

## 14. COMMITMENTS AND CONTINGENCIES

### Qui Tam Matters

*Washington v. Education Management Corporation.* On May 3, 2011, a *qui tam* action captioned *United States of America, and the States of California, Florida, Illinois, Indiana, Massachusetts, Minnesota, Montana, New Jersey, New Mexico, New York and Tennessee, and the District of Columbia, each ex rel. Lynntoya Washington and Michael T. Mahoney v. Education Management Corporation, et al.* (“Washington”) filed under the federal False Claims Act in April 2007 was unsealed due to the U.S. Department of Justice's decision to intervene in the case. Five of the states listed on the case caption joined the case based on *qui tam* actions filed under their respective False Claims Acts. The Court granted the Company's motion to dismiss the District of Columbia from the case and denied the Commonwealth of Kentucky's motion to intervene in the case under its consumer protection laws.

The case, which is pending in federal district court in the Western District of Pennsylvania, relates to whether the Company's compensation plans for admission representatives violated the HEA and U.S. Department of Education regulations prohibiting an institution participating in Title IV programs from providing any commission, bonus or other incentive payment based directly or indirectly on success in securing enrollments to any person or entity engaged in any student recruitment or admissions activity during the period of July 1, 2003 through June 30, 2011. The complaint was initially filed by a former admissions representative at The Art Institute of Pittsburgh Online Division and a former director of training at EDMC Online Higher Education and asserts the relators are entitled to recover treble the amount of actual damages allegedly sustained by the federal government as a result of the alleged activity, plus civil monetary penalties. The complaint does not specify the amount of damages sought but claims that the Company and/or students attending the Company's schools received over \$11 billion in funds from participation in Title IV programs and state financial aid programs during the period of alleged wrongdoing.

On May 11, 2012, the Court ruled on the Company's motion to dismiss the case for failure to state a claim upon which relief can be granted, dismissing the claims that the design of the Company's compensation plan for admissions representatives, which included both quantitative and qualitative factors, violated the incentive compensation rule and allowing common law claims and the allegations that the plan as implemented violated the rule to continue to discovery. On May 8, 2014, the Court denied the Company's motion for summary judgment based on a statistical analysis of the salary adjustments for admissions representatives under the compensation plan. The Company believes the case to be without merit and intends to vigorously defend itself. From time to time, the Company engages in settlement discussions with respect to this case. At this time, the Company is unable to estimate the amount of any reasonably possible loss related to this matter because of the status of current settlement negotiations and the fact that the Company is only willing to settle the case if a settlement can be negotiated in an amount that the Company believes is reasonable. There can be no assurance that the settlement conversations will lead to a settlement acceptable to all parties and approved by all parties. There can also be no assurance that any settlement will be within amounts currently accrued or be covered by insurance or not be material to the Company.

In July 2014, our excess insurer filed a declaratory judgment action in federal district court in the Western District of Pennsylvania seeking a ruling that it has no liability to provide coverage to us in connection with Washington and the other *qui tam* litigation matters. Because of the many questions of fact and law that may arise, the outcome of this legal proceeding is uncertain at this point.

*Sobek v. Education Management Corporation.* On March 13, 2012, a *qui tam* action captioned *United States of America, ex rel. Jason Sobek v. Education Management Corporation, et al.* filed under the federal False Claims Act on January 28, 2010 was unsealed after the U.S. Department of Justice declined to intervene in the case. The case, which is pending in the federal district court in the Western District of Pennsylvania, alleges that the defendants violated the U.S. Department of Education's regulation prohibiting institutions from making substantial misrepresentations to prospective students, did not adequately track student academic progress and violated the U.S. Department of Education's prohibition on the payment of incentive compensation to admissions representatives. The complaint was filed by a former project associate director of admissions at EDMC Online Higher Education who worked for South University and asserts the

relator is entitled to recover treble the amount of actual damages allegedly sustained by the federal government as a result of the alleged activity, plus civil monetary penalties. The complaint does not specify the amount of damages sought but claims that the Company's institutions were ineligible to participate in Title IV programs during the period of alleged wrongdoing.

In August 2013, the parties to the action, along with the U.S. Department of Justice, participated in a private mediation in which the relator and defendants reached an agreement in principle regarding the financial terms of a potential settlement. The agreement between the parties remains subject to approval by the U.S. Department of Justice. Significant terms remain to be negotiated, and there is no certainty that a final agreement will be reached. The settlement amount agreed to by the parties under the terms of the agreement in principle would be paid by the Company's insurer and the Company would pay an immaterial amount of attorneys' fees incurred by the relator. The ultimate dismissal of the action, should a final settlement be reached, is subject to the Court's approval.

In the course of settlement discussions regarding the *Sobek* matter, the U.S. Department of Justice informed the Company that it is the subject of an investigation related to a claim under the federal false claims act by the U. S. Attorney's Office for the Middle District of Tennessee. Additionally, in March 2014 the U.S. Department of Justice informed the Company that it is the subject of an investigation related to a claim under the federal false claims act by the U.S. Attorney's Office for the Western District of Pennsylvania. The Company plans to cooperate with the U.S. Department of Justice with regard to these matters. However, the Company cannot predict the eventual scope, duration or outcome of the investigations at this time nor can it estimate any amount of a reasonably possible loss related to these investigations because of their status.

### **Shareholder Derivative Lawsuits**

On May 21, 2012, a shareholder derivative class action captioned *Oklahoma Law Enforcement Retirement System v. Todd S. Nelson, et al.* was filed against the directors of the Company in state court located in Pittsburgh, PA. The Company is named as a nominal defendant in the case. The complaint alleges that the defendants violated their fiduciary obligations to the Company's shareholders due to the Company's violation of the U.S. Department of Education's prohibition on paying incentive compensation to admissions representatives, engaging in improper recruiting tactics in violation of Title IV of the HEA and accrediting agency standards, improper classification of job placement data for graduates of its schools and failure to satisfy the U.S. Department of Education's financial responsibility standards. The Company previously received two demand letters from the plaintiff which were investigated by a Special Litigation Committee of the EDMC Board of Directors and found to be without merit.

The Company and the director defendants filed a motion to dismiss the case with prejudice on August 13, 2012. In response, the plaintiffs filed an amended complaint making substantially the same allegations as the initial complaint on September 27, 2012. The Company and the director defendants filed a motion to dismiss the amended complaint on October 17, 2012. On July 16, 2013, the Court dismissed the claims that the Company engaged in improper recruiting tactics and mismanaged the Company's financial well-being with prejudice and found that the Special Litigation Committee could conduct a supplemental investigation of the plaintiff's claims related to incentive compensation paid to admissions representatives and graduate placement statistics. The Special Litigation Committee filed supplemental reports on October 15, 2013, January 9, 2014 and February 28, 2014, finding no support for the incentive compensation and graduate placement statistic claims. The Court held a hearing on the defendants' supplemental motion to dismiss the case on January 29, 2014 and granted the plaintiff's request for limited discovery on June 11, 2014.

On August 3, 2012, a shareholder derivative class action captioned *Stephen Bushansky v. Todd S. Nelson, et al.* was filed against certain of the directors of the Company in federal district court in the Western District of Pennsylvania. The Company is named as a nominal defendant in the case. The complaint alleges that the defendants violated their fiduciary obligations to the Company's shareholders due to the Company's use of improper recruiting, enrollment admission and financial aid practices and violation of the U.S. Department of Education's prohibition on the payment of incentive compensation to admissions representatives. The Company previously received a demand letter from the plaintiff which was investigated by a Special Litigation Committee of the EDMC Board of Directors and found to be without merit. The Company believes that the claims set forth in the complaint are without merit and intends to vigorously defend itself. The Company and the named director defendants filed a motion to stay the litigation pending the resolution of the *Oklahoma Law Enforcement Retirement System* shareholder derivative case or, alternatively, dismiss the case on October 19, 2012. On August 5, 2013, the Court granted the Company's motion to stay the case in light of the ruling on the defendants' motion to dismiss the *Oklahoma Law Enforcement Retirement System* case.

Because of the many questions of fact and law that may arise, the outcome of these legal proceedings is uncertain at this point. Based on the information presently available, the Company cannot reasonably estimate a range of loss for these actions and, accordingly, has not accrued any liability associated with these actions.

### **Securities Class Action**

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On September 19, 2014, a securities class action complaint captioned *Robb v. Education Management Corporation*, et. al was filed against the Company and certain of its executive officers. The complaint alleges violations of Sections 10(b) and 20(a) of the Exchange Act of 1934 and rule 10b--5 promulgated thereunder due to allegedly materially false and misleading statements made by the Company during the period of August 8, 2012 through September 16, 2014 in connection with the Company's filings with the SEC, press releases and other statements and documents. Because of the many questions of fact and law that may arise, the outcome of this legal proceeding is uncertain at this point. Based on the information available to us at present, we cannot reasonably estimate a range of loss for this action and, accordingly, we have not accrued any liability associated with this action.

## **OIG Subpoena**

On May 24, 2013, the Company received a subpoena from the Office of Inspector General of the U.S. Department of Education requesting policies and procedures related to Argosy University's attendance, withdrawal and return to Title IV policies during the period of July 1, 2010 through December 31, 2011 and detailed information on a number of students who enrolled in Argosy University's Bachelor's of Psychology degree program. The Company plans to cooperate with the Office of Inspector General in connection with its investigation. However, the Company cannot predict the eventual scope, duration or outcome of the investigation at this time nor can it estimate any amount of a reasonably possible loss related to the investigation because of its status.

## **State Attorneys General Investigations**

The Company received inquiries from 13 states in January 2014 and an additional state in March 2014 regarding the Company's business practices. The Attorney General of the Commonwealth of Pennsylvania informed the Company that it will serve as the point of contact for the inquiries related to the Company. The inquiries focus on the Company's practices relating to the recruitment of students, graduate placement statistics, graduate certification and licensing results, and student lending activities, among other matters. Several other companies in the proprietary education industry have disclosed that they received similar inquiries. The Company has cooperated with the states involved and, from time to time, engaged in preliminary discussions designed to lead to a settlement of the investigation. However, the Company is unable to estimate the amount of any reasonably possible loss related to this matter or the eventual scope, duration or outcome of the investigation due to the nature and status of the preliminary discussions.

In January 2013, The New England Institute of Art received a civil investigative demand from the Commonwealth of Massachusetts Attorney General requesting information for the period from January 1, 2010 to the present pursuant to an investigation of practices by the school in connection with marketing and advertising job placement and student outcomes, the recruitment of students and the financing of education. The Company previously responded to a similar request that The New England Institute of Art received in June 2007 and intends to continue to cooperate with the Attorney General in connection with its investigation. However, the Company cannot predict the eventual scope, duration or outcome of the investigation at this time nor can it estimate any amount of a reasonably possible loss related to the investigation because of its status.

In August 2011, the Company received a subpoena from the Attorney General of the State of New York requesting documents and detailed information for the time period of January 1, 2000 through the present. The Art Institute of New York City is the Company's only school located in New York though the subpoena also addresses fully--online students who reside in the State. The subpoena is primarily related to the Company's compensation of admissions representatives and recruiting activities. The relators in the Washington *qui tam* case filed the complaint under the State of New York's False Claims Act though the state has not announced an intention to intervene in the matter. The Company intends to continue to cooperate with the investigation. However, the Company cannot predict the eventual scope, duration or outcome of the investigation at this time nor can it estimate any amount of a reasonably possible loss related to the investigation because of its status.

In December 2010, the Company received a subpoena from the Office of Consumer Protection of the Attorney General of the Commonwealth of Kentucky requesting documents and detailed information for the time period of January 1, 2008 through December 31, 2010. The Company has three Brown Mackie College locations in Kentucky. The Kentucky Attorney General announced an investigation of the business practices of proprietary post--secondary schools and that subpoenas were issued to six proprietary colleges that do business in Kentucky in connection with the investigation. The Company intends to continue to cooperate with the investigation. However, the Company cannot predict the eventual scope, duration or outcome of the investigation at this time nor can it estimate any amount of a reasonably possible loss related to the investigation because of its status.

In October 2010, Argosy University received a subpoena from the Florida Attorney General's office seeking a wide range of documents related to the Company's institutions, including the nine institutions located in Florida, from January 2, 2006 to the present. The Florida Attorney General has announced that it is investigating potential misrepresentations in recruitment, financial aid and other areas. The Company is cooperating with the investigation, but has also filed a suit to quash or limit the subpoena and to protect information sought that constitutes proprietary or trade secret information. The Company cannot predict the eventual scope, duration or outcome of the investigation at this time nor can it estimate any

amount of a reasonably possible loss related to the investigation because of its status.

### **Argosy University, Seattle APA Program Accreditation Lawsuits**

In August 2013, a petition was filed in the Superior Court of the State of Washington (King County) in the case of *Winters, et al. v. Argosy Education Group, et al.* by 20 former students in the Clinical Psychology program offered by the Seattle campus of Argosy University. In December 2013, a similar petition was filed in the same court in the case of *McMath, et al. v. Argosy Education Group, et al.* by nine former students in the Clinical Psychology program offered by the Seattle campus of Argosy University. Both cases allege negligent misrepresentation due to the failure of the Clinical Psychology program to obtain accreditation from the American Psychology Association ("APA"), breach of contract, violation of the Washington State Consumer Protection Act, negligent infliction of emotional distress, negligence and lack of institutional control, negligent misrepresentation, breach of fiduciary duty, negligent failure to disclose and fraud. The Seattle campus of Argosy University announced that it was teaching--out (i.e., not accepting new students into the program) the Clinical Psychology program in November 2011 due to the inability to obtain APA accreditation. The Company believes the claims in the lawsuits to be without merit and intends to vigorously defend itself. Because of the many questions of fact and law that may arise, the outcome of these legal proceedings is uncertain at this point. Based on the information presently available, the Company cannot reasonably estimate a range of loss for these actions and, accordingly, has not accrued any liability associated with these actions.

### **Other Matters**

The Company is a defendant in certain other legal proceedings arising out of the conduct of its business. Additionally, the Company is subject to compliance reviews by various state and federal agencies which provide student financial aid programs, of which noncompliance may result in liability for educational benefits paid as well as fines and other corrective action. In the opinion of management, based upon an investigation of these matters and discussion with legal counsel, the ultimate outcome of such other legal proceedings and compliance reviews, individually and in the aggregate, is not expected to have a material adverse effect on the Company's financial position, results of operations or liquidity.