan shall be addressed to the Secretary of the Company and shall be effective when received.

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23. Governing Law; Interpretation of Plan and Awards.

- (a) This Plan and all determinations made and actions taken pursuant hereto shall be governed by the substantive laws, but not the choice of law rules, of the state of Delaware.
- (b) In the event that any provision of the Plan or any Award granted under the Plan is declared to be illegal, invalid or otherwise unenforceable by a court of competent jurisdiction, such provision shall be reformed, if possible, to the extent necessary to render it legal, valid and enforceable, or otherwise deleted, and the remainder of the terms of the Plan and/or Award shall not be affected except to the extent necessary to reform or delete such illegal, invalid or unenforceable provision.
- (c) The headings preceding the text of the sections hereof are inserted solely for convenience of reference, and shall not constitute a part of the Plan, nor shall they affect its meaning, construction or effect.
- (d) The terms of the Plan and any Award shall inure to the benefit of and be binding upon the parties hereto and their respective permitted heirs, beneficiaries, successors and assigns.
- (e) All questions arising under the Plan or under any Award shall be decided by the Administrator in its total and absolute discretion. In the event the Participant believes that a decision by the Administrator with respect to such person was arbitrary or capricious, the Participant may request arbitration with respect to such decision. The review by the arbitrator shall be limited to determining whether the Administrator's decision was arbitrary or capricious. This arbitration shall be the sole and exclusive review permitted of the Administrator's decision, and the Awardee shall as a condition to the receipt of an Award be deemed to explicitly waive any right to judicial review.

24. Limitation on Liability. The Company and any Affiliate which is in existence or hereafter comes into existence shall not be liable to a Participant, an Employee, an Awardee or any other persons as to:

(a) The Non-Issuance of Shares. The non-issuance or sale of Shares as to which the Company has been unable to obtain from any regulatory body having jurisdiction the authority deemed by the Company's counsel to be necessary to the lawful issuance and sale of any shares hereunder; and

(a) Tax Consequences. Any tax consequence expected, but not realized, by any Participant, Employee, Awardee or other person due to the receipt, exercise or settlement of any Option or other Award granted hereunder.

25. Unfunded Plan. Insofar as it provides for Awards, the Plan shall be unfunded. Although bookkeeping accounts may be established with respect to Awardees who are granted Stock Awards under this Plan, any such

accounts will be used merely as a bookkeeping convenience. The Company shall not be required to segregate any assets which may at any time be represented by Awards, nor shall this Plan be construed as providing for such segregation, nor shall the Company nor the Administrator be deemed to be a trustee of stock or cash to be awarded under the Plan. Any liability of the Company to any Participant with respect to an Award shall be based solely upon any contractual obligations which may be created by the Plan; no such obligation of the Company shall be deemed to be secured by any pledge or other encumbrance on any property of the Company. Neither the Company nor the Administrator shall be required to give any security or bond for the performance of any obligation which may be created by this Plan.

**15378 AVENUE OF SCIENCE
SUITE 100
SAN DIEGO, CA 92128**

VOTE BY INTERNET - www.proxyvote.com

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

ELECTRONIC DELIVERY OF FUTURE SHAREHOLDER COMMUNICATIONS

If you would like to reduce the costs incurred by American Technology Corporation in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access shareholder communications electronically in future years.

VOTE BY PHONE - 1-800-690-6903

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you call and then follow the instructions.

VOTE BY MAIL

Mark, sign, and date your proxy card and return it in the postage-paid envelope we have provided or return it to American Technology Corporation, c/o ADP, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE
OR BLACK INK AS FOLLOWS:

KEEP THIS PORTION FOR
AMTEC1 YOUR RECORDS

DETACH AND RETURN THIS
PORTION ONLY

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.

**AMERICAN TECHNOLOGY
CORPORATION**

THE BOARD OF DIRECTORS RECOMMENDS A
VOTE **FOR** THE NOMINEES FOR DIRECTOR
LISTED BELOW

PROPOSAL ONE: To elect directors to serve for
the ensuing year and until their successors are
elected.

- Nominees:** 01) Elwood G. Norris, 02)
Thomas R. Brown,
03) Daniel Hunter, 04) Raymond
C. Smith and
05) Laura M. Clague

For All	Withhold For All	For All Except
0	0	0

**To withhold authority
to vote for any such
nominee(s), mark "For
All Except" and write
such nominee(s)'
name(s) on the line
below.**

THE BOARD OF DIRECTORS
RECOMMENDS A VOTE **FOR**
PROPOSALS TWO, THREE AND
FOUR.

PROPOSAL TWO: To ratify the
selection of Swenson Advisors,
LLP as independent registered
public accounting firm of the
Company for the fiscal year
ending September 30, 2007.

For Against Abstain

0 0 0

PROPOSAL FOUR: To approve
certain terms of the Securities
Purchase Agreement.

For Against Abstain

0 0 0

PROPOSAL THREE: To approve
amendments to the Company's 2005
Equity Incentive Plan.

0 0 0

(Please date and sign exactly as name or names appear(s) on your stock certificate(s). When signing as attorney, executor, administrator, trustee or guardian, please give full title as such. If a corporation, please sign in the full corporate name by President or other authorized officer. If a partnership, please sign in the partnership name by authorized person. IF THE STOCK IS HELD JOINTLY, BOTH OWNERS MUST SIGN.)

YES NO

Please indicate if you plan to attend this
meeting.

0 0

Signature [PLEASE SIGN
WITHIN BOX]

Date

Signature (Joint Owners)

Date

AMERICAN TECHNOLOGY CORPORATION

THIS PROXY RELATES TO AN ANNUAL MEETING OF THE STOCKHOLDERS TO BE HELD

MAY 9, 2007

The undersigned hereby appoints ELWOOD G. NORRIS, THOMAS R. BROWN, and KAREN JORDAN or any of them, with full power of substitution, as attorneys and proxies to vote all shares of Common Stock of American Technology Corporation which the undersigned is entitled to vote at the Annual Meeting of Stockholders of AMERICAN TECHNOLOGY CORPORATION (the "Company") to be held at 2:00 p.m. (local time) at the Company's principal offices located at 15378 Avenue of Science, San Diego, California 92128 on May 9, 2007 and any postponements, continuations and adjournments thereof, with all powers which the undersigned would possess if personally present, upon and in respect of the matters listed on the reverse side and in accordance with the instructions indicated on the reverse side, with discretionary authority as to any and all other matters that may properly come before the meeting.

UNLESS A CONTRARY DIRECTION IS INDICATED, THIS PROXY WILL BE VOTED FOR ALL NOMINEES LISTED IN PROPOSAL ONE AND FOR PROPOSALS TWO, THREE AND FOUR, AS MORE SPECIFICALLY DESCRIBED IN THE PROXY STATEMENT. IF SPECIFIC INSTRUCTIONS ARE INDICATED, THIS PROXY WILL BE VOTED IN ACCORDANCE THEREWITH.

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This proxy has been solicited by or for the benefit of the Board of Directors of the Company. I understand that I may revoke this proxy only by written instructions to that effect, signed and dated by me, which must be actually received by the Company prior to commencement of the Annual Meeting.

(Continued and to be signed on the other side)
