ITT EDUCATIONAL SERVICES INC
Form DEF 14A
March 04, 2003

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SCHEDULE 14A INFORMATION

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

Filed by the Registrant ý

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Check the appropriate box:
o Preliminary Proxy Statement
o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
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o Soliciting Material Pursuant to §240.14a-12

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.

2003 Annual Meeting Notice
Proxy Statement
and
2002 Annual Report to Shareholders

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ITT EDUCATIONAL SERVICES, INC.

5975 Castle Creek Parkway, N. Dr.
P.O. Box 50466
Indianapolis, IN 46250-0466

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

TO BE HELD MAY 6, 2003

The 2003 Annual Meeting of Shareholders of ITT Educational Services, Inc. ("ITT/ESI") will be held at The Jefferson Hotel, 1200 16th Street, NW, Washington, DC 20036, on Tuesday, May 6, 2003, at 9:00 a.m., local time, for the following purposes:

1. To elect two Directors to serve until the 2006 Annual Meeting of Shareholders and until their successors are elected and have qualified.

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 7, 2003 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.

5975 Castle Creek Parkway, N. Drive
P.O. Box 50466
Indianapolis, IN 46250-0466

PROXY STATEMENT
Annual Meeting of Shareholders
May 6, 2003

This Proxy Statement and accompanying proxy are being sent to shareholders on or about March 21, 2003 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 2003 Annual Meeting of Shareholders to be held at 9:00 a.m., local time, Tuesday, May 6, 2003, at The Jefferson Hotel, 1200 16th Street, NW, Washington, DC 20036, for the purposes set forth in the accompanying Notice.

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 7, 2003, the record date for the meeting, 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 February 15, 2003, 45,078,824 shares of ITT/ESI Common Stock were issued and outstanding.

If you execute and return the enclosed form of proxy, you may revoke it at any time before it is exercised. You can revoke your proxy by giving us written notice of revocation, executing a subsequently dated proxy and delivering it to us, or attending the meeting and voting in person. Unless revoked, your proxy will be voted at the meeting in accordance with your instructions specified on the proxy. If your proxy does not contain any instructions, your proxy will be voted at the meeting for the election as Directors of the nominees listed under the caption "Election of Directors." The election of Directors will be determined by the vote of the holders of a plurality of the shares voting on such election. A proxy may indicate that all or a portion of the shares represented by such proxy are not being voted with respect to a specific proposal. This could occur, for example, when a broker is not permitted to vote shares held in street name on certain proposals in the absence of instructions from the beneficial owner. Shares that are not voted with respect to a specific proposal will be considered as not present and entitled to vote on such proposal, even though such shares will be considered present for purposes of determining a quorum and voting on other proposals. Abstentions on a specific proposal will be considered as present, but not as voting in favor of such proposal. As a result, neither broker non-votes nor abstentions will affect the determination of whether a nominee will be elected.

Our Board of Directors is not aware of any matters, other than the election of two Directors, 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.

Officers, Directors and other employees of ITT/ESI may solicit proxies 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 $6,000, 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.

ELECTION OF DIRECTORS

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.

At the meeting, two Directors are to be elected to hold office for a three-year term to expire at the 2006 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 Rand V. Araskog and Daniel P. Weadock, the 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 may recommend. Alternatively, our Board may reduce the number of Directors to eliminate the vacancy.

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 2006 Annual Meeting.

Rand V. Araskog, age 71, served as chairman and chief executive officer of ITT Corporation, a Delaware corporation ("ITT Delaware"), from 1980 through November 1995. Mr. Araskog served as chairman and chief executive officer of ITT Corporation, a Nevada corporation ("ITT"), a hotel, gaming and entertainment company and a spin-off of ITT Delaware, from December 1995 until his retirement in February 1998. He also served as chairman of ITT Sheraton Corporation ("ITT Sheraton"), a hotel and gaming company and a subsidiary of ITT, and Caesar's World, Inc., a gaming company and a subsidiary of ITT, from December 1996 until his retirement in February 1998. He is also a director of The Hartford Financial Services Group, Inc., ITT Industries, Inc. ("Old ITT") and Rayonier, Inc. Mr. Araskog has been a Director of ITT/ESI since April 1994.

Daniel P. Weadock, age 63, has served as president of The International, a golf resort and conference center in Bolton, MA, since January 1999. He served as special assistant to the chairman of Starwood Hotels & Resorts Worldwide, Inc. ("Starwood, Inc."), a hotel and resort company, from March 1998 through December 1998. Mr. Weadock served as president and chief executive officer of ITT Sheraton from January 1995 through February 1998. He served as senior vice president of ITT from December 1995 through February 1998. Mr. Weadock has been a Director of ITT/ESI since April 1999.

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

Directors Continuing in Office

Term Expiring at the 2004 Annual Meeting.

Rene R. Champagne, age 61, 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.

James D. Fowler, Jr., age 58, served as senior vice president and director, human resources of Old ITT, an industrial, commercial machinery and equipment company, from November 2000 until his retirement in October 2002. Mr. Fowler served as president of Fowler & Associates, a consulting firm, from February 1996 through October 2000. He also served as president of the Executive Leadership Council and Foundation ("ELCF"), a non-profit, non-partisan charitable and educational organization, from February 2000 through October 2000 and executive director and administrator of the ELCF from October 1997 through January 2000. Mr. Fowler has been a Director of ITT/ESI since April 1994.

Harris N. Miller, age 51, has served as president of the Information Technology Association of America, a trade association, since April 1995, and as president of the World Information Technology and Services Alliance, an association of trade associations, since April 1995. Mr. Miller has been a Director of ITT/ESI since July 1999.

Term Expiring at the 2005 Annual Meeting.

John E. Dean, age 52, is a founding partner of the law firm Dean Blakey, established June 2002. From July 1995 through May 2002, Mr. Dean was a partner at the Dean, Blakey & Moskowitz law firm. Since June 2002, Mr. Dean has also served as a principal of Washington Partners, LLC, a public affairs firm. Mr. Dean has been a Director of ITT/ESI since December 1994.

Omer E. Waddles, age 43, has served as President and Chief Operating Officer of ITT/ESI since January 2002. From April 1999 through December 2001, he served as Executive Vice President of ITT/ESI. Mr. Waddles served as president of the Career College Association, a trade association, from October 1996 through March 1999. Mr. Waddles has been a Director of ITT/ESI since January 2002.

Vin Weber, age 50, has been a partner at Clark & Weinstock Inc., a management and public policy consulting firm, since 1994. He is vice chairman and co-founder of Empower America, a public interest group. Mr. Weber is also 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 Department 56, Inc. and OneLink Communications, Inc. Mr. Weber has been a Director of ITT/ESI since December 1994.

Meetings and Committees of the Board of Directors

During 2002, there were five regular meetings and no special meetings of the Board of Directors. 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 served, except for Vin Weber who attended 43% 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 Board of Directors has adopted a written charter for the Audit Committee. A copy of the charter is set forth in Appendix A. 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 auditor; and
- the performance of our internal audit function.

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 auditor and pre-approving all services to be provided to us by our independent auditor.

The Audit Committee held four meetings during 2002. The members of the Audit Committee are Rand V. Araskog, John E. Dean, Harris N. Miller and Daniel P. Weadock. Each of the members of the Audit Committee is independent, as defined in Sections 303.01(B)(2)(a) and

(3) and proposed Sections 303A(2) and (6) of the New York Stock Exchange ("NYSE") Listed Company Manual.

Compensation Committee.

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 two meetings during 2002. The members of the Compensation Committee are James D. Fowler, Jr., Daniel P. Weadock and Vin Weber. Each of the members of the Compensation Committee is independent, as defined in proposed Section 303A(2) of the NYSE Listed Company Manual.

Nominating and Corporate Governance Committee.

The functions of the Nominating and Corporate Governance Committee 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 the 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 did not hold any meetings during 2002. The members of the Nominating and Corporate Governance Committee are James D. Fowler, Jr., Harris N. Miller and Vin Weber. Each of the members of the Nominating and Corporate Governance Committee is independent, as defined in proposed Section 303A(2) of the NYSE Listed Company Manual. In considering persons to nominate for election as Directors, the Nominating and Corporate Governance Committee will entertain recommendations from shareholders that are submitted in writing to us in accordance with the procedures set forth in our By-Laws, a copy of which may be obtained from our Secretary.

Non-Management Directors.

The non-management Directors on our Board of Directors meet at regularly scheduled executive sessions without our management. Our Board of Directors has chosen Vin Weber to preside over the executive sessions of our non-management Directors in 2003. Interested parties may communicate directly with the presiding Director by e-mail at PresidingDirector@ittesi.com or by regular mail addressed to:

ITT Educational Services, Inc.
5975 Castle Creek Parkway, N. Dr.
P.O. Box 50466
Indianapolis, IN 46250-0466
Attention: Presiding Director

INDEPENDENT PUBLIC ACCOUNTANTS

Audit Committee Report

The Audit Committee oversees our financial reporting process on behalf of our Board of Directors. Our management has the primary responsibility for our financial statements and the reporting process, including the system of disclosure controls and procedures and internal controls. PricewaterhouseCoopers LLP ("PWC"), who is our independent auditor, is responsible for expressing an opinion on the conformity of our audited financial statements with generally accepted accounting principles. The Committee has reviewed and discussed with our management and PWC the audited financial statements for our 2002 fiscal year.

In 2002, the Committee discussed with PWC the matters required to be discussed by Statement on Auditing Standards Nos. 61 and 90 (Communication with Audit Committees). This discussion involved certain information relating to PWC's judgments about the quality, not just the acceptability, of our accounting principles and included such other matters as are required to be discussed with the Committee under generally accepted auditing standards.

The Committee also received the written disclosures and the letter from PWC required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees) and discussed with PWC its independence from us and our management. In addition, the Committee considered whether PWC's independence would be jeopardized by providing non-audit services to us.

In reliance on the review and discussions referred to above, the Committee recommended to our Board of Directors, and the Board has approved, that the audited financial statements for our 2002 fiscal year be included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2002 for filing with the Securities and Exchange Commission ("SEC").

Audit Committee
Rand V. Araskog
John E. Dean
Harris N. Miller
Daniel P. Weadock

Notwithstanding anything to the contrary set forth in any of our previous filings under the Securities Act of 1933, as amended (the "1933 Act") or the Securities and Exchange Act of 1934, as amended (the "1934 Act") that may incorporate future filings (including this Proxy Statement, in whole or in part), the preceding Audit Committee Report shall not be incorporated by reference in any such filings.

Audit Fees

In aggregate, PWC's fees were $273,000 for the professional services rendered by PWC in auditing our annual consolidated financial statements for our 2002 fiscal year and reviewing our financial statements included in our 2002 quarterly reports on Form 10-Q which were filed with the SEC.

Financial Information Systems Design and Implementation Fees

PWC did not render any information technology services to us in 2002 relating to: (a) the operation of our information systems or the management of our local area network; or (b) the design or implementation of a hardware or software system that aggregates data underlying the financial statements or otherwise generates information significant to our financial statements.

All Other Fees

In aggregate, PWC billed us $390,835 in fees that are in addition to those specified above in " Audit Fees" and " Financial Information Systems Design and Implementation Fees" for services rendered by PWC in 2002. Those fees included, without limitation, $340,380 for compliance audits relating to our participation in federal and state student financial aid programs, actuarial services, preparation of federal and state tax returns and audits of employee benefit plans.

Reappointment

The Audit Committee has reappointed PWC as our independent auditors for 2003. A PWC representative is not expected to attend the meeting. The Audit Committee reserves the right to replace the independent auditors at any time.

Pre-Approved Services

In October 2002, the Audit Committee adopted policies and procedures pertaining to our engagement of our independent accountant to perform services for us. These policies and procedures require the Audit Committee to approve each such service and the related fees and terms before we engage our independent auditor to perform that service. These policies and procedures also provide for the Audit Committee's oversight of our independent auditor's independence and are detailed in the Committee's written charter.

None of the fees reported above in " Audit Fees," or " All Other Fees" for services rendered by PWC in our 2002 fiscal year were pre-approved by the Audit Committee. The Audit Committee has pre-approved the following services to be provided to us by PWC in 2003:

- audit our annual consolidated financial statements for our 2003 fiscal year;
- review our financial statements included in our 2003 quarterly reports on Form 10-Q filed with the SEC;
- conduct compliance audits in 2003 relating to the federal and state student financial aid programs in which we participate;
- provide us with other accounting and auditing related services in 2003, such as supplying us with technical accounting guidance and conducting special audit projects;
- assist us in the preparation and filing of our 2002 federal and state tax returns;
- provide us with federal, state and international tax planning services in 2003; and
- audit the 2002 financial statements for the ESI Pension Plan and ESI 401(k) Plan in 2003.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the 1934 Act requires our executive officers and Directors, and persons who own more than 10% of ITT/ESI Common Stock, to file reports of ownership with the SEC. These persons also are required to furnish us with copies of all Section 16(a) forms they file.

Based solely on our review of copies of such forms received by us, or written representations from certain reporting persons that no Forms 5 were required for those persons, we believe that, during 2002, all of our executive officers, Directors and greater than 10% shareholders complied with all applicable filing requirements.

EXECUTIVE OFFICERS

Name	Age	Position
Rene R. Champagne	61	Chairman and Chief Executive Officer
Omer E. Waddles	43	President and Chief Operating Officer
Clark D. Elwood	42	Senior Vice President, General Counsel and Secretary
Martin A. Grossman	56	Senior Vice President, Director of Marketing and Investor Relations

Name	Age	Position
Thomas W. Lauer	56	Senior Vice President, Director of Operations
Kevin M. Modany	36	Senior Vice President and Chief Financial Officer

Rene R. Champagne 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.

Omer E. Waddles has served as President and Chief Operating Officer of ITT/ESI since January 2002. From April 1999 through December 2001, he served as Executive Vice President of ITT/ESI. Mr. Waddles served as president of the Career College Association, a trade association, from October 1996 through March 1999. Mr. Waddles has been a Director of ITT/ESI since January 2002.

Clark D. Elwood has served as Senior Vice President of ITT/ESI since December 1996, Secretary of ITT/ESI since October 1992 and General Counsel of ITT/ESI since May 1991.

Martin A. Grossman has served as Senior Vice President of ITT/ESI since July 2002 and Director of Marketing and Investor Relations of ITT/ESI since May 2002. He was self-employed as a consultant from October 2001 through April 2002. Mr. Grossman served as senior vice president of insurance products at Trilegiant Corp., a direct marketing company, from July 2001 through September 2001. He was self-employed as a consultant from August 2000 through June 2001. Mr. Grossman served as executive vice president for the U.S. Direct Marketing Group of Grolier Incorporated ("Grolier"), a publisher and direct marketing company, from August 1999 through July 2000. He also served as senior vice president of marketing for the U.S. Direct Marketing Group of Grolier from May 1997 through July 1999.

Thomas W. Lauer has served as Senior Vice President, Director of Operations of ITT/ESI since January 1993.

Kevin M. Modany has served as Chief Financial Officer of ITT/ESI since January 2003 and Senior Vice President of ITT/ESI since July 2002. From June 2002 through December 2002, he served as Director of Finance of ITT/ESI. Mr. Modany served as chief financial officer, chief operating officer and director of Cerebellum Software, Inc., a software development and professional services company, from October 2000 through May 2002. He also served as president and director of USA Clean, LLC, a distributor of products and chemicals for the textile care industry, from October 1998 through

September 2000. Mr. Modany served as executive vice president, chief financial officer, director of finance and controller of Consolidated Products Systems, Inc., a food distribution and retail services merchandising company, from February 1995 through September 1998.

COMPENSATION OF EXECUTIVE OFFICERS AND DIRECTORS

Summary Compensation Table

The following table sets forth certain information regarding compensation paid or accrued during each of the last three fiscal years to our Chief Executive Officer and each of our four other most highly compensated executive officers, based on salary and bonus earned during the 2002 fiscal year (the "Named Executive Officers").

Summary Compensation Table

		Annual Compensation		Long-Term Compensation	
				Awards	
Name and Principal Position	Year	Salary	Bonus(1)	Securities Underlying Options(2)	All Other Compensation(3)

				Long-Term Compensation	
Rene R. Champagne	2002	$ 413,000	$ 680,000	110,000	$ 14,175
Chairman and Chief	2001	388,000	615,090	135,000	21,642
Executive Officer	2000	366,800	181,650	135,000	14,864
Omer E. Waddles	2002	260,000	360,000	50,000	9,776
President and Chief	2001	225,200	280,071	60,000	8,171
Operating Officer	2000	210,800	77,936	100,000	5,021
Thomas W. Lauer	2002	210,467	248,000	30,000	10,170
Senior Vice President,	2001	199,433	220,008	40,000	9,912
Director of Operations	2000	189,133	61,800	40,000	8,476
Gene A. Baugh(4)	2002	201,900	242,000	30,000	9,343
Senior Vice President and	2001	189,666	220,008	40,000	9,143
Chief Financial Officer	2000	179,067	61,800	40,000	7,836
Clark D. Elwood	2002	173,600	189,000	30,000	5,317
Senior Vice President,	2001	163,600	170,054	40,000	5,726
General Counsel and Secretary	2000	153,900	46,659	40,000	5,289

(1) Amounts shown represent bonus compensation accrued in the stated year and paid in the subsequent year. The annual bonuses for 2000 and 2001 were paid in components of cash and shares of ITT/ESI Common Stock, and the percentage of the share component depended on both the value of the recipient's holdings of ITT/ESI Common Stock prior to the payment of the bonus award and the recipient's preferred form of payment.

(2) Stock options relate solely to shares of ITT/ESI Common Stock and reflect adjustments made to such options in connection with the June 2002 two-for-one stock split. None of the Named Executive Officers has received any SARs or restricted stock from ITT/ESI.

(3) Except as otherwise specified, amounts shown represent: (a) employer contributions under the ESI 401(k) Plan, a defined contribution plan; and (b) employer contributions under the ESI Excess Savings Plan, a non-qualified retirement plan, and the interest accrued on those contributions. All contributions to the ESI 401(k) Plan are in the form of ITT/ESI Common Stock.

(4) Mr. Baugh retired from ITT/ESI effective February 4, 2003.

Compensation of Directors

We do not compensate any Director who is an employee of ours for service as a member of our Board of Directors or any standing committee of our Board of Directors. Compensation for non-employee Directors consists of:

- an annual retainer of $18,000;
- a $1,000 fee for each Board meeting attended in person;
- a $500 fee for each Board meeting attended telephonically, unless the meeting is a telephonic meeting in which case the fee is $1,000;

a $500 fee for each standing committee meeting attended in person; and

a $250 fee for each standing committee meeting attended telephonically, unless the meeting is a telephonic meeting in which case the fee is $500.

Each non-employee Director also automatically receives a stock option to purchase 4,000 shares of ITT/ESI Common Stock on the tenth business day following the annual meeting of shareholders, provided that such non-employee Director served in that capacity both before and after the annual meeting. See " Equity Compensation Plans   1999 Outside Directors Stock Option Plan." We reimburse Directors for reasonable, out-of-pocket travel expenses incurred on our behalf.

Equity Compensation Plans

1994 Stock Plan. On December 16, 1994, our shareholders approved the ITT Educational Services, Inc. 1994 Stock Option Plan (the "1994 Stock Plan"), which became effective on December 27, 1994 and provides for awards of nonqualified stock options to our key employees. An aggregate of 810,000 shares of ITT/ESI Common Stock are reserved for issuance for option awards under the 1994 Stock Plan, subject to adjustment in certain events and as adjusted for the: (a) three-for-two stock split declared on March 22, 1996 that became effective on April 15, 1996 (the "April 1996 Stock Split"); (b) three-for-two stock split declared on October 8, 1996 that became effective on November 4, 1996 (the "November 1996 Stock Split"); and (c) two-for-one stock split declared on May 10, 2002 that became effective on June 6, 2002 (the "2002 Stock Split"). The 1994 Stock Plan expires on December 29, 2004.

The 1994 Stock Plan is administered by the Compensation Committee. Subject to the limitations set forth in the 1994 Stock Plan, the Compensation Committee has the authority to select the persons to whom awards will be made, to designate the number of shares to be covered by each award, to establish vesting schedules and, subject to certain restrictions, to specify other terms of the awards, including the status of awards subsequent to the termination of a participant's employment with us. Awards of options are not transferable other than by will or pursuant to the laws of descent and distribution.

The exercise price of a stock option awarded under the 1994 Stock Plan may not be less than 100% of the fair market value of the ITT/ESI Common Stock on the date of the award. No option may be exercised prior to one year after the award date. Subject to the discretion of the Compensation Committee, stock options granted under the 1994 Stock Plan will generally expire upon the termination of an employee's employment for reasons other than death, disability or retirement. Notwithstanding the foregoing, the Compensation Committee has the authority to establish different terms and conditions relating to the exercise of an option subsequent to the termination of a participant's employment. The maximum term of a stock option awarded under the 1994 Stock Plan will be ten years and two days from the date of the award. The shares of ITT/ESI Common Stock issued upon the exercise of a stock option under the 1994 Stock Plan may be made available from treasury shares or authorized but unissued shares.

No individual may receive options for more than 135,000 shares of ITT/ESI Common Stock under the 1994 Stock Plan in any given calendar year, as adjusted for the (a) April 1996 Stock Split, (b) November 1996 Stock Split, and (c) 2002 Stock Split. The option price may be paid (a) by check, (b) in ITT/ESI Common Stock, (c) through a simultaneous sale through a broker of ITT/ESI Common Stock acquired upon the exercise of the stock option or (d) by any combination of the foregoing.

During 2002, the Compensation Committee did not grant any stock options under the 1994 Stock Plan.

1997 Stock Plan. On May 13, 1997, our shareholders approved the 1997 ITT Educational Services, Inc. Incentive Stock Plan (the "1997 Stock Plan"), which became effective on the same date and provides for the grant of stock options that are intended to qualify as "incentive stock options" under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"). It also provides for the grant of nonqualified stock options, stock appreciation rights ("SARs"), performance shares and restricted stock, or any combination of the foregoing, as the Compensation Committee may determine, as well as substitute stock options, SARs and restricted stock (collectively, including incentive stock options, "Awards"). The 1997 Stock Plan will expire on May 15, 2007.

Recipients of Awards under the 1997 Stock Plan must be, or have been at the time of grant, key employees (including any officer or director who is also an employee) whose responsibilities and decisions directly affect our performance or the performance of any of our subsidiaries or other affiliates. We presently have approximately 150 employees who fall within the category of key employees and may be considered for Awards under the 1997 Stock Plan.

The 1997 Stock Plan contains a formula for establishing an annual limit on the number of shares which may be awarded (or with respect to which non-stock Awards may be made) in any given calendar year (the "Annual Limit"). The Annual Limit formula is expressed as a percentage of the total issued and outstanding ITT/ESI Common Stock as of the year end immediately preceding the year of the Awards (the "Plan Year"). Under the Annual Limit formula, the maximum number of shares of ITT/ESI Common Stock for which Awards may be granted in each Plan Year is 1.5% of the total of the issued and outstanding shares of ITT/ESI Common Stock as reported in our Annual Report on Form 10-K for the fiscal year ending immediately prior to any Plan Year. Any unused portion of the Annual Limit for any Plan Year is carried forward and made available for Awards in succeeding Plan Years. In addition, in no event will more than 8,100,000 shares of ITT/ESI Common Stock be cumulatively available for Awards of incentive stock options under the 1997 Stock Plan (subject to adjustments in certain events and as adjusted for the 2002 Stock Split), and provided further, no more than 20% of the total number of shares available on a cumulative basis will be available for restricted stock and performance share Awards. For any Plan Year, no individual employee may receive stock options for more than 135,000 shares, as adjusted for the 2002 Stock Split. Subject to the above limitations, shares of ITT/ESI Common Stock issued under the 1997 Stock Plan may be made available from the authorized but unissued ITT/ESI Common Stock, from treasury stock or from shares purchased on the open market.

The Compensation Committee administers the 1997 Stock Plan and makes determinations with respect to the designation of those employees who shall receive Awards, the number of shares to be covered by options, SARs and restricted stock awards, the exercise price of options (which may not be less than 100% of the fair market value of ITT/ESI Common Stock on the date of grant), other option terms and conditions and the number of performance shares to be granted and the applicable performance objectives. The Compensation Committee may impose such additional terms and conditions on an Award as it deems advisable.

Incentive stock options and related SARs under the 1997 Stock Plan must expire within ten years after grant; nonqualified stock options and related SARs will expire not more than ten years and two days after grant. The aggregate fair market value (determined on the date of grant) of the shares

subject to incentive stock options that become exercisable for the first time by an employee in any calendar year may not exceed $100,000. No SAR may be exercised until at least six months after it is granted. The exercise price for options and SARs must be at least equal to the fair market value of the ITT/ESI Common Stock on the date of grant. The exercise price for options must be paid to us at the time of exercise and, in the discretion of the Compensation Committee, may be paid in the form of cash or already-owned shares of ITT/ESI Common Stock or a combination thereof. An option may be exercised only by the employee who received the option (or his or her estate or designated beneficiary), no later than three months after his or her termination of employment (or for longer periods as determined by the Compensation Committee if termination is caused by retirement, total disability or death, but in no event later than the expiration of the original term of the option). If an optionee voluntarily resigns or is terminated for cause, the options and SARs are canceled immediately.

Performance shares under the 1997 Stock Plan are contingent rights to receive future payments based on the achievement of individual or company performance objectives as prescribed by the Compensation Committee. The maximum number of performance shares that may be granted to any employee in any given year is 100,000. The amounts paid will be based on actual performance over a period from two to five years, as determined by the Compensation Committee, using one or more of the following objective criteria, as it deems appropriate: our earnings per share, return on equity, cash flow or total shareholder return. Payments may be made in the form of shares of ITT/ESI Common Stock, cash or a combination of ITT/ESI Common Stock and cash. The ultimate payments are determined by the number of shares earned and the price of ITT/ESI Common Stock at the end of the performance period. In the event an employee terminates employment during such a performance period, the employee will forfeit any right to payment. In the case of retirement, total disability, death or cases of special circumstances, however, the employee may, in the discretion of the Compensation Committee, be entitled to an Award prorated for the portion of the performance period during which he or she was employed by us.

Restricted shares of ITT/ESI Common Stock awarded under the 1997 Stock Plan will be issued subject to a restriction period set by the Compensation Committee during which time the shares may not be sold, transferred, assigned or pledged. In the event an employee terminates employment during a restriction period, all such shares still subject to restrictions will be forfeited by the employee and reacquired by us. The Compensation Committee may provide for the lapse of restrictions in installments where deemed appropriate and it may also require the achievement of predetermined performance objectives in order for such shares to vest. The recipient, as owner of the awarded shares, shall have all other rights of a shareholder, including the right to vote the shares and receive dividends and other distributions during the restriction period. The restrictions may be waived, in the discretion of the Compensation Committee, in the event of the awardee's retirement, total disability, death or in cases of special circumstances.

During 2002, the Compensation Committee granted nonqualified stock options under the 1997 Stock Plan to purchase an aggregate of 250,000 shares of ITT/ESI Common Stock to the Named Executive Officers at an exercise price of $17.25 per share. Nonqualified stock options were granted to other employees of ours in 2002 under the 1997 Stock Plan to purchase a total of:

581,000 shares of ITT/ESI Common Stock at an exercise price of $17.25 per share;

30,000 shares of ITT/ESI Common Stock at an exercise price of $24.92 per share;

30,000 shares of ITT/ESI Common Stock at an exercise price of $23.41 per share;

5,000 shares of ITT/ESI Common Stock at an exercise price of $18.59 per share;

4,000 shares of ITT/ESI Common Stock at an exercise price of $22.48 per share;

3,000 shares of ITT/ESI Common Stock at an exercise price of $17.59 per share;

2,000 shares of ITT/ESI Common Stock at an exercise price of $24.99 per share;

2,000 shares of ITT/ESI Common Stock at an exercise price of $22.48 per share;

2,000 shares of ITT/ESI Common Stock at an exercise price of $22.08 per share;

1,000 shares of ITT/ESI Common Stock at an exercise price of $21.20 per share;

1,000 shares of ITT/ESI Common Stock at an exercise price of $18.58 per share;

1,000 shares of ITT/ESI Common Stock at an exercise price of $15.45 per share;

1,000 shares of ITT/ESI Common Stock at an exercise price of $21.78 per share; and

1,000 shares of ITT/ESI Common Stock at an exercise price of $22.63 per share.

The number of shares of ITT/ESI Common Stock subject to the stock options discussed above that were granted in 2002 on or before the record date of the 2002 Stock Split and the exercise prices of those stock options have been adjusted for the 2002 Stock Split. No other Awards were made in 2002 under the 1997 Stock Plan.

Option Grants in Last Fiscal Year. The following table sets forth information with respect to stock options granted by ITT/ESI under the 1997 Stock Plan to the Named Executive Officers during 2002. No stock options were granted under the 1994 Stock Plan during 2002.

Option Grants in Last Fiscal Year

Individual Grants

Name	Individual Grants: Number of Securities Underlying Options Granted(1)	% of Total Options Granted to Employees in Fiscal Year	Exercise Price(2)	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term(3): 5%	10%
Rene R. Champagne	110,000	12.0%	$ 17.25	1/24/12	$ 1,193,280	$ 3,024,120
Omer E. Waddles	50,000	5.5%	$ 17.25	1/24/12	542,400	1,374,600
Thomas W. Lauer	30,000	3.3%	$ 17.25	1/24/12	325,440	824,760
Gene A. Baugh	30,000	3.3%	$ 17.25	1/24/12	325,440	824,760
Clark D. Elwood	30,000	3.3%	$ 17.25	1/24/12	325,440	824,760

(1) Numbers shown represent nonqualified stock options to purchase ITT/ESI Common Stock, as adjusted for the 2002 Stock Split.

(2) Nonqualified stock options granted at 100% of the fair market value of ITT/ESI Common Stock on the date of grant, as adjusted for the 2002 Stock Split. The options granted are exercisable in thirds on January 22 of each of the years 2003, 2004 and 2005.

(3) The amounts shown are the result of calculations at the 5% and 10% rates set by the SEC and, therefore, are not intended to forecast possible future appreciation, if any, of our stock price. We did not use an alternative formula for a grant date valuation, as we are not aware of any formula which will determine with reasonable accuracy a present value based on future unknown or volatile factors. At the end of the term of the options granted on January 22, 2002, the projected price per share of ITT/ESI Common Stock would be $28.098 at an assumed annual appreciation rate of 5% and $44.742 at an assumed annual appreciation rate of 10%.

Aggregated Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values. The following table sets forth information with respect to the exercise of options to purchase ITT/ESI Common Stock by the Named Executive Officers during 2002 and with respect to the value of options held by the Named Executive Officers at the end of 2002.

Aggregated Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values

Name	Shares Acquired on Exercise(1)	Value Realized	Number of Securities Underlying Unexercised Options at Fiscal Year-End(1): Exercisable	Unexercisable	Value of Unexercised In-the-Money Options at Fiscal Year-End(2): Exercisable	Unexercisable
Rene R. Champagne	0	$ 0	**681,500**	**245,000**	**$ 9,709,282**	**$ 2,693,790**
Omer E. Waddles	0	0	**136,666**	**123,334**	**1,667,859**	**1,428,251**
Thomas W. Lauer	60,000	705,893	**79,999**	**70,001**	**891,878**	**781,842**
Gene A. Baugh	127,500	1,382,016	**107,499**	**70,001**	**1,987,595**	**781,842**
Clark D. Elwood	0	0	**212,499**	**70,001**	**2,815,340**	**781,842**

(1) Numbers shown have been adjusted for the 2002 Stock Split.

(2)

The closing price for ITT/ESI Common Stock on the New York Stock Exchange on December 31, 2002 was $23.55. Value is calculated on the basis of the difference between the option exercise price and $23.55, multiplied by the number of "In-the-Money" shares of ITT/ESI Common Stock underlying the option.

1999 Outside Directors Stock Option Plan. On July 28, 1999, we established the 1999 Outside Directors Stock Option Plan (the "1999 Directors Stock Plan"), which provides for awards of nonqualified stock options to non-employee Directors. An aggregate of 500,000 shares of ITT/ESI Common Stock are reserved for issuance for option awards under the 1999 Directors Stock Plan (subject to adjustment in certain events and as adjusted for the 2002 Stock Split). The 1999 Directors Stock Plan has not been approved by our shareholders.

The 1999 Directors Stock Plan is administered by the Board. Under the plan, each non-employee Director automatically receives a stock option to purchase 4,000 shares of ITT/ESI Common Stock (as adjusted for the 2002 Stock Split) on the tenth business day following the annual meeting of shareholders, provided that such non-employee Director served in that capacity both before and after the annual meeting. In addition, the 1999 Directors Stock Plan permits the Board, at its discretion, to make special awards of stock options to non-employee Directors. No special awards of stock options were made to non-employee Directors in 2002. The automatic stock option grant and any special awards are subject to the limitations set forth in the 1999 Directors Stock Plan.

The number of shares of ITT/ESI Common Stock reserved for issuance and the number of shares subject to options under the 1999 Directors Stock Plan are subject to adjustment in certain events.

The exercise price of a stock option awarded under the 1999 Directors Stock Plan may not be less than 100% of the fair market value of the ITT/ESI Common Stock on the date of the award. No option may be exercised prior to one year after the award date (except for special awards of stock options by the Board as permitted under the plan). Stock options granted under the 1999 Directors Stock Plan will expire three months following the end of the non-employee Director's service on the Board for reasons other than death, disability or retirement. Notwithstanding the foregoing, the Board has the authority to establish different terms and conditions relating to the exercise of an option after the end of a non-employee Director's service on the Board. Stock options awarded under the 1999 Directors Stock Plan are not transferable other than by will or pursuant to the laws of descent and distribution. The maximum term of a stock option awarded under the 1999 Directors Stock Plan is ten years from the date of the award. The shares of ITT/ESI Common Stock issued upon the exercise of a stock option under the 1999 Directors Stock Plan may be made available from treasury shares or authorized but unissued shares. The option price may be paid:

- by check;
- in ITT/ESI Common Stock;

- through a simultaneous sale through a broker of ITT/ESI Common Stock acquired upon the exercise of the stock option; or
- by any combination of the foregoing.

During 2002, an automatic award of nonqualified stock options was made under the 1999 Directors Stock Plan to six non-employee Directors to purchase an aggregate of 24,000 shares of ITT/ESI Common Stock at an exercise price of $25.15, as adjusted for the 2002 Stock Split. Each of the six non-employee Directors received a stock option to purchase 4,000 shares of ITT/ESI Common Stock, and each of those options become exercisable one year after the date of the award.

ESI Non-Employee Directors Deferred Compensation Plan. On October 1, 1999, we established the ESI Non-Employee Directors Deferred Compensation Plan (the "Directors Deferred Compensation Plan") covering all of our non-employee Directors. The Directors Deferred Compensation Plan provides that each non-employee Director may elect to receive payment of the annual retainer in cash or in shares of ITT/ESI Common Stock, in increments of 25% each. A non-employee Director who elects payment in shares of ITT/ESI Common Stock will receive that number of shares equal to the number obtained by dividing the dollar amount of the portion of the annual retainer to be paid in shares of ITT/ESI Common Stock by the fair market value of one share of ITT/ESI Common Stock determined as of the payment date. The value of any fractional share resulting from this calculation will be paid to the Director in cash.

The Directors Deferred Compensation Plan also provides that each non-employee Director may elect to defer payment of all or a portion of the annual retainer. The deferral of payment of cash or shares of ITT/ESI Common Stock can only be made in increments of 25%. Any deferred cash amounts will accrue interest at the rate of 6% compounded annually. Any deferred shares of ITT/ESI Common Stock will be credited with any cash dividends on those shares and, on a semi-annual basis, those cash dividends will be converted to shares of ITT/ESI Common Stock based on its fair market value at the time of the conversion.

No cash or shares of ITT/ESI Common Stock deferred by a non-employee Director under the Directors Deferred Compensation Plan will be paid to the non-employee Director until he or she is no longer a Director.

ESI Executive Deferred Bonus Compensation Plan. On March 15, 2000, we established the ESI Executive Deferred Bonus Compensation Plan (the "Deferred Bonus Plan"), an unfunded, non-qualified deferred compensation plan for a select group of our management and highly compensated employees. The Deferred Bonus Plan provides that each eligible employee may elect to defer payment of all or a portion of his or her annual bonus compensation in the form of cash and/or shares of ITT/ESI Common Stock. The deferral of payment of cash or shares of ITT/ESI Common Stock can only be made in increments of 25%. Any deferred cash amounts will accrue interest at the rate of 6% compounded annually. Any deferred shares of ITT/ESI Common Stock will be credited with any cash dividends on those shares and, on a semi-annual basis, those cash dividends will be converted to shares of ITT/ESI Common Stock, based on its fair market value at the time of the conversion.

An eligible employee under the Deferred Bonus Plan may elect to receive payment of the deferred portion of his or her annual bonus compensation (a) upon termination of his or her employment with us or (b) in January of any calendar year that is no earlier than the second calendar year after the year in which the deferred bonus compensation was determined.

Equity Compensation Plan Information. The following table sets forth information, as of December 31, 2002, about shares of ITT/ESI Common Stock that may be issued under our equity compensation plans that (a) have been approved by our shareholders and (b) have not been approved by our shareholders.

Equity Compensation Plan Information

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)
Equity compensation plans approved by security holders(1)	3,599,415	$ 11.900	2,855,241(2)(3)(4)
Equity compensation plans not approved by security holders(5)	204,988	12.741	284,000(6)
Total	3,804,403	$ 11.950	3,139,241

(1) These equity compensation plans include the: (a) 1994 Stock Plan; and (b) 1997 Stock Plan. The material terms of each of these plans are described above in this Proxy Statement. See " 1994 Stock Plan" and " 1997 Stock Plan."

(2) Under the Annual Limit formula of the 1997 Stock Plan, the maximum number of shares of ITT/ESI Common Stock for which Awards may be granted in each Plan Year is 1.5% of the total issued and outstanding shares of ITT/ESI Common Stock as reported in our Annual Report on Form 10-K for the fiscal year ending immediately prior to that Plan Year. Any unused portion of the Annual Limit for any Plan Year is carried forward and made available for Awards in succeeding Plan Years. In addition, in no event will more

than 8,100,000 shares of ITT/ESI Common Stock be cumulatively available for Awards of incentive stock options (subject to adjustments in certain events and as adjusted for the 2002 Stock Split), and provided further, that no more than 20% of the total number of shares available on a cumulative basis will be available for restricted stock and performance share Awards.

(3)

The aggregate fair market value (determined on the date of grant) of the shares subject to incentive stock options awarded to employees under the 1997 Stock Plan that become exercisable for the first time by the employee in any calendar year may not exceed $100,000.

(4)

Securities remaining available for future issuance under the 1997 Stock Plan include stock options (both incentive and nonqualified), SARs, performance shares and restricted stock, or any combination of the foregoing, as the Compensation Committee may determine, as well as substitute stock options, SARs and restricted stock. The maximum number of performance shares under the 1997 Stock Plan that may be granted to any employee in any given year is 100,000.

(5)

These equity compensation plans include the: (a) 1999 Directors Stock Plan; (b) Director's Deferred Compensation Plan; and (c) Deferred Bonus Plan. The material terms of each of these plans are described above in this Proxy Statement. See " 1999 Outside Directors Stock Option Plan," " ESI Non-Employee Directors Deferred Compensation Plan" and " ESI Executive Deferred Bonus Compensation Plan."

(6)

This figure represents the number of securities remaining available for future issuance under the 1999 Directors Stock Plan. There is no limit on the number of shares of ITT/ESI common stock available for future issuance under either the Director's Deferred Compensation Plan or the Deferred Bonus Plan.

Employment Contract

We have not entered into an employment contract with any of the Named Executive Officers.

Severance Pay Plans

Senior Executive Severance Pay Plan. On February 16, 1999, we established the Senior Executive Severance Pay Plan (the "Severance Plan"), which provides severance benefits for Rene R. Champagne, the sole participant in the Severance Plan. Under the Severance Plan, Mr. Champagne will be entitled to severance benefits, unless his employment is terminated by us:

- for cause;
- on or after his normal retirement date; or
- as a result of:
  - acceptance of employment, or refusal of comparable employment, with a purchaser of us;
  - voluntary resignation;
  - voluntary retirement;
  - failure to return from an approved leave of absence (including a medical leave of absence);

death; or

disability.

The severance benefits include: (a) severance pay in an amount equal to the lower of 24 months' base salary, base salary for the number of months remaining between the termination of employment and his normal retirement date, or two times his total annual compensation during the year immediately preceding his termination; and (b) continued participation in our employee benefit plans (except for any short-term or long-term disability plans, the business travel accident plan or any new employee benefit plan adopted by us after his termination) during the period he receives severance pay.

The Severance Plan includes offset provisions for other compensation from us and requirements on the part of Mr. Champagne with respect to non-competition and compliance with our Code of Business Conduct and Ethics. While severance payments would ordinarily be made monthly over the scheduled term of such payments, we have the option to make such payments in the form of a single lump-sum payment discounted to present value.

ESI Special Senior Executive Severance Pay Plan. On October 16, 2001 we established the ESI Special Senior Executive Severance Pay Plan (the "Special Severance Plan"), which provides severance benefits for a select group of our executives (including all of the Named Executive Officers) whose employment is terminated other than for cause or where the covered executive terminates his or her employment for good reason within two years after the occurrence of an acceleration event, as described below. The Special Severance Plan provides two levels of benefits for covered executives, based on the covered executive's position with us. If an executive is terminated within two years of an acceleration event, he or she would be entitled to:

two or three times his or her highest annual base salary during the three years immediately preceding termination and two or three times his or her highest bonus paid or awarded in the three years preceding an acceleration event;

continuation of health and life insurance benefits at the same levels for two or three years;

continued use of any automobile provided by us at the same level for two or three years;

continuation of any tax or financial advisory services at the same level for two or three years;

a lump sum payment equal to the difference between the total lump sum value of his or her pension benefit under our pension plans and the total lump sum value of his or her pension benefit under our pension plans after crediting an additional two or three years of age and eligibility and benefit service using his or her highest annual base salary and bonus for purposes of determining his or her compensation under our pension plans;

credit for an additional two or three years of age and two or three years of eligibility service under the retiree life insurance benefits;

a lump sum payment equal to two or three times his or her highest annual base salary during the three years preceding termination times the highest percentage rate of our contributions to the ESI 401(k) Plan and/or the ESI Excess Savings Plan;

outplacement services for one