

ITT EDUCATIONAL SERVICES INC
Form DEF 14A
March 15, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934
(Amendment No.)

Filed by the Registrant Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
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- Definitive Proxy Statement
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ITT EDUCATIONAL SERVICES, INC.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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ITT Educational Services, Inc.

2006 Annual Meeting Notice

Proxy Statement

and

2005 Annual Report to Shareholders

<u>Table of Contents</u>	<u>Page</u>
<u>NOTICE OF ANNUAL MEETING OF SHAREHOLDERS</u>	
<u>PROXY STATEMENT</u>	1
<u>Record Date and Outstanding Shares</u>	1
<u>Voting of Proxies</u>	1
<u>Quorum</u>	1
<u>Required Vote</u>	1
<u>Annual Report to Shareholders</u>	2
<u>Proxy Solicitation</u>	2
<u>PROPOSAL ONE: ELECTION OF TWO DIRECTORS TO SERVE UNTIL THE 2009 ANNUAL MEETING OF SHAREHOLDERS AND UNTIL THEIR SUCCESSORS ARE ELECTED AND HAVE QUALIFIED</u>	3
<u>Nominees for Director</u>	3
<u>Retiring Director</u>	3
<u>Directors Continuing in Office</u>	4
<u>Meetings and Committees of the Board of Directors</u>	4
<u>Shareholder Derivative Lawsuits</u>	7
<u>PROPOSAL TWO: APPROVE THE ADOPTION BY ITT/ESI OF THE 2006 ITT EDUCATIONAL SERVICES, INC. EQUITY COMPENSATION PLAN</u>	9
<u>Objectives</u>	9
<u>Eligibility to Receive Awards</u>	10
<u>Types of Awards</u>	10
<u>Duration of the Plan</u>	10
<u>Administration</u>	10
<u>Shares Subject to the 2006 Plan</u>	10
<u>Adjustments Upon Changes in Capitalization</u>	12
<u>No Repricing</u>	12
<u>Stock Options</u>	12
<u>Stock Appreciation Rights</u>	13
<u>Restricted Stock and Restricted Stock Units</u>	14
<u>Performance Shares and Performance Units</u>	15
<u>Other Stock-Based Awards</u>	15
<u>Performance-Based Awards</u>	16
<u>Non-Transferability of Awards</u>	16
<u>Change in Control, Cash-Out and Subsidiary Disposition</u>	16
<u>Amendment, Suspension and Termination of the 2006 Plan</u>	17
<u>Future Benefits Under the 2006 Plan</u>	17
<u>U.S. Federal Income Tax Treatment</u>	17
<u>PROPOSAL THREE: RATIFY THE APPOINTMENT OF PRICEWATERHOUSECOOPERS LLP TO SERVE AS ITT/ESI'S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR ITS FISCAL YEAR ENDING DECEMBER 31, 2006</u>	19
<u>INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</u>	20
<u>Audit Committee Report</u>	20
<u>Audit Fees</u>	20
<u>Audit-Related Fees</u>	21
<u>Tax Fees</u>	21
<u>All Other Fees</u>	22
<u>Audit and Non-Audit Services Pre-Approval Policy</u>	22
<u>SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE</u>	25
<u>EXECUTIVE OFFICERS</u>	25
<u>COMPENSATION OF EXECUTIVE OFFICERS AND DIRECTORS</u>	26

Table of Contents	Page
<u>Summary Compensation Table</u>	26
<u>Compensation of Directors</u>	28
<u>Equity Compensation Plans</u>	29
<u>Employment Contracts</u>	38
<u>Severance Pay Plans</u>	38
<u>Pension and Savings Plans</u>	40
<u>Compensation Committee Interlocks and Insider Participation</u>	44
<u>Compensation Committee Report on Executive Compensation</u>	45
<u>Performance Graph</u>	50
<u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT</u>	51
<u>CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS</u>	54
<u>SHAREHOLDER PROPOSALS FOR 2007 ANNUAL MEETING</u>	54
<u>ADDITIONAL INFORMATION</u>	55
<u>Code of Ethics</u>	55
<u>Transfer Agent Information</u>	55
<u>Shareholder Information</u>	55
<u>Annual Report to Shareholders</u>	56
<u>APPENDIX A CHARTER OF THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS OF ITT EDUCATIONAL SERVICES, INC.</u>	A-1
<u>APPENDIX B ITT EDUCATIONAL SERVICES, INC. S CATEGORICAL STANDARDS OF DIRECTOR INDEPENDENCE</u>	B-1
<u>APPENDIX C 2006 ITT EDUCATIONAL SERVICES, INC. EQUITY COMPENSATION PLAN</u>	C-1
<u>APPENDIX D ITT EDUCATIONAL SERVICES, INC. S 2005 ANNUAL REPORT TO SHAREHOLDERS</u>	D-1
<u>2005 FINANCIAL STATEMENTS AND OTHER INFORMATION</u>	D-1
<u>BUSINESS</u>	D-1
<u>RISK FACTORS</u>	D-21
<u>MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</u>	D-31
<u>SELECTED FINANCIAL DATA</u>	D-32
<u>MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	D-33
<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	D-47
<u>CONTROLS AND PROCEDURES</u>	D-48
<u>MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING</u>	D-50
<u>REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</u>	D-51
<u>CONSOLIDATED FINANCIAL STATEMENTS</u>	D-53
<u>NOTES TO CONSOLIDATED FINANCIAL STATEMENTS</u>	D-57
<u>FINANCIAL STATEMENT SCHEDULE</u>	D-75
<u>QUARTERLY RESULTS</u>	D-76
<u>DIRECTORS AND EXECUTIVE OFFICERS</u>	D-77
<u>OFFICER CERTIFICATIONS</u>	D-78

ITT EDUCATIONAL SERVICES, INC.

13000 North Meridian Street

Carmel, IN 46032-1404

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

TO BE HELD MAY 9, 2006

The 2006 Annual Meeting of Shareholders of ITT Educational Services, Inc. (ITT/ESI) will be held at The Jefferson Hotel, 1200th Street, NW, Washington, DC 20036, on Tuesday, May 9, 2006, at 9:00 a.m., local time, for the following purposes:

1. To consider and vote upon three proposals described in the accompanying Proxy Statement providing for:

Proposal One: Election of two Directors to serve until the 2009 Annual Meeting of Shareholders and until their successors are elected and have qualified.

Proposal Two: Approve the adoption by ITT/ESI of the 2006 ITT Educational Services, Inc. Equity Compensation Plan.

Proposal Three: Ratify the appointment of PricewaterhouseCoopers LLP to serve as ITT/ESI 's independent registered public accounting firm for its fiscal year ending December 31, 2006.

2. To act upon such other matters that may properly come before the meeting.
All shareholders of record at the close of business on March 10, 2006 will be entitled to vote at the meeting.

It is important that your shares be represented at this meeting. Whether or not you expect to be present, please fill in, date, sign and return the enclosed proxy form in the accompanying addressed, postage-prepaid envelope. If you attend the meeting, you may revoke your proxy and vote in person.

By Order of the Board of Directors,

Clark D. Elwood

Senior Vice President, General

Counsel and Secretary

ITT EDUCATIONAL SERVICES, INC.

13000 North Meridian Street

Carmel, IN 46032-1404

PROXY STATEMENT

Annual Meeting of Shareholders

May 9, 2006

This Proxy Statement and accompanying proxy are being sent to shareholders on or about March 24, 2006 in connection with the solicitation by the Board of Directors of ITT Educational Services, Inc. (ITT/ESI, we or us) of proxies to be voted at the 2006 Annual Meeting of Shareholders to be held at 9:00 a.m., local time, Tuesday, May 9, 2006, at The Jefferson Hotel, 1200 16th Street, NW, Washington, DC 20036, for the purposes set forth in the accompanying Notice.

Record Date and Outstanding Shares

The accompanying proxy represents all of the shares of ITT/ESI common stock, \$0.01 par value per share (the ITT/ESI Common Stock), you are entitled to vote at the meeting. Each of the shares of ITT/ESI Common Stock outstanding at the close of business on March 10, 2006, the record date for the meeting (the Record Date), is entitled to one vote at the meeting. Shareholders holding a majority of such shares must be present at the meeting, whether in person or by proxy, in order to constitute a quorum for the transaction of business. As of March 10, 2006, 43,736,440 shares of ITT/ESI Common Stock were issued and outstanding.

Voting of Proxies

Clark D. Elwood and Kevin M. Modany, the persons named as proxies on the proxy card accompanying this Proxy Statement, were selected by our Board of Directors to serve in such capacity. Messrs. Elwood and Modany are both executive officers of ITT/ESI. Each executed and returned proxy will be voted in accordance with the directions indicated thereon, or if no direction is indicated, such proxy will be voted in accordance with the recommendations of our Board of Directors contained in this Proxy Statement. Each shareholder giving a proxy has the power to revoke it at any time before the shares it represents are voted. Revocation of a proxy is effective upon receipt by our Secretary of either (a) an instrument revoking the proxy or (b) a duly executed proxy bearing a later date. Additionally, a shareholder may change or revoke a previously executed proxy by voting in person at the Annual Meeting. Our Board of Directors is not aware of any matters, other than those described below, which are to be voted on at the meeting. If any other matters are properly raised at the meeting, however, the persons named in the enclosed form of proxy intend to vote the proxy in accordance with their judgment on such matters.

Quorum

In order for business to be conducted at the Annual Meeting, a quorum must be present. A quorum will be present if the holders of a majority of the shares issued and outstanding as of the Record Date and entitled to vote are represented in person or by proxy at the Annual Meeting. Votes cast by proxy or in person at the Annual Meeting will be tabulated by the election inspector appointed for the meeting and will determine whether a quorum is present. The election inspector will treat abstentions and broker non-votes (as defined below) as shares that are present for purposes of determining the presence of a quorum.

Required Vote

Election of Two Directors. A plurality of the shares of the ITT/ESI Common Stock voted in person or by proxy is required to elect the nominees for Directors. A plurality means that the two nominees receiving the

largest number of votes cast will be elected. Shareholders will not be allowed to cumulate their votes in the election of Directors. Abstentions and broker non-votes will not be considered as votes cast on this proposal and therefore will have no effect on the outcome of this proposal.

Approve the Adoption of the Equity Compensation Plan. To approve the adoption of the 2006 ITT Educational Services, Inc. Equity Compensation Plan (2006 Plan), the proposal must be approved by the affirmative vote of a majority of the shares of the ITT/ESI Common Stock represented in person or by proxy at the Annual Meeting. In addition, pursuant to the rules of the New York Stock Exchange (NYSE), the number of votes cast on the proposal must represent more than 50% of the votes entitled to be cast. Abstentions will be counted for purposes of determining whether a quorum is present and will be considered shares represented at the Annual Meeting. Accordingly, an abstention will have the same effect as a vote against this proposal.

If you are the beneficial owner of shares held in street name by a broker, the broker, as the record holder of the shares, is required to vote those shares in accordance with your instructions. If you do not give instructions to the broker, the broker will nevertheless be entitled to vote the shares with respect to discretionary items but will not be permitted to vote the shares with respect to non-discretionary items (in which case, the shares will be treated as broker non-votes). The proposal to approve the adoption of the 2006 Plan is a non-discretionary item. Therefore, if you do not provide your broker with voting instructions on this proposal, your shares of ITT/ESI Common Stock will not be voted on this proposal. Broker non-votes will not be considered as votes cast on this proposal but will be counted for purposes of determining whether a quorum is present and will be considered shares represented at the Annual Meeting. Accordingly, a broker non-vote will have the same effect as a vote against this proposal. Also, a broker non-vote would affect the requirement that the number of votes cast on such proposal represent more than 50% of the votes entitled to be cast.

Ratify the Appointment of the Independent Registered Public Accounting Firm. The affirmative vote of a majority of the shares of the ITT/ESI Common Stock represented in person or by proxy at the Annual Meeting is required to ratify the appointment by the Audit Committee of the Board of Directors of PricewaterhouseCoopers LLP (PWC) as our independent registered public accounting firm for our fiscal year ending December 31, 2006. Abstentions and broker non-votes will be counted for purposes of determining whether a quorum is present and will be considered shares represented at the Annual Meeting. Accordingly, an abstention or broker non-vote will have the same effect as a vote against this proposal.

Annual Report to Shareholders

Our 2005 Annual Report to Shareholders for the year ended December 31, 2005, containing financial and other information pertaining to us, is being furnished to shareholders with this Proxy Statement.

Proxy Solicitation

Officers, Directors and other employees of ITT/ESI may solicit proxies, without additional compensation, by telephone, electronic mail, facsimile or mail, or by meetings with shareholders or their representatives. We will reimburse brokers, banks or other custodians, nominees and fiduciaries for their charges and expenses in forwarding proxy material to beneficial owners. We will pay all expenses of solicitation of proxies. In addition, we have retained Georgeson Shareholder Communications, Inc. to assist us in the solicitation of proxies for a fee of approximately \$7,000, plus reimbursement for its out-of-pocket expenses and for payments made to brokers and other nominees for their expenses in forwarding soliciting material. Georgeson Shareholder Communications, Inc. will perform a broker search, distribute proxy materials to beneficial owners and solicit voted proxies from banks, brokers, nominees and intermediaries.

PROPOSAL ONE: ELECTION OF TWO DIRECTORS TO SERVE UNTIL THE 2009 ANNUAL MEETING OF SHAREHOLDERS AND UNTIL THEIR SUCCESSORS ARE ELECTED AND HAVE QUALIFIED

Our Board of Directors currently consists of eight Directors divided into three classes. Two classes contain three Directors each and one class contains two directors. The term of one class expires each year. Generally, each Director serves until the annual meeting of shareholders held in the year that is three years after the Director's election and thereafter until the Director's successor is elected and has qualified. One of the Directors in the class of Directors whose terms expire at the 2006 Annual Meeting of Shareholders, however, will be retiring on May 9, 2006. Following this Director's retirement, the Board of Directors intends to fill the vacancy caused by that retirement when a suitable candidate has been identified.

At the meeting, two Directors are to be elected to hold office for a three-year term to expire at the 2009 Annual Meeting of Shareholders and until their successors are elected and have qualified. The persons named in the accompanying proxy intend to vote such proxy for the election to the Board of Directors of Joanna T. Lau and Samuel L. Odle, two of the three current Directors whose terms expire this year, unless you direct them to vote otherwise.

Each of the nominees has consented to serve as a Director. If for any reason a nominee should become unable or unwilling to accept nomination or election, the persons named in the accompanying proxy intend to vote the proxy for the election of such other person as our Board, upon recommendation of the Nominating and Corporate Governance Committee, may select. Alternatively, our Board may reduce the number of Directors to eliminate the vacancy.

Our Board of Directors does not have a policy with respect to the Directors' attendance at our annual shareholder meetings, but all of our Directors are encouraged to attend those meetings. Our 2005 Annual Meeting of Shareholders was held on May 3, 2005, and all nine members of our Board of Directors at that time attended that meeting.

A brief summary of each Director's principal occupation, business affiliations and other information follows. Unless otherwise indicated, each Director's principal occupation has been the same for the past five years.

Nominees for Director

Term Expiring at the 2009 Annual Meeting.

Joanna T. Lau, age 47, has served as chairperson and chief executive officer of Lau Acquisition Corporation (d/b/a LAU Technologies), a management consulting and investment firm, since March 1990. Ms. Lau has been a Director of ITT/ESI since October 2003.

Samuel L. Odle, age 56, has served as president and chief executive officer of Methodist Hospital (MH) and Indiana University Hospital (IUH) and executive vice president of Clarian Health Partners (Clarian), an Indianapolis-based private, non-profit healthcare organization comprised of MH, IUH and Riley Hospital for Children, since July 2004. Mr. Odle served as chief administrative officer of MH and senior vice president of Clarian from January 1997 through June 2004. Mr. Odle has been a Director of ITT/ESI since January 2006.

The Board of Directors recommends a vote FOR each of the nominees listed above.

Retiring Director

Term Expiring at the 2006 Annual Meeting.

Rand V. Araskog, age 74, served as chairman and chief executive officer of ITT Corporation (ITT), a diversified conglomerate, from 1980 until his retirement in February 1998. He is also a director of Rayonier, Inc. and Cablevision Systems Corporation. Mr. Araskog has been a Director of ITT/ESI since April 1994.

Directors Continuing in Office

Term Expiring at the 2007 Annual Meeting.

Rene R. Champagne, age 64, has served as Chairman of ITT/ESI since October 1994 and Chief Executive Officer of ITT/ESI since September 1985. From September 1985 through December 2001, he also served as President of ITT/ESI. Mr. Champagne has been a Director of ITT/ESI since October 1985.

John F. Cozzi, age 44, has served as a managing director of AEA Investors LLC, a private equity firm, since January 2004. Mr. Cozzi served as a managing director of Arena Capital Partners, LLC, a private equity firm, from May 1999 through December 2003. Mr. Cozzi has been a Director of ITT/ESI since October 2003.

Term Expiring at the 2008 Annual Meeting.

John E. Dean, age 55, is an attorney who has specialized in higher education law since April 1985. Mr. Dean has been a partner at the Law Offices of John E. Dean since June 2005. He was a partner of the Dean Blakey law firm from June 2002 through May 2005. Mr. Dean was a partner at the Dean, Blakey & Moskowitz law firm from July 1995 through May 2002. Mr. Dean has also served as a principal of Washington Partners, LLC, a public affairs firm since June 2002. Mr. Dean has been a Director of ITT/ESI since December 1994.

James D. Fowler, Jr., age 61, served as senior vice president and director, human resources of ITT Industries, Inc., an industrial, commercial machinery and equipment company, from November 2000 until his retirement in October 2002. Mr. Fowler has been a Director of ITT/ESI since April 1994.

Vin Weber, age 53, has been a partner at Clark & Weinstock Inc., a management and public policy consulting firm, since 1994. He is also chairman of the National Endowment for Democracy, a public interest group. Mr. Weber is a senior fellow at the University of Minnesota's Humphrey Institute of Public Affairs and co-director of the Institute's Policy Forum. He is also a director of Lenox Group, Inc. Mr. Weber has been a Director of ITT/ESI since December 1994.

Meetings and Committees of the Board of Directors

During 2005, there were six regular meetings of the Board of Directors. During 2005, each of the Directors attended 75% or more of the aggregate number of meetings of the Board of Directors and the standing Board committees on which he or she served, except for Rand V. Araskog who, for health reasons, was only able to attend 58% of those meetings. The standing committees of the Board of Directors are the Audit Committee, the Compensation Committee and the Nominating and Corporate Governance Committee.

Audit Committee. Our Audit Committee was established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934 ("1934 Act"). Our Board of Directors has adopted a written charter for the Audit Committee, a copy of which is set forth in Appendix A or may be obtained from our website at www.ittesi.com. The functions of the Audit Committee are to assist the Board of Directors in its oversight of:

- the integrity of our financial statements and other financial information provided by us to any governmental body or the public;
- our compliance with legal and regulatory requirements;
- our systems of internal controls regarding finance, accounting, legal compliance and ethics that our management and the Board of Directors establish;
- our auditing, accounting and financial reporting processes generally;
- the qualifications, independence and performance of our independent registered public accounting firm; and
- the performance of our compliance and internal audit functions.

The Audit Committee also performs other functions as detailed in the Audit Committee's charter, including, without limitation, appointing, compensating, retaining and overseeing our independent registered public accounting firm and pre-approving all services to be provided to us by our independent registered public accounting firm.

The Audit Committee held five meetings during 2005. The members of the Audit Committee in 2005 through January 25, 2005 were Rand V. Araskog, John F. Cozzi, John E. Dean, Harris N. Miller and Daniel P. Weadock. The members of the Audit Committee from January 26, 2005 through July 12, 2005 were John F. Cozzi, John E. Dean, Harris N. Miller and Daniel P. Weadock. The members of the Audit Committee from July 13, 2005 through January 9, 2006 were John F. Cozzi, John E. Dean and Harris N. Miller. At the next Audit Committee meeting on January 23, 2006, following Mr. Miller's resignation from the Board of Directors on January 9, 2006, the members of the Audit Committee were John F. Cozzi, John E. Dean and Vin Weber. The current members of the Audit Committee have been members since January 24, 2006 and include John F. Cozzi, John E. Dean, Samuel L. Odle and Vin Weber. Our Board of Directors has determined that John F. Cozzi is an audit committee financial expert, as that term is defined in Item 401(h)(2) of Regulation S-K under the 1934 Act, and is independent pursuant to Item 7(d)(3)(iv) of Schedule 14A under the 1934 Act. Each of the current members of the Audit Committee is independent and each of the members of the Audit Committee in 2005 was independent, as defined in Sections 303.01(B)(2)(a) and (3) and Sections 303A.02 and .06 of the NYSE Listed Company Manual and Rule 10A-3 of the 1934 Act.

Compensation Committee. Our Board of Directors has a written charter for the Compensation Committee. A copy of the charter may be obtained from our website at www.ittesi.com. The functions of the Compensation Committee are to discharge the Board of Directors responsibilities relating to compensation of our Directors and officers. The Compensation Committee has overall responsibility for approving and evaluating our Director and officer compensation plans, policies and programs. The Compensation Committee also performs other functions as detailed in the Compensation Committee's charter. In addition, the Compensation Committee is responsible for producing an annual report on executive compensation for inclusion in our proxy statement, in accordance with applicable rules and regulations.

The Compensation Committee held four meetings during 2005. The members of the Compensation Committee in 2005 through January 25, 2005 were James D. Fowler, Jr., Joanna T. Lau, Harris N. Miller, Daniel P. Weadock and Vin Weber. The members of the Compensation Committee from January 26, 2005 through January 22, 2006 were Rand V. Araskog, James D. Fowler, Jr., Joanna T. Lau and Vin Weber. The current members of the Compensation Committee have been members since January 23, 2006 and include Rand V. Araskog, James D. Fowler, Jr. and Joanna T. Lau. Each of the current members of the Compensation Committee is independent and each of the members of the Compensation Committee in 2005 was independent, as defined in Section 303A.02 of the NYSE Listed Company Manual.

Nominating and Corporate Governance Committee. Our Board of Directors has a written charter for the Nominating and Corporate Governance Committee. A copy of the charter may be obtained from our website www.ittesi.com. The functions of the Nominating and Corporate Governance Committee, which are detailed in its charter, are to:

- assist the Board of Directors by identifying individuals qualified to become Directors, and recommend to the Board of Directors the Director nominees for each annual meeting of shareholders;
- develop and recommend to the Board the Corporate Governance Guidelines applicable to us;
- lead the Board of Directors in its annual review of the Board of Directors' performance; and
- recommend to the Board of Directors Board members for each standing Board committee.

The Nominating and Corporate Governance Committee held three meetings during 2005. The members of the Nominating and Corporate Governance Committee in 2005 through January 25, 2005 were John F. Cozzi, John E. Dean, James D. Fowler, Jr., Joanna T. Lau and Vin Weber. The members of the Nominating and

Corporate Governance Committee from January 26, 2005 through January 22, 2006 were Rand V. Araskog, James D. Fowler, Jr., Joanna T. Lau and Vin Weber. The current members of the Nominating and Corporate Governance Committee have been members since January 23, 2006 and include Rand V. Araskog, James D. Fowler, Jr. and Joanna T. Lau. Each of the current members of the Nominating and Corporate Governance Committee is independent and each of the members of the Nominating and Corporate Governance Committee in 2005 was independent, as defined in Section 303A.02 of the NYSE Listed Company Manual.

The Nominating and Corporate Governance Committee will consider Director candidates recommended by our shareholders. A shareholder who wishes to recommend a Director candidate for consideration by the Nominating and Corporate Governance Committee should send the recommendation to our Secretary at ITT Educational Services, Inc., 13000 North Meridian Street, Carmel, Indiana 46032-1404, who will forward it to the Committee. Any such recommendation should include a description of the candidate's qualifications for Board service, the candidate's written consent to be considered for nomination and to serve if nominated and elected, and addresses and telephone numbers for contacting the shareholder and the candidate for more information. A shareholder who wishes to nominate an individual as a Director candidate at an annual meeting of shareholders, rather than recommend the individual to the Nominating and Corporate Governance Committee as a nominee, must comply with the advance notice requirements set forth in our By-Laws. See Shareholder Proposals for 2007 Annual Meeting.

The Nominating and Corporate Governance Committee selects nominees for Directors on the basis of each candidate's broad experience, judgment, integrity, ability to make independent inquiries, understanding of our business environment and willingness to devote adequate time to the duties of our Board of Directors. The Nominating and Corporate Governance Committee identifies possible nominees for a Director who meet specified objectives in terms of the composition of our Board of Directors that are established by law, the NYSE and/or our Board of Directors, taking into account such factors as geographic, occupational, gender, race and age diversity. The only minimum specified qualities and skills that the Nominating and Corporate Governance Committee believes are necessary for one or more of our Directors to possess and the only specific standards for the overall structure and composition of our Board of Directors are those imposed by law and the NYSE or contained in our Corporate Governance Guidelines and the charters of the standing committees of our Board of Directors, such as independence, financial expertise and age.

The Nominating and Corporate Governance Committee utilizes various resources for identifying nominees for Directors, including recommendations of our Directors, management and shareholders, the media, industry affiliations, government service and search firms to name a few. The Nominating and Corporate Governance Committee evaluates nominees for Directors by assessing the nominees' qualities, skills and potential contributions to our Board based on available information, against the qualities, skills and contributions sought and the current composition of our Board.

Independent Directors. Our Board of Directors currently contains seven non-management Directors: Messrs. Araskog, Cozzi, Dean, Fowler, Odle and Weber, and Ms. Lau. As permitted by the rules of the NYSE, our Board of Directors has adopted categorical standards to assist it in making determinations of independence. Any relationships that we may have with any of our Directors that do not cause the Director to violate any of those standards are immaterial. A copy of the categorical standards is set forth in Appendix B. Our Board of Directors has determined that each of our non-management Directors meets those standards, is independent (as defined in Section 303A.02 of the NYSE Listed Company Manual) and, as a result, any relationships that we have with any of our non-management Directors are immaterial under those standards.

The non-management Directors on our Board of Directors meet at regularly scheduled executive sessions without our management. The Directors on our Board of Directors who are determined to be independent meet by themselves in executive session at least once annually. Our Board of Directors has chosen Joanna T. Lau to preside over the executive sessions of our non-management and independent Directors in 2006 (Presiding Director). Interested parties may send communications to the non-management Directors, independent Directors or the entire Board of Directors by e-mail to PresidingDirector@ittesi.com or by regular mail addressed to:

ITT Educational Services, Inc.

13000 North Meridian Street

Carmel, IN 46032-1404

Attention: Presiding Director

Although such communications are available to any Director who wishes to review them, our General Counsel initially reviews all communications and forwards to the Presiding Director those communications that meet certain criteria set by the non-management Directors.

Shareholder Derivative Lawsuits

On or about April 29, 2004, a consolidated complaint in a shareholder derivative lawsuit was filed against five of our current and former executive officers, ten of our current and former Directors and PWC, our independent registered public accounting firm, in the Superior Court of Hamilton County, Indiana under the following caption: *In Re ITT Educational Services, Inc. Derivative Litigation*. This action was a result of the court's March 30, 2004 order to consolidate two separate shareholder derivative lawsuits filed on or about February 27, 2004. On December 1, 2004, the court dismissed the consolidated complaint without prejudice and gave the plaintiffs 30 days to replead their complaint. On January 3, 2005, the plaintiffs filed an amended consolidated complaint. The amended consolidated complaint alleged, among other things, that:

certain individual defendants breached a fiduciary duty by selling our common stock and misappropriating our information; all defendants breached their fiduciary duties to us, abused their ability to control and influence us, grossly mismanaged us, caused us to waste corporate assets and were unjustly enriched; and

PWC breached a duty of care and professional competence to us and breached its contracts with us.

The amended consolidated complaint sought unspecified damages, extraordinary equitable and/or injunctive relief, disgorgement of profits, benefits and other compensation, costs and attorneys' fees. On September 16, 2005, the court dismissed with prejudice all of the claims against all of the defendants, because the plaintiffs' allegations failed to meet the pleading requirement of particularity for demand futility allegations. On January 4, 2006, the plaintiffs filed a notice of appeal to the Indiana Court of Appeals.

On September 7, 2004, a shareholder derivative lawsuit was filed against five of our current and former executive officers, ten of our current and former Directors and PWC, in the U.S. District Court for the Southern District of Indiana under the following caption: *Alaska Electrical Pension Fund Derivatively on Behalf of ITT Educational Services, Inc. v. Rene R. Champagne, et al.* (the Alaska Action). The complaint alleges, among other things, that the defendants caused us to violate state and federal education finance laws and regulations by falsifying our student records and federal securities laws by falsifying our accounting, auditing and financial reporting between October 2002 and April 2004. As a result, the complaint alleges, among other things, that the individual defendants:

breached and/or aided and abetted in the breach of:

a duty to disseminate accurate information about us;

fiduciary duties of care, candor and loyalty to us and disclosure to our shareholders;

a duty to test, oversee and monitor our system of internal controls, governance procedures and disclosure procedures; and

a duty to ensure that our internal controls, governance procedures and disclosure procedures were functioning in an effective manner and in compliance with Pub. L. 107-204, 116 Stat. 745 (2002);
abused their ability to control and influence us;
grossly mismanaged us;
committed constructive fraud;
will be and have been unjustly enriched at our expense; and
violated Section 10(b) of the 1934 Act and Rule 10-5 promulgated thereunder by:
disseminating or approving false statements that they knew or recklessly disregarded were misleading;
failing to disclose material facts necessary in order to make those statements not misleading; and
misappropriating our proprietary information.

In addition, the complaint alleges, among other things, that PWC:

violated Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder by:
disseminating or approving false statements that it knew or recklessly disregarded were misleading; and
failing to disclose material facts necessary in order to make those statements not misleading;
was negligent and committed accounting malpractice by failing to conduct its audits of our 2002 and 2003 fiscal year financial statements in accordance with generally accepted accounting principles, generally accepted auditing standards and U.S. Securities and Exchange Commission (SEC) rules;
aided and abetted the individual defendants :
breach of fiduciary duties to us;
abuse of their control of us;
gross mismanagement of us; and
violated their duty of candor to our shareholders.

The complaint seeks unspecified damages, extraordinary equitable and/or injunctive relief, punitive damages, costs and expenses, attorneys' fees, pre-judgment interest, an order directing the defendants to account for all damages caused by them and all profits, special benefits and unjust enrichment they obtained, and an order directing us to reform and improve our corporate governance and internal control procedures. On December 8, 2004, the parties agreed to stay this action pending the entry of a final judgment in the *In Re ITT Educational Services, Inc. Derivative Litigation* action filed in the Superior Court of Hamilton County, Indiana on or about April 29, 2004 (the *In Re ITT Action*). On September 16, 2005, the court dismissed the *In Re ITT Action* with prejudice. On February 1, 2006, the court dismissed without prejudice all of the claims against all of the defendants in the Alaska Action.

On November 17, 2004, a shareholder derivative lawsuit was filed against ten of our current and former Directors, in the Chancery Court of New Castle County, Delaware under the following caption: *Albert Reitan, derivatively on behalf of nominal defendant ITT Educational Services, Inc. v. Rand V. Araskog, et al.* (the *Reitan Action*). The complaint alleges, among other things, that the defendants abdicated their fiduciary duty of good faith to us by making no effort to oversee our operations and business practices to ensure that we comply with all applicable laws, rules and regulations. The complaint seeks unspecified damages, equitable relief, attorneys' fees, accountants' fees, experts' fees, costs and expenses. On March 31, 2005, in response to the parties' request, the court issued an order staying this action until the entry of a final judgment in the *City of Austin Police Retirement System, Individually and on Behalf of All Others Similarly Situated v. ITT Educational Services, Inc. et al.* action filed in the U.S. District Court for the Southern District of Indiana (the *City of Austin Action*). On October 24, 2005, the *City of Austin Action* was dismissed with prejudice. On March 7, 2006, the court dismissed with prejudice all of the claims against all of the defendants in the *Reitan Action*.

Although the derivative actions are brought nominally on behalf of us, we expect to incur defense costs and other expenses in connection with the derivative lawsuits, and we cannot assure you that the ultimate outcome of these or other actions will not have a material adverse effect on our financial condition or results of operations.

On July 7, 2004, we received a derivative demand letter pursuant to Del. Ct. Ch. R. 23.1 on behalf of Arthur Stein, a purported shareholder, demanding that our Board of Directors commence a civil action against ten of our current and former Directors and four of our current and former executive officers to recover for our benefit the amount of damages sustained by us as a result of the misconduct alleged in the letter. The misconduct alleged in the letter is similar to the type of misconduct alleged against the individual defendants in the consolidated shareholder derivative lawsuit described above. The demand letter indicates that Mr. Stein will commence a shareholder's derivative action on our behalf, if our Board does not commence an action as demanded therein within a reasonable period of time. We informed Mr. Stein that our Board deferred its decision with respect to Mr. Stein's demand until the conclusion of the U.S. Department of Justice (DOJ) investigation of us, the inquiry initiated by the SEC into the allegations investigated by the DOJ and the securities class action lawsuits filed against us, or until the receipt of additional information concerning the allegations made in the demand.

The current and former executive officers named in one or more of the shareholder derivative lawsuits and derivative demand letter described above include: Gene A. Baugh, Rene R. Champagne, Clark D. Elwood, Eugene W. Feichtner, Martin A. Grossman, Thomas W. Lauer, Kevin M. Modany and Omer E. Waddles.

Certain of our current and former officers and Directors are or may become a party in certain of the actions described above. Our By-Laws and Restated Certificate of Incorporation obligate us to indemnify our officers and Directors to the fullest extent permitted by Delaware law, provided that their conduct complied with certain requirements. We are obligated to advance defense costs to our officers and Directors, subject to the individual's obligation to repay such amount if it is ultimately determined that the individual was not entitled to indemnification. In addition, our indemnity obligation can, under certain circumstances, include indemnifiable judgments, penalties, fines and amounts paid in settlement in connection with those actions.

PROPOSAL TWO: APPROVE THE ADOPTION BY ITT/ESI OF THE 2006 ITT EDUCATIONAL SERVICES, INC. EQUITY COMPENSATION PLAN

On January 24, 2006, based on the recommendation of our Compensation Committee, our Board of Directors adopted the 2006 ITT Educational Services, Inc. Equity Compensation Plan (the 2006 Plan) and directed that the 2006 Plan be submitted to our shareholders for consideration at the 2006 Annual Meeting of Shareholders. As described more fully in the Compensation Committee Report on Executive Compensation appearing elsewhere in this Proxy Statement, it remains the intent of the Compensation Committee that incentives based on long-term performance should be a major component in the pay package for senior executives. The 2006 Plan provides for a broad array of equity-based awards to further the Compensation Committee's intent of creating performance incentives and aligning executive's interests with those of our shareholders. In addition, the 2006 Plan will permit awards to members of our Board of Directors which will promote equity ownership in us by our Directors.

The following is a summary of the principal features of the 2006 Plan and is qualified in its entirety by reference to the complete text of the 2006 Plan as set forth as Appendix C to this Proxy Statement. Shareholders are urged to read the actual text of the 2006 Plan. Capitalized terms used but not defined herein have the meanings assigned to them in the 2006 Plan.

Objectives

The objectives of the 2006 Plan are to attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentives to participants, and to optimize the profitability and growth of ITT/ESI through incentives that are consistent with our goals and that link the participants' personal interests to those of our shareholders.

Eligibility to Receive Awards

The 2006 Plan provides that awards may be granted to employees and Directors of ITT/ESI and its subsidiaries. The approximate number of persons eligible to participate in the 2006 Plan is 200.

Types of Awards

The 2006 Plan permits the grant of the following types of awards:

- stock options (incentive and nonqualified);
- stock appreciation rights (SARs);
- restricted stock;
- restricted stock units (RSUs);
- performance shares;
- performance units; and
- other stock-based awards.

Duration of the Plan

No award may be granted under the 2006 Plan after May 9, 2016.

Administration

The 2006 Plan will be administered by a committee consisting of two or more members of our Board of Directors (the Committee). It is intended that each member of the Committee will be a non-employee director within the meaning of Rule 16b-3 of the 1934 Act, an outside director under regulations promulgated under Section 162(m) of the Internal Revenue Code of 1986, as amended (the IRC), and an independent director under the NYSE listing standards. Our Board of Directors has currently designated the Compensation Committee as the Committee for the 2006 Plan; however, the entire Board will act as the Committee with respect to awards to non-employee Directors. Subject to applicable law, the Committee may delegate its authority under the 2006 Plan.

Subject to the provisions of the 2006 Plan, the Committee has the authority to:

- select the employees and non-employee Directors to whom awards are to be granted;
- determine whether and to what extent awards are to be granted;
- determine the size, type, terms and conditions of awards;
- approve the form of award agreements for use under the 2006 Plan;
- establish performance measures for any performance period and determine whether such goals were satisfied;
- amend any outstanding award in the event of termination of employment or service or a change in control, subject to certain limitations;
- construe and interpret the 2006 Plan and any award agreement and apply their provisions; and
- take any other action consistent with the terms of the 2006 Plan that the Committee deems appropriate.

All decisions, determinations and interpretations of the Committee will be final, binding and conclusive on all persons, including ITT/ESI and the participants.

Shares Subject to the 2006 Plan

The total number of shares available for awards under the 2006 Plan is 4,000,000, subject to antidilution adjustments. Each share underlying stock options and SARs granted under the 2006 Plan, and not forfeited or terminated, will reduce the number of shares available for future awards under the 2006 Plan by one share. The

delivery of a share in connection with a full-value award (i.e., an award of restricted stock, RSUs, performance shares, performance units or any other stock-based award with value denominated in shares) will reduce the number of shares remaining for other awards by three shares. For example, if the Committee grants to a participant:

an option to purchase 100 shares, the number of shares available for future awards under the 2006 Plan would be reduced by 100; and
an award of 100 shares of restricted stock, the number of shares available for future awards under the 2006 Plan would be reduced by 300.

The source of shares for issuance under the 2006 Plan may be authorized and unissued shares or treasury shares.

If an award under the 2006 Plan is forfeited or terminated for any reason before being exercised, fully vested or settled, as the case may be, then the shares underlying that award will be added back to the remaining shares and will be available for further awards under the 2006 Plan. The number of shares available for future grant under the 2006 Plan, however, will be reduced by: (a) any shares subject to an award that are withheld or otherwise not issued upon the exercise of the award to satisfy the participant's tax withholding obligations or to pay the exercise price of the award; and (b) shares subject to an award that is settled in cash in lieu of shares.

Pursuant to the 2006 Plan, subject to antidilution adjustments:

the maximum aggregate number of shares that may be delivered in connection with stock options intended to be incentive stock options under Section 422 of the IRC (incentive stock options) may not exceed 4,000,000 shares;
the maximum aggregate number of shares that may be granted to an individual participant during any calendar year:
pursuant to all forms of awards is 200,000 shares;