

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2009 or

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

For the transition period from _____ to _____

COMMISSION FILE NUMBER: 000-26489

ENCORE CAPITAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

48-1090909
(IRS Employer
Identification No.)

8875 Aero Drive, Suite 200 San Diego, California
(Address of principal executive offices)

92123
(Zip code)

(877) 445-4581

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
Common Stock, \$.01 Par Value Per Share	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

The aggregate market value of the voting stock held by non-affiliates of the registrant totaling 11,166,717 shares was \$147,959,000 at June 30, 2009, based on the closing price of the common stock of \$13.25 per share on such date, as reported by the NASDAQ Global Select Market.

The number of shares of our Common Stock outstanding at January 29, 2010, was 23,359,087.

Documents Incorporated by Reference

Portions of the registrant's proxy statement in connection with its annual meeting of shareholder to be held in 2010 are incorporated by reference in Items 10, 11, 12, 13, and 14 of Part III of this Form 10-K.

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PART I

Item 1—Business

An Overview of Our Business

Nature of Business

We are a systems-driven purchaser and manager of charged-off consumer receivable portfolios and, through our wholly owned subsidiary Ascension Capital Group, Inc., or Ascension, a provider of bankruptcy services to the finance industry. We acquire receivable portfolios at deep discounts from their face values using our proprietary valuation process that is based upon an analysis of the individual consumer attributes of the underlying accounts. Based upon our ongoing analysis of these accounts, we employ a dynamic mix of collection strategies to maximize our return on investment. The receivable portfolios we purchase consist primarily of unsecured, charged-off domestic consumer credit card, auto loan deficiency and telecom receivables purchased from national financial institutions, major retail credit corporations, telecom companies and resellers of such portfolios. From September 2005 through June 2007, we also purchased healthcare receivables from hospitals and resellers of healthcare receivables. In September 2007, we exited our healthcare purchasing and internal collection activities, although we are still receiving collections from certain healthcare portfolios that we own. Acquisitions of receivable portfolios are financed from operating cash flows and borrowings from third parties. See Note 8 to our consolidated financial statements for further discussion of our debt.

We have been in the collection business for 56 years and started purchasing portfolios for our own account approximately 19 years ago. From our inception through December 31, 2009, we have invested approximately \$1.4 billion to acquire 28.8 million consumer accounts with a face value of approximately \$43.8 billion.

We have established certain relationships with credit card issuers, other lenders and resellers that allow us to purchase portfolios directly through negotiated transactions. We also participate in auction-style purchase processes that typify our industry and enter into “forward flow” arrangements in which we agree to buy receivables that meet agreed upon parameters over the course of the contract term.

We evaluate each portfolio for purchase using the proprietary valuation and underwriting processes developed by our in-house team of statisticians. Unlike many of our competitors, which we believe primarily base their purchase decisions on numerous aggregated portfolio-level factors, including the originator, the type of receivables to be purchased, or the number of collection agencies the accounts have been placed with previously, we base our purchase decisions primarily on our analysis of the specific accounts included in a portfolio. Based upon this analysis, we determine a value for each account, which we aggregate to produce a valuation of the entire portfolio. We believe this capability allows us to perform more accurate valuations of receivable portfolios. We have successfully applied this methodology to receivables across multiple asset classes.

After we purchase a portfolio, we continuously refine our analysis of the accounts to determine the best strategy for collection. As with our purchase decisions, our collection strategies are based on account level criteria. Our collection strategies include:

- the use of a nationwide network of collection attorneys to pursue legal action where appropriate;
- outbound calling, driven by proprietary, predictive software, by our own collection workforce located at our three domestic call centers and our international call center in India;
- the use of multiple third party collection agencies;
- direct mail campaigns coordinated by our in-house marketing group;
- the transfer of accounts to a credit card provider, generating a payment to us; and
- the sale of accounts where appropriate.

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Investors wishing to obtain more information about us may access our Internet site (www.encorecapitalgroup.com). Our site allows access to relevant investor related information, free of charge, such as Securities and Exchange Commission ("SEC") filings, analyst coverage and earnings estimates, press releases, featured articles, an event calendar and frequently asked questions. SEC filings are available on our website as soon as reasonably practicable after being filed with, or furnished to, the SEC. The content of our Internet site is not incorporated by reference into this Annual Report on Form 10-K.

Our Strengths

Empirically Based and Technology-Driven Business Processes. We have assembled a team of statisticians, business analysts and software programmers that have developed and continually enhance proprietary valuation models, software and other business systems that guide our portfolio purchases and collection efforts. Our information technology department has developed and continually updates sophisticated software that manages the movement of data, account details and information throughout the company. These proprietary systems give us the flexibility, speed and control to capitalize on business opportunities.

Account-Based Portfolio Valuation. We analyze each account within a portfolio presented to us for purchase to determine the likelihood and expected amount of payment. We utilize an internally-developed valuation process based on a set of proprietary statistical models that predict behavior at the consumer level. Individual consumer characteristics are weighted and account-level payment expectations are determined. The expectations for each account are then aggregated to arrive at a portfolio-level liquidation assessment and a valuation for the entire portfolio is made. Our valuations are derived in large part from information accumulated on approximately 26.3 million accounts acquired since mid-2000, supplemented by external data purchased from data providers.

Dynamic Collections Approach. Over the past several years, we have dramatically reduced our dependence on general outbound calling by expanding our collection strategies. Moreover, because the status of individual debtors changes continually, once each quarter we re-analyze all of our accounts with refreshed external data, which we supplement with information gleaned from our own collection efforts. We modify our collection method for each account if warranted.

Experienced Management Team. Our management team has considerable experience in finance, banking, consumer collections and other industries. We believe that the expertise of our executives obtained by managing businesses across numerous other industries has been critical to the enhancement of our operations. Our management team has created a culture of new ideas and progressive thinking, coupled with the increased use of technology and statistical analysis.

Our Strategy

To enhance our position in the industry, we have implemented a business strategy that emphasizes the following elements:

Implement and Refine New and Existing Collection Channels. We continually refine our collection processes and evaluate new collection strategies, such as strategic outsourcing, to further supplement our traditional call center approach. We believe that our multiple and dynamic approach to collections increases our opportunity to achieve enhanced returns on our investments.

Leverage Expertise in New Markets. We believe that our internally developed underwriting and collection processes can be extended to a variety of charged-off consumer receivables in addition to charged-off credit card receivables. We intend to continue to leverage our valuation, underwriting and collection processes to other charged-off receivable markets, including auto loan deficiencies, telecom and general consumer loans. To date, our purchases in other charged-off receivable markets have generally performed to expectations.

Continue to Build Our Data Management and Analysis Capabilities. We are continually improving our technology platform and our pricing, underwriting and collection processes through software development, statistical analysis and experience.

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Consider Complementary Acquisitions. We will actively pursue acquisitions of complementary companies to expand into new markets, add capacity in our current business, or leverage our knowledge of the distressed consumer.

Acquisition of Receivables

Typically, receivable portfolios are offered for sale through a general auction, “forward flow” contract or direct negotiation. A “forward flow” contract is a commitment to purchase a defined volume of accounts from a seller for a period of typically three to 12 months, though such commitments can extend up to several years. We believe long-term success is best pursued by combining a diverse sourcing approach with an account level scoring methodology and a disciplined evaluation process.

Identify purchase opportunities. We employ a team of professionals who maintain relationships with the largest credit grantors in the United States. Their role is to identify purchase opportunities and secure, if possible, exclusive negotiation rights for us.

Analyze purchase opportunities using account level analytics. Once a portfolio of interest is identified, our internal modeling team analyzes individual account level information provided by the seller and, if appropriate, other external sources, in order to determine the expected value of each potential new consumer. Our collections expectations are based on demographic data, account characteristics, and economic variables, which we use to predict a consumer’s willingness and ability to repay their debt. The expected value of collections for each account is aggregated to calculate an overall value for the portfolio. Additional adjustments are made to account for prior collection activities, the underwriting approaches of the sellers, and any other qualitative factor that may impact the payment behavior of our consumers. The expected value of each individual consumer is aggregated into a total portfolio value. As in the past, we continue to base our purchasing decisions on a combination of empirical data, proprietary statistical models, and deep industry knowledge, and will remain focused on making purchasing decisions based on sound quantitative and qualitative analysis.

Collection Strategies

We expand upon the insights created during our purchasing process when building account collection strategies. Our proprietary consumer-level collectability analysis is the primary determinant of whether an account is actively worked post-purchase. Throughout our ownership period, we continuously refine this analysis to determine the most effective collection strategy to pursue for each account. These strategies consist of:

- *Legal Action.* We generally refer accounts for legal action where it appears the debtor is able, but unwilling, to pay their obligations. Prior to sending accounts to a law firm, we generally first attempt to communicate with the debtor to see if appropriate payment arrangements can be made without the need for collection litigation. Our efforts may include using a specialized internal group of collectors, or “Recovery Collectors,” who communicate our intention to have an attorney evaluate the suitability of the account for litigation if payment arrangements cannot be established. When we decide to refer an account for legal action, we utilize law firms that specialize in collection matters in the states where we intend to pursue collections. Prior to engaging a collection firm, we evaluate aspects of the firm’s business that we believe are relevant to its performance, obtaining disclosures from the firm concerning its operations, financial condition, experience, and professional affiliations, among other key criteria. We rely on the law firms’ expertise with respect to applicable debt collection laws. We also rely on these law firms to evaluate the accounts we refer to them and to make the decision about whether or not to pursue collection litigation on each account. The law firms we have hired may also attempt to communicate with the debtors in an attempt to collect their debts prior to initiating litigation. We pay the law firms a contingency fee based on amounts they collect on our behalf.
- *Call Centers.* We maintain domestic collection call centers in San Diego, California, Phoenix, Arizona and St. Cloud, Minnesota and an international call center in Gurgaon, India. Each call center consists of multiple collection departments. Account Managers supervised by Group Managers are divided into

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specialty teams. Account Managers are trained to use a friendly, but firm approach to assess our consumers' willingness and capacity to pay. They attempt to work with consumers to evaluate sources and means of repayment to achieve a full or negotiated lump sum settlement or develop payment programs customized to the individual's ability to pay. In some cases, Account Managers advise the consumers of alternative sources of financing to pay off their debt. In cases where a payment plan is developed, Account Managers encourage consumers to pay through automatic payment arrangements. During the first week of new hire training, we educate Account Managers to understand and apply the sections of the Fair Debt Collection Practices Act, or FDCPA, the Soldiers and Sailors Act, the Graham Leach Bliley Act, company policies and state laws that are relevant in the Account Manager's daily collection activities. These laws and policies are then reiterated throughout training to ensure proper integration into the collections process. Monitoring and coaching by Group Managers is performed to help ensure compliance with applicable laws and policies by Account Managers.

- *Third Party Collection Agencies.* We selectively employ a strategy that uses collection agencies. Collection agencies receive a contingency fee for each dollar collected. Generally, we use these agencies on accounts when we believe they can liquidate better or less expensively on certain accounts than we can in our internal call centers. These include, among others, accounts that generally have recently been charged-off or have low liquidation expectations, such as accounts with small balances or with limited consumer contact information. We also use agencies to initially provide us a way to scale quickly when large purchases are made and as a challenger to our internal call center collection teams. Prior to engaging a collection agency, we evaluate aspects of the agency's business that we believe are relevant to its performance, obtaining disclosures from the firm concerning its operations, financial condition, experience, and professional affiliations, among other key criteria.
- *Direct Mail.* We have an in-house marketing team that develops innovative mail campaigns. The mail campaigns generally offer debtors targeted discounts on their balances owed to encourage settlement of their accounts and to provide us with a low cost recovery method.
- *Sale.* We believe our ability to analyze portfolios enables us to periodically sell a portion of such portfolios to buyers at a favorable price. We may consider selling certain accounts if we believe the current market price exceeds our estimate of the net present value of the estimated remaining collections or determine that additional recovery efforts are not warranted. In addition, prior to July 2008, under contractual obligations with Jefferson Capital Systems, LLC, or Jefferson Capital, we sold, on a forward flow basis, all accounts for which the debtor had filed for protection under the United States Bankruptcy Code.
- *Account Balance Transfer.* We may transfer to our credit card partners accounts for which this approach offers the highest opportunity for success. The credit card partners may offer the debtor the opportunity to establish new credit and to transfer the balance onto a new credit card. If the account is transferred we receive an agreed-upon payment.
- *Skip Tracing.* If a debtor's phone number proves inaccurate when a collector calls an account, or if current contact information for a debtor is not available at the time of account purchase, then the account is automatically routed to our skip tracing process. We currently use a number of different skip tracing companies to provide phone numbers and addresses.
- *Inactive.* We use our collection resources judiciously and efficiently by not deploying resources on accounts where the prospects of collection are remote. For example, for accounts where the debtor is currently unemployed, overburdened by debt, incarcerated, or deceased, no collection method of any sort is assigned.

Competition

The consumer credit recovery industry is highly competitive and fragmented. We compete with a wide range of collection companies, financial services companies and a number of well-funded entrants with limited experience in our industry. We also compete with traditional contingency collection agencies and in-house

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recovery departments. Competitive pressures affect the availability and pricing of receivable portfolios, as well as the availability and cost of qualified recovery personnel. In addition, some of our competitors may have signed forward flow contracts under which originating institutions have agreed to transfer charged-off receivables to them in the future, which could restrict those originating institutions from selling receivables to us. We believe some of our major competitors, which include companies that focus primarily on the purchase of charged-off receivable portfolios, have continued to diversify into third-party agency collections and into offering credit card and other financial services as part of their recovery strategy. In the current economic environment, we have seen significant changes in the competitive arena over the last year characterized by fewer potential purchasers of accounts, limited new entrants into the business, increases of portfolios available for purchase and resulting decreases in portfolio purchase prices. Recently, pricing has begun to increase slightly from some of the low levels experienced in most of 2009, although pricing is still favorable when compared to 2005 – 2008 purchases.

When purchasing receivables, we compete primarily on the basis of the price paid for receivable portfolios, the ease of negotiating and closing the prospective portfolio purchases with us, including our ability to obtain funding and our reputation with respect to the quality of services that we provide. We believe that our ability to compete effectively in this market is also dependent upon, among other things, our relationships with originators and sellers of charged-off consumer receivables, and our ability to provide quality collection strategies in compliance with applicable collections laws.

There continues to be consolidation of issuers of credit cards, which have been a principal source of receivable purchases. Countering the forces described in the preceding paragraph, this consolidation has limited the number of sellers in the market and has correspondingly given the remaining sellers increasing market strength in establishing the price and terms of the sale of credit card accounts.

Government Regulation

In a number of states we must maintain licenses to perform debt recovery services and must satisfy related bonding requirements. It is our policy to comply with all material licensing and bonding requirements. Our failure to comply with existing licensing requirements, changing interpretations of existing requirements, or adoption of new licensing requirements, could restrict our ability to collect in states, subject us to increased regulation, increase our costs, or adversely affect our ability to collect our receivables and could have a material adverse effect on us if they apply to some or all of our recovery activities.

Federal and state statutes establish specific guidelines and procedures which debt collectors must follow when collecting consumer receivables. The FDCPA and comparable state statutes establish specific guidelines and procedures which debt collectors must follow when communicating with consumers, including the time, place and manner of the communications. It is our policy to comply with the provisions of the FDCPA and comparable state statutes in all of our recovery activities. Our failure to comply with these laws could have a material adverse effect on us if they apply to some or all of our recovery activities. In addition to the FDCPA, significant federal laws applicable to our business include the following:

- Truth-In-Lending Act;
- Fair Credit Billing Act;
- Equal Credit Opportunity Act;
- Fair Credit Reporting Act;
- Electronic Funds Transfer Act;
- U.S. Bankruptcy Code;
- Credit CARD Act of 2009;
- Gramm-Leach-Bliley Act;
- Soldiers and Sailors Act;
- Health Insurance Portability and Accountability Act; and
- Regulations that relate to these Acts

Additionally, there may be comparable statutes in those states in which our consumers reside or in which the originating institutions are located. State laws may also limit the interest rate and the fees that a credit originator may impose on its consumers, and also limit the time in which we may file legal actions to enforce consumer accounts.

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The relationship between a consumer and a credit card issuer is extensively regulated by federal and state consumer protection and related laws and regulations. While we do not issue credit cards, these laws affect some of our operations because the majority of our receivables were originated through credit card transactions. The laws and regulations applicable to credit card issuers, among other things, impose disclosure requirements when a credit card account is advertised, when it is applied for and when it is opened, at the end of monthly billing cycles and at year-end. Federal law requires, among other things, that credit card issuers disclose to consumers the interest rates, fees, grace periods and balance calculation methods associated with their credit card accounts. Some laws prohibit discriminatory practices in connection with the extension of credit. If the originating institution fails to comply with applicable statutes, rules, and regulations, it could create claims and rights for the debtors that would reduce or eliminate their obligations under their receivables, and have a possible material adverse effect on us. When we acquire receivables, we generally require the originating institution to contractually indemnify us against losses caused by its failure to comply with applicable statutes, rules and regulations relating to the receivables before they are sold to us.

Federal statutes further provide that, in some cases, consumers cannot be held liable for, or their liability is limited with respect to, charges to their credit card accounts that resulted from unauthorized use of their credit cards. These laws, among others, may give consumers a legal cause of action against us, or may limit our ability to recover amounts owing with respect to the receivables, whether or not we committed any wrongful act or omission in connection with the account.

State and federal laws concerning identity theft, privacy, data security, the use of automated dialing equipment and other laws related to debtors and consumer protection, as well as laws applicable to specific types of debt, impose requirements or restrictions on collection methods or our ability to enforce and recover certain debts. These requirements or restrictions could adversely affect our ability to enforce the collection of the receivables.

The laws described above, among others, as well as any new or changed laws, rules or regulations, may adversely affect our ability to recover amounts owing with respect to our receivables.

Employees

As of December 31, 2009, we had approximately 1,500 employees. None of our employees is represented by a labor union. We believe that our relations with our employees are good.

Item 1A—Risk Factors

This section highlights some specific risks affecting our business, operating results and financial condition. The list of risks is not intended to be exhaustive and the order in which the risks appear is not intended as an indication of their relative weight or importance.

Risk Factors

Recent instability in the financial markets and global economy may affect our access to capital, our ability to purchase accounts, and the success of our collection efforts.

The residential real estate market in the U.S. has experienced a significant downturn due to declining real estate values, substantially reducing mortgage loan originations and securitizations and precipitating more generalized credit market dislocations and a significant contraction in available liquidity globally. Financial markets in the United States, Europe and Asia have experienced extreme disruption, including, among other things, volatility in security prices, rating downgrades of certain investments and declining valuations of others. These factors, combined with fluctuating oil prices, declining business and consumer confidence and increased

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unemployment, have led to an economic recession. Individual consumers are experiencing higher delinquency rates on various consumer loans and defaults on indebtedness of all kinds have increased. These developments, as well as further declines in real estate values in the U.S. or elsewhere and continuing credit and liquidity concerns, could reduce our ability to collect on our purchased consumer receivable portfolios further and would adversely affect their value. In addition, continued or further credit market dislocations or sustained market downturns may reduce the ability of lenders to originate new credit, limiting our ability to purchase consumer receivable portfolios in the future. Further, increased financial pressure on the distressed consumer may result in additional regulatory restrictions on our operations and increased litigation filed against us. We are unable to predict the likely duration or severity of the current disruption in financial markets and adverse economic conditions and the effects they may have on our business, financial condition and results of operations.

Our quarterly operating results may fluctuate due to a variety of factors.

Our quarterly operating results will likely vary in the future due to a variety of factors that could affect our revenues and operating expenses in any particular quarter. We expect that our operating expenses as a percentage of collections will fluctuate in the future as we expand into new markets, increase our new business development efforts, hire additional personnel and incur increased insurance and regulatory compliance costs. In addition, our operating results have fluctuated and may continue to fluctuate as the result of the factors described below and elsewhere in this Annual Report on Form 10-K:

- the timing and amount of collections on our receivable portfolios, including the effects of seasonality and economic recession;
- any change to earnings resulting from an impairment in the carrying value of our receivable portfolios;
- increases in operating expenses associated with the growth or change of our operations;
- the cost of credit to finance our purchases of receivable portfolios; and
- the timing and terms of our purchases of receivable portfolios.

Due to fluctuating prices for consumer receivable portfolios, there has been considerable variation in our purchasing volume from quarter to quarter and we expect that to continue. The volume of our portfolio purchases will be limited while prices are high, and may or may not increase when portfolio pricing is more favorable to us. We believe our ability to collect on consumer receivable portfolios may be negatively impacted because of current economic conditions, and this may require us to increase our projected return hurdles in calculating prices we are willing to pay for individual portfolios. An increase in portfolio return hurdles may decrease the volume of portfolios we are successful in purchasing. Because we recognize revenue on the basis of projected collections on purchased portfolios, we may experience variations in quarterly revenue and earnings due to the timing of portfolio purchases.

Accordingly, results for any one quarter are not necessarily indicative of results to be expected for any other quarter or for any year, and revenues and earnings for any particular future period may decrease.

Fluctuations in our operating results may lead to decreases in the trading prices of our common stock and convertible notes.

In the future, if operating results fall below the expectations of securities analysts and investors, the price of our common stock and convertible notes likely would decrease. In addition, uncertainty about current global economic conditions have impacted and could continue to increase the volatility of our stock price.

We may not be able to purchase receivables at sufficiently favorable prices or terms, or at all.

Our ability to continue to operate profitably depends upon the continued availability of receivable portfolios that meet our purchasing standards and are cost-effective based upon projected collections exceeding our costs. Our profitability is also affected by our actual collections on accounts meeting or exceeding our projected

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collections. The market for acquiring receivable portfolios is competitive. Our industry has historically attracted a large amount of investment capital. With this inflow of capital, we saw an increase in the pricing of receivable portfolios to levels that we believed may generate reduced returns on investment. While more recently, the downturn in the economy and contraction of available capital have somewhat lessened competition for these receivable portfolios and reduced prices, there is no assurance as to how long these current economic conditions and competitive climate will continue or that portfolios will be available for purchase on terms acceptable to us or that we will collect a sufficient amount to make the portfolio collections cost-effective.

In addition to the competitive factors discussed above, the availability of consumer receivable portfolios at favorable prices and on favorable terms depends on a number of factors, within and outside of our control, including:

- the continuation of the current growth and charge-off trends in consumer debt;
- the continued sale of receivable portfolios by originating institutions at prevailing price levels;
- our ability to develop and maintain long-term relationships with key major credit originators;
- our ability to obtain adequate data from credit originators or portfolio resellers to appropriately evaluate the collectability of, and estimate the value of, portfolios;
- changes in laws and regulations governing consumer lending, bankruptcy and collections; and
- the potential availability of government funding to competing purchasers for the acquisition of account portfolios under various programs intended to serve as an economic stimulus.

In addition, because of the length of time involved in collecting charged-off consumer receivables on acquired portfolios and the volatility in the timing of our collections, we may not be able to identify trends and make changes in our purchasing strategies in a timely manner. Ultimately, if we are unable to continually purchase and collect on a sufficient volume of receivables to generate cash collections that exceed our costs, our business will be materially and adversely affected.

We may not be successful in acquiring and collecting on portfolios consisting of new types of receivables.

We may pursue the acquisition of portfolios consisting of assets with which we have little collection experience. We may not be successful in completing any of these acquisitions. If we do purchase such assets, our lack of experience with new types of receivables may cause us to pay too much for these receivable portfolios, which may substantially hinder our ability to generate profits from such portfolios. Even if we successfully acquire such new types of receivables, our existing methods of collections may prove ineffective for such new receivables and our inexperience may have a material and adverse affect on our results of operations.

We may purchase receivable portfolios that contain unprofitable accounts and we may not be able to collect sufficient amounts to recover our costs and to fund our operations.

We acquire and service receivables that the obligors have failed to pay and the sellers have deemed uncollectible and written off. The originating institutions generally make numerous attempts to recover on their nonperforming receivables, often using a combination of their in-house collection and legal departments as well as third-party collection agencies. In order to operate profitably over the long term, we must continually purchase and collect on a sufficient volume of receivables to generate revenue that exceeds our costs. These receivables are difficult to collect, and we may not be successful in collecting amounts sufficient to cover the costs associated with purchasing the receivables and funding our operations. If we are not able to collect on these receivables or collect sufficient amounts to cover our costs, this may materially and adversely affect our results of operations.

We may purchase portfolios that contain accounts which do not meet our account collection criteria.

In the normal course of our portfolio acquisitions, some receivables may be included in the portfolios that fail to conform to the terms of the purchase agreements and we may seek to return these receivables to the seller

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for payment or replacement. However, we cannot guarantee that such sellers will be able to meet their obligations to us. Accounts that we are unable to return to sellers may yield no return. If we purchase portfolios containing too many accounts that do not conform to the terms of the purchase contracts or contain accounts that are otherwise uncollectible, we may be unable to collect a sufficient amount and the portfolio purchase could be unprofitable, which would have an adverse effect on our cash flows. If cash flows from operations are less than anticipated, our ability to satisfy our debt obligations, purchase new portfolios and our future growth and profitability may be materially and adversely affected.

We may not be able to use our sales channel to sell unprofitable accounts.

Due to current economic conditions, portfolio pricing in the resale market is currently lower than historical levels. While we have in the past periodically sold certain accounts in a portfolio when we believed the current market price exceeded our estimate of the net present value of the estimated remaining collections or determined that additional recovery efforts are not warranted, we may not be able to do so if resale pricing is unfavorable or if the number of resale transactions is limited. The inability to resell unprofitable accounts may reduce our portfolio returns.

The statistical models we use to project remaining cash flows from our receivable portfolios may prove to be inaccurate, which could result in reduced revenues or the recording of an impairment charge if we do not achieve the collections forecasted by our models.

We use our internally developed Unified Collection Score, or UCS model, and Behavioral Liquidation Score, or BLS model, to project the remaining cash flows from our receivable portfolios. Our UCS and BLS models consider known data about our consumers' accounts, including, among other things, our collection experience and changes in external consumer factors, in addition to all data known when we acquired the accounts. There can be no assurance, however, that we will be able to achieve the collections forecasted by our UCS and BLS models. If we are not able to achieve these levels of forecasted collection, our revenues will be reduced or we may be required to record an impairment charge, which may materially and adversely impact our results of operations.

We may not be successful in recovering the level of court costs we anticipate recovering.

We contract with a nationwide network of attorneys that specialize in collection matters. We generally refer charged-off accounts to our contracted attorneys when we believe the related debtor has sufficient assets to repay the indebtedness but has, to date, been unwilling to pay. In connection with our agreements with our contracted attorneys, we advance certain out-of-pocket court costs, or Deferred Court Costs. Deferred Court Costs represent amounts we believe we will recover from our consumers. Deferred Court Costs are in addition to the amounts owed on our consumers' accounts that we expect to collect. These court costs may be difficult or impossible to collect, and we may not be successful in collecting amounts sufficient to cover the amounts deferred in our financial statements. Further, our network of attorneys may not utilize all, or a portion, of the amounts we advanced for the payment of court costs in the manner for which they were intended. If we are not able to recover these court costs, this may materially and adversely affect our results of operations.

Our industry is highly competitive, and we may be unable to continue to compete successfully with businesses that may have greater resources than we have.

We face competition from a wide range of collection and financial services companies that may have substantially greater financial, personnel and other resources, greater adaptability to changing market needs and more established relationships in our industry than we currently have. We also compete with traditional contingency collection agencies and in-house recovery departments. Competitive pressures adversely affect the availability and pricing of charged-off receivable portfolios, as well as the availability and cost of qualified recovery personnel. Because there are few significant barriers to entry for new purchasers of charged-off

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receivable portfolios, there is a risk that additional competitors with greater resources than ours, including competitors that have historically focused on the acquisition of different asset types, will enter our market. If we are unable to develop and expand our business or adapt to changing market needs as well as our current or future competitors, we may experience reduced access to charged-off receivable portfolios at acceptable prices, which could reduce our profitability.

Moreover, we may not be able to offer competitive bids for charged-off receivable portfolios. We face bidding competition in our acquisition of charged-off receivable portfolios. In our industry, successful bids generally are awarded on a combination of price, service and relationships with the debt sellers. Some of our current and future competitors may have more effective pricing and collection models, greater adaptability to changing market needs and more established relationships in our industry. They also may pay prices for portfolios that we determine are not reasonable. We may not be able to offer competitive bids for charged-off consumer receivable portfolios. In addition, there continues to be consolidation of issuers of credit cards, which have been a principal source of receivable purchases. This consolidation has limited the number of sellers in the market and has correspondingly given the remaining sellers increasing market strength in the price and terms of the sale of credit card accounts.

In addition, we believe that issuers of credit cards are increasingly using outsourced, off-shore alternatives in connection with their collection of delinquent accounts in an effort to reduce costs. If these off-shore efforts are successful, these issuers may decrease the number of portfolios they offer for sale and increase the purchase price for portfolios they offer for sale.

Our failure to purchase sufficient quantities of receivable portfolios may necessitate workforce reductions, which may harm our business.

Because fixed costs, such as certain personnel costs and lease or other facilities costs, constitute a significant portion of our overhead, we may be required to reduce the number of employees in our collection operations if we do not continually augment the receivable portfolios we service with additional receivable portfolios or collect sufficient amounts on receivables we own. Reducing the number of employees can affect our business adversely and lead to:

- lower employee morale, higher employee attrition rates, fewer experienced employees and higher recruiting and training costs;
- disruptions in our operations and loss of efficiency in collection functions; and
- excess costs associated with unused space in collection facilities.

A significant portion of our portfolio purchases during any period may be concentrated with a small number of sellers.

We expect that a significant percentage of our portfolio purchases for any given fiscal year may be concentrated with a few large sellers, some of which also may involve forward flow arrangements. We cannot be certain that any of our significant sellers will continue to sell charged-off receivables to us on terms or in quantities acceptable to us, or that we would be able to replace such purchases with purchases from other sellers.

A significant decrease in the volume of purchases from any of our principal sellers would force us to seek alternative sources of charged-off receivables. We may be unable to find alternative sources from which to purchase charged-off receivables, and even if we could successfully replace such purchases, the search could take time, the receivables could be of lower quality, cost more, or both, any of which could materially adversely affect our financial performance.

We may be unable to meet our future short- or long-term liquidity requirements.

We depend on both internal and external sources of financing to fund our purchases of receivable portfolios and our operations. Our need for additional financing and capital resources increases dramatically as our business

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grows. Our inability to obtain financing and capital as needed or on terms acceptable to us would limit our ability to acquire additional receivable portfolios and to operate our business.

Volatility in U.S. credit markets could affect our ability to refinance and/or retire existing debt, obtain financing to fund acquisitions, investments, or other significant operating or capital expenditures.

At the end of 2009, we had approximately \$42.9 million principal amount of outstanding 3.375% Convertible Subordinated Notes due September 19, 2010, and a balance on our revolving credit facility of \$260.0 million which was due to expire in May 2010. A tightening of credit availability could restrict our ability to refinance and/or retire our existing debt and to obtain funds needed to operate or expand our business. If we are unable to retire or obtain suitable replacement financing for our long-term debt when and as it becomes due, this may have a material and adverse impact on our business and financial condition. On February 8, 2010, we terminated the existing revolving credit facility and entered into a new \$327.5 million three-year revolving facility which expires in May 2013.

We may not be able to continue to satisfy the restrictive covenants in our debt agreements.

All of our receivable portfolios are pledged to secure amounts owed to our lenders. Our debt agreements impose a number of restrictive covenants on how we operate our business. Failure to satisfy any one of these covenants could result in all or any of the following consequences, each of which could have a materially adverse effect on our ability to conduct business:

- acceleration of outstanding indebtedness;
- our inability to continue to purchase receivables needed to operate our business; or
- our inability to secure alternative financing on favorable terms, if at all.

We use estimates in our revenue recognition and our earnings will be reduced if actual results are less than estimated.

We utilize the interest method to determine revenue recognized on substantially all of our receivable portfolios. Under this method, each pool of receivables is modeled based upon its projected cash flows. A yield is then established which, when applied to the outstanding balance of the pool of receivables, results in the recognition of revenue at a constant yield relative to the remaining balance in the pool. The actual amount recovered by us may substantially differ from our projections and may be lower than initially projected. If the differences are material, we may be required to take an impairment charge on a portion of our investment, which would negatively affect our earnings.

We may incur impairment charges based on the provisions of Financial Accounting Standards Board Accounting Standards Codification Subtopic 310-30.

We account for our portfolio revenue in accordance with the Financial Accounting Standards Board's Accounting Standards Codification Subtopic 310-30 "Loans and Debt Securities Acquired with Deteriorated Credit Quality," or ASC 310-30. ASC 310-30 limits the revenue that may be accrued to the excess of the estimate of expected future cash flows over a portfolio's initial cost of accounts receivable acquired, requires that the excess of the contractual cash flows over expected cash flows not be recognized as an adjustment of revenue, expense, or on the balance sheet, and freezes the internal rate of return, or IRR originally estimated when the accounts receivable are purchased for subsequent impairment testing. Rather than lower the estimated IRR if the expected future cash flow estimates are decreased, the carrying value of our receivable portfolios would be written down to maintain the then-current IRR. Increases in expected future cash flows would be recognized prospectively through an upward adjustment of the IRR over a portfolio's remaining life. Any increased yield then becomes the new benchmark for impairment testing. Since ASC 310-30 does not permit yields to be lowered, there is an increased probability of our having to incur impairment charges in the future, which would negatively impact our profitability.

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Negative news regarding the debt collection industry and individual debt collectors may have a negative impact on a debtor's willingness to pay the debt we acquire.

Consumers are exposed to information from a number of sources that may cause them to be more reluctant to pay their debts or to pursue legal actions against us. Print and other media publish stories about the debt collection industry which cite specific examples of abusive collection practices. These stories are also published on websites, which can lead to the rapid dissemination of the story, adding to the level of exposure to negative publicity about our industry. Various Internet sites are maintained where consumers can list their concerns about the activities of debt collectors and seek guidance from other website posters on how to handle the situation. And advertisements by debt relief attorneys and credit counseling centers are becoming more common, adding to the negative attention given to our industry. As a result of this negative publicity, debtors may be more reluctant to pay their debts or could pursue legal action against us regardless of whether those actions are warranted. These actions could impact our ability to collect on the receivables we acquire and affect our revenues and profitability.

Our business of enforcing the collection of purchased receivables is subject to extensive statutory and regulatory oversight.

Some laws and regulations applicable to credit card issuers or other debt originators may preclude us from collecting on receivables we purchase where the card issuer or originator failed to comply with applicable federal or state laws in generating or servicing the receivables that we have acquired. Because our receivables generally are originated and serviced nationwide, we cannot be certain that the originating lenders have complied with applicable laws and regulations. While our receivable acquisition contracts typically contain provisions indemnifying us for losses owing to the originating institution's failure to comply with applicable laws and other events, we cannot be certain that any indemnities received from originating institutions will be adequate to protect us from losses on the receivables or liabilities to consumers.

We sometimes purchase accounts in asset classes that are subject to industry-specific restrictions that limit the collections methods that we can use on those accounts. Our inability to collect sufficient amounts from these accounts through available collections methods could materially and adversely affect our results of operations.

Present and future government regulation, legislation or enforcement actions may limit our ability to recover and enforce the collection of receivables.

Federal and state laws and regulations may limit our ability to recover and enforce the collection of receivables regardless of any act or omission on our part. Laws relating to debt collections also directly apply to our business. Our failure or the failure of third party agencies and attorneys or the originators of our receivables to comply with existing or new laws, rules or regulations could limit our ability to recover on receivables or cause us to pay damages to the original debtors, which could reduce our revenues and harm our business.

Additional consumer protection or privacy laws and regulations may be enacted that impose additional restrictions on the collection of receivables. Such new laws may materially adversely affect our ability to collect on our receivables, which could materially and adversely affect our earnings.

Failure to comply with government regulation could result in the suspension or termination of our ability to conduct business, may require the payment of significant fines and penalties, or require other significant expenditures.

The collections industry is regulated under various federal and state laws and regulations. Many states and several cities require that we be licensed as a debt collection company. The Federal Trade Commission, state Attorneys General and other regulatory bodies have the authority to investigate consumer complaints against debt collection companies and to recommend enforcement actions and seek monetary penalties. If we or our third party collection agencies or law firms fail to comply with applicable laws and regulations, it could result in the suspension or termination of our ability to conduct collection operations, which would materially adversely affect

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us. In addition, new federal, state or local laws or regulations, or changes in the ways these rules or laws are interpreted or enforced, could limit our activities in the future or significantly increase the cost of regulatory compliance.

We are dependent upon third parties to service a substantial portion of our consumer receivable portfolios.

Although we utilize our in-house collection staff to collect a substantial portion of our receivables, we also use outside collection services. Further, we are increasing the portion of our collection activity through the legal channel, whereby third-party law firms initiate legal actions on our behalf to collect accounts. As a result, we are dependent upon the efforts of those third-party collection agencies and attorneys to service and collect our consumer receivables. Any failure by our third-party collection agencies and attorneys to perform collection services for us adequately or remit such collections to us could materially reduce our revenue and our profitability. In addition, if one or more of those third-party collection agencies or attorneys were to cease operations abruptly, or to become insolvent, such cessation or insolvency could materially reduce our revenue and profitability. Our revenue and profitability could also be materially adversely affected if we are not able to secure replacement third party collection agencies or attorneys and transfer account information to our new third party collection agencies or attorneys promptly in the event our agreements with our third-party collection agencies and attorneys are terminated, our third-party collection agencies or attorneys fail to perform their obligations adequately, or if our relationships with such third-party collection agencies and attorneys otherwise change adversely.

A significant portion of our collections relies upon our success in individual lawsuits brought against consumers and our ability to collect on judgments in our favor.

We generate a significant portion of our revenue by collecting on judgments that are granted by courts in lawsuits filed against debtors. A decrease in the willingness of courts to grant such judgments, a change in the requirements for filing such cases or obtaining such judgments, or a decrease in our ability to collect on such judgments could have a material and adverse effect on our results of operations. As we increase our use of the legal channel for collections, our short-term margins may decrease as a result of an increase in upfront court costs and costs related to counter claims. We may not be able to collect on certain aged accounts because of applicable statutes of limitations and we may be subject to adverse effects of regulatory changes that we cannot predict. Further, courts in certain jurisdictions require that a copy of the account statements or applications be attached to the pleadings in order to obtain a judgment against the account debtors. If we are unable to produce account documents, these courts will deny our claims.

Increases in costs associated with our collections through a network of attorneys can materially raise our costs associated with our collection strategies and the individual lawsuits brought against consumers to collect on judgments in our favor.

We generally outsource those accounts where it appears the consumer is able, but unwilling to pay. We utilize lawyers that specialize in collection matters, paying them a contingency fee on amounts collected. In connection with our agreement with the contracted attorneys, we advance certain out-of-pocket court costs and capitalize those costs in our consolidated financial statements. We are increasing the portion of our collection activity through the legal channel, and as a consequence, due to an increase in upfront court costs associated with our pursuit of legal collections, and an increase in costs related to counterclaims, our costs in collecting on these accounts can increase, which can have a material and adverse affect on our results of operations. We also rely on our network of attorneys to interact with consumers in accordance with state and federal law, to appropriately handle funds advanced by us in connection with collections activities, and to appropriately apply and account for funds remitted by consumers. In the event that one or more of our attorneys fails to apply funds as intended, fails to observe applicable laws, or otherwise fails in their duties, this may also materially and adversely affect our results of operations.

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We are subject to ongoing risks of litigation, including individual and class actions under consumer credit, collections, employment, securities and other laws, and may be subject to awards of substantial damages.

We operate in an extremely litigious climate and currently are, and may in the future, be named as defendants in litigation, including individual and class actions under consumer credit, collections, employment, securities and other laws.

In the past, securities class-action litigation has often been filed against a company after a period of volatility in the market price of its stock. Our industry experiences a high volume of litigation, and legal precedents have not been clearly established in many areas applicable to our business. Additionally, employment-related litigation is increasing throughout the country. Defending a lawsuit, regardless of its merit, could be costly and divert management's attention from the operation of our business. Damage awards or settlements could be significant. The use of certain collection strategies could be restricted if class-action plaintiffs were to prevail in their claims. All of these factors could have an adverse effect on our business and financial condition.

We may make acquisitions that prove unsuccessful or strain or divert our resources.

From time to time, we consider acquisitions of other companies that could complement our business, including the acquisition of entities in diverse geographic regions and entities offering greater access to businesses and markets that we do not currently serve. For instance, during 2005 we acquired Ascension Capital Group and certain assets of Jefferson Capital. We may not be able to successfully acquire other businesses or, if we do, the acquisition may be unprofitable. In addition, we may not successfully operate the businesses acquired, or may not successfully integrate such businesses with our own, which may result in our inability to maintain our goals, objectives, standards, controls, policies or culture. In addition, through acquisitions, we may enter markets in which we have limited or no experience. The occurrence of one or more of these events may place additional constraints on our resources such as diverting the attention of our management from other business concerns, which can materially adversely affect our operations and financial condition. Moreover, any acquisition may result in a potentially dilutive issuance of equity securities, incurrence of additional debt and amortization of identifiable intangible assets, all of which could reduce our profitability.

We are dependent on our management team for the adoption and implementation of our strategies and the loss of their services could have a material adverse effect on our business.

Our management team has considerable experience in finance, banking, consumer collections and other industries. We believe that the expertise of our executives obtained by managing businesses across numerous other industries has been critical to the enhancement of our operations. Our management team has created a culture of new ideas and progressive thinking, coupled with increased use of technology and statistical analysis. The loss of the services of one or more of our key executive officers could disrupt our operations and seriously impair our ability to continue to acquire or collect on portfolios of charged-off consumer receivables and to manage and expand our business. Our success depends on the continued service and performance of our management team, and we cannot guarantee that we will be able to retain such individuals.

We may not be able to hire and retain enough sufficiently trained employees to support our operations, and/or we may experience high rates of personnel turnover.

Our industry is very labor-intensive, and companies in our industry typically experience a high rate of employee turnover. We generally compete for qualified collections personnel with companies in our business and in the collection agency, teleservices and telemarketing industries and we compete for qualified non-collections personnel with companies in many industries. We will not be able to service our receivables effectively, continue our growth or operate profitably if we cannot hire and retain qualified collection personnel. Further, high turnover rates among our employees increases our recruiting and training costs and may limit the number of

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experienced collection personnel available to service our receivables. Our newer employees tend to be less productive and generally produce the greatest rate of personnel turnover. If the turnover rate among our employees increases, we will have fewer experienced employees available to service our receivables, which could reduce collections and therefore materially and adversely impact our results of operations.

Exposure to regulatory, political and economic conditions in India exposes us to risks or loss of business.

A significant element of our business strategy is to continue to develop and expand offshore operations in India. While wage costs in India are significantly lower than in the U.S. and other industrialized countries for comparably skilled workers, wages in India are increasing at a faster rate than in the U.S., and we experience higher employee turnover in our India site than is typical in our U.S. locations. The continuation of these trends could result in the loss of the cost savings we sought to achieve by moving a portion of our collection operations to India. In the past, India has experienced significant inflation and shortages of readily available foreign currency exchange, and has been subject to civil unrest. We may be adversely affected by changes in inflation, exchange rate fluctuations, interest rates, tax provisions, social stability or other political, economic or diplomatic developments in or affecting India in the future. In addition, the infrastructure of the Indian economy is relatively poor. Further, the Indian government is significantly involved in and exerts considerable influence over its economy through its complicated tax code and pervasive bureaucracy. In the recent past, the Indian government has provided significant tax incentives and relaxed certain regulatory restrictions in order to encourage foreign investment in certain sectors of the economy, including the technology industry. Changes in the business or regulatory climate of India could have a material and adverse effect on our business, results of operations and financial condition.

India has also experienced persistent though declining mass poverty, civil unrest and terrorism and has been involved in conflicts with neighboring countries. In recent years, there have been military confrontations between India and Pakistan that have occurred in the region of Kashmir and along the Indian-Pakistan border. The potential for hostilities between the two countries has been high in light of tensions related to recent terrorist incidents in India and the unsettled nature of the regional geopolitical environment, including events in and related to Afghanistan and Iraq. Additionally, India's recent nuclear activity could expose it to increased political scrutiny, exclusion, or sanctions. Changes in the political stability of India could have a material adverse effect on our business, results of operations and financial condition.

We may not be able to manage our growth effectively, including the expansion of our operations in India.

We have expanded significantly in recent years. However, future growth will place additional demands on our resources, and we cannot be sure that we will be able to manage our growth effectively. Continued growth could place a strain on our management, operations and financial resources. We cannot be certain that our infrastructure, facilities and personnel will be adequate to support our future operations or to effectively adapt to future growth. If we cannot manage our growth effectively, our results of operations may be materially and adversely affected.

The failure of our technology and telecommunications systems could have an adverse effect on our operations.

Our success depends in large part on sophisticated computer and telecommunications systems. The temporary or permanent loss of our computer and telecommunications equipment and software systems, through casualty, operating malfunction, software virus, or service provider failure, could disrupt our operations. In the normal course of our business, we must record and process significant amounts of data quickly and accurately to properly bid on prospective acquisitions of receivable portfolios and to access, maintain and expand the databases we use for our collection activities. Any simultaneous failure of our information systems and their backup systems would interrupt our business operations.

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Our business depends heavily on services provided by various local and long-distance telephone companies. A significant increase in telephone service costs or any significant interruption in telephone services could negatively affect our operating results or disrupt our operations.

We may not be able successfully to anticipate, invest in or adopt technological advances within our industry.

Our business relies on computer and telecommunications technologies, and our ability to integrate new technologies into our business is essential to our competitive position and our success. We may not be successful in anticipating, managing, or adopting technological changes in a timely basis. Computer and telecommunications technologies are evolving rapidly and are characterized by short product life cycles.

We are making significant modifications to our information systems to ensure that they continue to meet our current and foreseeable demands and continued expansion, and our future growth may require additional investment in these systems. These system modifications may exceed our cost or time estimates for completion or may be unsuccessful. If we cannot update our information systems effectively, our results of operations may be materially and adversely affected.

We depend on having the capital resources necessary to invest in new technologies to acquire and service receivables. We cannot be certain that adequate capital resources will be available to us.

We may not be able adequately to protect the intellectual property rights upon which we rely.

We rely on proprietary software programs and valuation and collection processes and techniques, and we believe that these assets provide us with a competitive advantage. We consider our proprietary software, processes and techniques to be trade secrets, but they are not protected by patent or registered copyright. We may not be able to protect our technology and data resources adequately, which may materially diminish our competitive advantage.

Our results of operations may be materially adversely affected if bankruptcy filings increase or if bankruptcy or other debt collection laws change.

Our business model may be uniquely vulnerable to an economic recession, which typically results in an increase in the amount of defaulted consumer receivables, thereby contributing to an increase in the amount of personal bankruptcy filings. Under certain bankruptcy filings, a debtor's assets are sold to repay credit originators, with priority given to holders of secured debt. Since the defaulted consumer receivables we typically purchase are generally unsecured, we often would not be able to collect on those receivables. In addition, since we purchase receivables that are seriously delinquent, this is often an indication that many of the consumer debtors from whom we collect would be unable to service their debts going forward and are more likely to file for bankruptcy in an economic recession. We cannot be certain that our collection experience would not decline with an increase in bankruptcy filings. If our actual collection experience with respect to a defaulted consumer receivable portfolio is significantly lower than we projected when we purchased the portfolio, our results of operations could be materially and adversely affected.

In 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act, or the Protection Act, was enacted which made significant changes in the treatment of consumer filers for bankruptcy protection. Since the Protection Act was enacted, the number of bankruptcy filings has decreased, and the volume of business at Ascension has decreased as a result. We cannot determine the impact of the Protection Act on the number of bankruptcy filings, on a prospective basis, and its impact on the collectability of consumer debt.

Current federal legislative and executive branch proposals made in response to current economic conditions may have an effect on the rights of creditors in a consumer bankruptcy. We cannot predict whether these or other proposals will be enacted or the extent to which they may affect our business.

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We are subject to examinations and challenges by tax authorities.

We are subject to periodic examination from federal, state and international taxing authorities. In calculating any taxes due as a result of our operations, we undertake a diligent review of key data, and make decisions with respect to the appropriate application of relevant tax laws. In areas where the appropriate application of tax laws is subject to competing views or interpretation, we make determinations based on our view of the probable outcome, document the reasoning behind those determinations, and seek the concurrence of outside tax consultants. Positions we take with respect to the application of tax laws, may, from time to time, be challenged by tax authorities. If such challenges are made, and not resolved in our favor, they could have an adverse effect on our financial condition and results of operations.

Item 1B—Unresolved Staff Comments

None.

Item 2—Properties

The following chart indicates the facilities we lease as of December 31, 2009, the location and size of each facility and their designated use.

	<u>Square Footage</u>	<u>Lease Expiration Date</u>	<u>Primary Use</u>
San Diego, California	51,000	April 2015	Corporate headquarters, call center, and strategic outsourcing activities
Phoenix, Arizona	33,000	September 2013	Call center
St. Cloud, Minnesota	46,000	June 2013	Call center and administrative offices
Arlington, Texas	28,600	December 2010	Bankruptcy servicing center
Gurgaon, India	83,000	April 2018	Call center, bankruptcy servicing center and administrative offices

During 2009, we signed a lease and took occupancy of a new, larger site in India which allowed us to expand our collector headcount in India. We believe that our current leased facilities are generally well maintained and in good operating condition. We believe that these facilities are suitable and sufficient for our present operational needs.

Item 3—Legal Proceedings

On October 18, 2004, Timothy W. Moser, one of our former officers, filed an action in the United States District Court for the Southern District of California against us, and certain individuals, including several of our officers and directors. On February 14, 2005, we were served with an amended complaint in this action alleging defamation, intentional interference with contractual relations, breach of contract, breach of the covenant of good faith and fair dealing, intentional and negligent infliction of emotional distress and civil conspiracy arising out of certain statements in our Registration Statement on Form S-1, originally filed in September 2003, and alleged to be included in our Registration Statement on Form S-3, originally filed in May 2004. The amended complaint sought injunctive relief, economic and punitive damages in an unspecified amount plus an award of profits allegedly earned by the defendants and alleged co-conspirators as a result of the alleged conduct, in addition to attorney's fees and costs. On June 1, 2006, the plaintiff filed a second amended complaint in which he amended his claim for negligent infliction of emotional distress. During the pendency of the action, the parties filed various motions and discovery was stayed during a portion of that time pending the decision on our appeal of an unsuccessful decision on one such motion. On May 25, 2006, we filed a notice of appeal of the court's order

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denying the anti-SLAPP motion. On July 28, 2008, the appellate court affirmed the trial court's denial of our anti-SLAPP motion and returned the case to the District Court where the parties engaged in extensive discovery and filed various motions. On November 24, 2009, the District Court heard oral argument on motions for summary judgment filed by all of the defendants. On January 19, 2010, the District Court issued an order granting defendants' summary judgment motions, dismissed all causes of action against all of the defendants and entered judgment in favor of the defendants. The judgment will become final unless plaintiff takes action to perfect his right to appeal.

On September 7, 2005, Mr. Moser filed a related action in the United States District Court for the Southern District of California against Triarc Companies, Inc. ("Triarc"), which at the time, was a significant stockholder of ours, alleging intentional interference with contractual relations and intentional infliction of emotional distress. The case arose out of the same statements made or alleged to have been made in our Registration Statements mentioned above. The amended complaint sought injunctive relief, an order directing Triarc to issue a statement of retraction or correction of the allegedly false statements, economic and punitive damages in an unspecified amount and attorney's fees and costs. Triarc tendered the defense of this action to us, and we accepted the defense and will indemnify Triarc, pursuant to the indemnification provisions of the Registration Rights Agreements dated as of October 31, 2000 and February 21, 2002, and the Underwriting Agreements dated September 25, 2004 and January 20, 2005 to which Triarc is a party. This action was also dismissed by the District Court on January 19, 2010. The judgment will become final unless plaintiff takes action to perfect his right to appeal.

We, along with others in our industry, are subject to legal actions based on the Fair Debt Collection Practices Act, or FDCPA, and comparable state statutes, which could have a material adverse effect on us due to the remedies available under these statutes, including punitive damages. The violations of law alleged in these actions often include claims that we lack specified licenses to conduct our business, attempt to collect debts on which the statute of limitations has run, and have made inaccurate assertions of fact in support of our collection actions. A number of these cases are styled as class actions and a class has been certified in several of these cases. Many of these cases present novel issues on which there is no clear legal precedent. As a result, we may be unable to predict the range of possible outcomes.

In one such action, captioned *Brent v. Midland Credit Management, Inc et. al.*, filed on May 19, 2008, in the United States District Court for the Northern District of Ohio [Western Division], the plaintiff has filed a class action counter-claim against Midland Credit Management, Inc. and Midland Funding LLC (the "Midland Defendants"). The complaint alleges that the Midland Defendants' business practices violated consumers' rights under the FDCPA and the Ohio Consumer Sales Practices Act. The plaintiff is seeking actual and statutory damages for the class of Ohio residents, plus attorney's fees and costs of class notice and class administration. On August 11, 2009, the court issued an order partially granting plaintiff's motion for summary judgment and entering findings adverse to the Midland Defendants on certain of plaintiff's claims. The Midland Defendants subsequently moved the court to reconsider the order and were partially successful. However, because the court did not completely reverse the August 11 order, certain portions of the order remain subject to reversal only on appeal. Plaintiff is currently seeking to enlarge the case to include a national class of consumers; however, no class has been certified in this case. There are a number of other lawsuits, claims and counterclaims pending or threatened against us. In general, these lawsuits, claims or counterclaims have arisen in the ordinary course of business and involve claims for damages arising from a variety of alleged misconduct or improper reporting of credit information by us or our employees or agents. In addition, from time to time, we are subject to various regulatory investigations, inquiries and other actions, relating to our collection activities.

On January 6, 2010, the Office of the Attorney General of the State of California, the "California Attorney General," issued a subpoena to us to answer interrogatories and to produce documents in a proceeding entitled "*In the Matter of the Investigation of Encore Capital Group, Inc., Midland Credit Management, Inc. and Affiliated Persons and Entities*" concerning our debt collection practices and related topics. We intend to cooperate fully with the California Attorney General in response to this subpoena, subject to applicable law.

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On December 16, 2009, the Federal Trade Commission, or FTC, issued an order directing us to submit information about our practices in buying and collecting consumer debt, which the FTC intends to use for a study of the debt-buying industry. We are one of nine companies that received such an order from the FTC requesting the production of information for use in the FTC's study of the industry. The nine companies were described by the FTC as the nation's largest consumer debt buyers. The order was publicly announced by the FTC on January 5, 2010. We intend to cooperate fully with the FTC in connection with its study, subject to applicable law.

On September 16, 2009, the Maryland State Agency Licensing Board in the Office of the Commissioner of Financial Regulation (the "Agency"), issued a cease and desist order barring all collection activities by us and certain of our affiliates, alleging that we had failed to obtain necessary business licenses and had improperly filed lawsuits to collect credit card accounts, among other claims raised in certain of the legal actions pending against us. Pursuant to an Interim Settlement Agreement we executed with the Agency on September 23, 2009, and a Settlement Agreement we executed with the Agency on December 17, 2009, certain of our affiliates agreed to refrain from collection activities in Maryland until obtaining licenses. Under the terms of the Settlement Agreement, we resolved all of the allegations raised by the Agency without any admission of liability. The Agency agreed to a final resolution of the matter without an administrative hearing, in exchange for an agreement from Midland Credit Management, Inc. and three other affiliates to pay aggregate civil penalties of approximately \$1.0 million, to obtain licenses for three of our affiliates from the Agency, and to make certain other changes in business practices. The companies in question are compliant with the agreement, have since obtained licenses and have resumed doing business in Maryland.

In June 2008, the FTC announced that it had sued Jefferson Capital and its parent company, CompuCredit Corporation, alleging that Jefferson Capital and CompuCredit had violated the FTC Act with deceptive marketing practices when issuing credit cards. The FTC announced in December, 2008, that it had agreed to a settlement of the litigation with Jefferson Capital and CompuCredit, whereby those companies would credit approximately \$114.0 million to certain consumer accounts. Jefferson Capital and CompuCredit advised us that a substantial number of the accounts affected by the settlement had been sold to us.

In July 2008, we initiated an arbitration proceeding against Jefferson Capital and CompuCredit in connection with our forward flow purchase obligation based upon the allegations noted in the FTC complaint and other claims. Jefferson Capital and CompuCredit raised their own claims against us in the arbitration. In September 2009, we settled our dispute with Jefferson Capital and CompuCredit. Under the terms of the settlement, we purchased a large portfolio of charged-off credit card account balances on commercially reasonable terms and agreed to resume balance transfers to Jefferson Capital. We also agreed to return to Jefferson Capital certain accounts that were subject to Jefferson Capital's settlement with the FTC. Following our settlement with Jefferson Capital and CompuCredit, we have no further forward flow purchase obligations with Jefferson Capital and CompuCredit.

We have established loss provisions only for matters in which losses are probable and can be reasonably estimated. Some of the matters pending against us involve potential compensatory, punitive damage claims, fines or sanctions that, if granted, could require us to pay damages or make other expenditures in amounts that could have a material adverse effect on our financial position or results of operations. Although litigation is inherently uncertain, at this time, based on past experience, the information currently available and the possible availability of insurance and/or indemnification in some cases, we do not believe that the resolution of these matters will have a material adverse effect on our consolidated financial position or results of operations.

Item 4—Submission of Matters to a Vote of Security Holders

None.

PART II

Item 5—Market for the Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchase of Equity Securities

Our common stock is traded on the NASDAQ Global Select Market under the symbol “ECPG.”

The high and low sales prices of our common stock, as reported by NASDAQ Global Select Market for each quarter during our two most recent fiscal years, are reported below:

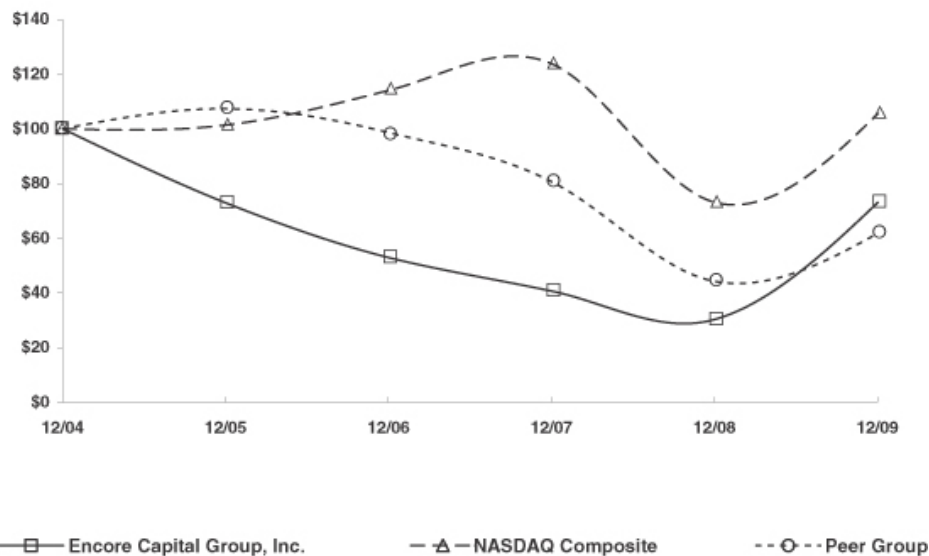
	Market Price	
	High	Low
Fiscal Year 2009		
First Quarter	\$ 8.43	\$ 2.62
Second Quarter	\$14.14	\$ 4.20
Third Quarter	\$17.50	\$ 10.30
Fourth Quarter	\$19.89	\$11.79
Fiscal Year 2008		
First Quarter	\$ 9.67	\$ 6.53
Second Quarter	\$10.99	\$ 6.10
Third Quarter	\$14.19	\$ 8.14
Fourth Quarter	\$13.73	\$ 5.89

The closing price of our common stock on January 29, 2010, was \$15.77 per share and there were 16 holders of record, including 110 NASD registered broker/dealers.

The following Performance Graph and related information shall not be deemed “soliciting material” or “filed” with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that we specifically incorporate it by reference into such filing.

The following graph compares the total cumulative stockholder return on our common stock for the period December 31, 2004, through December 31, 2009, with the cumulative total return of (a) the NASDAQ Index and (b) Asset Acceptance Capital Corp., Asta Funding, Inc. and Portfolio Recovery Associates, Inc., which we believe are comparable companies. The comparison assumes that \$100 was invested on December 31, 2004, in our common stock and in each of the comparison indices.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*
 Among Encore Capital Group, Inc., The NASDAQ Composite Index
 And A Peer Group



*\$100 invested on 12/31/04 in stock or index, including reinvestment of dividends.
 Fiscal year ending December 31.

	12/2004	12/2005	12/2006	12/2007	12/2008	12/2009
Encore Capital Group, Inc.	\$ 100.00	\$ 72.96	\$ 52.99	\$ 40.71	\$ 30.28	\$ 73.17
NASDAQ Composite	\$ 100.00	\$ 101.33	\$ 114.01	\$ 123.71	\$ 73.11	\$ 105.61
Peer Group	\$ 100.00	\$ 107.40	\$ 98.66	\$ 80.67	\$ 44.25	\$ 61.87

Dividend Policy

As a public company, we have never declared or paid dividends on our common stock. However, the declaration, payment and amount of future dividends, if any, is subject to the discretion of our board of directors, which may review our dividend policy from time to time in light of the then existing relevant facts and circumstances. Under the terms of our Revolving Credit Facility, we are permitted to declare and pay dividends in an amount not to exceed, during any fiscal year, 20% of our audited consolidated net income for the then most recently completed fiscal year, so long as no default or unmatured default under the facility has occurred and is continuing or would arise as a result of the dividend payment. We may also be subject to additional dividend restrictions under future financing facilities.

Item 6—Selected Financial Data

This table presents selected historical financial data of Encore and its consolidated subsidiaries. This information should be carefully considered in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this report. The selected data in this section are not intended to replace the consolidated financial statements. The selected financial data (except for “Selected Operating Data”) in the table below, as of December 31, 2007, 2006, and 2005 and for the years ended December 31, 2006 and 2005, were derived from our audited consolidated financial statements not included in this report. The selected financial data as of December 31, 2009, and 2008 and for the years ended December 31, 2009, 2008, and 2007, were derived from our audited consolidated financial statements included elsewhere in this report. The Selected Operating Data were derived from our books and records (*in thousands, except per share, and personnel data*):

	As of and For The Year Ended December 31,				
	2009	2008	2007	2006	2005
	<u>Adjusted⁽¹⁾</u>	<u>Adjusted⁽¹⁾</u>	<u>Adjusted⁽¹⁾</u>	<u>Adjusted⁽¹⁾</u>	<u>Adjusted⁽¹⁾</u>
Revenue					
Revenue from receivable portfolios, net ⁽²⁾	\$299,732	\$240,802	\$241,402	\$239,340	\$215,931
Servicing fees and related revenue ⁽³⁾	16,687	15,087	12,609	15,800	5,904
Total revenue	<u>316,419</u>	<u>255,889</u>	<u>254,011</u>	<u>255,140</u>	<u>221,835</u>
Operating expenses					
Salaries and employee benefits	58,025	58,120	64,153	63,962	52,410
Stock-based compensation expense	4,384	3,564	4,287	5,669	—
Cost of legal collections	112,570	96,187	78,636	52,079	35,090
Other operating expenses	26,013	23,652	21,533	22,585	16,973
Collection agency commissions	19,278	13,118	12,411	18,030	17,287
General and administrative expenses	26,920	19,445	17,478	17,310	13,375
Depreciation and amortization	2,592	2,814	3,351	3,894	2,686
Total operating expenses	<u>249,782</u>	<u>216,900</u>	<u>201,849</u>	<u>183,529</u>	<u>137,821</u>
Income before other (expense) income and income taxes	<u>66,637</u>	<u>38,989</u>	<u>52,162</u>	<u>71,611</u>	<u>84,014</u>
Other (expense) income					
Interest expense	(16,160)	(20,572)	(18,648)	(16,790)	(10,673)
Contingent interest expense	—	—	(4,123)	(18,520)	(23,187)
Pay-off of future contingent interest expense	—	—	(11,733)	—	—
Gain on repurchase of convertible notes, net	3,268	4,771	—	—	—
Other (expense) income	(2)	358	1,071	609	929
Total other expense	<u>(12,894)</u>	<u>(15,443)</u>	<u>(33,433)</u>	<u>(34,701)</u>	<u>(32,931)</u>
Income before income taxes	53,743	23,546	18,729	36,910	51,083
Provision for income taxes	(20,696)	(9,700)	(6,498)	(15,436)	(20,673)
Net income	<u>\$ 33,047</u>	<u>\$ 13,846</u>	<u>\$ 12,231</u>	<u>\$ 21,474</u>	<u>\$ 30,410</u>
Earnings per common share:					
Basic	\$ 1.42	\$ 0.60	\$ 0.53	\$ 0.94	\$ 1.36
Diluted	\$ 1.37	\$ 0.59	\$ 0.52	\$ 0.92	\$ 1.27

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	As of and For The Year Ended December 31,				
	2009	2008 Adjusted ⁽¹⁾	2007 Adjusted ⁽¹⁾	2006 Adjusted ⁽¹⁾	2005 Adjusted ⁽¹⁾
Weighted-average shares outstanding:					
Basic	23,215	23,046	22,876	22,754	22,299
Diluted	24,082	23,577	23,386	23,390	23,998
Cash flow data:					
Cash flows provided by (used in):					
Operating activities	\$ 76,116	\$ 63,071	\$ 19,610	\$ 38,027	\$ 31,226
Investing activities	\$ (79,171)	\$(107,252)	\$ (95,059)	\$ (37,190)	\$(144,344)
Financing activities	\$ 1,102	\$ 45,846	\$ 73,334	\$ 2,928	\$ 110,413
Selected operating data:					
Purchases of receivable portfolios, at cost ⁽⁴⁾	\$256,632	\$ 230,278	\$208,953	\$144,287	\$ 195,554
Gross collections for the period	\$487,792	\$ 398,633	\$355,193	\$337,097	\$ 292,163
Average active employees for the period ⁽⁵⁾	1,102	913	907	858	739
Gross collections per average active employee	\$ 443	\$ 436	\$ 392	\$ 393	\$ 395
Consolidated statements of financial condition data:					
Cash and cash equivalents	\$ 8,388	\$ 10,341	\$ 8,676	\$ 10,791	\$ 7,026
Investment in receivable portfolios, net	526,877	461,346	392,209	300,348	256,333
Total assets	595,159	549,079	483,011	394,673	367,599
Accrued profit sharing arrangement	—	—	—	6,869	16,528
Total debt	303,075	303,655	256,223	179,010	172,540
Total liabilities	352,068	345,653	295,576	222,803	224,160
Total stockholders' equity	\$243,091	\$ 203,426	\$187,435	\$171,870	\$ 143,439

(1) Adjusted for our change in accounting principle related to our convertible notes. See Note 15 to our consolidated financial statements for additional information and the effect of the change on our financial statements.

(2) Includes net impairments of \$19.3 million, \$41.4 million, \$11.2 million, \$1.4 million and \$3.1 million for the years ended December 31, 2009, 2008, 2007, 2006 and 2005, respectively.

(3) Includes \$16.8 million, \$15.0 million, \$12.5 million, \$15.7 million and \$5.5 million in revenue from Ascension Capital Group for the years ending December 31, 2009, 2008, 2007, 2006 and 2005, respectively.

(4) Purchase price includes a \$10.3 million, \$5.6 million, \$11.7 million, \$10.6 million and \$4.3 million allocation of our forward flow asset for 2009, 2008, 2007, 2006 and 2005, respectively. In July 2008, we ceased forward flow purchases from Jefferson Capital due to an alleged breach by Jefferson Capital and its parent, CompuCredit Corporation, of certain agreements. In September 2009, we settled our dispute with Jefferson Capital. As part of the settlement, we purchased a receivable portfolio and applied the remaining forward flow asset to that purchase. See Note 12 to our consolidated financial statements for further information.

(5) Excludes employees of Ascension Capital Group, which averaged approximately 125, 116, 133, 184 and 198, for the years ended December 31, 2009, 2008, 2007, 2006 and 2005, respectively.

Item 7—Management’s Discussion and Analysis of Financial Condition and Results of Operations

Introduction

We are a systems-driven purchaser and manager of charged-off consumer receivable portfolios and a provider of bankruptcy services to the finance industry. We acquire receivable portfolios at deep discounts from their face values using our proprietary valuation process that is based on the consumer attributes of the underlying accounts. Based upon the ongoing analysis of these accounts, we employ a dynamic mix of collection strategies to maximize our return on investment.

Market Overview

Despite initial signals of an economic recovery, the United States and global economies remain in a recession. In the U.S., consumer credit availability is limited and the average annual unemployment rate is at a 25-year high, while credit card charge-offs and delinquencies have reached a 20-year high increasing more than 30% from fourth quarter 2008 levels to estimated levels of greater than 10% in the fourth quarter of 2009. At the same time, home foreclosures have dramatically increased and the housing market continues to experience a significant downturn. These conditions present us with both opportunities and challenges.

On the opportunities side, the increase in credit card charge-offs and delinquencies (which contribute to an increase in supply), combined with the challenges some of our competitors are facing in (i) generating sufficient returns on receivables they purchased in 2005 – 2007, when prices were high and (ii) obtaining sufficient capital to fund future purchases (which contributes to a decrease in demand) have resulted in a significant reduction in the market price for portfolios of charged-off receivables. For example, prices for fresh charge-offs (receivables that are sold immediately after charge-off) have declined from 8% – 13% of face value in 2008 to 4% – 8% of face value in 2009. We have seen similar pricing declines across all ages of charge-offs and the decline is more pronounced in the resale market. Recently, however, pricing has begun to increase slightly from the low levels experienced in most of 2009, although pricing is still favorable when compared to 2005 – 2008 purchases. Additionally, as a result of the significant price decline, some sellers of portfolios have chosen not to sell and, as an alternative to selling their charge-offs, have collected on accounts internally or placed accounts with third-party collection agencies. As such, the full impact the price reduction will have on our purchasing volumes is presently unclear.

On the challenges side, increases in unemployment, high foreclosure rates and the difficulties consumers are experiencing in obtaining credit may, for a period of time, negatively impact collections on receivables that we currently own or that we purchase during these challenging economic times. Despite these market conditions, during 2009, most of the collection metrics we track have remained relatively consistent, as compared to 2008. For example, payer rates and average payment size, adjusted for the change in single payment/payment plan mix, have remained relatively constant. One change we have noted is that more consumers are settling their debts through payment plans rather than in one-time settlements. Payments made over longer periods of time impact our business in two ways: First, when payments are extended over longer periods of time rather than received up front, the delay in cash flows could result in a provision for impairment. This is because discounting a long-term payment stream using a pool group’s internal rate of return, or IRR, rather than discounting a one-time settlement payment using the same IRR, will result in a lower net present value. As a result, even if the total amount of cash received through long-term payment plans is the same as the cash received through one-time settlements, accounting for the stream of payments in the former may result in a provision for impairment. Second, when debts are settled through payment plans, there is a possibility that consumers will not make all of the payments required by those plans. We refer to consumers who do not make all of their payments as “broken payers.” When this happens, we are often successful in getting the consumer back on plan but this is not always the case and, in those instances where we are unable to get the consumer back on plan, we experience a resulting shortfall in collections. Despite the current economic environment, we have not experienced an increase in the broken payer rate in 2009 as compared to the same period in 2008. Please refer to “Management’s Discussion and Analysis—Revenue” below for a more detailed explanation of the provision for impairment for the year ended December 31, 2009.

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In light of the uncertainties presented by the current economic environment, we believe we are applying conservative assumptions when valuing portfolios for purchase and when establishing our forecasted collections. Additionally, while we believe that consumers who are currently charging off their debt (when economic conditions are bad) are more likely to recover faster than consumers who charged off their debt historically (when economic times were good), we have not factored any such recovery into our forecasts.

When evaluating the overall long-term returns of our business, we believe that the benefits resulting from the current lower portfolio pricing will outweigh the negative impacts from the collection shortfalls we may experience from a more distressed consumer. However, if the lower pricing environment re-attracts significant capital to our industry and prices are bid up as a result of increased demand, or if the ability of consumers to repay their debt deteriorates further, our returns would be negatively impacted.

Purchases and Collections

Purchases by Paper Type

The following table summarizes the types of charged-off consumer receivables portfolios we purchased for the periods presented (*in thousands*):

	Year Ended December 31,		
	2009	2008	2007
Credit card	\$ 256,632	\$ 201,315	\$ 188,207
Other	—	28,963	20,746
	<u>\$ 256,632</u>	<u>\$ 230,278</u>	<u>\$ 208,953</u>

During the year ended December 31, 2009, we invested \$256.6 million for portfolios with face values aggregating \$6.5 billion for an average purchase price of 4.0% of face value. This is a \$26.4 million increase, or 11.4%, in the amount invested, compared with the \$230.3 million invested during the year ended December 31, 2008, to acquire portfolios with a face value aggregating \$6.6 billion for an average purchase price of 3.5% of face value.

During the year ended December 31, 2008, we invested \$230.3 million for portfolios with face values aggregating \$6.6 billion for an average purchase price of 3.5% of face value. This is a \$21.3 million increase, or 10.2%, in the amount invested, compared with the \$209.0 million invested during the year ended December 31, 2007, to acquire portfolios with a face value aggregating \$6.9 billion for an average purchase price of 3.0% of face value.

Average purchase price, as a percentage of face value, varies from period to period depending on, among other things, the quality of the accounts purchased and the length of time from charge off to the time we purchase the portfolios.

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Collections by Channel

During 2009, 2008 and 2007, we utilized numerous business channels for the collection of charged-off credit card receivables and other charged-off receivables. The following table summarizes gross collections by collection channel (*in thousands*):

	Year Ended December 31,		
	2009	2008	2007
Legal collections	\$ 232,667	\$ 193,201	\$ 169,005
Collection sites	185,789	157,077	126,093
Collection agencies	62,653	34,736	33,325
Sales	6,677	12,550	24,001
Other	6	1,069	2,769
	<u>\$ 487,792</u>	<u>\$ 398,633</u>	<u>\$ 355,193</u>

Gross collections increased \$89.2 million, or 22.4%, to \$487.8 million during the year ended December 31, 2009, from \$398.6 million during the year ended December 31, 2008.

Gross collections increased \$43.4 million, or 12.2%, to \$398.6 million during the year ended December 31, 2008, from \$355.2 million during the year ended December 31, 2007.

Results of Operations

Results of operations in dollars and as a percentage of total revenue were as follows (*in thousands, except percentages*):

	Year Ended December 31,					
	2009		2008		2007	
			Adjusted ⁽¹⁾		Adjusted ⁽¹⁾	
Revenue						
Revenue from receivable portfolios, net	\$299,732	94.7%	\$240,802	94.1%	\$241,402	95.0%
Servicing fees and related revenue	16,687	5.3%	15,087	5.9%	12,609	5.0%
Total revenue	<u>316,419</u>	<u>100.0%</u>	<u>255,889</u>	<u>100.0%</u>	<u>254,011</u>	<u>100.0%</u>
Operating expenses						
Salaries and employee benefits	58,025	18.4%	58,120	22.7%	64,153	25.2%
Stock-based compensation expense	4,384	1.4%	3,564	1.4%	4,287	1.7%
Cost of legal collections	112,570	35.6%	96,187	37.6%	78,636	31.0%
Other operating expenses	26,013	8.2%	23,652	9.2%	21,533	8.5%
Collection agency commissions	19,278	6.1%	13,118	5.1%	12,411	4.9%
General and administrative expenses	26,920	8.5%	19,445	7.6%	17,478	6.9%
Depreciation and amortization	2,592	0.8%	2,814	1.1%	3,351	1.3%
Total operating expenses	<u>249,782</u>	<u>79.0%</u>	<u>216,900</u>	<u>84.7%</u>	<u>201,849</u>	<u>79.5%</u>
Income before other (expense) income and income taxes	<u>66,637</u>	<u>21.0%</u>	<u>38,989</u>	<u>15.3%</u>	<u>52,162</u>	<u>20.5%</u>
Other (expense) income						
Interest expense	(16,160)	(5.1)%	(20,572)	(8.0)%	(18,648)	(7.3)%
Contingent interest expense	—	0.0%	—	0.0%	(4,123)	(1.6)%
Pay-off of future contingent interest	—	0.0%	—	0.0%	(11,733)	(4.6)%
Gain on repurchase of convertible notes, net	3,268	1.0%	4,771	1.8%	—	0.0%
Other (expense) income	(2)	0.0%	358	0.1%	1,071	0.4%
Total other expense	<u>(12,894)</u>	<u>(4.1)%</u>	<u>(15,443)</u>	<u>(6.1)%</u>	<u>(33,433)</u>	<u>(13.1)%</u>
Income before income taxes	<u>53,743</u>	<u>16.9%</u>	<u>23,546</u>	<u>9.2%</u>	<u>18,729</u>	<u>7.4%</u>
Provision for income taxes	(20,696)	(6.5)%	(9,700)	(3.8)%	(6,498)	(2.6)%
Net income	<u>\$ 33,047</u>	<u>10.4%</u>	<u>\$ 13,846</u>	<u>5.4%</u>	<u>\$ 12,231</u>	<u>4.8%</u>

⁽¹⁾ Adjusted for change in accounting principle related to our convertible notes. See Note 15 to our consolidated financial statements for additional information and the effect of the change to our financial statements.

Comparison of Results of Operations

Year Ended December 31, 2009 Compared to Year Ended December 31, 2008

Revenue

Our revenue consists primarily of portfolio revenue and bankruptcy servicing revenue. Portfolio revenue consists of accretion revenue and zero basis revenue. Accretion revenue represents revenue derived from pools (quarterly groupings of purchased receivable portfolios) with a cost basis that has not been fully amortized. Revenue from pools with a remaining unamortized cost basis is accrued based on each pool's effective interest rate applied to each pool's remaining unamortized cost basis. The cost basis of each pool is increased by revenue earned and decreased by gross collections and impairments. The effective interest rate is the internal rate of return derived from the timing and amounts of actual cash received and anticipated future cash flow projections for each pool. All collections realized after the net book value of a portfolio has been fully recovered, or Zero Basis Portfolios, are recorded as revenue, or Zero Basis Revenue. We account for our investment in receivable portfolios utilizing the interest method in accordance with the provisions of ASC Subtopic 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality," or ASC 310-30. Servicing fee revenue is revenue primarily associated with bankruptcy servicing fees earned from our Ascension subsidiary, a provider of bankruptcy services to the finance industry.

Effective January 1, 2008, we revised our Unified Collection Score, or UCS, and Behavioral Liquidation Score, or BLS, methodologies by extending our collection forecast from 72 months to 84 months. UCS is a proprietary forecasting tool that generates portfolio level expectations of liquidation for portfolios that we have owned and serviced for more than six months. BLS forecasts portfolio level expectations based on credit characteristics for portfolios owned and serviced less than six months. We have observed that receivable portfolios purchased in 2001 and prior have consistently experienced cash collections beyond 72 months from the date of purchase. When we first developed our cash forecasting models in 2001, limited historical collection data was available with which to accurately model projected cash flows beyond 60 months. During the quarter ended June 30, 2006, we determined there was enough additional collection data accumulated over the previous several years, in addition to improvements in our forecasting tools, allowing us to extend the collection forecast to 72 months. During the quarter ended March 31, 2008, we determined that there was enough additional collection data to accurately extend the collection forecast in both our UCS and BLS models to 84 months. The increase in the collection forecast from 72 to 84 months was applied, effective January 1, 2008, to each portfolio for which we could accurately forecast through such term and resulted in an increase in the aggregate total estimated remaining collections for the receivable portfolios by \$67.3 million, or 7.5%, as of March 31, 2008. We did not extend the forecast on telecom portfolios as we do not anticipate significant collections past 72 months on these portfolios. The extension of the collection forecast is treated as a change in estimate and, in accordance with the provisions of ASC Topic 250, "Accounting Changes and Error Corrections," or ASC 250, is being recognized prospectively in our consolidated financial statements. This prospective treatment resulted in a reduction in our net impairment provision of \$3.1 million and an increase in revenue of \$0.1 million for the quarter ended March 31, 2008. The impact of the change in estimate resulted in an increase in net income of \$1.9 million and an increase in fully diluted earnings per share of \$0.08 for the quarter ended March 31, 2008.

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The following tables summarize collections, revenue, end of period receivable balance and other related supplemental data, by year of purchase (*in thousands, except percentages*):

	Year Ended December 31, 2009					As of December 31, 2009	
	Collections ⁽¹⁾	Gross Revenue ⁽²⁾	Revenue Recognition Rate ⁽³⁾	Net (Impairment) Reversal	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR
ZBA	\$ 8,927	\$ 8,927	100.0%	\$ —	2.8%	\$ —	—
2002	2,831	903	31.9%	1,254	0.3%	—	—
2003	8,021	5,932	74.0%	59	1.9%	629	31.4%
2004	11,363	6,922	60.9%	(629)	2.1%	4,600	8.1%
2005	41,948	26,332	62.8%	(2,192)	8.2%	30,804	5.6%
2006	44,554	31,864	71.5%	(4,622)	10.0%	44,030	5.1%
2007	111,116	64,045	57.6%	(6,357)	20.1%	68,739	5.8%
2008	162,846	112,657	69.2%	(6,823)	35.3%	157,807	5.0%
2009	95,852	61,460	64.1%	—	19.3%	220,268	4.4%
Total	<u>\$ 487,458</u>	<u>\$319,042</u>	<u>65.5%</u>	<u>\$ (19,310)</u>	<u>100.0%</u>	<u>\$ 526,877</u>	<u>5.0%</u>

	Year Ended December 31, 2008					As of December 31, 2008	
	Collections ⁽¹⁾	Gross Revenue ⁽²⁾	Revenue Recognition Rate ⁽³⁾	Net (Impairment) Reversal	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR
ZBA	\$ 9,606	\$ 9,606	100.0%	\$ —	3.4%	\$ —	—
2002	5,511	4,015	72.9%	360	1.4%	681	29.1%
2003	13,874	12,129	87.4%	15	4.3%	2,666	30.7%
2004	19,117	15,121	79.1%	(7,037)	5.4%	9,675	8.3%
2005	66,675	46,115	69.2%	(17,892)	16.3%	48,613	5.6%
2006	70,743	47,922	67.7%	(11,442)	17.0%	61,368	5.1%
2007	145,271	92,928	64.0%	(5,404)	32.9%	122,215	5.2%
2008	67,506	54,366	80.5%	—	19.3%	216,128	4.9%
Total	<u>\$ 398,303</u>	<u>\$282,202</u>	<u>70.9%</u>	<u>\$ (41,400)</u>	<u>100.0%</u>	<u>\$ 461,346</u>	<u>5.4%</u>

(1) Does not include amounts collected on behalf of others.

(2) Gross revenue excludes the effects of net impairment or net impairment reversals.

(3) Revenue recognition rate excludes the effects of net impairment or net impairment reversals.

Total revenue was \$316.4 million for the year ended December 31, 2009, an increase of \$60.5 million, or 23.7%, compared to total revenue of \$255.9 million for the year ended December 31, 2008. Portfolio revenue was \$299.7 million for the year ended December 31, 2009, an increase of \$58.9 million, or 24.5%, compared to portfolio revenue of \$240.8 million for the year ended December 31, 2008. The increase in portfolio revenue for the year ended December 31, 2009, was primarily the result of additional accretion revenue associated with a higher portfolio balance during the year ended December 31, 2009 compared to the year ended December 31, 2008. During the year ended December 31, 2009, we recorded a net impairment provision of \$19.3 million, compared to a net impairment provision of \$41.4 million in the prior year. The impairment for the year ended December 31, 2009 was largely due to a shortfall in collections in certain pool groups against our forecast. While our total collections exceeded our forecast, there is often variability at the pool group level between our actual collections and our forecasts, primarily our 2006 through 2008 vintage portfolios. This is the result of several factors, including pressures on the consumer due to a weak economy, changes in internal operating strategy, shifts in consumer payment patterns and the inherent challenge of forecasting collections at the pool group level. The impairment provision of \$41.4 million for the year ended December 31, 2008 was primarily due to a shortfall in collections in certain pool groups against our forecast, primarily our 2004 through 2007 vintages. We believe that this was the result of broadening pressure on our consumers due to a weakening economy as well as to particular challenges we experienced in working certain portfolios.

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Until economic conditions improve, we may continue to experience a shortfall in collections against our UCS forecast which, depending on the magnitude of the shortfall and the pool groups that experience such shortfall, may result in future provisions for impairment. In accordance with ASC 310-30, an impairment provision to reduce the book value and therefore, maintain a level yield on a pool group's internal rate of return, is only recorded when current information and events indicate that it is probable that an entity will be unable to collect all of its expected future cash flows, or when the timing of such cash flows is delayed. Since we cannot presently determine the future impact of the current economic conditions on our collections, we cannot conclude that further reductions in cash flows are probable or that the timing of cash flows has changed in a manner that would significantly impact any pool groups' internal rate of return and, therefore, have not recorded a related additional impairment.

Revenue associated with bankruptcy servicing fees earned from Ascension was \$16.7 million for the year ended December 31, 2009, an increase of \$1.6 million, or 10.6%, compared to revenue of \$15.1 million for the year ended December 31, 2008. The increase in Ascension revenue was due to a higher volume of bankruptcy placements in 2009.

Operating Expenses

Total operating expenses were \$249.8 million for the year ended December 31, 2009, an increase of \$32.9 million, or 15.1%, compared to total operating expenses of \$216.9 million for the year ended December 31, 2008.

Operating expenses are explained in more detail as follows:

Salaries and employee benefits

Total salaries and employee benefits decreased \$0.1 million, or less than one percent, to \$58.0 million during the year ended December 31, 2009, from \$58.1 million during the year ended December 31, 2008. The slight decrease was primarily the result of a decrease of \$0.4 million related to deferred compensation expense which was fully amortized in 2008, offset by an increase of \$0.4 million in health benefit related expenses. Additionally, total salaries and benefits declined slightly while company headcount increased. This decline is the result of a shift in our collection workforce from the United States to India and a change in our compensation plan structure in our domestic sites.

Stock-based compensation expenses

Stock-based compensation increased \$0.8 million, or 23.0%, to \$4.4 million during the year ended December 31, 2009, from \$3.6 million during the year ended December 31, 2008. This increase was a result of equity awards granted during the year ended December 31, 2009.

Cost of legal collections

The cost of legal collections increased \$16.4 million, or 17.0%, to \$112.6 million during the year ended December 31, 2009, compared to \$96.2 million during the year ended December 31, 2008. These costs represent contingent fees paid to our nationwide network of attorneys and costs of litigation. The increase in the cost of legal collections was primarily the result of an increase in commissions paid on increased collections through our legal channel and an increase in court cost expense. For the year ended December 31, 2009, we paid commissions of \$66.5 million, or 28.6%, on legal collections of \$232.7 million, compared to commissions of \$55.5 million, or 28.7%, on legal collections of \$193.2 million for the year ended December 31, 2008. Court costs advanced for the year ended December 31, 2009 amounted to \$64.0 million, compared to \$63.8 million for the year ended December 31, 2008. Court costs expensed increased to \$43.6 million, but decreased to 18.7% as a percent of collections, for the year ended December 31, 2009, compared to \$38.5 million, or 19.9% of collections, for the year ended December 31, 2008, due to a decrease in our expected court cost recovery rate. As

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a result, the cost of legal collections, as a percent of gross collections through this channel, decreased to 48.4% for the year ended December 31, 2009 from 49.8% for the year ended December 31, 2008.

The following table summarizes our legal collection channel performance and related direct costs (*in thousands, except percentages*):

	Year Ended December 31,			
	2009		2008	
Collections	\$232,667	100.0%	\$193,201	100.0%
Court costs advanced	\$ 64,047	27.5%	\$ 63,846	33.0%
Court costs deferred	(22,169)	(9.5)%	(25,354)	(13.1)%
Deferred court costs reversal ⁽¹⁾	1,714	0.7%	—	0.0%
Court cost expense ⁽²⁾	43,592	18.7%	38,492	19.9%
Other ⁽³⁾	2,444	1.1%	2,210	1.2%
Commissions	66,534	28.6%	55,485	28.7%
Total Costs	\$112,570	48.4%	\$ 96,187	49.8%

(1) Primarily related to our arbitration settlement with Jefferson Capital in September 2009. As part of the settlement with Jefferson Capital, we returned accounts that were subject to Jefferson Capital's settlement with the FTC. A portion of those accounts were in our legal channel and, when these were returned, resulted in the reversal of court costs previously deferred. See Note 12 to our consolidated financial statements for further information.

(2) In connection with our agreement with contracted attorneys, we advance certain out-of-pocket court costs. We capitalize these costs in our consolidated financial statements and provide a reserve and corresponding court cost expense for the costs that we believe will be ultimately uncollectible. This amount includes changes in our anticipated recovery rate of court costs expensed.

(3) Other costs consist of costs related to counter claims and legal network subscription fees.

Other operating expenses

Other operating expenses increased \$2.3 million, or 10.0%, to \$26.0 million during the year ended December 31, 2009, from \$23.7 million during the year ended December 31, 2008. The increase was primarily the result of an increase of \$0.7 million in telephone expenses, an increase of \$0.5 million in skip tracing expenses, an increase of \$0.5 million in direct mail campaign expenses, an increase of \$0.5 million in media-related expenses and a net increase in various other operating expenses of \$0.2 million.

Collection agency commissions

During the year ended December 31, 2009, we incurred \$19.3 million in commissions to third party collection agencies, or 30.8%, of the related gross collections of \$62.7 million, compared to \$13.1 million in commissions, or 37.8%, of the related gross collections of \$34.8 million during the year ended December 31, 2008. The increase in commissions was due to the increase in collections through this channel, offset by a lower net commission rate. The decrease in the net commission rate as a percentage of the related gross collections was primarily due to the mix of accounts placed with the agencies. Commissions, as a percentage of collections through this channel, vary from period to period depending on, among other things, the time from charge-off of the accounts placed with an agency. Generally, freshly charged-off accounts have a lower commission rate than accounts that have been charged off for a longer period of time. During the year ended December 31, 2009, we placed more freshly charged-off accounts with our agencies as compared to the prior year.

General and administrative expenses

General and administrative expenses increased \$7.5 million, or 38.4%, to \$26.9 million during the year ended December 31, 2009, from \$19.4 million during the year ended December 31, 2008. The increase was primarily the result of an increase of \$5.3 million in corporate legal expenses related primarily to our settled Jefferson Capital arbitration and other ongoing litigation, an increase of \$1.2 million in corporate settlements, an increase of \$0.9 million in building rent related to our India expansion discussed below, and a net increase in other general and administrative expenses of \$0.1 million.

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Depreciation and amortization

Depreciation and amortization expense decreased \$0.2 million, or 7.9%, to \$2.6 million during the year ended December 31, 2009, from \$2.8 million during the year ended December 31, 2008. Depreciation expense was \$2.0 million for the years ended December 31, 2009 and December 31, 2008. Amortization expense, relating to intangible assets acquired in conjunction with the acquisition of Ascension in 2005, was \$0.6 million for the year ended December 31, 2009, compared to \$0.8 million for the year ended December 31, 2008.

Cost per Dollar Collected

The following table summarizes our cost per dollar collected (*in thousands, except percentages*):

	Year Ended December 31,							
	2009				2008			
	Collections	Cost	Cost Per Channel Dollar Collected	Cost Per Total Dollar Collected	Collections	Cost	Cost Per Channel Dollar Collected	Cost Per Total Dollar Collected
Legal networks	\$232,667	\$112,570	48.4%	23.1%	\$193,201	\$ 96,187	49.8%	24.1%
Collection sites	185,789	22,912 ⁽¹⁾	12.3%	4.7%	157,077	25,267 ⁽¹⁾	16.1%	6.3%
Collection agency outsourcing	62,653	19,278	30.8%	4.0%	34,736	13,118	37.8%	3.3%
Sales and other	6,683	—	—	—	13,619	—	—	—
Other indirect costs	—	77,420	—	15.8%	—	65,395	—	16.5%
Total	<u>\$487,792</u>	<u>\$232,180⁽²⁾</u>		47.6%	<u>\$398,633</u>	<u>\$199,967⁽²⁾</u>		50.2%

⁽¹⁾ Represents only account manager salaries, variable compensation and employee benefits.

⁽²⁾ Represents all operating expenses excluding stock-based compensation expense of \$4.4 million and \$3.6 million for the years ended December 31, 2009 and 2008, respectively and costs related to Ascension of \$13.2 million and \$13.4 million for the years ended December 31, 2009 and 2008, respectively.

During the year ended December 31, 2009, cost per dollar collected decreased by 260 basis points to 47.6% of gross collections from 50.2% of gross collections during the year ended December 31, 2008. This decrease was primarily due to several factors, including:

- The cost of legal collections increased in total dollars but decreased as a percent of total collections to 23.1% from 24.1% and, as a percentage of legal collection, decreased to 48.4% from 49.8%. The dollar increase is primarily due to an increase in collections through this channel. The decrease in the percentage is primarily due to commissions and court cost expense growing at a rate slower than total collections.
- Account manager salaries, variable compensation and employee benefits, as a percentage of total collections, decreased to 4.3% from 6.7% and, as a percentage of our site collections, decreased to 12.3% from 16.1%. The decrease is primarily due to a shift in our collection workforce from the United States to India and a change in our compensation plan structure in the United States.
- Other costs not directly attributable to specific channel collections, including non collection salaries and employee benefits, general and administrative expenses, other operating expenses and depreciation and amortization, decreased as a percentage of total collection to 15.8% from 16.5%. This decrease is primarily due to the increased leverage of spreading our non direct collection costs over a larger pool of collections. The dollar increase is due to several factors including increases in corporate legal expense related primarily to our settled Jefferson Capital arbitration and other ongoing litigation, an increase in corporate settlements and other increases to support the growth of our company.

The decrease was offset by an increase in collection agency commissions, as a percentage of total collections, to 4.0% from 3.3%. The increase in the percentage of commissions to total collections is due to

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collection agency commissions growing at a rate faster than total collections, offset by a decline in our commission rate resulting in a decline in cost per dollar collected in this channel from 37.8% to 30.8%, due to a change in the mix of accounts placed into this channel, primarily freshly charged off accounts. Freshly charged-off accounts have a lower commission rate than accounts that have been charged off for a longer period of time.

India Expansion

Due to the strong performance of our team in India and our ability to reduce our overall site cost to collect through the expansion of our offshore collection efforts, on April 22, 2009, we signed a lease for a new, larger site in India. This facility, which is located in Gurgaon, India, allows us to expand our current collector headcount from approximately 650 to 1,100. Collector capacity at our previous site was 350. Our India team relocated to this new site in September 2009. We incurred lease costs at both our previous and new sites from April 2009 through October 2009. This resulted in incremental lease expense totaling approximately \$1.0 million during that period. Additionally, we have and will continue to incur costs associated with expanding our workforce in India.

Our plan is to continue to maintain headcount at current levels in our domestic collection sites and focus our future growth on India. As we expand headcount in our new, larger India site and migrate more of our collections there, we expect that our overall variable cost to collect will increase and our overall collector productivity will decline. However, once we are staffed to optimal levels, we expect that this expansion will have a positive long-term impact on both our overall cost to collect and our productivity.

Interest expense

Interest expense decreased \$4.4 million, or 21.4%, to \$16.2 million during the year ended December 31, 2009, from an adjusted \$20.6 million during the year ended December 31, 2008.

The following table summarizes our interest expense (*in thousands*):

	Year Ended December 31,			
	2009	2008 Adjusted	\$ Change	% Change
Stated interest on debt obligations	\$12,080	\$14,252	\$(2,172)	(15.2)%
Amortization of loan fees and other loan costs	1,179	1,213	(34)	(2.8)%
Amortization of debt discount—convertible notes	2,901	5,107	(2,206)	(43.2)%
Total interest expense	<u>\$16,160</u>	<u>20,572</u>	<u>\$(4,412)</u>	<u>(21.4)%</u>

Interest expense during the year ended December 31, 2008 was retrospectively adjusted as a result of a change in accounting principle. Effective January 1, 2009, we adopted the provisions of ASC Subtopic 470-20 (“ASC 470-20”), “*Debt with Conversion and Other Options*.” In accordance with the provisions of ASC 470-20, we adjusted our prior years’ financial statements to separately account for the liability and equity components of our convertible senior notes (“Convertible Notes”) in a manner that reflects our nonconvertible debt borrowing rate at the time of the issuance. As a result, we created a debt discount for our Convertible Notes and incurred additional interest expense due to the amortization of debt discount. See Note 15 to our consolidated financial statements for a further discussion of this change in accounting principle.

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The following table summarizes the impact of adopting ASC 470-20 on our interest expense, net debt balance and total stockholders' equity related to our Convertible Notes during the previous reporting periods (*in thousands*):

	Interest Expense For the Three Months ended		Net Convertible Note Balance		Total Stockholders' Equity	
	As Previously Reported	As Adjusted	As Previously Reported	As Adjusted	As Previously Reported	As Adjusted
September 30, 2005	\$ 101	\$ 230	\$ 100,000	\$ 73,347	\$ 111,078	\$ 137,211
December 31, 2005	842	1,914	100,000	74,419	118,352	143,439
March 31, 2006	857	1,912	100,000	75,474	125,890	149,948
June 30, 2006	844	1,942	100,000	76,572	135,296	158,282
September 30, 2006	844	1,963	100,000	77,691	142,561	164,454
December 31, 2006	844	2,031	100,000	78,878	151,136	171,870
March 31, 2007	844	2,011	100,000	80,045	158,137	177,730
June 30, 2007	844	2,059	100,000	81,260	159,675	178,079
September 30, 2007	844	2,081	100,000	82,497	166,042	183,235
December 31, 2007	844	2,150	100,000	83,803	171,520	187,435
March 31, 2008	844	2,143	100,000	85,102	179,804	194,446
June 30, 2008	809	2,099	95,000	82,124	189,987	202,644
September 30, 2008	801	2,103	95,000	83,426	195,248	206,628
December 31, 2008	704	1,920	71,422	63,758	195,890	203,426

Stated interest on debt obligations decreased \$2.2 million during the year ended December 31, 2009, compared to the prior year, primarily due to decreases in our variable interest rate on our Revolving Credit Facility and decreased stated interest expense on our Convertible Notes due to a reduced principal balance as a result of buy backs, offset by increases in amounts borrowed under our Revolving Credit Facility to fund our purchases of receivable portfolios, to fund our repurchases of a portion of our Convertible Notes and for general working capital needs.

Gain on repurchase of convertible notes, net

During the year ended December 31, 2009, we repurchased \$28.5 million principal amount of our outstanding Convertible Notes, for a total price of \$22.3 million, plus accrued interest. The repurchases left \$42.9 million principal amount of our Convertible Notes outstanding. These repurchases resulted in a pre-tax gain of \$3.5 million, which was partially offset by a \$0.2 million write-off of the debt issuance costs related to the portions of the Convertible Notes repurchased. The net gain of \$3.3 million was recognized in our consolidated statement of operations for the year ended December 31, 2009.

Effective January 1, 2009, we retrospectively adjusted our prior year's gain on repurchase of Convertible Notes, net upon adoption of ASC 470-20. See interest expense above and Note 15 to our consolidated financial statements for a further discussion of the change in accounting principle. During the year ended December 31, 2008, we repurchased \$28.6 million principal amount of our outstanding Convertible Notes, for a total price of \$20.1 million, plus accrued interest. The repurchases left \$71.4 million principal amount of our Convertible Notes outstanding. As a result of adopting ASC 470-20, we retrospectively adjusted our pre-tax gain on the repurchases to \$5.1 million, which was partially offset by a \$0.3 million write-off of the debt issuance costs related to the portions of the Convertible Notes repurchased. The adjusted net gain of \$4.8 million was recognized in our consolidated statement of operations for the year ended December 31, 2008.

Other income and expense

During the year ended December 31, 2009, total other expense was less than \$0.1 million, compared to \$0.4 million for the year ended December 31, 2008. The other income of \$0.4 million during the year ended December 31, 2008, was primarily attributable to a \$0.3 million gain recognized in connection with the early termination of a contract.

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Provision for income taxes

During the year ended December 31, 2009, we recorded an income tax provision of \$20.7 million, reflecting an effective rate of 38.5% of pretax income. The effective tax rate for the year ended December 31, 2009 consists primarily of a provision for federal income taxes of 32.4% (which is net of a benefit for state taxes of 2.6%), a blended provision for state taxes of 7.3%, a 1.0% beneficial adjustment to federal taxes payable as a result of state tax rate changes and a benefit for the effect of permanent book versus tax differences of 0.2%.

Effective January 1, 2009, we retrospectively adjusted our prior years' gain on repurchase of Convertible Notes, net upon adoption of ASC 470-20. See interest expense above and Note 15 to our consolidated financial statements for a further discussion of the change in accounting principle. The overall income tax rate for the year ended December 31, 2009, decreased to 38.5% from an adjusted 41.2% for the year ended December 31, 2008. This decrease was primarily due to a net state effective tax rate decrease in 2009, the release of a tax reserve established under the uncertainty in income taxes guidance within ASC Topic 740 ("ASC 740"), "Income Taxes" and a true-up of certain tax amounts.

During the year ended December 31, 2008, as a result of adopting ASC 470-20, we retrospectively adjusted our income tax provision to \$9.7 million, reflecting an effective rate of 41.2% of pretax income. The effective tax rate for the year ended December 31, 2008, consists primarily of a provision for federal income taxes of 32.3% (which is net of a benefit for state taxes of 2.7%), a blended provision for state taxes of 7.8%, a 1.2% adjustment to federal taxes payable as a result of state tax rate changes and a benefit for the effect of permanent book versus tax differences of 0.1%. See Note 11 to our consolidated financial statements for a further discussion of income taxes.

Year Ended December 31, 2008 Compared to Year Ended December 31, 2007

Revenue

The following tables summarize collections, revenue, end of period receivable balance and other related supplemental data, by year of purchase (*in thousands, except percentages*):

	Year Ended December 31, 2008					As of December 31, 2008	
	Collections ⁽¹⁾	Gross Revenue ⁽²⁾	Revenue Recognition Rate ⁽³⁾	Net (Impairment) Reversal	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR
ZBA	\$ 9,606	\$ 9,606	100.0%	\$ —	3.4%	\$ —	—
2002	5,511	4,015	72.9%	360	1.4%	681	29.1%
2003	13,874	12,129	87.4%	15	4.3%	2,666	30.7%
2004	19,117	15,121	79.1%	(7,037)	5.4%	9,675	8.3%
2005	66,675	46,115	69.2%	(17,892)	16.3%	48,613	5.6%
2006	70,743	47,922	67.7%	(11,442)	17.0%	61,368	5.1%
2007	145,271	92,928	64.0%	(5,404)	32.9%	122,215	5.2%
2008	67,506	54,366	80.5%	—	19.3%	216,128	4.9%
Total	<u>\$ 398,303</u>	<u>\$282,202</u>	<u>70.9%</u>	<u>\$ (41,400)</u>	<u>100.0%</u>	<u>\$ 461,346</u>	<u>5.4%</u>

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	Year Ended December 31, 2007					As of December 31, 2007	
	Collections ⁽¹⁾	Gross Revenue ⁽²⁾	Revenue Recognition Rate ⁽³⁾	Net Impairment	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR
ZBA	\$ 15,164	\$ 15,164	100.0%	\$ —	6.0%	\$ —	—
2002	10,216	9,175	89.8%	(699)	3.6%	1,823	26.3%
2003	26,605	24,615	92.5%	(2,485)	9.7%	4,417	30.7%
2004	34,626	26,092	75.4%	(3,861)	10.3%	20,721	8.0%
2005	107,800	70,199	65.1%	(2,466)	27.8%	87,350	5.6%
2006	92,265	63,573	68.9%	(1,563)	25.2%	95,739	4.9%
2007	68,048	43,813	64.4%	(156)	17.4%	182,159	4.3%
Total	<u>\$ 354,724</u>	<u>\$252,631</u>	<u>71.2%</u>	<u>\$ (11,230)</u>	<u>100.0%</u>	<u>\$ 392,209</u>	<u>5.4%</u>

(1) Does not include amounts collected on behalf of others.

(2) Gross revenue excludes the effects of net impairment or net impairment reversals.

(3) Revenue recognition rate excludes the effects of net impairment or net impairment reversals.

Total revenue was \$255.9 million for the year ended December 31, 2008, an increase of \$1.9 million, or 0.7%, compared to total revenue of \$254.0 million for the year ended December 31, 2007. Portfolio revenue was \$240.8 million for the year ended December 31, 2008, a decrease of \$0.6 million, or 0.2%, compared to portfolio revenue of \$241.4 million for the year ended December 31, 2007.

The decrease in portfolio revenue was primarily the result of a greater impairment on receivable portfolios, offset by additional accretion revenue associated with higher purchasing volumes in 2008 compared to 2007 and, as discussed above, from the extension of our collection forecast from 72 to 84 months.

During the year ended December 31, 2008, we recorded a net impairment provision of \$41.4 million, compared to a net impairment provision of \$11.2 million in the prior year, which included a \$1.4 million impairment on our healthcare receivables, recorded in connection with exiting our healthcare purchasing and collecting activities. The increase in the impairment provision in 2008, as compared to 2007, was primarily due to a shortfall in collections in certain pool groups against our forecast, primarily our 2004 through 2007 vintages. We believe that this was the result of the broadening pressure on our consumers due to a weakening economy as well as to particular challenges we experienced in working certain portfolios.

As a result of the deteriorating economic conditions, as mentioned in the Market Overview section above, we have seen a shift in payments from consumers from single payment settlements to payment plans. Payments made over longer periods of time impact our business in two ways. First, when payments are extended over longer periods of time rather than received up front, this delay in cash flows could result in a provision for impairment. Discounting a long-term payment stream using our pool group IRRs (2004 – 2007 pool group monthly IRRs range from 4.1% to 13.5%) rather than discounting a one-time settlement payment using the same IRR will result in a lower net present value. Therefore, even if the cash received through long-term payment plans is the same as the cash received through one-time settlements, accounting for the stream of payments under ASC 310-30 may result in a provision for impairment. Second, when debts are settled through payment plans, there is a possibility that consumers will not make all of the payments required by those plans. The impact of the broken payers will reduce our overall expected collections, which results in a provision for impairment. This shift from single payment settlements to payment plans has resulted in a decrease in our actual collections, as compared to our forecasts, in certain pool groups. Since we expect this trend to continue, we expect that there will also be a collection shortfall against our forecasts in certain pool groups. As such, we made downward adjustments to our forecasted collections in these pool groups, rather than assume that collections would be in line with previously forecasted levels. These adjustments resulted in greater impairment provisions than we have historically experienced.

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Further contributing to the significant increase in our impairment provision, approximately \$10.0 million of the impairment provision in 2008 (substantially all of which we recorded in the third and fourth quarters), related to the accounts we purchased from Jefferson Capital. This represented almost 40% of the impairment in those pool groups which contained Jefferson Capital accounts. In comparison, none of the impairment provision recorded in 2007 was related to accounts purchased from Jefferson Capital.

Revenue associated with bankruptcy servicing fees earned from Ascension was \$15.0 million for the year ended December 31, 2008, an increase of \$2.5 million, or 19.9%, compared to revenue of \$12.5 million for the year ended December 31, 2007. The increase in Ascension revenue was due to a higher volume of bankruptcy placements in 2008.

During the year ended December 31, 2008, we invested \$230.3 million to acquire portfolios with face values aggregating \$6.6 billion, for an average purchase price of 3.5% of face value. This is a \$21.3 million increase, or 10.2%, in the amount invested, compared with the \$209.0 million invested during the year ended December 31, 2007, to acquire portfolios with a face value aggregating \$6.9 billion, for an average purchase price of 3.0% of face value.

Operating Expenses

Total operating expenses were \$216.9 million for the year ended December 31, 2008, an increase of \$15.1 million, or 7.5%, compared to total operating expenses of \$201.8 million for the year ended December 31, 2007.

Operating expenses are explained in more detail as follows:

Salaries and employee benefits

Total salaries and employee benefits decreased \$6.1 million, or 9.4%, to \$58.1 million during the year ended December 31, 2008, from \$64.2 million during the year ended December 31, 2007. The decrease was primarily due to reduced average domestic headcount, as a result of the reduction in workforce, associated with our cost savings initiatives implemented in September 2007. The reduction in our average domestic headcount attributed to a net decrease of approximately \$4.9 million in wages, bonuses and related payroll taxes. The decrease also resulted from a reduction in severance costs in the current year compared to the prior year, when we recorded a one-time severance charge of \$1.4 million in connection with our cost savings initiatives. The decrease was offset by a \$0.2 million increase in our self insured health benefit plan costs as a result of increased claims.

Stock-based compensation expenses

Stock-based compensation decreased \$0.7 million, or 16.9%, to \$3.6 million during the year ended December 31, 2008, from \$4.3 million during the year ended December 31, 2007. This decrease was a result of fewer grants and the decreased fair value of stock options granted in recent years, certain grants becoming fully vested during the year ended December 31, 2008 and a reversal of expense due to actual versus estimated forfeiture true-ups.

Cost of legal collections

The cost of legal collections increased \$17.6 million, or 22.3%, to \$96.2 million during the year ended December 31, 2008, as compared to \$78.6 million during the year ended December 31, 2007. These costs represent contingent fees paid to our nationwide network of attorneys and costs of litigation. The increase in contingent fees was primarily the result of an increase of \$24.2 million, or 14.3%, in gross collections through our legal channel. Gross legal collections amounted to \$193.2 million during the year ended December 31, 2008, compared to \$169.0 million collected during the year ended December 31, 2007. The cost of legal collections increased as a percent of gross collections through this channel to 49.8% during the year ended December 31, 2008, from 46.5% during the year ended December 31, 2007, due to an increase in upfront court costs expensed

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associated with our pursuit of legal collections, and an increase in costs related to counter claims, offset by a lower overall commission rate, driven by lower bonus commissions paid to our law firms. Upfront court costs expensed were \$38.5 million and \$28.3 million for the years ended December 31, 2008 and 2007, respectively.

The following table summarizes our legal collection channel performance and related direct costs (*in thousands, except percentages*):

	Year Ended December 31,			
	2008		2007	
Collections	<u>\$193,201</u>	<u>100.0%</u>	<u>\$169,005</u>	<u>100.0%</u>
Court costs advanced	\$ 63,846	33.0%	\$ 53,041	31.4%
Court costs deferred	<u>(25,354)</u>	<u>(13.1)%</u>	<u>(24,741)</u>	<u>(14.7)%</u>
Court cost expense ⁽¹⁾	38,492	19.9%	28,300	16.7%
Other ⁽²⁾	2,210	1.2%	992	0.6%
Commissions	<u>55,485</u>	<u>28.7%</u>	<u>49,344</u>	<u>29.2%</u>
Total Costs	<u>\$ 96,187</u>	<u>49.8%</u>	<u>\$ 78,636</u>	<u>46.5%</u>

(1) In connection with our agreement with contracted attorneys, we advance certain out-of-pocket court costs. We capitalize these costs in our consolidated financial statements and provide a reserve and corresponding court cost expense for the costs that we believe will be ultimately uncollectible. This amount includes changes in our anticipated recovery rate of court costs expensed.

(2) Other costs consist of costs related to counter claims and legal network subscription fees.

Other operating expenses

Other operating expenses increased \$2.2 million, or 9.8%, to \$23.7 million during the year ended December 31, 2008, from \$21.5 million during the year ended December 31, 2007. The increase was primarily the result of an increase of \$2.4 million related to an increase in direct mail campaign expenses, driven by an increase in the cost of postage, an increase of \$0.8 million in Ascension legal expenses due to the addition of litigation only clients and a net increase of \$0.7 million in various other operating expenses. The increase was partially offset by a decrease of \$0.9 million in skip tracing expenses and a decrease of \$0.8 million in the amortization of a previously acquired deferred revenue asset.

Collection agency commissions

During the year ended December 31, 2008, we paid \$13.1 million in commissions to third party collection agencies, or 37.8% of the related gross collections of \$34.7 million, compared to \$12.4 million in commissions, or 37.2% of the related gross collections of \$33.3 million, during the year ended December 31, 2007. The increase in commissions is consistent with the increase in collections through this channel. The increase in commission rate as a percentage of the related gross collection is primarily the result of the mix of accounts placed with the agencies. Commissions, as a percentage of collections in this channel, vary from period to period depending on, among other things, the time from charge-off of the accounts placed with an agency. Generally, freshly charged-off accounts have a lower commission rate than accounts that have been charged-off for a longer period of time.

General and administrative expenses

General and administrative expenses increased \$1.9 million, or 11.3%, to \$19.4 million during the year ended December 31, 2008, from \$17.5 million during the year ended December 31, 2007. The increase was primarily the result of increased corporate legal expenses.

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Depreciation and amortization

Depreciation and amortization expense decreased \$0.6 million, or 16.0%, to \$2.8 million during the year ended December 31, 2008, from \$3.4 million during the year ended December 31, 2007. Depreciation expense was \$2.0 million for the year ended December 31, 2008, compared to \$2.3 million for the year ended December 31, 2007. Amortization expense, relating to intangible assets acquired in conjunction with the acquisition of Ascension in 2005, was \$0.8 million for the year ended December 31, 2008, compared to \$1.1 million for the year ended December 31, 2007.

Cost per Dollar Collected

The following table summarizes our cost per dollar collected (*in thousands, except percentages*):

	Year Ended December 31,							
	2008				2007			
	Collections	Cost	Cost Per Channel Dollar Collected	Cost Per Total Dollar Collected	Collections	Cost	Cost Per Channel Dollar Collected	Cost Per Total Dollar Collected
Legal networks	\$193,201	\$ 96,187	49.8%	24.1%	\$169,005	\$ 78,636	46.5%	22.1%
Collection sites	157,077	25,267 ⁽¹⁾	16.1%	6.3%	126,093	28,009 ⁽¹⁾	22.2%	7.9%
Collection agency outsourcing	34,736	13,118	37.8%	3.3%	33,325	12,411	37.2%	3.5%
Sales and other	13,619	—	—	—	26,770	—	—	—
Other indirect costs	—	65,395	—	16.5%	—	63,705	—	17.9%
Total	<u>\$398,633</u>	<u>\$199,967⁽²⁾</u>		50.2%	<u>\$355,193</u>	<u>\$182,761⁽²⁾</u>		51.5%

⁽¹⁾ Represents only account manager salaries, variable compensation and employee benefits.

⁽²⁾ Represents all operating expenses excluding stock-based compensation expense of \$3.6 million and \$4.3 million for the years ended December 31, 2008 and 2007, respectively and costs related to Ascension of \$13.4 million and \$14.8 million for the years ended December 31, 2008 and 2007, respectively.

During the year ended December 31, 2008, cost per dollar collected decreased by 130 basis points to 50.2% of gross collections from 51.5% of gross collections during the year ended December 31, 2007. This decrease was primarily due to several factors, including:

- Account manager salaries, variable compensation and employee benefits, as a percentage of total collections, decreased to 6.3% from 7.9% and, as a percentage of our site collections, decreased to 16.1% from 22.2%. The decrease is primarily due to reduced average domestic headcount, as a result of the reduction in workforce, associated with our cost savings initiatives implemented in September 2007 and a shift in our collection workforce from the United States to India.
- Collection agency commissions increased in total dollars but decreased as a percentage of total collections, to 3.3% from 3.5%. The dollar increase is due to a slight increase in both collections through this channel and a slight increase in the agency commission rate resulting in an increase in cost per dollar collected in this channel from 37.2% to 37.8%. Commissions, as a percentage of collections, vary from period to period depending on, among other things, the time from charge-off of the accounts placed with an agency. The decrease in the percentage of commissions to total collections is primarily due to collection agency collections and commissions growing at a rate slower than total collections.
- Other costs not directly attributable to specific channel collections, including non collection salaries and employee benefits, general and administrative expenses, other operating expenses and depreciation and amortization, decreased as a percentage of total collections to 16.5% from 17.9%. This decrease is primarily due to the increased leverage of spreading our non direct collection costs over a larger pool of collections.

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The decrease in cost per dollar collected was offset by an increase in the cost of legal collections, as a percent of total collections, to 24.1% from 22.1% and, an increase in the cost as a percentage of legal collections, to 49.8% from 46.5%. The increase is primarily due to an increase in gross collections through our legal channel, an increase in upfront court costs expensed associated with our pursuit of legal collections, and an increase in costs related to counter claims, offset by a lower overall commission rate, driven by lower bonus commissions paid to our law firms.

Interest expense

Interest expense decreased \$13.9 million, or 40.4%, to an adjusted \$20.6 million during the year ended December 31, 2008, from an adjusted \$34.5 million during the year ended December 31, 2007.

The following table summarizes our interest expense (*in thousands*):

	Year Ended December 31,			
	2008	2007	\$ Change	% Change
	Adjusted	Adjusted		
Stated interest on debt obligations	\$14,252	\$12,401	\$ 1,851	14.9%
Amortization of loan fees and other loan costs	1,213	1,322	(109)	(8.2)%
Amortization of debt discount—convertible notes	5,107	4,925	182	3.7%
Subtotal	20,572	18,648	1,924	10.3%
Contingent interest	—	4,123	(4,123)	(100.0)%
Pay-off of future contingent interest	—	11,733	(11,733)	(100.0)%
Total interest expense	<u>\$20,572</u>	<u>\$34,504</u>	<u>\$(13,932)</u>	<u>(40.4)%</u>

As of December 31, 2004, we no longer made borrowings under our prior secured financing facility (“Secured Financing Facility”). As of December 31, 2006, we repaid in full the principal balance of the Secured Financing Facility. Prior to May 7, 2007, we shared with the lender the residual collections on purchases made under this facility, net of servicing fees paid to us. The residual collections paid to the lender were classified as contingent interest, or Contingent Interest. On May 7, 2007, we entered into an agreement with the lender under the Secured Financing Facility to eliminate all future Contingent Interest payments for a one-time payment of \$16.9 million. This agreement effectively eliminated all future Contingent Interest payments and released our lender’s security interests in the remaining receivables originally financed under the Secured Financing Facility. Subsequent to the second quarter of 2007, we no longer are required to pay any Contingent Interest expense under the Secured Financing Facility.

We have financed portfolio purchases subsequent to December 31, 2004 using our Revolving Credit Facility, which does not require the sharing of residual collections with the lender. See Note 8 to our consolidated financial statements for a further discussion of our Revolving Credit Facility.

Interest expense during the years ended December 31, 2008 and December 31, 2007 was retrospectively adjusted as a result of a change in accounting principle. Effective January 1, 2009, we adopted the provisions ASC 470-20. In accordance with the provisions of ASC 470-20, we adjusted our prior years’ financial statements to separately account for the liability and equity components of our Convertible Notes in a manner that reflects our nonconvertible debt borrowing rate at the time of the issuance. As a result, we created a debt discount for our Convertible Notes and incurred additional interest expense due to the amortization of debt discount. See Note 15 to our consolidated financial statements for a further discussion of this change in accounting principle.

Stated interest on debt obligations increased \$1.9 million during the year ended December 31, 2008, as compared to the prior year, due to an increase in amounts borrowed to fund our purchases of receivable portfolios and general working capital needs, offset by decreased interest expense on our Convertible Notes driven by the reduced principal balance.

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Gain on repurchase of convertible notes, net

During the year ended December 31, 2008, we repurchased \$28.6 million principal amount of our outstanding Convertible Notes, for a total price of \$20.1 million, plus accrued interest. The repurchases left \$71.4 million principal amount of our Convertible Notes outstanding.

Effective January 1, 2009, we retrospectively adjusted our prior years' gain on repurchase of Convertible Notes, net upon adoption of ASC 470-20. See interest expense above and Note 15 to our consolidated financial statements for a further discussion of the change in accounting principle. As a result of adopting ASC 470-20, we retrospectively adjusted our pre-tax gain on the repurchases to \$5.1 million, which was partially offset by a \$0.3 million write-off of the debt issuance costs related to the portions of the Convertible Notes repurchased. The adjusted net gain of \$4.8 million was recognized in our consolidated statement of operations for the year ended December 31, 2008.

Other income and expense

During the year ended December 31, 2008, total other income was \$0.4 million, compared to \$1.1 million for the year ended December 31, 2007. The decrease in other income was primarily attributable to the realization of a \$0.8 million gain associated with the plan assets of our non-qualified employee benefit plan in the prior year. During the year ended December 31, 2007, we liquidated all of our mutual funds within the plan assets. As a result, previously unrealized investment gains of \$0.8 million were recognized as other income.

Provision for income taxes

Effective January 1, 2009, we retrospectively adjusted our prior year's gain on repurchase of Convertible Notes, net upon adoption of ASC 470-20. See interest expense above and Note 15 to our consolidated financial statements for a further discussion of the change in accounting principle.

During the year ended December 31, 2008, as a result of adopting ASC 470-20, we retrospectively adjusted our income tax provision to \$9.7 million, reflecting an effective rate of 41.2% of pretax income. The effective tax rate for the year ended December 31, 2008, consists primarily of a provision for federal income taxes of 32.3% (which is net of a benefit for state taxes of 2.7%), a blended provision for state taxes of 7.8%, a 1.2% adjustment to federal taxes payable as a result of state tax rate changes and a benefit for the effect of permanent book versus tax differences of 0.1%.

The overall income tax rate for the year ended December 31, 2008 increased to 41.2% from 34.7% as compared to the year ended December 31, 2007. This increase was primarily due to a net state effective tax rate increase in 2008 and to one time state related tax reductions experienced in 2007. In 2008, a number of state taxing methodology changes became effective, the majority of which resulted in an increase to our 2008 net state effective tax rate. The one-time reductions in 2007 resulted from the cumulative effect of 2007 and prior years' favorable state tax ruling, a net beneficial adjustment to the state and federal tax payables resulting from the completion of back state tax returns and a beneficial adjustment to deferred taxes as a result of the recognition of certain state generated net operating losses.

During the year ended December 31, 2007, as a result of adopting ASC 470-20, we retrospectively adjusted our income tax provision to \$6.5 million, reflecting an effective rate of 34.7% of pretax income. The effective tax rate for the year ended December 31, 2007, consists primarily of a provision for federal income taxes of 32.6% (which is net of a benefit for state taxes of 2.4%), a blended provision for state taxes of 6.7%, a benefit for the effect of permanent book versus tax differences of 1.1% and a benefit of 3.5% relating to state taxes. The 3.5% benefit for 2007 is primarily due to a new effective state tax rate resulting from the receipt of a favorable ruling from a state tax authority granting us the right to use a more favorable filing methodology, a net beneficial adjustment of \$0.3 million to the state and federal tax payables resulting from the completion of our 1999-2006 state tax returns, a beneficial adjustment to our deferred taxes and the recognition of the benefit of certain state net operating losses generated in 2006. See Note 11 to our consolidated financial statements for a further discussion of income taxes.

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Supplemental Performance Data

Cumulative Collections to Purchase Price Multiple

The following table summarizes our purchases and related gross collections by year of purchase (in thousands, except multiples):

Year of Purchase	Purchase Price ⁽¹⁾	Cumulative Collections through December 31, 2009								Total ⁽²⁾	CCM ⁽³⁾
		<2003	2003	2004	2005	2006	2007	2008	2009		
<2003	\$ 195,661 ⁽⁴⁾	\$ 331,683	\$ 126,730	\$ 105,982	\$ 74,843	\$ 54,248	\$ 24,055	\$ 12,880	\$ 8,313	\$ 738,734	3.8
2003	88,503	—	59,038	86,958	69,932	55,131	26,653	13,897	8,032	319,641	3.6
2004	101,330	—	—	39,400	79,845	54,832	34,625	19,116	11,363	239,181	2.4
2005	192,591	—	—	—	66,491	129,809	109,078	67,346	42,387	415,111	2.2
2006	141,972	—	—	—	—	42,354	92,265	70,743	44,553	249,915	1.8
2007	204,308	—	—	—	—	—	68,048	145,272	111,117	324,437	1.6
2008	227,961	—	—	—	—	—	—	69,049	165,164	234,213	1.0
2009	254,660	—	—	—	—	—	—	—	96,529	96,529	0.4
Total	\$ 1,406,986	\$ 331,683	\$ 185,768	\$ 232,340	\$ 291,111	\$ 336,374	\$ 354,724	\$ 398,303	\$ 487,458	\$ 2,617,761	1.9

(1) Adjusted for put-backs, account recalls, purchase price rescissions, and the impact of an acquisition in 2000. Put-backs represent accounts that are returned to the seller in accordance with the respective purchase agreement ("Put-Backs"). Recalls represents accounts that are recalled by the seller in accordance with the respective purchase agreement ("Recalls").

(2) Cumulative collections from inception through December 31, 2009, excluding collections on behalf of others.

(3) Cumulative Collections Multiple ("CCM") through December 31, 2009 – collections as a multiple of purchase price.

(4) From inception through December 31, 2002.

Total Estimated Collections to Purchase Price Multiple

The following table summarizes our purchases, resulting historical gross collections, and estimated remaining gross collections, by year of purchase (in thousands, except multiples):

	Purchase Price ⁽¹⁾	Historical Collections ⁽²⁾	Estimated Remaining Collections ⁽³⁾	Total Estimated Gross Collections	Total Estimated Gross Collections to Purchase Price
<2003	\$ 195,661 ⁽⁴⁾	\$ 738,734	\$ 159	\$ 738,893	3.8
2003	88,503	319,641	2,047	321,688	3.6
2004	101,330	239,181	8,106	247,287	2.4
2005	192,591	415,111	57,030	472,141	2.5
2006	141,972	249,915	93,667	343,582	2.4
2007	204,308	324,437	148,619	473,056	2.3
2008	227,961	234,213	344,832	579,045	2.5
2009	254,660	96,529	505,551	602,080	2.4
Total	\$ 1,406,986	\$ 2,617,761	\$ 1,160,011	\$ 3,777,772	2.7

(1) Adjusted for Put-Backs, Recalls, purchase price rescissions, and the impact of an acquisition in 2000.

(2) Cumulative collections from inception through December 31, 2009, excluding collections on behalf of others.

(3) Includes \$0.5 million in expected collections for the healthcare portfolios on cost recovery.

(4) From inception through December 31, 2002.

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Estimated Remaining Gross Collections by Year of Purchase

The following table summarizes our estimated remaining gross collections by year of purchase (*in thousands*):

	Estimated Remaining Gross Collections by Year of Purchase							Total
	2010	2011	2012	2013	2014	2015	2016	
<2003 ⁽¹⁾	\$ 159	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 159
2003	2,047	—	—	—	—	—	—	2,047
2004	6,067	2,039	—	—	—	—	—	8,106
2005	30,160	19,859	6,994	17	—	—	—	57,030
2006	36,209	27,613	20,050	9,795	—	—	—	93,667
2007	64,932	39,636	25,707	14,507	3,837	—	—	148,619
2008	135,897	89,331	56,536	35,909	20,142	7,017	—	344,832
2009	156,132	146,768	91,872	55,471	32,274	17,169	5,865	505,551
Total	\$ 431,603	\$ 325,246	\$ 201,159	\$ 115,699	\$ 56,253	\$ 24,186	\$ 5,865	\$ 1,160,011

⁽¹⁾ Estimated remaining collections for Zero Basis Portfolios can extend beyond the 84-month accrual basis collection forecast.

Unamortized Balances of Portfolios

The following table summarizes the remaining unamortized balances of our purchased receivable portfolios by year of purchase (*in thousands, except percentages*):

	Unamortized Balance as of December 31, 2009 ⁽¹⁾	Purchase Price ⁽²⁾	Unamortized Balance as a Percentage of Purchase Price	Unamortized Balance as a Percentage of Total
2003	\$ 629	\$ 88,503	0.7%	0.1%
2004	4,600	101,330	4.5%	0.9%
2005	30,804	192,591	16.0%	5.8%
2006	44,030	141,972	31.0%	8.4%
2007	68,739	204,308	33.6%	13.0%
2008	157,807	227,961	69.2%	30.0%
2009	220,268	254,660	86.5%	41.8%
Total	\$ 526,877	\$1,211,325	43.5%	100.0%

⁽¹⁾ Includes \$0.5 million for healthcare portfolios being accounted for on the cost recovery method.

⁽²⁾ Purchase price refers to the cash paid to a seller to acquire a portfolio less Put-Backs, plus an allocation of our forward flow asset (if applicable), and less the purchase price for accounts that were sold at the time of purchase to another debt purchaser.

Changes in the Investment in Receivable Portfolios

Revenue related to our investment in receivable portfolios comprises two groups. First, revenue from those portfolios that have a remaining book value and are accounted for on the accrual basis (“Accrual Basis Portfolios”), and second, revenue from those portfolios that have fully recovered their book value Zero Basis Portfolios and, therefore, every dollar of gross collections is recorded entirely as Zero Basis Revenue. If the amount and timing of future cash collections on a pool of receivables are not reasonably estimable, we account for such portfolios on the cost recovery method (“Cost Recovery Portfolios”). No revenue is recognized on Cost Recovery Portfolios until the cost basis has been fully recovered, at which time they become Zero Basis Portfolios.

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The following tables summarize the changes in the balance of the investment in receivable portfolios and the proportion of revenue recognized as a percentage of collections (*in thousands, except percentages*):

	Year Ended December 31, 2009			Total
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	
Balance, beginning of period	\$ 460,598	\$ 748	\$ —	\$ 461,346
Purchases of receivable portfolios	256,632	—	—	256,632
Gross collections ⁽¹⁾	(478,253)	(237)	(8,968)	(487,458)
Put-backs and recalls	(3,371)	—	(4)	(3,375)
Revenue recognized ⁽²⁾	310,116	—	8,926	319,042
Impairment, net	(19,356)	—	46	(19,310)
Balance, end of period	<u>\$ 526,366</u>	<u>\$ 511</u>	<u>\$ —</u>	<u>\$ 526,877</u>
Revenue as a percentage of collections ⁽³⁾	<u>64.8%</u>	<u>0.0%</u>	<u>99.5%</u>	<u>65.4%</u>

	Year Ended December 31, 2008			Total
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	
Balance, beginning of period	\$ 390,564	\$ 1,645	\$ —	\$ 392,209
Purchases of receivable portfolios	230,278	—	—	230,278
Gross collections ⁽¹⁾	(388,110)	(587)	(9,606)	(398,303)
Put-backs and recalls	(3,330)	(310)	—	(3,640)
Revenue recognized ^{(2),(4)}	272,596	—	9,606	282,202
Impairment, net ⁽⁴⁾	(41,400)	—	—	(41,400)
Balance, end of period	<u>\$ 460,598</u>	<u>\$ 748</u>	<u>\$ —</u>	<u>\$ 461,346</u>
Revenue as a percentage of collections ⁽³⁾	<u>70.2%</u>	<u>0.0%</u>	<u>100.0%</u>	<u>70.9%</u>

	Year Ended December 31, 2007			Total
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	
Balance, beginning of period	\$ 300,348	\$ —	\$ —	\$ 300,348
Purchases of receivable portfolios	208,953	—	—	208,953
Transfer of healthcare receivables	(3,241)	3,241	—	—
Gross collections ⁽¹⁾	(339,357)	(203)	(15,164)	(354,724)
Put-backs and recalls	(3,767)	(2)	—	(3,769)
Revenue recognized ⁽²⁾	237,467	—	15,164	252,631
Impairment, net	(9,839)	—	—	(9,839)
Write-down of healthcare receivables	—	(1,391)	—	(1,391)
Balance, end of period	<u>\$ 390,564</u>	<u>\$ 1,645</u>	<u>\$ —</u>	<u>\$ 392,209</u>
Revenue as a percentage of collections ⁽³⁾	<u>70.0%</u>	<u>0.0%</u>	<u>100.0%</u>	<u>71.2%</u>

(1) Does not include amounts collected on behalf of others.

(2) Includes retained interest.

(3) Revenue as a percentage of collections excludes the effects of net impairment or net impairment reversals.

(4) Reflects additional revenue of \$0.1 million and a lower net impairment of \$3.1 million, as a result of extending the collection curves from 72 to 84 months.

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As of December 31, 2009, we had \$526.9 million in investment in receivable portfolios. This balance will be amortized based upon current projections of cash collections in excess of revenue applied to the principal balance. The estimated amortization of the investment in receivable portfolio balance is as follows (in thousands):

<u>Year Ended December 31,</u>	<u>Amortization</u>
2010	\$ 147,792
2011	152,167
2012	103,101
2013	65,859
2014	35,388
2015	17,467
2016	5,103
Total	<u>\$ 526,877</u>

Analysis of Changes in Revenue

The following table analyzes the components of the change in revenue from our receivable portfolios between the years ended December 31, 2009, 2008 and 2007 (in thousands, except percentages):

<u>Variance Component</u>	<u>Year Ended December 31,</u>			<u>Revenue Variance</u>
	<u>2009</u>	<u>2008</u>	<u>Change</u>	
Average portfolio balance	\$483,392	\$409,298	\$74,094	\$ 49,346
Weighted average effective interest rate ⁽¹⁾	64.2%	66.6%	(2.4)%	\$(11,827)
Zero basis revenue	\$ 8,927	\$ 9,606		\$ (679)
Net impairment	\$ (19,310)	\$ (41,400)		\$ 22,090
Total variance				<u>\$ 58,930</u>

<u>Variance Component</u>	<u>Year Ended December 31,</u>			<u>Revenue Variance</u>
	<u>2008</u>	<u>2007</u>	<u>Change</u>	
Average portfolio balance	\$409,298	\$328,204	\$81,094	\$ 58,674
Weighted average effective interest rate ⁽¹⁾	66.6%	72.4%	(5.8)%	\$(23,546)
Zero basis revenue	\$ 9,606	\$ 15,164		\$ (5,558)
Net impairment	\$ (41,400)	\$ (11,230)		\$(30,170)
Total variance				<u>\$ (600)</u>

⁽¹⁾ For accrual basis portfolios, the weighted average annualized effective interest rate is the accrual rate utilized in recognizing revenue on our accrual basis portfolios. This rate represents the monthly internal rate of return, which has been annualized utilizing the simple interest method. The monthly internal rate of return is determined based on the timing and amounts of actual cash received to date and the anticipated future cash flow projections for each pool.

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Collections by Channel

We utilize numerous business channels for the collection of charged-off credit cards and other receivables. The following table summarizes the gross collections by collection channel (*in thousands*):

	Year Ended December 31,		
	2009	2008	2007
Legal collections	\$ 232,667	\$ 193,201	\$ 169,005
Collection sites	185,789	157,077	126,093
Collection agencies	62,653	34,736	33,325
Sales	6,677	12,550	24,001
Other	6	1,069	2,769
	<u>\$ 487,792</u>	<u>\$ 398,633</u>	<u>\$ 355,193</u>

External Collection Channels and Related Direct Costs

The following tables summarize our external collection channel performance and related direct costs (*in thousands, except percentages*):

	Legal Collections					
	Year Ended December 31,					
	2009		2008		2007	
Collections	\$ 232,667	100.0%	\$ 193,201	100.0%	\$ 169,005	100.0%
Commissions	\$ 66,534	28.6%	\$ 55,485	28.7%	\$ 49,344	29.2%
Court cost expense ⁽¹⁾	43,592	18.7%	38,492	19.9%	28,300	16.7%
Other ⁽²⁾	2,444	1.1%	2,210	1.2%	992	0.6%
Total costs	<u>\$ 112,570</u>	<u>48.4%</u>	<u>\$ 96,187</u>	<u>49.8%</u>	<u>\$ 78,636</u>	<u>46.5%</u>

⁽¹⁾ In connection with our agreement with contracted attorneys, we advance certain out-of-pocket court costs. We capitalize these costs in our consolidated financial statements and provide a reserve and corresponding court cost expense for the costs that we believe will be ultimately uncollectible. This amount includes changes in our anticipated recovery rate of court costs expensed.

⁽²⁾ Other costs consist primarily of costs related to counter claims and legal network subscription fees.

	Collection Agencies					
	Year Ended December 31,					
	2009		2008		2007	
Collections	\$62,653	100.0%	\$34,736	100.0%	\$33,325	100.0%
Total costs	\$19,278	30.8%	\$13,118	37.8%	\$12,411	37.2%

Legal Outsourcing Collections and Related Costs

The following tables summarize our legal outsourcing collection channel performance and related direct costs (*in thousands, except percentages*):

Placement Year	Gross Collections by Year of Collection ⁽¹⁾							Total Collections
	2003	2004	2005	2006	2007	2008	2009	
2003	\$ 10,750	\$ 27,192	\$ 17,212	\$ 9,566	\$ 5,561	\$ 3,050	\$ 2,014	\$ 75,345
2004	—	\$ 23,455	\$ 37,674	\$ 21,676	\$ 12,029	\$ 5,840	\$ 3,665	\$ 104,339
2005	—	—	\$ 21,694	\$ 40,762	\$ 22,152	\$ 10,582	\$ 6,226	\$ 101,416
2006	—	—	—	\$ 39,395	\$ 82,740	\$ 43,303	\$ 22,527	\$ 187,965
2007	—	—	—	—	\$ 41,958	\$ 80,211	\$ 44,321	\$ 166,490
2008	—	—	—	—	—	\$ 47,320	\$ 110,868	\$ 158,188
2009	—	—	—	—	—	—	\$ 40,856	\$ 40,856

⁽¹⁾ Includes collections for accounts placed in our legal channel beginning January 1, 2003. We continue to collect on accounts placed in this channel prior to that date.

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Court Costs by Year of Collection⁽¹⁾

Placement Year	2003	2004	2005	2006	2007	2008	2009	Total Court Costs
2003	\$ 908	\$ 2,046	\$ 571	\$ 300	\$ 147	\$ 103	\$ 86	\$ 4,161
2004	—	\$ 2,509	\$ 2,937	\$ 1,087	\$ 406	\$ 223	\$ 153	\$ 7,315
2005	—	—	\$ 3,271	\$ 4,426	\$ 859	\$ 356	\$ 218	\$ 9,130
2006	—	—	—	\$ 10,158	\$ 10,291	\$ 1,829	\$ 407	\$ 22,685
2007	—	—	—	—	\$ 15,357	\$ 11,952	\$ 1,178	\$ 28,487
2008	—	—	—	—	—	\$ 19,322	\$ 15,842	\$ 35,164
2009	—	—	—	—	—	—	\$ 17,009	\$ 17,009

⁽¹⁾ Includes court cost expense for accounts placed in our legal channel beginning January 1, 2003. We continue to incur court cost expense on accounts placed in this channel prior to that date. Court cost expense in this table is calculated based on our blended court cost expense rate.

Commissions by Year of Collection⁽¹⁾

Placement Year	2003	2004	2005	2006	2007	2008	2009	Total Commissions
2003	\$ 3,574	\$ 8,606	\$ 5,496	\$ 2,898	\$ 1,574	\$ 872	\$ 577	\$ 23,597
2004	—	\$ 7,273	\$ 12,060	\$ 6,653	\$ 3,498	\$ 1,690	\$ 1,063	\$ 32,237
2005	—	—	\$ 6,725	\$ 12,108	\$ 6,364	\$ 3,036	\$ 1,792	\$ 30,025
2006	—	—	—	\$ 11,451	\$ 23,659	\$ 12,370	\$ 6,464	\$ 53,944
2007	—	—	—	—	\$ 11,845	\$ 22,927	\$ 12,697	\$ 47,469
2008	—	—	—	—	—	\$ 13,678	\$ 31,794	\$ 45,472
2009	—	—	—	—	—	—	\$ 11,476	\$ 11,476

⁽¹⁾ Includes commissions for accounts placed in our legal channel beginning January 1, 2003. We continue to incur commissions on collections for accounts placed in this channel prior to that date.

Court Cost Expense and Commissions as a % of Gross Collections by Year of Collection

Placement Year	2003	2004	2005	2006	2007	2008	2009	Cumulative Average
2003	41.7%	39.2%	35.2%	33.4%	31.0%	32.0%	32.9%	36.8%
2004	—	41.7%	39.8%	35.7%	32.4%	32.8%	33.2%	37.9%
2005	—	—	46.1%	40.6%	32.6%	32.1%	32.3%	38.6%
2006	—	—	—	54.9%	41.0%	32.8%	30.5%	40.8%
2007	—	—	—	—	64.8%	43.5%	31.3%	45.6%
2008	—	—	—	—	—	69.7%	43.0%	51.0%
2009	—	—	—	—	—	—	69.7%	69.7%

Lawsuits Filed by Year⁽¹⁾

Placement Year ⁽²⁾	2003	2004	2005	2006	2007	2008	2009	Total
2003	23	29	5	2	—	—	—	59
2004	—	59	39	11	2	—	—	111
2005	—	—	76	46	3	—	—	125
2006	—	—	—	205	105	4	—	314
2007	—	—	—	—	269	106	4	379
2008	—	—	—	—	—	338	136	474
2009	—	—	—	—	—	—	245	245

⁽¹⁾ Represents the year the account was placed into litigation.

⁽²⁾ Represents the year the account was placed into our legal channel.

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Headcount by Function by Site

The following table summarizes our headcount by function by site:

	Headcount as of December 31,					
	2009		2008		2007	
	U.S.	India	U.S.	India	U.S.	India
General & Administrative	345	170	312	87	313	58
Account Manager	223	665	240	341	318	234
Bankruptcy Specialist	64	56	67	35	47	18
	<u>632</u>	<u>891</u>	<u>619</u>	<u>463</u>	<u>678</u>	<u>310</u>

Gross Collections by Account Manager

The following table summarizes our collection performance by Account Manager (*in thousands, except headcount*):

	Year Ended December 31,		
	2009	2008	2007
Gross collections—collection sites	\$ 185,789	\$ 157,078	\$ 126,851
Average active account managers	678	574	560
Collections per average active account manager	\$ 274.0	\$ 273.7	\$ 226.5

Gross Collections per Hour Paid

The following table summarizes our gross collections per hour paid to Account Managers (*in thousands, except gross collections per hour paid*):

	Year Ended December 31,		
	2009	2008	2007
Gross collections—collection sites	\$ 185,789	\$ 157,077	\$ 126,093
Total hours paid	1,242	1,078	964
Collections per hour paid	\$ 149.6	\$ 145.7	\$ 130.8

Collection Sites Direct Cost per Dollar Collected

The following table summarizes our gross collections in collection sites and the related direct cost (*in thousands, except percentages*):

	Year Ended December 31,		
	2009	2008	2007
Gross collections—collection sites	\$185,789	\$157,077	\$126,093
Direct cost ⁽¹⁾	\$ 22,912	\$ 25,267	\$ 28,009
Cost per dollar collected	12.3%	16.1%	22.2%

⁽¹⁾ Represents salaries, variable compensation and employee benefits.

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Salaries and Employee Benefits by Function

The following table summarizes our salaries and employee benefits by function (excluding stock-based compensation) (*in thousands*):

	Year Ended December 31,		
	2009	2008	2007
Portfolio Purchasing and Collecting Activities			
Collections related	\$22,912	\$25,267	\$28,009
General & administrative	27,291	25,615	27,314
Subtotal	50,203	50,882	55,323
Bankruptcy Services	7,822	7,238	8,830
	<u>\$58,025</u>	<u>\$58,120</u>	<u>\$64,153</u>

Purchases by Quarter

The following table summarizes the purchases we made by quarter, and the respective purchase prices (*in thousands*):

Quarter	# of Accounts	Face Value	Purchase Price	Forward Flow Allocation ⁽¹⁾
Q1 2006	673	558,574	27,091	2,403
Q2 2006	837	594,190	21,262	2,118
Q3 2006	1,469	1,081,892	32,334	2,939
Q4 2006	814	1,439,826	63,600	3,184
Q1 2007	1,434	2,510,347	45,386	3,539
Q2 2007	1,042	1,341,148	41,137	2,949
Q3 2007	659	1,281,468	47,869	2,680
Q4 2007	1,204	1,768,111	74,561	2,536
Q1 2008	647	1,199,703	47,902	2,926
Q2 2008	676	1,801,902	52,492	2,635
Q3 2008	795	1,830,292	66,107	—
Q4 2008	1,084	1,729,568	63,777	—
Q1 2009	505	1,341,660	55,913	—
Q2 2009	719	1,944,158	82,033	—
Q3 2009	1,515	2,173,562	77,734	10,302
Q4 2009	519	1,017,998	40,952	—

⁽¹⁾ Allocation of the forward flow asset to the cost basis of receivable portfolio purchases. In July 2008, we ceased forward flow purchases from Jefferson Capital due to an alleged breach by Jefferson Capital and its parent, CompuCredit Corporation, of certain agreements. In September 2009, we settled our dispute with Jefferson Capital. As part of the settlement, we purchased a receivable portfolio and applied the remaining forward flow asset to that purchase. See Note 12 to our consolidated financial statements for further information.

Purchases by Paper Type

The following table summarizes the types of charged-off consumer receivable portfolios we purchased by paper type for the periods presented (*in thousands*):

	Year Ended December 31,		
	2009	2008	2007
Credit card	\$ 256,632	\$ 201,315	\$ 188,207
Other	—	28,963	20,746
	<u>\$ 256,632</u>	<u>\$ 230,278</u>	<u>\$ 208,953</u>

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Liquidity and Capital Resources

Overview

Historically, we have met our cash requirements by utilizing our cash flows from operations, bank borrowings and equity offerings. Our primary cash requirements have included the purchase of receivable portfolios, operational expenses, and the payment of interest and principal on bank borrowings and tax payments.

The following table summarizes our cash flows by category for the periods presented (*in thousands*):

	Year Ended December 31,		
	2009	2008	2007
Net cash provided by operating activities	\$ 76,116	\$ 63,071	\$ 19,610
Net cash used in investing activities	\$(79,171)	\$(107,252)	\$(95,059)
Net cash provided by financing activities	\$ 1,102	\$ 45,846	\$ 73,334

On December 31, 2004, our prior Secured Financing Facility expired. All of our portfolio purchases are funded with cash or financed under our \$335.0 million Revolving Credit Facility. Unlike the Secured Financing Facility, our Revolving Credit Facility does not require us to share with the lender the residual collections on the portfolios financed. See Note 8 to our consolidated financial statements for a further discussion on our Revolving Credit Facility, Secured Financing Facility and Contingent Interest.

On May 7, 2007, we entered into an agreement with the lender under our prior Secured Financing Facility to eliminate all future Contingent Interest payments, for a one-time payment of \$16.9 million. As a result, beginning in May 2007, we are no longer obligated to make future Contingent Interest payments under this facility.

On February 8, 2010, we entered into a new \$327.5 million, three-year revolving credit facility ("2010 Revolving Credit Facility"). The 2010 Revolving Credit Facility replaces the Revolving Credit Facility and as a result, the Revolving Credit Facility terminated on February 8, 2010. See Note 17 to our consolidated financial statements for a further discussion of our 2010 Revolving Credit Facility.

Amendments of Revolving Credit Facility

During 2005, we entered into a three-year Revolving Credit Facility, to be used for the purposes of purchasing receivable portfolios and for general working capital needs. This Revolving Credit Facility has been amended several times to meet our needs. We entered into two amendments to our Revolving Credit Facility during the year ended December 31, 2008. The most significant of these amendments was entered into and effective on July 3, 2008, which expanded the capacity of our Revolving Credit Facility to \$335.0 million, added three additional lenders to our syndicate and increased the applicable interest rate spread, under certain circumstances, by 25 to 75 basis points. See Note 8 to our consolidated financial statements for a further discussion of our debt and amendments to our Revolving Credit Facility.

Repurchase of Convertible Notes

On February 27, 2007, our board of directors authorized a securities repurchase program under which we may buy back up to \$50.0 million (at cost) of a combination of our common stock and Convertible Notes. The purchases may be made from time to time in the open market or through privately negotiated transactions and will be dependent upon various business and financial considerations. Repurchases are subject to compliance with applicable legal requirements and other factors. During the year ended December 31, 2009, we repurchased \$28.5 million principal amount of our outstanding Convertible Notes, for a total price of \$22.3 million, plus accrued interest. From the inception of the securities repurchase program, we have repurchased \$57.1 million principal amount of our Convertible Notes, for a total cash payment of \$42.4 million. We have not repurchased any common stock under this program. As of December 31, 2009, we had approximately \$42.9 million principal amount of outstanding Convertible Notes due September 19, 2010.

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On February 8, 2010, our board of directors approved a new \$50.0 million securities repurchase program to replace our existing program. With the execution of our new \$327.5 million, three-year revolving credit facility, we now have the renewed ability to repurchase up to \$50.0 million in any combination of our common stock and Convertible Notes, subject to compliance with certain covenants and available borrowing capacity. Our board authorized this new securities repurchase program allowing us to repurchase an aggregate of up to \$50.0 million of any combination of our common stock and Convertible Notes. This new program replaces our remaining available repurchase authority under our prior program. See Note 17 to our consolidated financial statements for a further discussion of the new revolving credit facility and securities repurchase program.

Operating Cash Flows

Net cash provided by operating activities was \$76.1 million, \$63.1 million and \$19.6 million for the years ended December 31, 2009, 2008 and 2007, respectively.

Cash provided by operating activities for the year ended December 31, 2009, is primarily related to net income of \$33.0 million, \$19.3 million in a non-cash add back related to the net impairment of our receivable portfolios and \$11.2 million increase in income taxes payable. Cash provided by operating activities for the year ended December 31, 2008, is primarily related to net income of \$13.8 million and \$41.4 million in a non-cash add back related to the net impairment of our receivable portfolios. Cash provided by operating activities for the year ended December 31, 2007, is primarily related to net income of \$12.2 million and \$11.2 million in a non-cash add back related to the net impairment of our receivable portfolios.

Investing Cash Flows

Net cash used in investing activities was \$79.2 million, \$107.3 million and \$95.1 million for the years ended December 31, 2009, 2008 and 2007, respectively.

The cash flows used in investing activities for the year ended December 31, 2009, are primarily related to receivable portfolio purchases of \$246.3 million (\$256.6 million of gross purchases less our forward flow allocation of \$10.3 million), offset by gross collection proceeds applied to the principal of our receivable portfolios in the amount of \$168.4 million. The cash flows used in investing activities for the year ended December 31, 2008, are primarily related to receivable portfolio purchases of \$224.7 million (\$230.3 million of gross purchases less our forward flow allocation of \$5.6 million), offset by gross collection proceeds applied to the principal of our receivable portfolios in the amount of \$116.1 million. The cash flows used in investing activities for the year ended December 31, 2007, are primarily related to receivable portfolio purchases of \$197.2 million (\$208.9 million of gross purchases less our forward flow allocation of \$11.7 million), offset by gross collection proceeds applied to the principal of our receivable portfolios in the amount of \$102.1 million.

Capital expenditures for fixed assets acquired with internal cash flow were \$4.6 million, \$2.3 million and \$1.4 million for years ended December 31, 2009, 2008 and 2007, respectively.

Financing Cash Flows

Net cash provided by financing activities was \$1.1 million, \$45.8 million and \$73.3 million for the years ended December 31, 2009, 2008 and 2007, respectively.

The cash provided by financing activities during the year ended December 31, 2009, reflects \$68.5 million in repayments of amounts outstanding under our line of credit and \$22.3 million in repurchase of our outstanding Convertible Notes, offset by \$90.5 million in borrowings under our line of credit agreement. The cash provided by financing activities during the year ended December 31, 2008, reflects \$42.2 million in repayments of amounts outstanding under our line of credit and \$20.1 million in repurchase of our outstanding Convertible Notes, offset by \$108.0 million in borrowings under our line of credit agreement. Cash provided by financing

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activities during the year ended December 31, 2007, reflects \$48.5 million in repayments of amounts outstanding under our line of credit and other borrowings, offset by \$121.0 million in borrowings under our line of credit agreement.

Future Contractual Cash Obligations

The following table summarizes our future contractual cash obligations as of December 31, 2009 (*in thousands*):

	Payments Due by Period				
	Total	Less Than 1 Year	1 – 3 Years	3 – 5 Years	More Than 5 Years
Revolving credit facility ⁽¹⁾	\$ 260,000	\$ —	\$ —	\$ 260,000	\$ —
3.375% convertible notes	42,920	42,920	—	—	—
Estimated interest payments ⁽²⁾	63,638	15,167	41,538	6,933	—
Accrued income taxes ⁽³⁾	2,681	2,681	—	—	—
Purchase commitments on receivable portfolios ⁽⁴⁾	104,679	104,679	—	—	—
Lease obligations	26,055	4,571	11,844	7,210	2,430
Employee agreements	172	172	—	—	—
Total contractual cash obligations	<u>\$ 500,145</u>	<u>\$ 170,190</u>	<u>\$ 53,382</u>	<u>\$ 274,143</u>	<u>\$ 2,430</u>

(1) On February 8, 2010, we entered into our 2010 Revolving Credit Facility which expires in May 2013. The 2010 Revolving Credit Facility replaces the Revolving Credit Facility and as a result, the Revolving Credit Facility was terminated.

(2) We calculated estimated interest payments for long-term debt as follows: for the 3.375% convertible notes, we calculated interest based on the applicable rates and payment dates. For our Revolving Credit Facility, we calculated the interest for the hedged portion using fixed interest rates plus the required spread. For the remaining balance, which is subject to a variable interest rate, we estimated the debt balance and interest rates based on our determination of the most likely scenario including entering into a replacement revolving line of credit. We expect to settle such interest payments with cash flows from operating activities.

(3) The non-current portion of our income tax liability was approximately \$17.0 million, which was not included in the total above. At this time, the settlement period for the non-current portion of our income tax liability cannot be determined. In addition, any payments related to unrecognized tax benefits would be partially offset by reductions in payments in other jurisdictions. Refer to Note 10 to the consolidated financial statements for further information on our income taxes. We expect to settle cash income tax payments with cash flows from operating activities.

(4) Certain of these purchase commitments allow us to cancel the commitment with a 60-day notice or a one-time cancellation fee. We do not anticipate canceling any of these commitments at this time and, as a result, have included the entire anticipated future commitment. We expect to fund forward flow purchases with cash flows from operating activities and/or borrowings from our Revolving Credit Facility.

The outstanding balance on our Revolving Credit Facility as of December 31, 2009, was \$260.0 million. As discussed above, effective July 3, 2008, we expanded the capacity of our Revolving Credit Facility from \$230.0 million to \$335.0 million, which provided us with a significant amount of additional capital to fund our growth. For additional information on our debt, see Note 8 to our consolidated financial statements.

We are in compliance with all covenants under our financing arrangements and, excluding the effects of the one-time payment of \$16.9 million to eliminate all future Contingent Interest payments in the second quarter of 2007 (this payment, less amounts accrued on our balance sheet, resulted in a charge to our statement of operations of \$6.9 million after the effect of income taxes) and the effects of the adoption of ASC 470-20, we have achieved 32 consecutive quarters of positive net income. We believe that we have sufficient liquidity to fund our operations for at least the next twelve months, given our expectation of continued positive cash flows from operations, our cash and cash equivalents of \$8.4 million as of December 31, 2009, and availability under our new \$327.5 million 2010 Revolving Credit Facility which expires in May 2013.

Off Balance Sheet Arrangements

We do not have any off balance sheet arrangements as defined by Item 303(a)(4) of Regulation S-K.

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Inflation

We believe that inflation has not had a material impact on our results of operations for the three years ended December 31, 2009, 2008, and 2007, since inflation rates have generally remained at relatively low levels and our operations are not otherwise uniquely affected by inflation concerns.

Critical Accounting Policies

Investment in Receivable Portfolios and Related Revenue. Commencing January 1, 2005, we began accounting for our investment in receivable portfolios in accordance with the provisions of ASC 310-30. ASC 310-30 addresses accounting for differences between initial estimated cash flows expected to be collected from purchased receivables, or “pools,” and subsequent changes to those estimated cash flows. ASC 310-30 limits the revenue that may be accreted, (also known as accretable yield), to the excess of our estimate of undiscounted cash flows expected to be collected over our investment, or cost basis, in the pool.

As permitted by ASC 310-30, static pools are established on a quarterly basis with accounts purchased during the quarter that have common risk characteristics. Discrete receivable portfolio purchases during a quarter are aggregated into pools based on these common risk characteristics. Once a static pool is established, the portfolios are permanently assigned to the pool. The discount (*i.e.*, the difference between the cost of each static pool and the related aggregate contractual receivable balance) is not recorded because we expect to collect a relatively small percentage of each static pool’s contractual receivable balance. As a result, receivable portfolios are recorded at cost at the time of acquisition. All portfolios with common risk characteristics purchased prior to the adoption of ASC 310-30 were aggregated by quarter of purchase.

In compliance with ASC 310-30, we account for our investments in consumer receivable portfolios, using either the interest method or the cost recovery method. The interest method applies an effective interest rate, or IRR, to the cost basis of the pool, which is to remain level, or unchanged throughout the life of the pool unless there is an increase in subsequent expected cash flows. Subsequent increases in cash flows expected to be collected generally are recognized prospectively through an upward adjustment of the pool’s IRR over its remaining life. Subsequent decreases in expected cash flows do not change the IRR, but are recognized as an impairment of the cost basis of the pool, and are reflected in the consolidated statements of income as a reduction in revenue, with a corresponding valuation allowance offsetting the investment in receivable portfolios in the consolidated statements of financial condition.

We account for each static pool as a unit for the economic life of the pool (similar to one loan) for recognition of revenue from receivable portfolios, for collections applied to the cost basis of receivable portfolios and for provision for loss or impairment. Revenue from receivable portfolios is accrued based on each pool’s effective interest rate applied to each pool’s adjusted cost basis. The cost basis of each pool is increased by revenue earned and decreased by gross collections and impairments.

If the amount and timing of future cash collections on a pool of receivables are not reasonably estimable, we account for such portfolios as Cost Recovery Portfolios. The accounts in these portfolios have different risk characteristics than those included in other portfolios acquired during the same quarter, or the necessary information was not available to estimate future cash flows and, accordingly, they were not aggregated with other portfolios.

Contingent Interest. Prior to May 7, 2007, under the terms of our prior Secured Financing Facility, once we repaid the lender for the notes for each purchased portfolio and collected sufficient amounts to recoup our initial cash investment in each purchased portfolio, we then shared the residual collections, or Contingent Interest, from the receivable portfolios, net of servicing fees, with the lender. We made estimates with respect to the timing and amount of collections of future cash flows from these receivable portfolios. Based on these estimates, we recorded a portion of the estimated future profit sharing obligation as Contingent Interest expense.

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On May 7, 2007, we entered into an agreement with the lender under our prior Secured Financing Facility to eliminate all future Contingent Interest payments, for a one-time payment of \$16.9 million. Subsequent to that date, we are no longer obligated to make any contingent interest payments under the Secured Financing Facility and as a result, no longer record such interest in our statements of income.

Deferred Revenue. On August 30, 2005, we acquired substantially all the assets and assumed certain liabilities of Ascension. Ascension provides bankruptcy administration services primarily to holders of motor vehicle secured loans, on which the debtor has filed for Chapter 7 or 13 bankruptcy protection. These services are provided subject to the terms of long-term contracts. Such contracts generally have initial terms of one or two years and automatically renew annually. Fees for the bankruptcy administration services are charged on a 'per referred' account basis and generally consist of an upfront fee at the time of account referral. This upfront fee is typically coupled with either an ongoing monthly service fee per referred account or service specific fees based on a predetermined fee schedule. The servicing deliverable for Chapter 7 accounts is focused on the completion of the entire bankruptcy process resulting in the most favorable possible conclusion for the customer. As a result, revenue is deferred and not recognized until the bankruptcy case is closed (dismissal/discharge). Due to practical limitations and constraints, a historical average life of seven months is used rather than actual closure dates. Therefore, the total financial consideration (less efforts applied to litigation for client contracts without a separate litigation fee schedule) is recognized seven months after a referred account is activated. Chapter 13 bankruptcy proceedings, also known as reorganization, are generally designed to restructure an individual's debts and allow them to propose a repayment plan detailing how they are going to pay back their debts over the plan period. The responsibility of Ascension is to ensure that the client's claim is recognized by the court to the maximum benefit of Ascension's client, and to monitor and/or collect the debtor payments throughout the confirmed bankruptcy plan term. The average duration period for Chapter 13 bankruptcy placements is thirty-five months. Given the nature and duration of a Chapter 13 proceeding, the monthly servicing deliverable provided relative to a Chapter 13 referred account is considered "delivered" each month and revenue is recognized ratably, including any upfront fees we received over time as the services are provided. The litigation deliverable is an as incurred event, with revenue recognized based on the historical percentage of accounts litigated over the average duration of an account. Any billings in excess of the ratable revenue will be deferred. The average duration period for Chapter 7 and 13 bankruptcy placements is reviewed periodically for changes.

Convertible Notes Hedge. In 2005, we issued \$100.0 million of 3.375% Convertible Notes due September 19, 2010. Concurrent with the sale of the Convertible Notes, we purchased call options to purchase shares of our common stock and sold warrants to sell shares of our common stock to the parties to which the Convertible Notes were issued. In accordance with ASC Topic 480, "*Distinguishing Liabilities from Equity*," we recorded the net call options and warrants as a reduction in additional paid in capital as of December 31, 2005, and will not recognize subsequent changes in fair value of the call options and warrants in our consolidated financial statements.

Forward Flow Asset. In connection with our acquisition of certain assets from Jefferson Capital in June 2005, we entered into a forward flow agreement to purchase a minimum of \$3.0 billion in face value of credit card charge-offs over the following five years at a fixed price. We allocated \$42.5 million of the acquisition purchase price to this agreement, which is reflected on the consolidated statements of financial condition as forward flow asset. As part of this forward flow agreement, the seller is obligated to sell a predetermined minimum amount of charged-off credit card accounts to us. The forward flow agreement contains penalty provisions if the seller fails to meet such minimum requirements. Any monies received pursuant to such penalty provisions would be applied to the carrying balance of the forward flow asset.

In July 2008, we ceased forward flow purchases from Jefferson Capital due to an alleged breach by Jefferson Capital and its parent, CompuCredit Corporation, of certain agreements. In September 2009, we settled our dispute with Jefferson Capital and CompuCredit. Under the terms of the settlement, we purchased a large portfolio of charged-off credit card account balances on commercially reasonable terms and agreed to resume balance transfers to Jefferson Capital.

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Prior to our cessation of forward flow purchases from Jefferson Capital and CompuCredit, we allocated a portion of the forward flow asset to the cost basis of receivable portfolio purchases under the forward flow agreement as purchases are made. As a result of the settlement as discussed above, the remaining forward flow asset of \$10.3 million was fully allocated to the purchase price of the large portfolio we acquired as part of the settlement. Following the settlement, we will have no further forward flow purchase obligations with Jefferson Capital and CompuCredit. See Note 12 to our consolidated financial statements, for more information on our settled dispute with Jefferson Capital and CompuCredit.

Deferred Court Costs. We contract with a nationwide network of attorneys that specialize in collection matters. We generally refer charged-off accounts to our contracted attorneys when we believe the related debtor has sufficient assets to repay the indebtedness and has, to date, been unwilling to pay. In connection with our agreements with our contracted attorneys, we advance certain out-of-pocket court costs, or Deferred Court Costs. We capitalize these costs in the consolidated financial statements and provide a reserve for those costs that we believe will ultimately be uncollectible. We determine the reserve based on our analysis of court costs that have been advanced and recovered, or that we anticipate recovering. Deferred Court Costs not recovered within three years of placement are fully written off.

Derivative Instruments and Hedging Activities. We use derivative instruments to manage risks related to interest rates and foreign currency. Our interest rate swap contracts and foreign exchange contracts qualify for hedge accounting treatment under the provisions of ASC Topic 815 “*Derivatives and Hedging*,” or ASC 815.

ASC 815 requires that qualifying derivative instruments be recorded on the balance sheet as either an asset or liability measured at its fair value. The effective portion of the change in fair value of the derivative is recorded in other comprehensive income. The ineffective portion of the change in fair value of the derivatives, if any, is recognized in earnings in the period of change. See Note 3 to our consolidated financial statements for further discussion of our derivative instruments.

Stock-Based Compensation. On January 1, 2006, we adopted the provisions within ASC Topic 718 “*Compensation—Stock Compensation*.” Under this guidance, share-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as expense over the employee’s requisite service period. We use the Black-Scholes option-pricing model to determine the fair-value of stock-based awards. See Note 9 to our consolidated financial statements for further discussion of our stock-based compensation.

Income Taxes. We use the liability method of accounting for income taxes in accordance with ASC 740. When we prepare the consolidated financial statements, we estimate our income taxes based on the various jurisdictions where we conduct business. This requires us to estimate our current tax exposure and to assess temporary differences that result from differing treatments of certain items for tax and accounting purposes. Deferred income taxes are recognized based on the differences between the financial statement and income tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. We then assess the likelihood that our deferred tax assets will be realized. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. When we establish a valuation allowance or increase this allowance in an accounting period, we record a corresponding tax expense in our statements of income. When we reduce our valuation allowance in an accounting period, we record a corresponding tax benefit in our statements of income. See Note 10 to our consolidated financial statements for further discussion of income taxes.

Accounting for Uncertainty in Income Taxes. On January 1, 2007, we adopted the provisions within ASC 740 related to uncertainty in income taxes. This guidance establishes recognition and measurement thresholds that must be met before a tax benefit can be recognized in the financial statements. Additionally, these provisions provide guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. Upon adoption, we did not have any uncertain tax positions and as a result, we were not required to record any cumulative effect adjustment to retained earnings. See Note 10 to our consolidated financial statements for further discussion of the impact of the provisions for uncertainty in income taxes.

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Use of Estimates. We have made significant estimates with respect to the rate of return established to recognize accretion revenue on our receivable portfolios and with respect to the provision for impairment of receivable portfolios. In connection with these estimates, we have made significant estimates with respect to the timing and amount of collections of future cash flows from receivable portfolios owned.

Significant estimates have also been made with respect to Ascension's service revenue, the realizability of our net deferred court costs, forward flow asset, other assets, intangible assets, net deferred tax assets and tax reserve, stock-based compensation, and the potential liabilities with respect to our health benefits plans.

Changes in Accounting Estimate

Effective January 1, 2008, we revised our UCS and BLS methodologies by extending our collection forecast from 72 months to 84 months. UCS is a proprietary forecasting tool that generates portfolio level expectations of liquidation for portfolios that we have owned and serviced for more than six months. BLS forecasts portfolio level expectations based on credit characteristics for portfolios owned and serviced less than six months. We have observed that receivable portfolios purchased in 2001 and prior have consistently experienced cash collections beyond 72 months from the date of purchase. When we first developed our cash forecasting models in 2001, limited historical collection data was available with which to accurately model projected cash flows beyond 60 months. During the quarter ended June 30, 2006, we determined there was enough additional collection data accumulated over the previous several years, in addition to improvements in our forecasting tools, allowing us to extend the collection forecast to 72 months. During the quarter ended March 31, 2008, we determined that there were enough additional collection data to accurately extend the collection forecast in both our UCS and BLS models to 84 months. The increase in the collection forecast from 72 to 84 months was applied effective January 1, 2008, to each portfolio for which we could accurately forecast through such term and resulted in an increase in the aggregate total estimated remaining collections for the receivable portfolios by \$67.3 million, or 7.5%, as of March 31, 2008. We did not extend the forecast on telecom portfolios as we do not anticipate significant collections past 72 months on these portfolios. The extension of the collection forecast was treated as a change in estimate and, in accordance with ASC 250 was recognized prospectively in our consolidated financial statements, effective January 1, 2008. In the quarter ended March 31, 2008, this prospective treatment resulted in a reduction in our net impairment provision of \$3.1 million and an increase in revenue of \$0.1 million. The impact of the change in estimate resulted in an increase in net income of \$1.9 million and an increase in fully diluted earnings per share of \$0.08, which we recorded in the quarter ended March 31, 2008.

New Accounting Pronouncements

On July 1, 2009, the FASB officially launched the FASB Accounting Standards Codification, which has become the single official source of authoritative, nongovernmental U.S. Generally Accepted Accounting Principles, in addition to guidance issued by the Securities and Exchange Commission. The codification supersedes all prior FASB, AICPA, EITF, and related literature. The codification, which is effective for interim and annual periods ending after September 15, 2009, is organized into approximately 90 accounting topics. The FASB no longer issues new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, amendments to the codification are made by issuing "Accounting Standards Updates." We have incorporated the current codification in our Form 10-K.

In August 2009, the FASB issued Accounting Standards Update No. 2009-05, "*Fair Value Measurements and Disclosures (Topic 820)—Measuring Liabilities at Fair Value*," which provides guidance on how to measure liabilities at fair value in circumstance in which a quoted price in an active market for the identical liability is not available. This update is effective for the first reporting period, including interim periods, beginning after issuance. We have no liabilities that are governed by this update but will apply its provisions in the future as applicable.

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In October 2009, the FASB issued Accounting Standards Update No. 2009-13, “*Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements—a consensus of the FASB Emerging Issues Task Force*,” which establishes a selling price hierarchy for determining the selling price of a deliverable, and eliminates the residual method of allocation. This update requires the arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. This update is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. We are currently analyzing the impact of this update, if any, to our consolidated financial statements.

In December 2009, the FASB issued Accounting Standards Update No. 2009-16, “*Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets*.” This guidance will require more information about transferred financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. This standard is effective at the start of a company’s first fiscal year beginning after November 15, 2009, or January 1, 2010, for companies reporting earnings on a calendar-year basis. We are currently analyzing the impact of this statement, if any, to our consolidated financial statements.

Special Note on Forward-Looking Statements

This Annual Report on Form 10-K contains “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”) and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), which we believe are subject to certain safe harbors. Many statements, other than statements of historical facts, included or incorporated into this Annual Report on Form 10-K are forward-looking statements. The words “believe,” “expect,” “anticipate,” “estimate,” “project,” “intend,” “plan,” “will,” “may” and similar expressions often characterize forward-looking statements. These statements may include, but are not limited to, projections of collections, revenues, income or loss, estimates of capital expenditures, plans for future operations, products or services and financing needs or plans, as well as assumptions relating to these matters. In particular, these statements may be found, among other places, under the “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” “Business,” and “Risk Factors” sections.

Although we believe that the expectations reflected in these forward-looking statements are reasonable, we caution that these expectations or predictions may not prove to be correct or we may not achieve the financial results, savings or other benefits anticipated in the forward-looking statements. These forward-looking statements are necessarily estimates reflecting the best judgment of our senior management and involve a number of risks and uncertainties, some of which may be beyond our control or cannot be predicted or quantified, that could cause actual results to differ materially from those suggested by the forward-looking statements. Many factors, including but not limited to those set forth in this Annual Report on Form 10-K under “Part I, Item 1A. Risk Factors,” could cause our actual results, performance, achievements, or industry results to be very different from the results, performance or achievements expressed or implied by these forward-looking statements. Our business, financial condition or results of operations could also be materially and adversely affected by other factors besides those listed here. However, these are the risks we currently believe are material.

Forward-looking statements speak only as of the date the statements were made. We do not undertake any obligation to update or revise any forward-looking statements to reflect new information or future events, or for any other reason even if experience or future events make it clear that any expected results expressed or implied by these forward-looking statements will not be realized.

In addition, it is generally our policy not to make any specific projections as to future earnings, and we do not endorse projections regarding future performance that may be made by third parties.

Item 7A—Quantitative and Qualitative Disclosure About Market Risk

Our exposure to market risk relates to interest rate risk associated with our variable rate borrowings. As of December 31, 2009, we had total borrowings of \$260.0 million outstanding under our Revolving Credit Facility, of which \$210.0 million was subject to variable interest rates. See Note 8 to our consolidated financial statements for a further discussion of debt.

Changes in short-term interest rates also affect our earnings as a result of our borrowings under variable rate borrowing agreements. If the market interest rates for our variable rate agreements increase at an average of 10.0%, interest expense would increase, and income before income taxes would decrease by approximately \$0.8 million, on an annualized basis, based on the amount of related outstanding borrowings subject to variable interest rates as of December 31, 2009, of \$210.0 million. Conversely, if market interest rates decreased an average of 10.0%, our interest expense would decrease, thereby increasing income before income taxes by approximately \$0.8 million, on an annualized basis, based on borrowings subject to variable interest rates as of December 31, 2009.

Item 8—Financial Statements and Supplementary Data

Our consolidated financial statements, the notes thereto and the Report of BDO Seidman LLP, our Independent Registered Public Accounting Firm, are included in this Annual Report on Form 10-K on pages F-1 through F-38.

Item 9—Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A—Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e) and 15d-15(e). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this Annual Report on Form 10-K, our disclosure controls and procedures are effective in enabling us to record, process, summarize and report information required to be included in our periodic SEC filings within the required time period.

Management's Report on Internal Control over Financial Reporting

The Company's management, including our Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting (as such term is defined in Exchange Act Rule 13a-15(f) and 15d-15(f)) for Encore Capital Group, Inc. and its subsidiaries (the "Company"). The Company's internal control system was designed to provide reasonable assurance to the Company's management and Board of Directors regarding the preparation and fair presentation of published consolidated financial statements in accordance with accounting principles generally accepted in the United States of America.

Because of its inherent limitations, a system of internal control over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. Further, because of changing conditions, effectiveness of internal control over financial reporting may vary over time. The Company's processes contain self-monitoring mechanisms and actions are taken to correct deficiencies as they are identified.

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Management has assessed the effectiveness of Encore's internal control over financial reporting as of December 31, 2009, based on the criteria for effective internal control described in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on its assessment, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2009.

BDO Seidman LLP, the independent registered public accounting firm that audited the consolidated financial statements included in this Annual Report on Form 10-K, was engaged to attest to and report on the effectiveness of Encore's internal control over financial reporting as of December 31, 2009, as stated in their report below.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders
Encore Capital Group, Inc.
San Diego, California

We have audited Encore Capital Group, Inc.'s internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Encore Capital Group, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Encore Capital Group, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of financial condition of Encore Capital Group, Inc. as of December 31, 2009 and 2008, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2009 and our report dated February 8, 2010 expressed an unqualified opinion thereon.

/s/ BDO Seidman, LLP

San Diego, California
February 8, 2010

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Changes in Internal Control over Financial Reporting

There was no change in internal control over financial reporting (as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f)), during our fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 9B—Other Information

None

PART III

Item 10—Directors, Executive Officers and Corporate Governance

The information under the captions “Election of Directors,” “Executive Officers” and “Section 16(a) Beneficial Ownership Reporting Compliance,” appearing in the 2010 Proxy Statement to be filed no later than April 30, 2010, is hereby incorporated by reference.

Item 11—Executive Compensation

The information under the caption “Executive Compensation and Other Information,” appearing in the 2010 Proxy Statement to be filed no later than April 30, 2010, is hereby incorporated by reference.

Item 12—Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information under the captions “Security Ownership of Principal Stockholders and Management” and “Equity Compensation Plan Information,” appearing in the 2010 Proxy Statement to be filed no later than April 30, 2010, is hereby incorporated by reference.

Item 13—Certain Relationships and Related Transactions, and Director Independence

The information under the captions “Certain Relationships and Related Transactions” and “Election of Directors—Corporate Governance—Director Independence,” appearing in the 2010 Proxy Statement to be filed no later than April 30, 2010, is hereby incorporated by reference.

Item 14—Principal Accounting Fees and Services

The information under the caption “Independent Registered Public Accounting Firm,” appearing in the 2010 Proxy Statement to be filed no later than April 30, 2010, is hereby incorporated by reference.

PART IV

Item 15—Exhibits, Financial Statement Schedules

(a) Financial Statements.

The following consolidated financial statements of Encore Capital Group, Inc. are filed as part of this annual report on Form 10-K:

Report of Independent Registered Public Accounting Firm	F-1
Consolidated Statements of Financial Condition at December 31, 2009 and 2008	F-2
Consolidated Statements of Income for the years ended December 31, 2009, 2008 and 2007	F-3
Consolidated Statements of Stockholders' Equity and Comprehensive Income for the years ended December 31, 2009, 2008 and 2007	F-4
Consolidated Statements of Cash Flows for the years ended December 31, 2009, 2008 and 2007	F-5
Notes to Consolidated Financial Statements	F-6

(b) Exhibits.

<u>Number</u>	<u>Description</u>
3.1	Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to Amendment No. 2 to the Company's Registration Statement on Form S-1/A filed on June 14, 1999, File No. 333-77483)
3.2	Certificate of Amendment to the Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on April 4, 2002, File No. 000-26489)
3.3	Bylaws, as amended through May 1, 2007 (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on May 3, 2007)
4.1	Registration Rights Agreement, dated as of February 21, 2002, between the Company and the several Purchasers listed on Schedule A thereto (incorporated by reference to Exhibit 4.3 to the Company's Current Report on Form 8-K filed on February 25, 2002, File No. 000-26489)
4.2	Amended and Restated Registration Rights Agreement, dated as of October 31, 2000, between the Company and the several stockholders listed therein (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed on August 22, 2003, File No. 000-26489)
4.3	Registration Rights Agreement, dated as of September 19, 2005, by and among Encore Capital Group, Inc. and Morgan Stanley & Co. Incorporated and J.P. Morgan Securities Inc. (incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K filed on September 22, 2005)
4.4	First Amendment, dated as of March 13, 2001, to Amended and Restated Registration Rights Agreement, dated as of October 31, 2000, between the Company and the several stockholders listed therein (incorporated by reference to Exhibit 4.3 to the Company's Current Report on Form 8-K filed on August 22, 2003, File No. 000-26489)
4.5	Indenture, dated September 19, 2005, by and between Encore Capital Group, Inc. and JP Morgan Chase Bank, N.A. (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on September 22, 2005)
4.6	Instrument of Resignation, Appointment and Acceptance, dated September 21, 2006, by and among Encore Capital Group, Inc., JPMorgan Chase Bank, N.A., and The Bank of New York (now known as The Bank of New York Mellon Trust Company, N.A.) as successor trustee (incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q filed on July 30, 2009)
4.7	Form of 3.375% Convertible Senior Notes due 2010 (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed on September 22, 2005)

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<u>Number</u>	<u>Description</u>
4.8	Form of Common Stock Certificate (incorporated by reference to Exhibit 4.7 to the Company's Registration Statement on Form S-3 filed on December 21, 2009, File No. 333-163876)
10.1	Multi-Tenant Office Lease dated as of April 8, 2004 between LBA Realty Fund-Holding Co. I, LLC and Midland Credit Management, Inc. (the "Midland Lease") (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 4, 2004, File No. 000-26489)
10.2	Lease Guaranty dated as of April 8, 2004 by the Company in favor of LBA Realty Fund-Holding Co. I, LLC in connection with the Midland Lease (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on May 4, 2004, File No. 000-26489)
10.3+	1999 Equity Participation Plan, as amended (incorporated by reference to Appendix I to the Company's proxy statement filed on April 1, 2004, File No. 000-26489)
10.4+	Form of Indemnification Agreement (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on May 4, 2006)
10.5+	Form of Option Amendment (incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K filed on May 4, 2006)
10.6+	Executive Non-Qualified Excess Plan (incorporated by reference to Exhibit 10.6 of the Company's Annual Report on Form 10-K filed on February 11, 2009)
10.7+	Encore Capital Group, Inc. 2005 Stock Incentive Plan, as amended and restated (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on June 15, 2009)
10.8+	Amended Form of Stock Option Agreement for awards under the 2005 Stock Incentive Plan (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on July 30, 2009)
10.9+	Amended Form of Restricted Stock Unit Grant Notice and Agreement (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed on July 30, 2009)
10.10+	Form of Split-Dollar Agreement (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on May 4, 2006)
10.11	Credit Agreement dated as of June 7, 2005 among Encore Capital Group, Inc., the Lenders from time to time parties thereto and JPMorgan Chase Bank, N.A. as Administrative Agent (the "Credit Agreement") (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on June 8, 2005)
10.12	Amendment No. 1 to the Credit Agreement, dated as of August 1, 2005 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on August 1, 2005)
10.13	Amendment No. 2, to the Credit Agreement, dated as of May 3, 2006 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 9, 2006)
10.14	Amendment No. 3, to the Credit Agreement, dated as of February 27, 2007 (incorporated by reference to Exhibit 10.29 to the Company's Annual Report on Form 10-K filed on February 28, 2007)
10.15	Consent and Amendment No. 4 to the Credit Agreement, dated as of May 7, 2007 (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on May 8, 2007)
10.16	Amendment No. 5 to the Credit Agreement, dated as of October 19, 2007 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on October 22, 2007)
10.17	Amendment No. 6 to the Credit Agreement, dated as of December 27, 2007 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 27, 2007)

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<u>Number</u>	<u>Description</u>
10.18	Amendment No. 7 to the Credit Agreement, dated as of May 9, 2008 (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed July 7, 2008)
10.19	Amendment No. 8 to the Credit Agreement, dated as of July 3, 2008 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed July 7, 2008)
10.20	Pledge and Security Agreement dated as of June 7, 2005, with respect to the Credit Agreement (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on June 8, 2005)
10.21	Guaranty dated as of June 7, 2005, with respect to the Credit Agreement (incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K filed on June 8, 2005)
10.22+	Severance protection letter agreement dated as of March 11, 2009 between the Company and J. Brandon Black (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on March 13, 2009)
10.23+	Severance protection letter agreement dated as of March 11, 2009 between the Company and Paul Grinberg (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on March 13, 2009)
10.24	Asset Purchase and Forward Flow Agreement dated as of June 2, 2005 among Jefferson Capital Systems, LLC, Midland Funding LLC and Encore Capital Group, Inc. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on June 8, 2005)
10.25	Acknowledgement Agreement dated as of June 7, 2005 between CompuCredit Corporation and Midland Funding LLC (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on June 8, 2005)
10.26	Asset Purchase Agreement dated as of August 30, 2005 among Ascension Capital Group, Ltd., Ascension Capital Management, L.L.C., The Erich M. Ramsey Trust, Erich M. Ramsey, Leonard R. Oszustowicz, Jeffrey J. Walter, Ascension Acquisition, LP, and Encore Capital Group, Inc. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on September 2, 2005)
10.27	Convertible Note Hedge Confirmation, dated as of September 13, 2005, by and between Encore Capital Group, Inc. and JPMorgan Chase Bank, National Association, an affiliate of J.P. Morgan Securities Inc. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on September 22, 2005)
10.28	Convertible Note Hedge Confirmation, dated as of September 13, 2005, by and between Encore Capital Group, Inc. and Morgan Stanley International Limited, an affiliate of Morgan Stanley & Co. Incorporated. (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on September 22, 2005)
10.29	Convertible Note Hedge Confirmation, dated as of September 30, 2005, by and between Encore Capital Group, Inc. and JPMorgan Chase Bank, National Association, an affiliate of J.P. Morgan Securities Inc. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on October 6, 2005)
10.30	Convertible Note Hedge Confirmation, dated as of September 30, 2005, by and between Encore Capital Group, Inc. and Morgan Stanley International Limited, an affiliate of Morgan Stanley & Co. Incorporated. (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on October 6, 2005)

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<u>Number</u>	<u>Description</u>
10.31	Warrant Confirmation, dated as of September 13, 2005, by and between Encore Capital Group, Inc. and JPMorgan Chase Bank, National Association, an affiliate of J.P. Morgan Securities Inc. (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on September 22, 2005)
10.32	Warrant Confirmation, dated as of September 13, 2005, by and between Encore Capital Group, Inc. and Morgan Stanley International Limited, an affiliate of Morgan Stanley & Co. Incorporated. (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on September 22, 2005)
10.33	Warrant Confirmation, dated as of September 30, 2005, by and between Encore Capital Group, Inc. and JPMorgan Chase Bank, National Association, an affiliate of J.P. Morgan Securities Inc. (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on October 6, 2005)
10.34	Warrant Confirmation, dated as of September 30, 2005, by and between Encore Capital Group, Inc. and Morgan Stanley International Limited, an affiliate of Morgan Stanley & Co. Incorporated. (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on October 6, 2005)
10.35	Lease Agreement, dated as of March 24, 2009, between Midland Credit Management India Private Limited, Dinesh Kumar and Manmohan Gaiind, for real property located in Gurgaon, India (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on April 29, 2009)
10.36	Lease Deed, dated as of April 22, 2009, between Midland Credit Management India Private Limited and R.S. Technologies Private Limited, for real property located in Gurgaon, India (incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q filed on April 29, 2009)
10.37	Sublease, dated as of March 31, 2008, by and between Encore Capital Group, Inc. and FMT Services, Inc., for real property located in St. Cloud, Minnesota (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed on August 4, 2008)
10.38	Multi-Tenant Net Commercial Lease, dated as of February 20, 2008, by and between Encore Capital Group, Inc. and Pranjiwan R. Lodhia and Lolita Lodhia, for real property located in Phoenix, Arizona (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on August 4, 2008)
10.39	Sublease, dated as of February 12, 2004, by and between Southwestern Bell Telephone, L.P. and Ascension Capital Group, Inc., as successor in interest to Ascension Capital Group, Ltd., for real property located in Arlington, Texas (filed herewith)
10.40	Assignment and Consent to Assignment of Sublease, dated as of August 18, 2005, by and between DBSI Housing, Inc., Ascension Capital Group, Ltd., Encore Capital Group, Inc., Ascension Acquisition, L.P., now known as Ascension Capital Group, Inc., and Southwestern Bell Telephone, L.P. (filed herewith)
10.41	Credit Agreement dated as of February 8, 2010 by and among Encore Capital Group, Inc., the Lenders from time to time parties thereto, and JPMorgan Chase Bank, N.A., as administrative agent (the "2010 Credit Agreement") (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 8, 2010)
10.42	Pledge and Security Agreement dated as of February 8, 2010 with respect to the 2010 Credit Agreement (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on February 8, 2010)

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<u>Number</u>	<u>Description</u>
10.43	Guaranty dated as of February 8, 2010 with respect to the 2010 Credit Agreement (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on February 8, 2010)
21	List of Subsidiaries (filed herewith)
23	Consent of Independent Registered Public Accounting Firm, BDO Seidman, LLP, dated February 8, 2010 to the incorporation by reference of their report dated February 8, 2010, in the Company's Registration Statements on Form S-8 (filed herewith)
24	Power of Attorney (filed herewith)
31.1	Certification of the Principal Executive Officer pursuant to rule 13-14(a) under the Securities Exchange Act of 1934 (filed herewith)
31.2	Certification of the Principal Financial Officer pursuant to rule 13-14(a) under the Securities Exchange Act of 1934 (filed herewith)
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley act of 2002 (furnished herewith)
+	Management contract or compensatory plan or arrangement.

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ENCORE CAPITAL GROUP, INC.
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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Encore Capital Group, Inc.
San Diego, California

We have audited the accompanying consolidated statements of financial condition of Encore Capital Group, Inc. as of December 31, 2009 and 2008, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Encore Capital Group, Inc. at December 31, 2009 and 2008, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 and Note 15 to the consolidated financial statements, effective January 1, 2009, the Company applied the provisions of Financial Accounting Standards Board Accounting Standards Codification 470-20, "*Debt with Conversion and Other Options*" to account for its convertible senior notes. Effective January 1, 2008, the Company adopted the provisions of Financial Accounting Standards Codification 820, "Fair Value Measurements and Disclosures."

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Encore Capital Group, Inc.'s internal control over financial reporting as of December 31, 2009, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 8, 2010 expressed an unqualified opinion thereon.

/s/ BDO Seidman, LLP

San Diego, California
February 8, 2010

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ENCORE CAPITAL GROUP, INC.
Consolidated Statements of Financial Condition
(In Thousands, Except Par Value Amounts)

	December 31, 2009	December 31, 2008 Adjusted
Assets		
Cash and cash equivalents	\$ 8,388	\$ 10,341
Accounts receivable, net	3,134	1,757
Investment in receivable portfolios, net	526,877	461,346
Deferred court costs	25,957	28,335
Property and equipment, net	9,427	6,290
Prepaid income tax	—	7,935
Forward flow asset	—	10,302
Other assets	4,252	5,049
Goodwill	15,985	15,985
Identifiable intangible assets, net	1,139	1,739
Total assets	\$ 595,159	\$ 549,079
Liabilities and stockholders' equity		
Liabilities:		
Accounts payable and accrued liabilities	\$ 21,815	\$ 18,204
Income taxes payable	2,681	—
Deferred tax liabilities, net	16,980	15,108
Deferred revenue and purchased servicing obligation	5,481	5,203
Debt	303,075	303,655
Other liabilities	2,036	3,483
Total liabilities	352,068	345,653
Commitments and contingencies		
Stockholders' equity:		
Convertible preferred stock, \$.01 par value, 5,000 shares authorized, no shares issued and outstanding	—	—
Common stock, \$.01 par value, 50,000 shares authorized, 23,359 shares and 23,053 shares issued and outstanding as of December 31, 2009 and 2008, respectively	234	231
Additional paid-in capital	104,261	98,521
Accumulated earnings	139,842	106,795
Accumulated other comprehensive loss	(1,246)	(2,121)
Total stockholders' equity	243,091	203,426
Total liabilities and stockholders' equity	\$ 595,159	\$ 549,079

See accompanying notes to consolidated financial statements

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ENCORE CAPITAL GROUP, INC.
Consolidated Statements of Income
(In Thousands, Except Per Share Amounts)

	Year Ended December 31,		
	2009	2008 Adjusted	2007 Adjusted
Revenue			
Revenue from receivable portfolios, net	\$299,732	\$240,802	\$241,402
Servicing fees and other related revenue	16,687	15,087	12,609
Total revenue	<u>316,419</u>	<u>255,889</u>	<u>254,011</u>
Operating expenses			
Salaries and employee benefits (excluding stock-based compensation expense)	58,025	58,120	64,153
Stock-based compensation expense	4,384	3,564	4,287
Cost of legal collections	112,570	96,187	78,636
Other operating expenses	26,013	23,652	21,533
Collection agency commissions	19,278	13,118	12,411
General and administrative expenses	26,920	19,445	17,478
Depreciation and amortization	2,592	2,814	3,351
Total operating expenses	<u>249,782</u>	<u>216,900</u>	<u>201,849</u>
Income before other (expense) income and income taxes	<u>66,637</u>	<u>38,989</u>	<u>52,162</u>
Other (expense) income			
Interest expense	(16,160)	(20,572)	(18,648)
Contingent interest expense	—	—	(4,123)
Pay-off of future contingent interest	—	—	(11,733)
Gain on repurchase of convertible notes, net	3,268	4,771	—
Other (expense) income	(2)	358	1,071
Total other expense	<u>(12,894)</u>	<u>(15,443)</u>	<u>(33,433)</u>
Income before income taxes	53,743	23,546	18,729
Provision for income taxes	(20,696)	(9,700)	(6,498)
Net income	<u>\$ 33,047</u>	<u>\$ 13,846</u>	<u>\$ 12,231</u>
Weighted average shares outstanding:			
Basic	23,215	23,046	22,876
Diluted	24,082	23,577	23,386
Earnings per share:			
Basic	\$ 1.42	\$ 0.60	\$ 0.53
Diluted	\$ 1.37	\$ 0.59	\$ 0.52

See accompanying notes to consolidated financial statements

ENCORE CAPITAL GROUP, INC.
Consolidated Statements of Stockholders' Equity and Comprehensive Income
(In Thousands)

	Common Stock		Additional Paid-In Capital	Accumulated Earnings	Accumulated Other Comprehensive Income (loss)	Total Equity	Comprehensive Income (loss)
	Shares	Par					
Balance at December 31, 2006 (Adjusted)	22,781	\$228	\$ 90,481	\$ 80,718	\$ 443	\$171,870	\$ 21,706
Net income (Adjusted)	—	—	—	12,231	—	12,231	12,231
Other comprehensive loss:							
Unrealized loss on non-qualified deferred compensation, net of tax	—	—	—	—	(443)	(443)	(443)
Unrealized loss on cash flow hedge, net of tax	—	—	—	—	(995)	(995)	(995)
Exercise of stock options and issuance of share-based awards	211	2	346	—	—	348	—
Stock-based compensation	—	—	4,287	—	—	4,287	—
Tax benefit from convertible notes interest expense (Adjusted)	—	—	43	—	—	43	—
Tax benefit related to stock-based compensation	—	—	94	—	—	94	—
Balance at December 31, 2007 (Adjusted)	22,992	230	95,251	92,949	(995)	187,435	10,793
Net income (Adjusted)	—	—	—	13,846	—	13,846	13,846
Other comprehensive loss:							
Unrealized loss on cash flow hedge, net of tax	—	—	—	—	(1,126)	(1,126)	(1,126)
Exercise of stock options and issuance of share-based awards	61	1	22	—	—	23	—
Stock-based compensation	—	—	3,564	—	—	3,564	—
Tax benefit from convertible notes interest expense (Adjusted)	—	—	52	—	—	52	—
Tax provision related to stock-based compensation	—	—	(461)	—	—	(461)	—
Tax benefit from repurchase of convertible notes	—	—	93	—	—	93	—
Balance at December 31, 2008 (Adjusted)	23,053	231	98,521	106,795	(2,121)	203,426	12,720
Net income	—	—	—	33,047	—	33,047	33,047
Other comprehensive loss:							
Unrealized loss on cash flow hedge, net of tax	—	—	—	—	875	875	875
Exercise of stock options and issuance of share-based awards	306	3	769	—	—	772	—
Stock-based compensation	—	—	4,384	—	—	4,384	—
Tax benefit from convertible notes interest expense	—	—	95	—	—	95	—
Tax provision related to stock-based compensation	—	—	468	—	—	468	—
Tax benefit from repurchase of convertible notes	—	—	24	—	—	24	—
Balance at December 31, 2009	<u>23,359</u>	<u>\$234</u>	<u>\$104,261</u>	<u>\$ 139,842</u>	<u>\$ (1,246)</u>	<u>\$243,091</u>	<u>\$ 33,922</u>

See accompanying notes to consolidated financial statements

ENCORE CAPITAL GROUP, INC.
Consolidated Statements of Cash Flows
(In Thousands)

	Year Ended December 31,		
	2009	2008 Adjusted	2007 Adjusted
Operating activities:			
Net Income	\$ 33,047	\$ 13,846	\$ 12,231
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	2,592	2,814	3,351
Amortization of loan costs and debt discount	4,080	6,320	5,963
Stock-based compensation expense	4,384	3,564	4,287
Gain on repurchase of convertible notes, net	(3,268)	(4,771)	—
Deferred income tax expense	1,872	1,642	3,077
Excess tax benefit from stock-based payment arrangements	(729)	—	(698)
Provision for impairment on receivable portfolios, net	19,310	41,400	11,230
Changes in operating assets and liabilities			
Restricted cash	—	—	4,660
Other assets	(1,668)	4,135	545
Deferred court costs	2,379	(7,803)	(9,599)
Prepaid income tax and income taxes payable	11,204	2,095	(6,482)
Accrued profit sharing arrangement	—	—	(6,869)
Deferred revenue and purchased service obligation	278	1,305	1,108
Accounts payable, accrued liabilities and other liabilities	2,635	(1,476)	(3,194)
Net cash provided by operating activities	<u>76,116</u>	<u>63,071</u>	<u>19,610</u>
Investing activities:			
Cash paid for India membership interest	—	—	(2,250)
Purchases of receivable portfolios, net of forward flow allocation	(246,330)	(224,717)	(197,249)
Collections applied to investment in receivable portfolios, net	168,416	116,101	102,093
Proceeds from put-backs of receivable portfolios	3,375	3,640	3,769
Purchases of property and equipment	(4,632)	(2,276)	(1,422)
Net cash used in investing activities	<u>(79,171)</u>	<u>(107,252)</u>	<u>(95,059)</u>
Financing activities:			
Proceeds from notes payable and other borrowings	90,500	108,000	121,000
Repayment of notes payable and other borrowings	(68,500)	(42,169)	(48,500)
Repurchase of convertible notes	(22,262)	(20,101)	—
Proceeds from exercise of stock options	1,175	23	348
Excess tax benefit from stock-based payment arrangements	729	—	698
Proceeds from capital lease	—	400	—
Repayment of capital lease obligations	(540)	(307)	(212)
Net cash provided by financing activities	<u>1,102</u>	<u>45,846</u>	<u>73,334</u>
Net increase (decrease) in cash	(1,953)	1,665	(2,115)
Cash and cash equivalents, beginning of period	10,341	8,676	10,791
Cash and cash equivalents, end of period	<u>\$ 8,388</u>	<u>\$ 10,341</u>	<u>\$ 8,676</u>
Supplemental disclosures of cash flow information:			
Cash paid for interest	\$ 12,521	\$ 14,427	\$ 35,707
Cash paid for income taxes	\$ 8,243	\$ 5,301	\$ 8,730
Supplemental schedule of non-cash investing and financing activities:			
Fixed assets acquired through capital lease	\$ 516	\$ 1,602	\$ —
Allocation of forward flow asset to acquired receivable portfolios	\$ 10,302	\$ 5,561	\$ 11,704

See accompanying notes to consolidated financial statements

ENCORE CAPITAL GROUP, INC.
Notes to Consolidated Financial Statements

Note 1: Ownership, Description of Business, and Significant Accounting Policies

Encore Capital Group, Inc. (“Encore”), through its subsidiaries (collectively, the “Company”), is a systems-driven purchaser and manager of charged-off consumer receivable portfolios and, through its wholly owned subsidiary Ascension Capital Group, Inc. (“Ascension”), a provider of bankruptcy services to the finance industry. The Company acquires its receivable portfolios at deep discounts from their face values using its proprietary valuation process that is based on the consumer attributes of the underlying accounts. Based upon the Company’s ongoing analysis of these accounts, it employs a dynamic mix of collection strategies to maximize its return on investment. The receivable portfolios the Company purchases consist primarily of unsecured, charged-off domestic consumer credit card, auto deficiency and telecom receivables purchased from national financial institutions, major retail credit corporations, telecom companies and resellers of such portfolios. Acquisitions of receivable portfolios are financed by operations and by borrowings from third parties. See Note 8 for further discussion of the Company’s debt.

Basis of Consolidation

Encore is a Delaware holding company whose principal assets are its investments in various wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could materially differ from those estimates.

Management has made significant estimates with respect to the rate of return established to recognize accretion revenue on its receivable portfolios and with respect to the provision for impairment of receivable portfolios. In connection with these estimates, management has made significant estimates with respect to the timing and amount of collections of future cash flows from receivable portfolios owned. Every quarter since the fourth quarter of 2003, the Company has updated its collection forecasts of the remaining cash flows of its receivable portfolios utilizing its internally developed Unified Collection Score (“UCS”) and Behavioral Liquidation Score (“BLS”) forecasting models.

The Company utilizes its UCS and BLS models to project the remaining cash flows from its receivable portfolios, considering known data about the Company’s consumers’ accounts, including, among other things, the Company’s collection experience, and changes in external consumer factors, in addition to all data known when it acquired the accounts. The Company routinely evaluates and implements enhancements to its UCS and BLS models. During the quarter ended March 31, 2008, the Company revised its UCS and BLS methodology by extending the collection forecast from 72 months to 84 months. See Note 4 for further discussion on the extension of the collection forecast.

Significant estimates have also been made with respect to the Company’s contingent interest obligation (see Note 8), the realizability of the Company’s net deferred court costs (see Note 5), forward flow asset (see Note 12), other assets (see Note 7), intangible assets (see below), net deferred tax assets and tax reserves (see Note 10), stock-based compensation (see Note 9) and the Company’s potential liabilities with respect to its health benefits plans (see Note 12). Actual results could materially differ from these estimates, making it possible that a material change in these estimates could occur within one year.

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Change in Accounting Principle

Effective January 1, 2009, the Company retrospectively applied the provisions of Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Subtopic 470-20 (“ASC 470-20”), “*Debt with Conversion and Other Options*” to account for its outstanding convertible senior notes (“Convertible Notes”). As a result, prior years’ consolidated financial statements have been retrospectively adjusted. See Note 15 for additional information on the application of this accounting principle.

Reclassification

During the year ended December 31, 2008, the Company changed the presentation of its cash flows from the direct method to the indirect method, in order to conform to comparable industry presentations. As a result, the December 31, 2007 consolidated statement of cash flows has been changed to the indirect method, to conform to the current presentation.

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid investments with maturities of three months or less at the date of purchase. The Company invests its excess cash in bank deposits and money market instruments, which are afforded the highest ratings by nationally recognized rating firms. The carrying amounts reported in the consolidated statements of financial condition for cash and cash equivalents approximates its fair value.

Investment in Receivables Portfolios

The Company accounts for its investment in receivable portfolios in accordance with the provisions of ASC Subtopic 310-30 (“ASC 310-30”), “*Loans and Debt Securities Acquired with Deteriorated Credit Quality*.” ASC 310-30 addresses accounting for differences between initial estimated cash flows expected to be collected from purchased receivables, or “pools,” and subsequent changes to those estimated cash flows. ASC 310-30 limits the revenue that may be accreted (also known as accretable yield) to the excess of the Company’s estimate of undiscounted cash flows expected to be collected over the Company’s investment, or cost basis, in the pool.

As permitted by ASC 310-30, static pools are established on a quarterly basis with accounts purchased during the quarter that have common risk characteristics. Discrete receivable portfolio purchases during a quarter are aggregated into pools based on these common risk characteristics. Once a static pool is established, the portfolios are permanently assigned to the pool. The discount (*i.e.*, the difference between the cost of each static pool and the related aggregate contractual receivable balance) is not recorded because the Company expects to collect only a relatively small percentage of each static pool’s contractual receivable balance. As a result, receivable portfolios are recorded at cost at the time of acquisition. All portfolios with common risk characteristics purchased prior to the adoption of ASC 310-30 were aggregated by quarter of purchase.

In compliance with ASC 310-30, the Company accounts for its investments in consumer receivable portfolios, using either the interest method or the cost recovery method. The interest method applies an effective interest rate, or internal rate of return (“IRR”) to the cost basis of the pool, which is to remain level, or unchanged throughout the life of the pool unless there is an increase in subsequent expected cash flows. Subsequent increases in cash flows expected to be collected generally are recognized prospectively through an upward adjustment of the pool’s IRR over its remaining life. Subsequent decreases in expected cash flows do not change the IRR, but are recognized as an impairment of the cost basis of the pool, and are reflected in the consolidated statements of income as a reduction in revenue, with a corresponding valuation allowance offsetting the investment in receivable portfolios in the consolidated statements of financial condition.

The Company accounts for each static pool as a unit for the economic life of the pool (similar to one loan) for recognition of revenue from receivable portfolios, for collections applied to the cost basis of receivable portfolios and for provision for loss or impairment. Revenue from receivable portfolios is accrued based on each pool’s IRR applied to each pool’s adjusted cost basis. The cost basis of each pool is increased by revenue earned and decreased by gross collections and impairments.

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If the amount and timing of future cash collections on a pool of receivables are not reasonably estimable, the Company accounts for such portfolios on the cost recovery method (“Cost Recovery Portfolios”). The accounts in these portfolios have different risk characteristics than those included in other portfolios acquired during the same quarter, or the necessary information was not available to estimate future cash flows and, accordingly, they were not aggregated with other portfolios. See Note 4 for further discussion of investment in receivable portfolios.

Deferred Revenue

Ascension’s services include, among others, negotiating bankruptcy plans, monitoring and managing the consumer’s compliance with bankruptcy plans, and recommending courses of action to clients when there is a deviation from a bankruptcy plan. The Company accounts for post-acquisition revenue related to the bankruptcy account services provided by Ascension in accordance with the general provisions of ASC Topic 605, “*Revenue Recognition*” and ASC Subtopic 605-25, “*Multiple Element Arrangements*.” Revenue for a given account is allocated between the servicing and litigation deliverables based on their relative fair values and recognized according to whether the referred account is the subject of a Chapter 7 or a Chapter 13 bankruptcy proceeding.

The servicing deliverable for Chapter 7 accounts is focused on the completion of the bankruptcy process as a whole, to the most favorable possible conclusion for the customer. As a result, revenue is deferred and not recognized until the bankruptcy case is closed (dismissal/discharge). The litigation deliverable is recorded as an “as incurred” event, with revenue recognized based on the historical percentage of accounts litigated over the average duration of an account. The average duration period used for Chapter 7 accounts is seven months. This estimate is periodically reviewed for changes.

Chapter 13 bankruptcy proceedings, also known as reorganizations, are generally designed to restructure an individual’s debts and allow the consumer to propose a repayment plan detailing how their debts will be repaid over the plan period. The responsibility of Ascension is to ensure that its customer’s claim is recognized by the court to the maximum benefit of the customer and to monitor and/or collect the debtor payments throughout the confirmed bankruptcy plan term. The average duration period used for Chapter 13 accounts is 35 months. Given the nature and duration of a Chapter 13 proceeding, the monthly servicing deliverable provided is considered “delivered” each month and revenue is recognized ratably, including any upfront fees received by the Company, over the time the services are provided. The litigation deliverable is recorded as an “as incurred” event with revenue recognized based on the historical percentage of accounts litigated over the average duration of an account. The average duration period for Chapter 13 accounts is periodically reviewed for changes.

Ascension bankruptcy services are provided under contract with its customers. The contracts for these services generally have initial terms of one or two years and typically renew automatically. Fees for bankruptcy administration services are charged on a per consumer account basis for both Chapter 7 and Chapter 13 accounts and consist of an upfront fee at the time of account referral, combined with either an ongoing monthly service fee or service specific fees based on a predetermined fee schedule.

Forward Flow Asset

In connection with the acquisition of certain assets of Jefferson Capital in June 2005, the Company entered into a forward flow agreement to purchase a minimum of \$3.0 billion in face value of credit card charge-offs over the subsequent five years at a fixed price. The Company allocated \$42.5 million of the acquisition purchase price to this agreement, which is reflected in the consolidated statements of financial condition as forward flow asset. The Company allocates a portion of the forward flow asset to the cost basis of receivable portfolio purchases under the forward flow agreement based on the proportion of the forward flow asset that the purchase represents compared to the total purchase commitment, as adjusted for the time-value of money. As part of this forward flow agreement, the seller is obligated to sell a predetermined minimum amount of charged-off credit card accounts to the Company. The forward flow agreement contains penalty provisions if the seller fails to meet such minimum requirements. Any monies received pursuant to such penalty provisions would be applied to the carrying balance of the forward flow asset.

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On July 15, 2008, the Company gave Jefferson Capital and its parent company, CompuCredit Corporation, notice of breach by Jefferson Capital and CompuCredit of the agreement under which the forward flow purchases are made and initiated arbitration as a result of the breach. In September 2009, the Company settled the dispute with Jefferson Capital and CompuCredit. Under the terms of the settlement, the Company purchased a large portfolio of charged-off credit card account balances on commercially reasonable terms and agreed to resume balance transfers to Jefferson Capital. The forward flow asset of \$10.3 million was fully allocated to the purchase price of this portfolio. The Company also agreed to return to Jefferson Capital certain accounts that were subject to Jefferson Capital's settlement with the FTC. Following its settlement with Jefferson Capital and CompuCredit, the Company has no further forward flow purchase obligations with Jefferson Capital and CompuCredit. See Note 12 for more information on the Company's dispute and settlement with Jefferson Capital and CompuCredit.

Identifiable Intangible Assets and Goodwill

In accordance with ASC Topic 350 ("ASC 350"), "Intangibles—Goodwill and Other," the Company's identifiable intangible assets are recorded at cost and are amortized using an accelerated method, based on discounted cash flows over their estimated useful lives, which range from four to nine years. Acquired identifiable intangible assets are presented net of accumulated amortization of \$4.9 million and \$4.3 million as of December 31, 2009 and 2008, respectively. The estimated annual aggregate amortization of intangibles assets is \$0.4 million, \$0.3 million, \$0.2 million, \$0.1 million and \$0.1 million for the years ended December 31, 2010, 2011, 2012, 2013 and 2014, respectively. The Company's identifiable intangibles assets are summarized as follows (*in thousands*):

	<u>December 31,</u> <u>2009</u>	<u>December 31,</u> <u>2008</u>
Customer relationships	\$ 5,500	\$ 5,500
Other	500	500
Gross carrying amount	6,000	6,000
Less: accumulated amortization	(4,861)	(4,261)
Total identifiable intangible assets	<u>\$ 1,139</u>	<u>\$ 1,739</u>

Goodwill, pursuant to ASC 350, is not amortized, but rather reviewed along with the identifiable intangible assets for impairment. The Company tests its goodwill for impairment at least annually in accordance with ASC 350. During the year ended December 31, 2009, the Company performed impairment testing on all reporting units that have goodwill, no impairment was identified. As of December 31, 2009, the Company's goodwill was approximately \$16.0 million.

Property and Equipment

Property and equipment are recorded at cost, less accumulated depreciation and amortization. The provision for depreciation and amortization is computed using the straight-line method over the estimated useful lives of the assets as follows:

<u>Fixed Asset Category</u>	<u>Estimated Useful Life</u>
Leasehold improvements	Lesser of lease term, including periods covered by renewal options, or useful life
Furniture and fixtures	5 to 7 years
Computer hardware and software	3 to 5 years

Maintenance and repairs are charged to expense in the year incurred. Expenditures for major renewals that extend the useful lives of fixed assets are capitalized and depreciated over the useful lives of such assets.

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Deferred Court Costs

The Company contracts with a nationwide network of attorneys that specialize in collection matters. The Company generally refers charged-off accounts to its contracted attorneys when it believes the related debtor has sufficient assets to repay the indebtedness and has, to date, been unwilling to pay. In connection with the Company's agreement with the contracted attorneys, it advances certain out-of-pocket court costs ("Deferred Court Costs"). The Company capitalizes these costs in its consolidated financial statements and provides a reserve for those costs that it believes will ultimately be uncollectible. The Company determines the reserve based on its analysis of court costs that have been advanced and those that have been recovered. Deferred Court Costs not recovered within three years of placement are fully written off. Collections received from these debtors are first applied against related court costs with the balance applied to the debtors' account. See Note 5 for further discussion of the Company's Deferred Court Costs.

Contingent Interest

Prior to May 7, 2007, under the terms of the Company's prior secured financing facility ("Secured Financing Facility"), once the Company repaid the lender for the notes for each purchased portfolio and collected sufficient amounts to recoup its initial cash investment in each purchased portfolio, the Company shared the residual collections ("Contingent Interest") from the receivable portfolios, net of its servicing fees, with the lender. The Company made estimates with respect to the timing and amount of collections of future cash flows from these receivable portfolios. Based on these estimates, the Company recorded a portion of the estimated Contingent Interest as accrued profit sharing arrangement and interest expense.

On May 7, 2007, the Company entered into an agreement with the lender under its prior Secured Financing Facility to eliminate all future Contingent Interest payments for a one-time payment of \$16.9 million. Subsequent to that date, the Company is no longer obligated to make any contingent interest payments under the Secured Financing Facility and, as a result, no longer records such interest in its statements of income. See Note 8 for further discussion of Contingent Interest.

Income Taxes

The Company uses the liability method of accounting for income taxes in accordance with ASC Topic 740 ("ASC 740"), "Income Taxes." When the Company prepares its consolidated financial statements, it estimates income taxes based on the various jurisdictions where it conducts business. This requires the Company to estimate current tax exposure and to assess temporary differences that result from differing treatments of certain items for tax and accounting purposes. Deferred income taxes are recognized based on the differences between the financial statement and income tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The Company then assesses the likelihood that deferred tax assets will be realized. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. When the Company establishes a valuation allowance or increases this allowance in an accounting period, it records a corresponding tax expense in the consolidated statement of operations. See Note 10 for further discussion of income taxes.

Management must make significant judgments to determine the provision for income taxes, deferred tax assets and liabilities and any valuation allowance to be recorded against the net deferred tax asset. The Company's net deferred tax liability as of December 31, 2009, was \$17.0 million.

While the Company has considered future taxable income in assessing the need for the valuation allowance, it could be required to increase the valuation allowance to take into account additional deferred tax assets that it may be unable to realize. An increase in the valuation allowance would have an adverse impact, which could be material, on the Company's income tax provision and net income in the period in which it makes the increase.

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Accounting for Uncertainty in Income Taxes

In July 2006, the FASB issued certain provisions related to uncertainty in income taxes within ASC 740, which established recognition and measurement thresholds that must be met before a tax benefit can be recognized in the financial statements. Additionally, these provisions provide guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. Effective January 1, 2007, the Company adopted these provisions within ASC 740. The Company was not required to record any cumulative effect adjustment to retained earnings as a result of this adoption. See Note 10 for further discussion of the impact of these provisions on the Company's consolidated financial statements.

Stock-Based Compensation

On January 1, 2006, the Company adopted the provisions of ASC Topic 718 ("ASC 718"), "*Compensation—Stock Compensation*." Under ASC 718, share-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as expense over the employee's requisite service period. See Note 9 for further discussion of the Company's stock-based compensation.

Fair Values of Financial Instruments

On January 1, 2008, the Company adopted the provisions of ASC Topic 820 ("ASC 820"), "*Fair Value Measurements and Disclosures*" for its financial assets and liabilities. ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value.

The Company's financial instruments consist of cash and cash equivalents, investment in receivable portfolios, net, derivative instruments and long-term debt. The fair value of cash and cash equivalents, certain derivative instruments and long-term debt approximates their respective carrying values. For investment in receivable portfolios, which are not required to be carried at fair value, the Company considers it not practical to attempt to estimate the fair value of such financial instruments due to the excessive costs that would be incurred in doing so. See Note 2 for further information on the Company's fair value measurements.

Derivative Instruments and Hedging Activities

Interest Rate Swap Agreements. The Company uses debt financing as a source of funds and is therefore exposed to interest rate fluctuations in the normal course of business. Certain of the Company's debt is subject to floating interest rates. The risk of unfavorable movements in interest rates is managed by hedging a portion of the outstanding loan balance, thereby locking in a fixed rate on a portion of the principal, reducing the effect of possible rising interest rates and making interest expense more predictable. The Company has entered into two interest rate swap agreements which are both designated as cash flow hedges and are accounted for under ASC Topic 815 ("ASC 815"), "*Derivatives and Hedging*."

Foreign Exchange Contracts. The Company uses foreign exchange contracts to hedge expense commitments that are denominated in currencies other than the U.S. dollar, specifically the Indian rupee. The purpose of the foreign currency hedging activities is to fix the dollar value of specific commitments and payments to foreign employees and vendors. The foreign exchange contracts have been designated as cash flow hedges and are accounted for under ASC 815.

The Company does not use derivative instruments for trading or other speculative purposes.

ASC 815 requires that the derivative instruments be recorded on the balance sheet as either an asset or liability measured at its fair value. The effective portion of the change in fair value of the derivative is recorded in other comprehensive income. The ineffective portion of the change in fair value of the derivative, if any, is recognized in earnings, in the period of change. At the inception of the hedging programs, the Company

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concluded that the hedge relationships were highly effective. The Company performs ongoing quarterly assessments to determine the effectiveness as well as ineffectiveness of the hedged instruments. See Note 3 for further discussion of the Company's derivative instruments.

Concentrations of Risk

Financial instruments, which potentially expose the Company to concentrations of credit risk, consist primarily of cash and cash equivalents. The Company places its cash with high quality financial institutions. Cash balances are generally substantially in excess of the amounts insured by the Federal Deposit Insurance Corporation.

Earnings Per Share

Basic earnings per share is calculated by dividing net earnings available to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is calculated on the basis of the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options and restricted stock units. The components of basic and diluted earnings per share are as follows (*in thousands, except earnings per share*):

	Year Ended December 31,		
	2009	2008	2007
Net income available for common shareholders (A)	\$33,047	\$13,846	\$12,231
Weighted average outstanding shares of common stock (B)	23,215	23,046	22,876
Dilutive effect of stock-based awards	867	531	510
Common stock and common stock equivalents (C)	24,082	23,577	23,386
Earnings per share:			
Basic (A/B)	\$ 1.42	\$ 0.60	\$ 0.53
Diluted (A/C)	\$ 1.37	\$ 0.59	\$ 0.52

Employee stock options to purchase approximately 1,177,000, 1,254,000, and 1,222,000 shares of common stock as of December 31, 2009, 2008 and 2007, respectively, were outstanding but not included in the computation of diluted earnings per common share because the effect on diluted earnings per share would be anti-dilutive.

Recent Accounting Pronouncements

In July 2009, the FASB officially launched the FASB Accounting Standards Codification, which has become the single official source of authoritative, nongovernmental U.S. Generally Accepted Accounting Principles ("GAAP"), in addition to guidance issued by the Securities and Exchange Commission. The codification supersedes all prior FASB, AICPA, EITF, and related literature. The codification, which is effective for interim and annual periods ending after September 15, 2009, is organized into approximately 90 accounting topics. The FASB no longer issues new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, amendments to the codification are made by issuing "Accounting Standards Updates." Accordingly, the Company has removed references to legacy GAAP in these financial statements and has incorporated the current codification in its December 31, 2009 Annual Report on Form 10-K.

In August 2009, the FASB issued Accounting Standards Update No. 2009-05, "*Fair Value Measurements and Disclosures (Topic 820)—Measuring Liabilities at Fair Value*," which provides guidance on how to measure liabilities at fair value in circumstance in which a quoted price in an active market for the identical liability is not available. This update is effective for the first reporting period, including interim periods, beginning after issuance. The Company has no liabilities that are governed by this update but will apply its provisions in the future as applicable.

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In October 2009, the FASB issued Accounting Standards Update No. 2009-13, “*Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements—a consensus of the FASB Emerging Issues Task Force*,” which establishes a selling price hierarchy for determining the selling price of a deliverable, and eliminates the residual method of allocation. This update requires the arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. This update is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company is currently analyzing the impact of this update, if any, to its consolidated financial statements.

In December 2009, the FASB issued Accounting Standards Update No. 2009-16, “*Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets*.” This guidance will require more information about transferred financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. This standard is effective at the start of a company’s first fiscal year beginning after November 15, 2009, or January 1, 2010, for companies reporting earnings on a calendar-year basis. The Company is currently analyzing the impact of this statement, if any, to its consolidated financial statements.

Note 2: Fair Value Measurements

On January 1, 2008, the Company adopted the provisions of ASC 820 for financial assets and liabilities. ASC 820 defines fair value, provides guidance for measuring fair value and requires certain disclosures. On January 1, 2009, the Company adopted the provisions of ASC 820 for non-financial assets and non-financial liabilities that are recognized and disclosed at fair value on a nonrecurring basis. It does not require any new fair value measurements, but rather applies to all other accounting pronouncements that require or permit fair value measurements.

The fair values of the Company’s financial instruments reflect the amounts that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (*i.e.* the “exit price”). The statement utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

- Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.
- Level 3: Unobservable inputs that reflect the reporting entity’s own assumptions.

The Company’s financial instruments consist of the following:

Financial instruments recognized at fair value in the statement of financial position

	Fair Value Hierarchy	December 31, 2009		December 31, 2008	
		Carrying Value	Fair Value	Carrying Value	Fair Value
Financial instruments measured at fair value (in thousands)					
Cash and cash equivalents	Level 1	\$ 8,388	\$ 8,388	\$10,341	\$10,341
Cash flow hedging instruments	Level 2	(2,036)	(2,036)	(3,483)	(3,483)

The fair value of cash and cash equivalents and accounts receivable approximates their respective carrying value. Cash flow hedging instruments, which are considered over-the-counter derivatives, are also carried at their fair values. The Company’s fair value estimate for such derivative instruments incorporates quoted market prices

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at the balance sheet date from the counter party using significant observable inputs, a level 2 fair value measurement. As of December 31, 2009, the Company did not have any financial instruments carried at fair value that required level 3 measurement.

Financial instruments not required to be carried at fair value

ASC 820 requires disclosures about fair value of financial instruments of publicly traded companies in their annual financial statements. The Company is required to estimate the fair value of financial instruments when it is practical to do so.

Borrowings under the Company's Revolving Credit Facility are carried at historical cost, adjusted for additional borrowings less principal repayments, which approximates fair value. The Company's Convertible Notes are carried at historical cost, adjusted for repurchases and debt discount. The fair value estimate for these notes incorporates quoted market prices at the balance sheet date, which was determined to be approximately \$42.9 million and \$51.4 million as of December 31, 2009 and December 31, 2008, respectively. For investment in receivable portfolios, there is no active market or observable inputs for the fair value estimation. The Company considers it not practical to attempt to estimate the fair value of such financial instruments due to the excessive costs that would be incurred in doing so.

The Company does not have any non-financial assets or liabilities that are measured at fair value.

Note 3: Derivatives and Hedging Instruments

The Company uses derivative instruments to manage risks related to interest rates and foreign currency. The Company's outstanding interest rate swap contracts and foreign exchange contracts qualify for hedge accounting treatment under the provisions of ASC 815.

Interest Rate Swaps

The Company periodically enters into derivative financial instruments, typically interest rate swap agreements, to reduce its exposure to fluctuations in interest rates on variable interest rate debt and their impact on earnings and cash flows. In April 2007, the Company entered into two separate interest rate swap agreements. Under the swap agreements, the Company receives floating interest rate payments and makes interest payments based on fixed interest rates. The first agreement is for a notional amount of \$25.0 million, a term of three years and a fixed interest rate of 4.99%. The second agreement is for a notional amount of \$25.0 million, a term of four years and a fixed interest rate of 5.01%. The Company intends to continue electing the one-month reserve-adjusted LIBOR as the benchmark interest rate on the debt being hedged through its term. No credit spread was hedged. In accordance with the provisions of ASC Subtopic 815-30, "*Cash Flow Hedges*," the Company designates its interest rate swap instruments as cash flow hedges.

ASC 815 requires companies to recognize derivative instruments as either an asset or liability measured at fair value in the statement of financial position. The effective portion of the change in fair value of the derivative instrument is recorded in other comprehensive income. The ineffective portion of the change in fair value of the derivative instrument, if any, is recognized in interest expense in the period of change. From the inception of the hedging program, the Company has determined that the hedging instruments are highly effective.

Foreign Exchange Contracts

The Company conducts business in currencies other than the U.S. dollar, primarily associated with its international subsidiary in India. As a result, India's forecasted expenditures expose the Company to foreign currency risk. To mitigate this risk, the Company enters into derivative financial instruments, principally forward contracts, which are designated as cash flow hedges to mitigate fluctuations in the cash payments of future

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forecasted transactions in Indian rupees for up to 24 months. The Company adjusts the level and use of derivatives as soon as practicable after learning that an exposure has changed and the Company reviews all exposures and derivative positions on an ongoing basis.

Gains and losses on cash flow hedges are recorded in accumulated other comprehensive income (loss) until the hedged transaction is recorded in the consolidated financial statements. Once the underlying transaction is recorded in the consolidated financial statements, the Company de-designates the derivative, reclassifies the accumulated gain or loss on the derivative into earnings and ceases to apply hedge accounting treatment. Once the derivative has been de-designated, any further gains or losses are recorded to earnings. If all or a portion of the forecasted transaction was cancelled, this would render all or a portion of the cash flow hedge ineffective and the Company would reclassify the ineffective portion of the hedge into earnings. The Company generally does not experience ineffectiveness of the hedge relationship and the accompanying consolidated financial statements do not include any such gains or losses.

As of December 31, 2009, the total notional amount of the forward contracts to buy Indian rupees in exchange for U.S. dollars was \$16.8 million. The fair value of all of the Company's forward contracts resulted in a liability of \$0.2 million as of December 31, 2009. All outstanding contracts qualified for hedge accounting treatment as of December 31, 2009. The Company estimates that approximately \$0.1 million of net derivative losses included in OCI will be reclassified into earnings within the next 12 months. No gains or losses were reclassified from OCI into earnings as a result of forecasted transactions that failed to occur during the year ended December 31, 2009.

The Company does not enter into derivative instruments for trading or speculative purposes.

The following table summarizes the fair value of derivative instruments as recorded in the Company's consolidated statements of financial position (*in thousands*):

	Liability Derivatives			
	December 31, 2009		December 31, 2008	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments under ASC 815				
Interest rate swaps	Other liabilities	\$ 1,791	Other liabilities	\$ 3,483
Foreign exchange contracts	Other liabilities	\$ 245	Other liabilities	\$ —

The following tables summarize the effects of derivatives in cash flow hedging relationships on the Company's statements of income for the years ended December 31, 2009 and 2008 (*in thousands*):

	Gain or (Loss) Recognized in OCI - Effective Portion		Location of Gain or (Loss) Reclassified from OCI into Income - Effective Portion	Gain or (Loss) Reclassified from OCI into Income - Effective Portion		Location of Gain or (Loss) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing	Amount of Gain or (Loss) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing	
	2009	2008		2009	2008		2009	2008
	Interest rate swaps	\$1,692		\$(1,842)	Interest expense		\$ —	\$ —
Foreign exchange contracts	\$ (184)	\$ —	Salaries and employee benefits	\$ (30)	\$ —	Other (expense) income	\$ —	\$ —
Foreign exchange contracts	\$ (61)	\$ —	General and administrative expenses	\$ (10)	\$ —	Other (expense) income	\$ —	\$ —

Note 4: Investment in Receivable Portfolios, Net

In accordance with the provisions of ASC 310-30, discrete receivable portfolio purchases during a quarter are aggregated into pools based on common risk characteristics. Once a static pool is established, the portfolios are permanently assigned to the pool. The discount (*i.e.*, the difference between the cost of each static pool and the related aggregate contractual receivable balance) is not recorded because the Company expects to collect a relatively small percentage of each static pool's contractual receivable balance. As a result, receivable portfolios are recorded at cost at the time of acquisition. All portfolios with common risk characteristics purchased prior to the adoption of ASC 310-30 in the first quarter of 2005 were aggregated by quarter of purchase.

In compliance with ASC 310-30, the Company accounts for its investments in consumer receivable portfolios using either the interest method or the cost recovery method. The interest method applies an effective interest rate, or IRR, to the cost basis of the pool, which remains unchanged throughout the life of the pool, unless there is an increase in subsequent expected cash flows. Subsequent increases in expected cash flows are generally recognized prospectively through an upward adjustment of the pool's IRR over its remaining life. Subsequent decreases in expected cash flows do not change the IRR, but are recognized as an impairment of the cost basis of the pool, and are reflected in the consolidated statements of income as a reduction in revenue, with a corresponding valuation allowance, offsetting the investment in receivable portfolios in the consolidated statements of financial condition.

The Company accounts for each static pool as a unit for the economic life of the pool (similar to one loan) for recognition of revenue from receivable portfolios, for collections applied to the cost basis of receivable portfolios and for provision for loss or impairment. Revenue from receivable portfolios is accrued based on each pool's IRR applied to each pool's adjusted cost basis. The cost basis of each pool is increased by revenue earned and decreased by gross collections and impairments.

If the amount and timing of future cash collections on a pool of receivables are not reasonably estimable, the Company accounts for such portfolios on the cost recovery method as Cost Recovery Portfolios. The accounts in these portfolios have different risk characteristics than those included in other portfolios acquired during the same quarter, or the necessary information was not available to estimate future cash flows and, accordingly, they were not aggregated with other portfolios. Under the cost recovery method of accounting, no income is recognized until the purchase price of a Cost Recovery Portfolio has been fully recovered. As of December 31, 2009, there were three portfolios accounted for using the cost recovery method, consisting of \$0.5 million in net book value of investment in receivable portfolios, representing all of the healthcare portfolios that the Company had acquired. In September 2007, the Company decided to exit its healthcare purchasing and collection activities. At that time the Company anticipated either selling these healthcare portfolios or placing the underlying accounts with external agencies for collections. The Company no longer anticipates a sale of these receivable portfolios and has placed them with external collection agencies. Since the Company is no longer actively collecting on these accounts internally, it has classified them as Cost Recovery Portfolios. The \$0.5 million net book value reflects the value the Company expects to realize through the collection activities of the external agencies.

Accretable yield represents the amount of revenue the Company expects to generate over the remaining life of its existing investment in receivable portfolios based on estimated future cash flows. Total accretable yield is the difference between future estimated collections and the current carrying value of a portfolio. All estimated cash flows on portfolios where the cost basis has been fully recovered are classified as zero basis cash flows.

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The following table summarizes the Company's accretable yield and an estimate of zero basis future cash flows at the beginning and end of the current period (*in thousands*):

	Accretable Yield	Estimate of Zero Basis Cash Flows	Total
Balance at December 31, 2007	\$ 486,652	\$ 13,002	\$ 499,654
Revenue recognized, net	(231,196)	(9,606)	(240,802)
(Reductions) additions on existing portfolios	(84,537)	4,941	(79,596)
Additions for 12 months curve extension	67,287	—	67,287
Additions for current purchases	<u>354,618</u>	<u>—</u>	<u>354,618</u>
Balance at December 31, 2008	\$ 592,824	\$ 8,337	\$ 601,161
Revenue recognized, net	(290,760)	(8,972)	(299,732)
(Reductions) additions on existing portfolios	(20,976)	5,330	(15,646)
Additions for current purchases	<u>347,351</u>	<u>—</u>	<u>347,351</u>
Balance at December 31, 2009	<u>\$ 628,439</u>	<u>\$ 4,695</u>	<u>\$ 633,134</u>

During the year ended December 31, 2009, the Company purchased receivable portfolios with a face value of \$6.5 billion for \$256.6 million, or a purchase cost of 4.0% of face value. The estimated future collections at acquisition for these portfolios amounted to \$615.8 million.

All collections realized after the net book value of a portfolio has been fully recovered ("Zero Basis Portfolios") are recorded as revenue ("Zero Basis Revenue"). During the years ended December 31, 2009 and 2008, approximately \$8.6 million and \$9.2 million, exclusive of \$0.3 million and \$0.4 million Zero Basis Revenue on the retained interest, respectively, were recognized as revenue on portfolios for which the related cost basis has been fully recovered.

During the quarter ended March 31, 2008, the Company revised the forecasting methodology it used to value a portfolio by extending the collection forecast from 72 months to 84 months. This change was made as a result of the Company's increased confidence in its ability to forecast future cash collections to 84 months. Extending the collection forecast from 72 months to 84 months resulted in an increase in the aggregate total estimated remaining collections for the receivable portfolios, as of March 31, 2008, by \$67.3 million, or 7.5%. The impact of the change in estimate resulted in an increase in net income of \$1.9 million and an increase in fully diluted earnings per share of \$0.08, for the quarter ended March 31, 2008.

The following tables summarize the changes in the balance of the investment in receivable portfolios during the following periods (*in thousands, except percentages*):

	Year Ended December 31, 2009			Total
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	
Balance, beginning of period	\$ 460,598	\$ 748	\$ —	\$ 461,346
Purchases of receivable portfolios	256,632	—	—	256,632
Gross collections ⁽¹⁾	(478,253)	(237)	(8,968)	(487,458)
Put-backs and recalls ⁽²⁾	(3,371)	—	(4)	(3,375)
Revenue recognized ⁽⁴⁾	310,116	—	8,926	319,042
Impairment, net	(19,356)	—	46	(19,310)
Balance, end of period	<u>\$ 526,366</u>	<u>\$ 511</u>	<u>\$ —</u>	<u>\$ 526,877</u>
Revenue as a percentage of collections ⁽⁵⁾	<u>64.8%</u>	<u>0.0%</u>	<u>99.5%</u>	<u>65.4%</u>

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	Year Ended December 31, 2008			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	\$ 390,564	\$ 1,645	\$ —	\$ 392,209
Purchases of receivable portfolios	230,278	—	—	230,278
Gross collections ⁽¹⁾	(388,110)	(587)	(9,606)	(398,303)
Put-backs and recalls ⁽²⁾	(3,330)	(310)	—	(3,640)
Revenue recognized ^{(3), (4)}	272,596	—	9,606	282,202
Impairment, net ⁽³⁾	(41,400)	—	—	(41,400)
Balance, end of period	<u>\$ 460,598</u>	<u>\$ 748</u>	<u>\$ —</u>	<u>\$ 461,346</u>
Revenue as a percentage of collections ⁽⁵⁾	<u>70.2%</u>	<u>0.0%</u>	<u>100.0%</u>	<u>70.9%</u>

	Year Ended December 31, 2007			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	\$ 300,348	\$ —	\$ —	\$ 300,348
Purchases of receivable portfolios	208,953	—	—	208,953
Transfer of healthcare receivables	(3,241)	3,241	—	—
Gross collections ⁽¹⁾	(339,357)	(203)	(15,164)	(354,724)
Put-backs and recalls ⁽²⁾	(3,767)	(2)	—	(3,769)
Revenue recognized ⁽⁴⁾	237,467	—	15,164	252,631
Impairment, net	(9,839)	—	—	(9,839)
Write-down of healthcare receivables	—	(1,391)	—	(1,391)
Balance, end of period	<u>\$ 390,564</u>	<u>\$ 1,645</u>	<u>\$ —</u>	<u>\$ 392,209</u>
Revenue as a percentage of collections ⁽⁵⁾	<u>70.0%</u>	<u>0.0%</u>	<u>100.0%</u>	<u>71.2%</u>

(1) Does not include amounts collected on behalf of others.

(2) Put-backs represent accounts that are returned to the seller in accordance with the respective purchase agreement ("Put-Backs"). Recalls represent accounts that are recalled by the seller in accordance with the respective purchase agreement ("Recalls").

(3) Reflects additional revenue of \$0.1 million and a lower net impairment of \$3.1 million, as a result of extending the collection curves from 72 to 84 months.

(4) Includes retained interest.

(5) Revenue as a percentage of collections excludes the effects of net impairment or net impairment reversals.

The following table summarizes the change in the valuation allowance for investment in receivable portfolios during the years ended December 31, 2007, 2008 and 2009 (in thousands):

	Valuation Allowance
Balance at December 31, 2006	\$ 4,522
Provision for impairment losses	14,303
Write-down of healthcare receivables	1,391
Reversal of prior allowance	(4,464)
Balance at December 31, 2007	\$15,752
Provision for impairment losses	42,532
Reversal of prior allowance	(1,132)
Balance at December 31, 2008	\$57,152
Provision for impairment losses	21,329
Reversal of prior allowance	(2,019)
Balance at December 31, 2009	<u>\$76,462</u>

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The Company currently utilizes various business channels for the collection of its receivables. The following table summarizes the collections by collection channel (*in thousands*):

	Year Ended December 31,		
	2009	2008	2007
Legal collections	\$ 232,667	\$ 193,201	\$ 169,005
Collection sites	185,789	157,077	126,093
Collection agencies	62,653	34,736	33,325
Sales	6,677	12,550	24,001
Other	6	1,069	2,769
	<u>\$ 487,792</u>	<u>\$ 398,633</u>	<u>\$ 355,193</u>

Note 5: Deferred Court Costs

The Company contracts with a nationwide network of attorneys that specialize in collection matters. The Company generally refers charged-off accounts to its contracted attorneys when it believes the related debtor has sufficient assets to repay the indebtedness and has, to date, been unwilling to pay. In connection with the Company's agreement with the contracted attorneys, it advances certain out-of-pocket court costs ("Deferred Court Costs"). The Company capitalizes Deferred Court Costs in its consolidated financial statements and provides a reserve for those costs that it believes will ultimately be uncollectible. The Company determines the reserve based on its analysis of court costs that have been advanced and those that have been recovered. Deferred Court Costs not recovered within three years of placement are fully written off. Collections received from these debtors are first applied against related court costs with the balance applied to the debtors' account.

Deferred Court Costs for the three-year deferral period consist of the following as of the dates presented (*in thousands*):

	December 31, 2009	December 31, 2008
Court costs advanced	\$ 172,488	\$ 145,579
Court costs recovered	(44,980)	(36,929)
Court costs reserve	<u>(101,551)</u>	<u>(80,315)</u>
	<u>\$ 25,957</u>	<u>\$ 28,335</u>

Note 6: Property and Equipment

Property and equipment consist of the following, as of the dates presented (*in thousands*):

	December 31, 2009	December 31, 2008
Furniture, fixtures and equipment	\$ 3,459	\$ 2,140
Computer equipment and software	17,614	15,833
Telecommunications equipment	2,986	2,034
Leasehold improvements	4,397	3,375
	<u>28,456</u>	<u>23,382</u>
Less: accumulated depreciation and amortization	<u>(19,029)</u>	<u>(17,092)</u>
	<u>\$ 9,427</u>	<u>\$ 6,290</u>

Depreciation expense was \$2.0 million for the years ended December 31, 2009 and 2008.

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Note 7: Other Assets

Other assets consist of the following (*in thousands*):

	<u>December 31, 2009</u>	<u>December 31, 2008</u> Adjusted
Prepaid expenses	\$ 1,728	\$ 973
Security deposit—India building lease	1,013	—
Deferred compensation assets	758	1,206
Debt issuance costs, net of amortization	553	1,953
Other	200	917
	<u>\$ 4,252</u>	<u>\$ 5,049</u>

Deferred compensation assets represent monies held in a trust associated with the Company's deferred compensation plan.

Note 8: Debt

The Company is obligated under borrowings, as follows (*in thousands*):

	<u>December 31, 2009</u>	<u>December 31, 2008</u> Adjusted
Convertible notes	\$ 42,920	\$ 71,422
Less: Debt discount	(2,013)	(7,664)
Revolving credit facility	260,000	238,000
Capital lease obligations	2,168	1,897
	<u>\$ 303,075</u>	<u>\$ 303,655</u>

Convertible Senior Notes

In 2005, the Company issued \$100.0 million of 3.375% Convertible Notes due September 19, 2010. Interest on the Convertible Notes is payable semi-annually, in arrears, on March 19 and September 19 of each year. The Convertible Notes rank equally with the Company's existing and future senior indebtedness and are senior to the Company's potential future subordinated indebtedness. Prior to the implementation of the net-share settlement feature discussed below, the Convertible Notes were convertible, prior to maturity, subject to certain conditions described below, into shares of the Company's common stock at an initial conversion rate of 44.7678 per \$1,000 principal amount of notes, which represented an initial conversion price of approximately \$22.34 per share, subject to adjustment.

In October 2005, the Company obtained stockholder approval of a net-share settlement feature that allows the Company to settle conversion of the Convertible Notes through a combination of cash and stock. Based on the provisions of ASC 470-20, the net-settlement feature is accounted for as convertible debt and is not subject to the provisions of ASC Subtopic 815-15, "Embedded Derivatives." As a result of the net-settlement feature, the Company will be able to substantially reduce the number of shares issuable in the event of conversion of the Convertible Notes by repaying principal in cash instead of issuing shares of common stock for that amount. Additionally, the Company will not be required to include the underlying shares of common stock in the calculation of the Company's diluted weighted average shares outstanding for earnings per share until the Company's common stock price exceeds \$22.34.

Effective January 1, 2009, the Company retrospectively adopted the provisions of ASC 470-20 to account for its Convertible Notes. ASC 470-20 requires that issuers of convertible debt instruments that, upon conversion, may be settled fully or partially in cash, must separately account for the liability and equity components in a

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manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. Additionally, debt issuance costs are required to be allocated in proportion to the allocation of the liability and equity components and accounted for as debt issuance costs and equity issuance costs, respectively. This subtopic requires retrospective application and, accordingly, the prior periods' financial statements included herein have been adjusted. See Note 15 for additional information and the effect of the change in accounting principle on the Company's consolidated financial statements.

In accordance with the provisions of ASC 470-20, the Company determined that the fair value of the Convertible Notes at issuance in 2005 was approximately \$73.2 million, and designated the residual value of approximately \$26.8 million as the equity component. Additionally, the Company allocated approximately \$2.5 million of the \$3.4 million original Convertible Notes issuance cost as debt issuance cost and the remaining \$0.9 million as equity issuance cost.

The balances of the liability and equity components as of each period presented are as follows (*in thousands*):

	December 31, 2009	December 31, 2008 <u>Adjusted</u>
Liability component—principal amount	\$ 42,920	\$ 71,422
Unamortized debt discount	(2,013)	(7,664)
Liability component—net carrying amount	40,907	63,758
Equity component	25,878	25,878

The remaining debt discount is being amortized into interest expense over the remaining life of the Convertible Notes using the effective interest rate. The Convertible Notes are due on September 19, 2010. The effective interest rate on the liability component was 10.38% for the years ended December 31, 2009 and 2008.

Interest expense related to the Convertible Notes was as follows (*in thousands*):

	Year Ended December 31,		
	2009	2008 <u>Adjusted</u>	2007 <u>Adjusted</u>
Interest expense—stated coupon rate	\$1,633	\$3,159	\$ 3,375
Interest expense—amortization of debt discount	2,901	5,107	4,925
Total interest expense—convertible notes	<u>\$4,534</u>	<u>\$8,266</u>	<u>\$ 8,300</u>

As of December 31, 2009, the Company is making the required interest payments on the Convertible Notes and no other changes in the balance or structure of the Convertible Notes has occurred.

The Convertible Notes also contain a restricted convertibility feature that does not affect the conversion price of the Convertible Notes but, instead, places restrictions on a holder's ability to convert their Convertible Notes into shares of the Company's common stock. A holder may convert the Convertible Notes prior to March 19, 2010, only if one or more of the following conditions are satisfied:

- the average of the trading prices of the Convertible Notes for any five consecutive trading day period is less than 103% of the average of the conversion values of the Convertible Notes during that period;
- the Company makes certain significant distributions to holders of the Company's common stock;
- the Company enters into specified corporate transactions; or
- the Company's common stock ceases to be approved for listing on the NASDAQ Global Select Market and is not listed for trading on a U.S. national securities exchange or any similar U.S. system of automated securities price dissemination.

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During the year ended December 31, 2009, the Company repurchased \$28.5 million principal amount of its outstanding Convertible Notes, for a total price of \$22.3 million, plus accrued interest. These repurchases left \$42.9 million principal amount of the Company's Convertible Notes outstanding as of December 31, 2009 and resulted in a net gain of \$3.3 million for the year ended December 31, 2009. The Company has written-off approximately \$0.2 million in debt issuance costs and \$2.7 million in debt discount in connection with the repurchase of its Convertible Notes during the year ended December 31, 2009. The Company is making the required interest payments on the Convertible Notes and no other changes in the balance or structure of the Convertible Notes has occurred.

During the year ended December 31, 2008, the Company repurchased \$28.6 million principal amount of its outstanding Convertible Notes, for a total price of \$20.1 million, plus accrued interest. These repurchases left \$71.4 million principal amount of the Company's Convertible Notes outstanding as of December 31, 2008 and resulted in a net gain of \$4.8 million for the year ended December 31, 2009. The Company has written-off approximately \$0.3 million in debt issuance costs and \$3.4 million in debt discount in connection with the repurchase of its Convertible Notes during the year ended December 31, 2008.

Holders may also surrender their Convertible Notes for conversion anytime on or after March 19, 2010, until the close of business on the trading day immediately preceding September 19, 2010, regardless of whether any of the foregoing conditions have been satisfied. Upon the satisfaction of any of the foregoing conditions, on the last day of a reporting period, or during the 12 months prior to September 19, 2010, the Company would write off to expense all remaining unamortized debt issuance costs in that period.

If the Convertible Notes are converted in connection with certain fundamental changes that occur prior to March 19, 2010, the Company may be obligated to pay an additional make-whole premium with respect to the Convertible Notes converted.

Convertible Notes Hedge Strategy. Concurrent with the sale of the Convertible Notes, the Company purchased call options to purchase from the counterparties an aggregate of 4,476,780 shares of the Company's common stock at a price of \$22.34 per share. The cost of the call options totaled \$27.4 million. The Company also sold warrants to the same counterparties to purchase from the Company an aggregate of 3,984,334 shares of the Company's common stock at a price of \$29.04 per share and received net proceeds from the sale of these warrants of \$11.6 million. Taken together, the call option and warrant agreements have the effect of increasing the effective conversion price of the Convertible Notes to \$29.04 per share. The call options and warrants must be settled in net shares, except in connection with certain termination events, in which case they would be settled in cash based on the fair market value of the instruments. On the date of settlement, if the market price per share of the Company's common stock is above \$29.04 per share, the Company will be required to deliver shares of its common stock representing the value of the call options and warrants in excess of \$29.04 per share.

The warrants have a strike price of \$29.04 and are generally exercisable at any time. The Company issued and sold the warrants in a transaction exempt from the registration requirements of the Securities Act of 1933, as amended, because the offer and sale did not involve a public offering. There were no underwriting commissions or discounts in connection with the sale of the warrants. In accordance with ASC Topic 480, "*Distinguishing Liabilities from Equity*," the Company recorded the net call options and warrants as a reduction in additional paid in capital as of December 31, 2005, and will not recognize subsequent changes in fair value of the call options and warrants in its consolidated financial statements.

Revolving Credit Facility

During 2005, the Company entered into a three-year Revolving Credit Facility, to be used for the purposes of purchasing receivable portfolios and for general working capital needs. This Revolving Credit Facility has been amended several times to meet the needs of the Company and is due to expire in May 2010.

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Effective February 27, 2007, the Company amended the Revolving Credit Facility to allow for the Company to repurchase up to \$50.0 million of its common stock and Convertible Notes, with no more than \$25.0 million to repurchase Convertible Notes. Effective May 9, 2008, the Company amended the Revolving Credit Facility to remove the \$25.0 million cap on Convertible Note repurchases and allow for the Company to repurchase up to \$50.0 million in any combination of its common stock and Convertible Notes, subject to compliance with certain covenants and available borrowing capacity.

Effective May 7, 2007, the Company amended the Revolving Credit Facility in connection with an agreement reached with the lender under the Company's prior Secured Financing Facility. This amendment allows the Company to exclude the expense associated with a one-time payment of \$16.9 million in connection with its termination of all future obligations under its Secured Financing Facility as further discussed below.

Effective October 19, 2007, the Company amended the Revolving Credit Facility to change the definition of "change of control" to exclude from that definition, acquisitions of stock by Red Mountain Capital Partners LLC ("Red Mountain"), JCF FPK I LP ("JCF FPK") and their respective affiliates.

Effective July 3, 2008, the Company amended the Revolving Credit Facility to expand the capacity from \$230.0 million to \$335.0 million. This amendment added three additional lenders to the syndicate of lenders in the Revolving Credit Facility and increased the applicable margin under certain circumstances between 25 and 75 basis points.

Other provisions of the amended Revolving Credit Facility include:

- Interest at a floating rate equal to, at the Company's option, either: (a) reserve adjusted LIBOR plus a spread that ranges from 225 to 275 basis points, depending on the Company's leverage; or (b) the higher of the federal funds rate then in effect plus a spread of 50 basis points or the prime rate plus a spread that ranges from 25 to 75 basis points.
- \$5.0 million sub-limits for swingline loans and letters of credit.
- A borrowing base that provides for an 85.0% initial advance rate for the purchase of qualified receivable portfolios. The borrowing base reduces for each qualifying portfolio by 3% per month beginning after the third complete month subsequent to the initial purchase. The aggregate borrowing base is equal to the lesser of (a) the sum of all of the borrowing bases of all qualified receivable portfolios under this facility, as defined above, or (b) 95% of the net book value of all receivable portfolios acquired on or after January 1, 2005.
- Restrictions and covenants, which limit, among other things, the payment of dividends and the incurrence of additional indebtedness and liens.
- Events of default which, upon occurrence, may permit the lenders to terminate the Revolving Credit Facility and declare all amounts outstanding to be immediately due and payable.
- Collateralization by all assets of the Company.

At December 31, 2009, the outstanding balance on the Revolving Credit Facility was \$260.0 million, which bore a weighted average interest rate of 3.82%. The aggregate borrowing base was \$309.8 million, of which \$49.8 million was available for future borrowings.

On February 8, 2010, the Company entered into a new \$327.5 million, three-year revolving credit facility. This new facility replaces the Revolving Credit Facility and as a result, the Revolving Credit Facility terminated on February 8, 2010. See Note 17 for a further discussion of this new revolving credit facility.

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Secured Financing Facility

The Company repaid in full the principal balance of the prior Secured Financing Facility at the end of 2006 and will make no further borrowings under that facility. Prior to May 7, 2007, the Company and the lender shared the residual collections, net of servicing fees paid to the Company. The residual collections paid to the lender were classified as Contingent Interest.

On May 7, 2007, the Company entered into an agreement with the lender under its prior Secured Financing Facility to eliminate all future Contingent Interest payments, for a one-time payment of \$16.9 million. This agreement released the lender's security interests in the remaining receivables originally financed under the Secured Financing Facility. Subsequent to the second quarter of 2007, the Company is no longer obligated to make any Contingent Interest payments under the Secured Financing Facility and, as a result, no longer records such interest in its statements of income.

Capital Lease Obligations

The Company has capital lease obligations for certain computer equipment. These lease obligations require monthly payments that range from approximately \$1,000 to \$20,000 through June 2013 and have implicit interest rates that range from approximately 5.9% to 7.7%.

The Company has financed certain leasehold improvement projects with its lessors in its Phoenix and St. Cloud facilities. As of December 31, 2009, the Company's combined obligation was approximately \$1.0 million. These financing agreements require monthly principal and interest payments, accrue interest at 8% to 9% per annum and will mature in June and September 2013.

Five-Year Maturity Schedule

The following table summarizes the five-year maturity of the Company's debt and other long term liabilities (*in thousands*):

	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>Total</u>
Convertible notes	\$42,920	\$—	\$—	\$—	\$—	\$ 42,920
Revolving credit facility ⁽¹⁾	—	—	—	260,000	—	260,000
Capital lease obligations	867	840	530	196	—	2,433
Less: interest portion of capital lease	(139)	(84)	(36)	(6)	—	(265)
	<u>\$43,648</u>	<u>\$756</u>	<u>\$494</u>	<u>\$260,190</u>	<u>\$—</u>	<u>\$305,088</u>

⁽¹⁾ On February 8, 2010, the Company entered into a new \$327.5 million, three-year revolving credit facility. This new facility replaces the Revolving Credit Facility and as a result, the Revolving Credit Facility terminated on February 8, 2010.

Note 9: Stock Based Compensation

On March 9, 2009, the Board of Directors approved an amendment and restatement of the 2005 Stock Incentive Plan ("2005 Plan") which was originally adopted on March 30, 2005, for Board members, employees, officers, and executives of, and consultants and advisors to, the Company. The amendment and restatement of the 2005 Plan increased by 2,000,000 shares the maximum number of shares of the Company's common stock that may be issued or subject to awards under the plan, established a new 10-year term for the plan and made certain other amendments. The 2005 Plan amendment was approved by the Company's stockholders on June 9, 2009. The 2005 Plan provides for the granting of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units, and performance-based awards to eligible individuals. As amended, the 2005 Plan allows the granting of an aggregate of 3,500,000 shares of the Company's common stock for awards, plus the number of ungranted shares of stock that were available for future awards under the prior 1999

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Equity Participation Plan ("1999 Plan"). In addition, shares subject to options granted under either the 1999 Plan or the 2005 Plan that terminate or expire without being exercised will become available for grant under the 2005 Plan. The benefits provided under these plans are share-based compensation subject to the provisions of ASC 718.

In accordance with ASC 718, compensation expense is recognized only for those shares expected to vest, based on the Company's historical experience and future expectations. Total compensation expense during the years ended December 31, 2009, 2008 and 2007 was \$4.4 million, \$3.6 million and \$4.3 million, respectively.

The Company's stock-based compensation arrangements are described below:

Stock Options

The 2005 Plan permits the granting of stock options to certain employees and directors of the Company. Option awards are generally granted with an exercise price equal to the market price of the Company's stock at the date of issuance. They generally vest based on three to five years of continuous service, and have ten-year contractual terms.

The Company uses the Black-Scholes option-pricing model to determine the fair-value of stock-based awards. All options are amortized ratably over the requisite service periods of the awards, which are generally the vesting periods.

The expected life of options granted, expected volatility and forfeitures are based on data specific to each employee class under the assumption that different classes of employees can act differently because of title, rank, number of options granted and other like characteristics. For the purposes of this analysis, these classes include: (i) officers (as defined under Section 16 of the Securities Exchange Act of 1934) and (ii) all others receiving options. The assumptions below are used by the Company to determine the fair value of stock-based awards.

Expected Life. The expected life of options granted represents the period of time for which the options are expected to be outstanding. The Company took into account the percentage of option exercises, the percentage of options that expire unexercised and the percentage of options outstanding. The Company used this valuation to determine the expected life of the options, which are 5.3 years for officers and 4.6 years for all others.

Expected Volatility. The expected volatility is based on the historical volatility of the Company's common stock over the estimated expected life of the options, which is 5.3 years for officers and 4.6 years for all others.

Risk-Free Interest Rate. The risk-free interest rate is derived from the U.S. Treasury yield curve in effect at the date of grant.

Dividends. The Company does not currently anticipate paying any cash dividends on its common stock. Consequently, the Company uses an expected dividend yield of zero in the Black-Scholes option valuation model.

Forfeitures. ASC 718 requires the Company to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. To determine an expected forfeiture rate, the Company examined the historical employee turnover rate over the prior five years as a proxy for forfeitures. Based on the internal analysis, the expected forfeiture rates were determined to be 13.3% of options granted to officers and 13.4% of options granted to all others.

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The fair value for options granted was estimated at the date of grant using a Black-Scholes option-pricing model with the following weighted-average assumptions:

	Year Ended December 31,		
	2009	2008	2007
Weighted average fair value of options granted	\$ 4.91	\$ 5.37	\$ 6.82
Risk free interest rate	2.1%	3.0%	4.5%
Dividend yield	0.0%	0.0%	0.0%
Volatility factors of the expected market price of the Company's common stock	57%	46%	71%
Weighted-average expected life of options	5 Years	5 Years	5 Years

Unrecognized compensation cost related to stock options as of December 31, 2009, was \$3.9 million. The weighted-average remaining expense period, based on the unamortized value of these outstanding stock options was approximately 2.4 years.

A summary of the Company's stock option activity as of December 31, 2009, and changes during the year then ended, is presented below:

	Number of Shares	Option Price Per Share	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2008	2,139,503	\$ 0.35 – \$20.09	\$ 9.14	
Granted	797,500	2.89 – 13.17	9.33	
Cancelled/forfeited	(80,383)	10.92 – 16.19	12.27	
Exercised	(189,483)	0.35 – 16.19	6.26	
Outstanding at December 31, 2009	<u>2,667,137</u>	<u>\$ 0.35 – \$20.09</u>	<u>\$ 9.28</u>	\$ 21,819
Exercisable at December 31, 2009	<u>1,647,622</u>	<u>\$ 0.35 – \$20.09</u>	<u>\$ 8.95</u>	\$ 14,090

The total intrinsic value of options exercised during the years ended December 31, 2009, 2008 and 2007 was \$2.0 million, \$0.3 million and \$1.7 million, respectively. As of December 31, 2009, the weighted-average remaining contractual life of options outstanding and options exercisable was 6.22 years and 4.46 years, respectively.

Restricted Stock Units

Under the Company's 2005 Plan, certain employees and directors are eligible to receive restricted stock units. In accordance with ASC 718, the fair value of restricted stock units is equal to the closing sale price of the Company's common stock on the date of issuance. The total number of restricted stock unit awards expected to vest is adjusted by estimated forfeiture rates. As of December 31, 2009, 88,825 of the non-vested shares are expected to vest over approximately one to three years based on certain performance goals ("Performance Shares"). The fair value of the Performance-Based Awards is expensed over the expected vesting period based on our forfeiture assumptions. If performance goals are not expected to be met, the compensation expense previously recognized would be reversed. No reversals of compensation expense related to the Performance-Based Awards have been made as of December 31, 2009. The remaining 586,965 non-vested shares are not performance-based, and will vest and are being expensed over approximately one to four years of continuous service.

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A summary of the status of the Company's restricted stock units as of December 31, 2009, and changes during the year then ended, is presented below:

Restricted Stock Units	Non-Vested Shares	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2008	628,752	\$ 11.18
Awarded	295,655	\$ 6.64
Vested	(196,705)	\$ 11.01
Cancelled/forfeited	(51,912)	\$ 10.86
Non-vested at December 31, 2009	<u>675,790</u>	<u>\$ 9.27</u>

Unrecognized compensation cost related to restricted stock units as of December 31, 2009, was \$2.8 million. The weighted-average remaining expense period, based on the unamortized value of these outstanding restricted stock units was approximately 2.4 years. The fair value of restricted stock units vested for the years ended December 31, 2009, 2008 and 2007 was \$1.7 million, \$0.3 million and \$0.1 million, respectively.

Note 10: Income Taxes

The Company recorded an income tax provision of \$20.7 million, reflecting an effective rate of 38.5% of pretax income during the year ended December 31, 2009. The effective tax rate for the year ended December 31, 2009, consists primarily of a provision for federal income taxes of 32.4% (which is net of a benefit for state taxes of 2.6%), a provision for state taxes of 7.3%, a 1.0% beneficial adjustment to the federal tax payable as a result of the effective state tax rate change and a benefit of 0.2%, due to permanent book versus tax differences. Effective January 1, 2009, the Company retrospectively adjusted its prior years' income tax provisions for the change in accounting principle related to its accounting for Convertible Notes. See Note 15 for additional information on the change in accounting principle. The Company recorded an adjusted income tax provision of \$9.7 million, reflecting an effective rate of 41.2% of pretax income during the year ended December 31, 2008. The effective tax rate for the year ended December 31, 2008, consists primarily of a provision for federal income taxes of 32.3% (which is net of a benefit for state taxes of 2.7%), a provision for state taxes of 7.8%, a 1.2% adjustment to the federal tax payable as a result of the effective state tax rate change and a benefit of 0.1%, due to permanent book versus tax differences.

The provision for income taxes consists of the following (*in thousands*):

	Year Ended December 31,		
	2009	2008 Adjusted	2007 Adjusted
Current expense:			
Federal	\$15,734	\$ 5,756	\$2,509
State	<u>3,551</u>	<u>1,597</u>	<u>36</u>
	19,285	7,353	2,545
Deferred expense:			
Federal	1,212	2,113	3,969
State	<u>199</u>	<u>234</u>	<u>(16)</u>
	<u>1,411</u>	<u>2,347</u>	<u>3,953</u>
	<u>\$20,696</u>	<u>\$9,700</u>	<u>\$6,498</u>

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The components of deferred tax assets and liabilities consist of the following for the years presented (*in thousands*):

	<u>December 31, 2009</u>	<u>December 31, 2008 Adjusted</u>
Deferred tax assets:		
State taxes	\$ 1,420	\$ 1,135
Stock option expense	5,139	4,354
Accrued expenses	1,126	551
Non-qualified plan	(189)	18
Deferred revenue	1,710	2,162
Interest rate swap	805	1,368
State net operating losses	399	462
Other	399	166
Valuation allowance	(12)	(12)
	<u>10,797</u>	<u>10,204</u>
Deferred tax liabilities:		
Deferred court costs	(10,892)	(11,800)
Difference in basis of amortizable assets	(4,678)	(3,603)
Difference in basis of depreciable assets	(988)	(980)
Differences in income recognition related to receivable portfolios and retained interest	(10,339)	(8,924)
Deferred debt cancellation income	(1,222)	—
Other	342	(5)
	<u>(27,777)</u>	<u>(25,312)</u>
Net deferred tax liability	<u>\$ (16,980)</u>	<u>\$ (15,108)</u>

The Company has a state tax credit carryforward, as a result of net operating losses, in the amount of \$0.4 million that will begin to expire at the end of 2012, if not previously utilized.

The differences between the total income tax expense and the income tax expense computed using the applicable federal income tax rate of 35% per annum were as follows (*in thousands*):

	<u>Year Ended December 31,</u>		
	<u>2009</u>	<u>2008 Adjusted</u>	<u>2007 Adjusted</u>
Computed “expected” Federal income tax expense	\$18,810	\$8,241	\$6,555
Increase (decrease) in income taxes resulting from:			
State income taxes, net	2,437	1,236	165
Other adjustments, net	(551)	224	(235)
Increase in valuation allowance	—	(1)	13
	<u>\$20,696</u>	<u>\$9,700</u>	<u>\$6,498</u>

The Company has not provided for the United States income taxes or foreign withholding taxes on the undistributed earnings from continuing operations of its subsidiary operating outside of the United States. Undistributed earnings of the subsidiary for the year ended December 31, 2009, were approximately \$0.9 million. Such undistributed earnings are considered permanently reinvested.

The Company’s subsidiary operating outside of the United States is currently operating under a tax holiday in India. The tax holiday is due to expire on March 31, 2011. The impact of the tax holiday on the Company’s consolidated financial statements is not material.

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The Company adopted the provisions related to uncertainty in income taxes within ASC 740 on January 1, 2007. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (*in thousands*):

	<u>Amount</u>
Balance at December 31, 2008	\$1,195
Additions based on tax positions related to prior years	195
Reductions for tax positions related to prior years	(525)
Balance at December 31, 2009	<u>\$ 865</u>

As of December 31, 2009, the Company has recorded net income for penalties and interest of less than \$0.1 million. The penalties and interest accruals are recorded as part of the provision for income taxes.

The Company has gross unrecognized tax benefits of \$0.9 million at December 31, 2009, that if recognized, would result in a net tax benefit of \$0.7 million and would have a positive effect on the Company's effective tax rate.

The Company believes that it is reasonably possible that its \$0.9 million gross unrecognized tax benefits will significantly decrease within the next 12 months or be eliminated entirely. The gross unrecognized tax benefits relate to the utilization of a federal net operating loss and the refund of state taxes previously paid. The events that could significantly reduce or eliminate the unrecognized tax benefits are the completion of a state tax audit that is currently in process and the resolution from the Internal Revenue Service Appeals Division on a position taken by the Company regarding a net operating loss.

The Company files U.S. federal and state income tax returns in jurisdictions with varying statutes of limitations. The 2006 through 2009 tax years remain subject to examination by federal taxing authorities and the 2001 through 2009 tax years generally remain subject to examination by state tax authorities.

Concurrent with the sale of the Convertible Notes in 2005 (see Note 8), the Company purchased call options to purchase from the counterparties an aggregate of 4,476,780 shares of the Company's common stock at a price of \$22.34 per share. The cost of the call options totaled \$27.4 million. The Company treats the Convertible Notes and the purchased call options as integrated synthetic debt instruments pursuant to applicable Treasury Regulations. The cost of the call options is treated as original issue discount ("OID"), reducing the carrying value of the Convertible Notes for tax purposes and is amortized using the constant yield method. The Company has treated the current deduction of the OID interest as a credit to equity in accordance with ASC 740.

Note 11: Purchase Concentrations

The following table summarizes the concentration of initial purchase cost by seller sorted by total aggregate costs (*in thousands, except percentages*):

	<u>Year Ended December 31, 2009</u>	
	<u>Cost</u>	<u>%</u>
Seller 1	\$ 59,399	23.1%
Seller 2	55,315	21.6%
Seller 3	52,360	20.4%
Seller 4	28,432	11.1%
Seller 5	27,000	10.5%
Other sellers	34,126	13.3%
	<u>\$ 256,632</u>	<u>100.0%</u>
Adjustments ⁽¹⁾	(1,972)	
Purchases, net	<u>\$ 254,660</u>	

⁽¹⁾ Adjusted for Put-backs and Recalls.

Note 12: Commitments and Contingencies

Litigation

On October 18, 2004, Timothy W. Moser, one of the Company's former officers, filed an action in the United States District Court for the Southern District of California against it, and certain individuals, including several of the Company's officers and directors. On February 14, 2005, the Company was served with an amended complaint in this action alleging defamation, intentional interference with contractual relations, breach of contract, breach of the covenant of good faith and fair dealing, intentional and negligent infliction of emotional distress and civil conspiracy arising out of certain statements in its Registration Statement on Form S-1, originally filed in September 2003, and alleged to be included in its Registration Statement on Form S-3, originally filed in May 2004. The amended complaint sought injunctive relief, economic and punitive damages in an unspecified amount plus an award of profits allegedly earned by the defendants and alleged co-conspirators as a result of the alleged conduct, in addition to attorney's fees and costs. On June 1, 2006, the plaintiff filed a second amended complaint in which he amended his claim for negligent infliction of emotional distress. During the pendency of the action, the parties filed various motions and discovery was stayed during a portion of that time pending the decision on the Company's appeal of an unsuccessful decision on one such motion. On May 25, 2006, the Company filed a notice of appeal of the court's order denying the anti-SLAPP motion. On July 28, 2008, the appellate court affirmed the trial court's denial of the Company's anti-SLAPP motion and returned the case to the District Court where the parties engaged in extensive discovery and filed various motions. On November 24, 2009, the District Court heard oral argument on motions for summary judgment filed by all of the defendants. On January 19, 2010, the District Court issued an order granting defendants' summary judgment motions, dismissed all causes of action against all of the defendants and entered judgment in favor of the defendants. The judgment will become final unless plaintiff takes action to perfect his right to appeal.

On September 7, 2005, Mr. Moser filed a related action in the United States District Court for the Southern District of California against Triarc Companies, Inc. ("Triarc"), which at the time was a significant stockholder of the Company, alleging intentional interference with contractual relations and intentional infliction of emotional distress. The case arose out of the same statements made or alleged to have been made in the Company's Registration Statements mentioned above. The amended complaint sought injunctive relief, an order directing Triarc to issue a statement of retraction or correction of the allegedly false statements, economic and punitive damages in an unspecified amount and attorney's fees and costs. Triarc tendered the defense of this action to the Company, and it accepted the defense and will indemnify Triarc, pursuant to the indemnification provisions of the Registration Rights Agreements dated as of October 31, 2000 and February 21, 2002, and the Underwriting Agreements dated September 25, 2004 and January 20, 2005 to which Triarc is a party. This action was also dismissed by the District Court on January 19, 2010. The judgment will become final unless plaintiff takes action to perfect his right to appeal.

The Company, along with others in its industry, is subject to legal actions based on the Fair Debt Collection Practices Act, or FDCPA, and comparable state statutes, which could have a material adverse effect on it due to the remedies available under these statutes, including punitive damages. The violations of law alleged in these actions often include claims that the Company lacks specified licenses to conduct its business, attempt to collect debts on which the statute of limitations has run, and have made inaccurate assertions of fact in support of its collection actions. A number of these cases are styled as class actions and a class has been certified in several of these cases. Many of these cases present novel issues on which there is no clear legal precedent. As a result, the Company may be unable to predict the range of possible outcomes.

In one such action, captioned *Brent v. Midland Credit Management, Inc et. al*, filed on May 19, 2008, in the United States District Court for the Northern District of Ohio [Western Division], the plaintiff has filed a class action counter-claim against Midland Credit Management, Inc. and Midland Funding LLC (the "Midland Defendants"). The complaint alleges that the Midland Defendants' business practices violated consumers' rights under the FDCPA and the Ohio Consumer Sales Practices Act. The plaintiff is seeking actual and statutory

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damages for the class of Ohio residents, plus attorney's fees and costs of class notice and class administration. On August 11, 2009, the court issued an order partially granting plaintiff's motion for summary judgment and entering findings adverse to the Midland Defendants on certain of plaintiff's claims. The Midland Defendants subsequently moved the court to reconsider the order and were partially successful. However, because the court did not completely reverse the August 11 order, certain portions of the order remain subject to reversal only on appeal. Plaintiff is currently seeking to enlarge the case to include a national class of consumers; however, no class has been certified in this case. There are a number of other lawsuits, claims and counterclaims pending or threatened against the Company. In general, these lawsuits, claims or counterclaims have arisen in the ordinary course of business and involve claims for damages arising from a variety of alleged misconduct or improper reporting of credit information by the Company or its employees or agents.

In addition, from time to time, the Company is subject to various regulatory investigations, inquiries and other actions, relating to its collection activities.

On January 6, 2010, the Office of the Attorney General of the State of California (the "California Attorney General") issued a subpoena to the Company to answer interrogatories and to produce documents in a proceeding entitled "In the Matter of the Investigation of Encore Capital Group, Inc., Midland Credit Management, Inc. and Affiliated Persons and Entities" concerning its debt collection practices and related topics. The Company intends to cooperate fully with the California Attorney General in response to this subpoena, subject to applicable law.

On December 16, 2009, the Federal Trade Commission (the "FTC") issued an order directing the Company to submit information about its practices in buying and collecting consumer debt, which the FTC intends to use for a study of the debt-buying industry. The Company is one of nine companies that received such an order from the FTC requesting the production of information for use in the FTC's study of the industry. The nine companies were described by the FTC as the nation's largest consumer debt buyers. The order was publicly announced by the FTC on January 5, 2010. The Company intends to cooperate fully with the FTC in connection with its study, subject to applicable law.

On September 16, 2009, the Maryland State Agency Licensing Board in the Office of the Commissioner of Financial Regulation (the "Agency"), issued a cease and desist order barring all collection activities by the Company and certain of its affiliates, alleging that it had failed to obtain necessary business licenses and had improperly filed lawsuits to collect credit card accounts, among other claims raised in certain of the legal actions pending against the Company. Pursuant to an Interim Settlement Agreement the Company executed with the Agency on September 23, 2009, and a Settlement Agreement the Company executed with the Agency on December 17, 2009, certain of the Company's affiliates agreed to refrain from collection activities in Maryland until obtaining licenses. Under the terms of the Settlement Agreement, the Company resolved all of the allegations raised by the Agency without any admission of liability. The Agency agreed to a final resolution of the matter without an administrative hearing, in exchange for an agreement from the Company and three other affiliates to pay aggregate civil penalties of approximately \$1.0 million, to obtain licenses for three of its affiliates from the Agency, and to make certain other changes in business practices. The companies in question are compliant with the agreement, have since obtained licenses and have resumed doing business in Maryland.

In June 2008, the FTC announced that it had sued Jefferson Capital and its parent company, CompuCredit Corporation, alleging that Jefferson Capital and CompuCredit had violated the FTC Act with deceptive marketing practices when issuing credit cards. The FTC announced in December, 2008, that it had agreed to a settlement of the litigation with Jefferson Capital and CompuCredit, whereby those companies will credit approximately \$114.0 million to certain consumer accounts. Jefferson Capital and CompuCredit advised the Company that a substantial number of the accounts affected by the settlement had been sold to it.

In July 2008, the Company initiated an arbitration proceeding against Jefferson Capital and CompuCredit in connection with its forward flow purchase obligation based upon the allegations noted in the FTC complaint and other claims. Jefferson Capital and CompuCredit raised their own claims against the Company in the arbitration.

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In September 2009, the Company settled its dispute with Jefferson Capital and CompuCredit. Under the terms of the settlement, the Company purchased a large portfolio of charged-off credit card account balances on commercially reasonable terms and agreed to resume balance transfers to Jefferson Capital. The Company also agreed to return to Jefferson Capital certain accounts that were subject to Jefferson Capital's settlement with the FTC. Following the settlement with Jefferson Capital and CompuCredit, the Company has no further forward flow purchase obligations with Jefferson Capital and CompuCredit.

The Company has established loss provisions only for matters in which losses are probable and can be reasonably estimated. Some of the matters pending against the Company involve potential compensatory, punitive damage claims, fines or sanctions that, if granted, could require it to pay damages or make other expenditures in amounts that could have a material adverse effect on its financial position or results of operations. Although litigation is inherently uncertain, at this time, based on past experience, the information currently available and the possible availability of insurance and/or indemnification in some cases, the Company does not believe that the resolution of these matters will have a material adverse effect on its consolidated financial position or results of operations.

Leases

The Company leases office facilities in San Diego, California; Phoenix, Arizona; Arlington, Texas; St. Cloud, Minnesota; and Gurgaon, India. The leases are structured as operating leases, and the Company incurred related rent expense in the amounts of \$4.3 million, \$3.4 million and \$3.4 million during the years ended December 31, 2009, 2008 and 2007, respectively.

The Company has financed certain leasehold improvement projects with its lessors in its Phoenix and St. Cloud facilities. As of December 31, 2009, the Company's obligation was approximately \$1.0 million. Commencing in October 2008, these financing agreements require monthly principal and interest payments, accrue interest at 8% to 9% per annum and will mature in June and September 2013.

The Company leases certain equipment through capital leases. These lease obligations require monthly payments that range from approximately \$1,000 to \$20,000 through June 2013 and have implicit interest rates that range from approximately 5.9% to 7.7%.

The related amortization expense was \$0.5 million, \$0.2 million and \$0.2 million, for the years ended December 31, 2009, 2008 and 2007, respectively. Amortization of assets under capital leases is included in depreciation and amortization expense.

Future minimum lease payments under lease obligations consist of the following for the years ending December 31 (*in thousands*):

	<u>Capital Leases</u>	<u>Operating Leases</u>	<u>Total</u>
2010	\$ 867	\$ 3,704	\$ 4,571
2011	840	3,455	4,295
2012	530	3,479	4,009
2013	196	3,344	3,540
2014	—	3,004	3,004
Thereafter	—	6,636	6,636
Total minimal leases payments	<u>2,433</u>	<u>\$23,622</u>	<u>\$26,055</u>
Less: Interest		<u>(265)</u>	
Present value of minimal lease payments	<u>\$2,168</u>		

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Purchase Commitments

In the normal course of business, the Company enters into forward flow purchase agreements and other purchase commitment agreements. As of December 31, 2009, the Company has entered into agreements to purchase receivable portfolios with a face value of approximately \$2.0 billion for a purchase price of approximately \$104.7 million. Certain of these agreements allow the Company to terminate the commitment with 60 days notice or by paying a one-time cancellation fee. The Company does not anticipate cancelling any of these commitments at this time. The Company has no purchase commitments extending past one year.

Employee Benefit Plans

The Company maintains a 401(k) Salary Deferral Plan (the "Plan") whereby eligible employees may voluntarily contribute up to a maximum percentage of compensation, as specified in Internal Revenue Code limitations. The Company may match a percentage of employee contributions at its discretion. Employer matching contributions and administrative costs relating to the Plan totaled \$0.7 million, \$0.7 million and \$0.7 million for the years ended December 31, 2009, 2008 and 2007, respectively.

The Company maintains a non-qualified deferred compensation plan for its senior management. This plan permits deferral of a portion of compensation until a specified period of time. As of December 31, 2009, the plan assets and plan liabilities were \$0.8 million and \$0.8 million, respectively. As of December 31, 2008, the plan assets and plan liabilities were \$1.2 million and \$0.9 million, respectively. These amounts are included in the Company's consolidated statements of financial condition in other assets and accrued liabilities. The use of plan assets is legally restricted to distributions to participants or to creditors in the event of bankruptcy.

Self Insured Health Benefits

The Company maintains a self-insured health benefit plan for its employees. This plan is administered by a third party. As of December 31, 2009, the plan had stop loss provisions insuring losses beyond \$0.2 million per employee per year. Effective January 1, 2009, the Company eliminated the aggregated stop loss provisions. As of December 31, 2009, the Company recorded a reserve for unpaid claims in the amount of \$0.8 million in accrued liabilities in the Company's consolidated statement of financial condition. This amount represents the Company's estimate of incurred but not reported claims, as of December 31, 2009.

Guarantees

The Company's Certificate of Incorporation and indemnification agreements between the Company and its officers and directors provide that the Company will indemnify and hold harmless its officers and directors for certain events or occurrences arising as a result of the officer or director serving in such capacity. The Company has also agreed to indemnify certain third parties under certain circumstances pursuant to the terms of certain underwriting agreements, registration rights agreements and portfolio purchase and sale agreements. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. The Company believes the estimated fair value of these indemnification agreements is minimal and has no liabilities recorded for these agreements as of December 31, 2009.

Note 13: Segment Reporting

ASC Topic 280, "*Segment Reporting*" establishes standards in reporting information about a public business enterprise's operating segments. Operating segments are components of an enterprise about which separate financial information is available, that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. For the year ended December 31, 2009, the Company has determined it operates in two segments. However, based on the requirements of ASC 280, under "Quantitative Thresholds," the smaller operating segment does not meet the minimum requirement of 10% of combined revenues, reported profit or loss, or combined assets and accordingly, no segment disclosures have been made for year ended December 31, 2009.

Note 14: Securities Repurchase Program

On February 27, 2007, the Company's board of directors authorized a securities repurchase program under which the Company may buy back up to \$50.0 million (at cost) of a combination of its common stock and Convertible Notes. The purchases may be made from time to time in the open market or through privately negotiated transactions and will be dependent upon various business and financial considerations. Repurchases are subject to compliance with applicable legal requirements and other factors. During the year ended December 31, 2009, the Company repurchased \$28.5 million principal amount of its outstanding Convertible Notes, for a total price of \$22.3 million, plus accrued interest. From the inception of the securities repurchase program, the Company has repurchased \$57.1 million principal amount of its Convertible Notes, for a total cash payment of \$42.4 million. The Company has not repurchased any common stock under this program.

On February 8, 2010, the Company's board of directors approved a new \$50.0 million securities repurchase program to replace its existing program. With the execution of the Company's new \$327.5 million, three-year revolving credit facility, the Company now has the renewed ability to repurchase up to \$50.0 million in any combination of the Company's common stock and Convertible Notes, subject to compliance with certain covenants and available borrowing capacity. The board authorized this new securities repurchase program allowing the Company to repurchase an aggregate of up to \$50.0 million of any combination of its common stock and Convertible Notes. This new program replaces the remaining available repurchase authority under the prior program. See Note 17 for a further discussion of the new revolving credit facility and securities repurchase program.

Note 15: Change in Accounting Principle

Effective January 1, 2009, the Company adopted the provisions of ASC 470-20. ASC 470-20 applies to convertible debt instruments that may be settled in cash upon conversion, including partial cash settlement, when the conversion option does not need to be bifurcated and accounted for separately as a derivative instrument in accordance with ASC 815.

ASC 470-20 requires that issuers of convertible debt instruments that, upon conversion, may be settled fully or partially in cash, must separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. Additionally, debt issuance costs are required to be allocated in proportion to the allocation of the liability and equity components and accounted for as debt issuance costs and equity issuance costs, respectively. ASC 470-20 requires retrospective application and, accordingly, the prior periods' financial statements included herein have been adjusted.

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Effect of Change in Accounting Principle to Consolidated Statements of Financial Condition

The following table summarizes the effect of the change in accounting principle related to the Company's Convertible Notes on the consolidated statements of financial condition as of December 31, 2009 and 2008 (in thousands):

	December 31,					
	2009			2008		
	As computed without change in accounting principle	As reported with change in accounting principle	Effect of Change	As Previously Reported	As Adjusted	Effect of Change
Assets:						
Other assets	\$ 4,308	\$ 4,252	\$ (56)	\$ 5,268 ⁽¹⁾	\$ 5,049	\$ (219)
Total assets	595,215	595,159	(56)	549,298	549,079	(219)
Liabilities:						
Income taxes payable	2,667	2,681	14	—	—	—
Deferred tax liabilities, net	17,088	16,980	(108)	15,199	15,108	(91)
Debt	305,088	303,075	(2,013)	311,319	303,655	(7,664)
Total liabilities	354,175	352,068	(2,107)	353,408	345,653	(7,755)
Stockholders' equity:						
Additional paid-in capital	87,821	104,261	16,440	79,971	98,521	18,550
Accumulated earnings	154,231	139,842	(14,389)	117,809	106,795	(11,014)
Total stockholders' equity	241,040	243,091	2,051	195,890	203,426	7,536
Total liabilities and stockholders' equity	595,215	595,159	(56)	549,298	549,079	(219)

⁽¹⁾ Certain reclassification other than the impact of ASC 470-20 has been made to conform to the current year's presentation.

Effect of Change in Accounting Principle to Consolidated Statements of Income

The following table summarizes the effect of the change in accounting principle related to the Company's Convertible Notes on the consolidated statements of income for the years ended December 31, 2009, 2008 and 2007 (in thousands):

	Year Ended December 31,									
	2009			2008			2007			
	As computed without change in accounting principle	As reported with change in accounting principle	Effect of Change	As Previously Reported	As Adjusted	Effect of Change	As Previously Reported	As Adjusted	Effect of Change	
Interest expense	\$(13,342)	\$(16,160)	\$(2,818)	\$(15,629)	\$(20,572)	\$(4,943)	\$(13,904)	\$(18,648)	\$(4,744)	
Gain on repurchase of convertible notes, net	5,938	3,268	(2,670)	8,096	4,771	(3,325)	—	—	—	
Income before income taxes	59,231	53,743	(5,488)	31,814	23,546	(8,268)	23,473	18,729	(4,744)	
Provision for income taxes	(22,809)	(20,696)	2,113	(12,980)	(9,700)	3,280	(8,431)	(6,498)	1,933	
Net Income	36,422	33,047	(3,375)	18,834	13,846	(4,988)	15,042	12,231	(2,811)	
Earnings Per Share:										
Basic	\$ 1.57	\$ 1.42	\$ (0.15)	\$ 0.82	\$ 0.60	\$ (0.22)	\$ 0.66	\$ 0.53	\$ (0.13)	
Diluted	\$ 1.51	\$ 1.37	\$ (0.14)	\$ 0.80	\$ 0.59	\$ (0.21)	\$ 0.64	\$ 0.52	\$ (0.12)	

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Effect of Change in Accounting Principle to Consolidated Statements of Stockholders' Equity

The following table summarizes the effect of the change in accounting principle related to the Company's Convertible Notes on the consolidated statements of stockholders' equity for the years ended December 31, 2009, 2008 and 2007 (in thousands):

	Year Ended December 31,								
	2009			2008			2007		
	As computed without change in accounting principle	As reported with change in accounting principle	Effect of Change	As Previously Reported	As Adjusted	Effect of Change	As Previously Reported	As Adjusted	Effect of Change
Balance, beginning of the year:	\$195,890	\$203,426	\$ 7,536	\$171,520	\$187,435	\$15,915	\$151,136	\$171,870	\$20,734
Net Income	36,422	33,047	(3,375)	18,834	13,846	(4,988)	15,042	12,231	(2,811)
Tax benefit from convertible note interest expense	1,144	95	(1,049)	2,082	52	(2,030)	2,051	43	(2,008)
Tax benefit from repurchase of convertible notes	1,085	24	(1,061)	1,454	93	(1,361)	—	—	—
Balance, end of the year:	241,040	243,091	2,051	195,890	203,426	7,536	171,520	187,435	15,915

Effect of Change in Accounting Principle to Consolidated Statements of Cash Flows

The following table summarizes the effect of the change in accounting principle related to the Company's Convertible Notes on the consolidated statements of cash flows for the years ended December 31, 2009, 2008 and 2007 (in thousands):

	Year Ended December 31,								
	2009			2008			2007		
	As computed without change in accounting principle	As reported with change in accounting principle	Effect of Change	As Previously Reported	As Adjusted	Effect of Change	As Previously Reported	As Adjusted	Effect of Change
Net Income	\$ 36,422	\$ 33,047	\$(3,375)	\$18,834	\$13,846	\$(4,988)	\$15,042	\$12,231	\$(2,811)
Amortization of loan costs and debt discount	1,262	4,080	2,818	1,377	6,320	4,943	1,219	5,963	4,744
Deferred income tax expense	1,888	1,872	(16)	1,531	1,642	111	3,002	3,077	75
Change in prepaid income tax ⁽¹⁾	13,301	11,204	(2,097)	5,486	2,095	(3,391)	(4,474)	(6,482)	(2,008)
Gain on repurchase of convertible notes, net	(5,938)	(3,268)	2,670	(8,096)	(4,771)	3,325	—	—	—
Net cash provided by operating activities ⁽¹⁾	76,116	76,116	—	63,071	63,071	—	19,610	19,610	—

⁽¹⁾ Certain reclassification other than the impact of ASC 470-20 has been made to conform to the current year's presentation.

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Note 16: Quarterly Information (Unaudited)

The following table summarizes quarterly financial data for the periods presented (*in thousands, except per share amounts*):

	Three Months Ended			
	March 31	June 30	September 30	December 31
2009				
Gross collections	\$ 115,233	\$ 122,373	\$ 125,710	\$ 124,476
Revenues	\$ 76,446	\$ 78,035	\$ 80,386	\$ 81,552
Total operating expenses	\$ 60,175	\$ 63,494	\$ 61,525	\$ 64,588
Net income	\$ 8,997	\$ 6,641	\$ 9,004	\$ 8,405
Basic earnings per share	\$ 0.39	\$ 0.29	\$ 0.39	\$ 0.36
Diluted earnings per share	\$ 0.38	\$ 0.28	\$ 0.37	\$ 0.34
2008				
Gross collections	\$ 104,355	\$ 102,130	\$ 97,777	\$ 94,371
Revenues	\$ 67,554	\$ 70,020	\$ 66,373	\$ 51,942
Total operating expenses	\$ 51,115	\$ 55,861	\$ 55,765	\$ 54,159
Net income (loss)	\$ 6,751 ⁽¹⁾	\$ 6,162 ⁽¹⁾	\$ 3,028 ⁽¹⁾	\$ (2,095) ⁽¹⁾
Basic earnings (loss) per share	\$ 0.29 ⁽¹⁾	\$ 0.27 ⁽¹⁾	\$ 0.13 ⁽¹⁾	\$ (0.09) ⁽¹⁾
Diluted earnings (loss) per share	\$ 0.29 ⁽¹⁾	\$ 0.26 ⁽¹⁾	\$ 0.13 ^{(1),(2)}	\$ (0.09) ^{(1),(3)}

⁽¹⁾ Adjusted for change in accounting principle related to the Company's Convertible Notes. See Note 15 for additional information and the effect of the change to the Company's financial statements.

⁽²⁾ Includes the pre-tax impact of \$7.3 million in net impairment charges.

⁽³⁾ Includes the pre-tax impact of \$25.4 million in net impairment charges, offset by the effect of a pre-tax \$6.7 million net gain associated with the repurchase of the Company's Convertible Notes.

Note 17: Subsequent Events

In accordance with the recently issued ASC Topic 855, "*Subsequent Events*," the Company evaluated subsequent events after the balance sheet date of December 31, 2009 through February 8, 2009, the date of the filing of its consolidated financial statements.

On February 8, 2010, the Company entered into a new \$327.5 million, three-year revolving credit facility ("2010 Revolving Credit Facility") to be used for the purpose of purchasing receivable portfolios and for general working capital needs. The 2010 Revolving Credit Facility expires in May 2013. The 2010 Revolving Credit Facility contains an accordion feature which allows the Company on or subsequent to closing, at its option, and subject to customary conditions, to request an increase in the facility by up to \$100.0 million, (not to exceed a total facility of \$427.5 million) by obtaining one or more commitments from one or more lenders or other entities with the consent of the administrative agent, but without the consent of any other lenders. The 2010 Revolving Credit Facility replaces the Revolving Credit Facility and as a result, the Revolving Credit Facility terminated on February 8, 2010.

Provisions of the 2010 Revolving Credit Facility include:

- Interest at a floating rate equal to, at the Company's option, either: (1) reserve adjusted LIBOR plus a spread that ranges from 375 to 425 basis points, depending on the Company's leverage; or (2) Alternate Base Rate ("ABR") plus a spread that ranges from 250 to 300 basis points, depending on the Company's leverage. ABR, as defined in the agreement, means the highest of (i) the rate of interest publicly announced by JP Morgan Chase Bank as its prime rate in effect at its principal office in New York City, (ii) the federal funds effective rate from time to time plus 0.5% and (iii) reserved adjusted LIBOR for a one month interest period on the applicable date plus 1%.
- \$10.0 million sub-limits for swingline loans and letters of credit.

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- A borrowing base equal to the lesser of (1) 30% of eligible estimated remaining collections minus, to the extent the borrowing base is being calculated on or after June 19, 2010, and so long as the Convertible Notes are outstanding, the aggregate outstanding principal amount of the Convertible Notes plus the aggregate amount of the Company's unrestricted and unencumbered cash and cash equivalent investments (not to exceed the aggregate outstanding principal amount of the Convertible Notes) and (2) the product of the net book value of all receivable portfolios acquired on or after January 1, 2005 multiplied by 95%.
- Restrictions and covenants, which limit, among other things, the payment of dividends and the incurrence of additional indebtedness and liens.
- Repurchases of up to \$50.0 million in any combination of the Company's common stock and Convertible Notes, subject to compliance with certain covenants and available borrowing capacity.
- A change of control definition which excludes acquisitions of stock by Red Mountain, JCF FPK and their respective affiliates.
- Events of default which, upon occurrence, may permit the lenders to terminate the 2010 Revolving Credit Facility and declare all amounts outstanding to be immediately due and payable.
- An annual capital expenditure maximum of \$12.5 million (increased from \$6.0 million allowed under the Revolving Credit Facility).
- An annual rental expense maximum of \$12.5 million (increased from \$5.0 million allowed under the Revolving Credit Facility).
- An outstanding capital lease maximum of \$12.5 million (increased from \$5.0 million allowed under the Revolving Credit Facility).
- An acquisition limit of \$100.0 million (increased from \$60.0 million allowed under the Revolving Credit Facility).
- Collateralization by all assets of the Company.

In conjunction with establishing the 2010 Revolving Credit Facility, the Company incurred estimated loan fees and other loan costs amounting to approximately \$4.5 million. These costs will be amortized over the term of the amended agreement. Additionally, unamortized loan fees and other loan costs, amounting to approximately \$0.3 million, associated with the Revolving Credit Facility, will be expensed in conjunction with its termination.

Using the formula in the 2010 Revolving Credit Facility, as of December 31, 2009, the aggregate borrowing base would have been \$327.5 million, of which \$67.5 million was available for future borrowings.

On February 8, 2010, the Board of Directors approved a new \$50.0 million securities repurchase program to replace its existing program, under which the Company has previously repurchased approximately \$42.4 million of its Convertible Notes. With execution of the 2010 Revolving Credit Facility, the Company now has the renewed ability to repurchase up to \$50.0 million in any combination of the Company's common stock and Convertible Notes, subject to compliance with certain covenants and available borrowing capacity. The board authorized this new securities repurchase program allowing the Company to repurchase an aggregate of up to \$50.0 million of any combination of its common stock and Convertible Notes. This new program replaces the remaining available repurchase authority under the prior program. The Company may, from time to time, purchase equity or debt securities in the open market or through privately negotiated transactions, and the purchases will be dependent upon various business and financial considerations. Securities' repurchases are subject to compliance with applicable legal requirements and other factors.

EXHIBIT INDEX

<u>Number</u>	<u>Description</u>
3.1	Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to Amendment No. 2 to the Company's Registration Statement on Form S-1/A filed on June 14, 1999, File No. 333-77483)
3.2	Certificate of Amendment to the Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on April 4, 2002, File No. 000-26489)
3.3	Bylaws, as amended through May 1, 2007 (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on May 3, 2007)
4.1	Registration Rights Agreement, dated as of February 21, 2002, between the Company and the several Purchasers listed on Schedule A thereto (incorporated by reference to Exhibit 4.3 to the Company's Current Report on Form 8-K filed on February 25, 2002, File No. 000-26489)
4.2	Amended and Restated Registration Rights Agreement, dated as of October 31, 2000, between the Company and the several stockholders listed therein (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed on August 22, 2003, File No. 000-26489)
4.3	Registration Rights Agreement, dated as of September 19, 2005, by and among Encore Capital Group, Inc. and Morgan Stanley & Co. Incorporated and J.P. Morgan Securities Inc. (incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K filed on September 22, 2005)
4.4	First Amendment, dated as of March 13, 2001, to Amended and Restated Registration Rights Agreement, dated as of October 31, 2000, between the Company and the several stockholders listed therein (incorporated by reference to Exhibit 4.3 to the Company's Current Report on Form 8-K filed on August 22, 2003, File No. 000-26489)
4.5	Indenture, dated September 19, 2005, by and between Encore Capital Group, Inc. and JP Morgan Chase Bank, N.A. (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on September 22, 2005)
4.6	Instrument of Resignation, Appointment and Acceptance, dated September 21, 2006, by and among Encore Capital Group, Inc., JPMorgan Chase Bank, N.A., and The Bank of New York (now known as The Bank of New York Mellon Trust Company, N.A.) as successor trustee (incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q filed on July 30, 2009)
4.7	Form of 3.375% Convertible Senior Notes due 2010 (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed on September 22, 2005)
4.8	Form of Common Stock Certificate (incorporated by reference to Exhibit 4.7 to the Company's Registration Statement on Form S-3 filed on December 21, 2009, File No. 333-163876)
10.1	Multi-Tenant Office Lease dated as of April 8, 2004 between LBA Realty Fund-Holding Co. I, LLC and Midland Credit Management, Inc. (the "Midland Lease") (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 4, 2004, File No. 000-26489)
10.2	Lease Guaranty dated as of April 8, 2004 by the Company in favor of LBA Realty Fund-Holding Co. I, LLC in connection with the Midland Lease (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on May 4, 2004, File No. 000-26489)
10.3+	1999 Equity Participation Plan, as amended (incorporated by reference to Appendix I to the Company's proxy statement filed on April 1, 2004, File No. 000-26489)
10.4+	Form of Indemnification Agreement (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on May 4, 2006)
10.5+	Form of Option Amendment (incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K filed on May 4, 2006)

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<u>Number</u>	<u>Description</u>
10.6+	Executive Non-Qualified Excess Plan (incorporated by reference to Exhibit 10.6 of the Company's Annual Report on Form 10-K filed on February 11, 2009)
10.7+	Encore Capital Group, Inc. 2005 Stock Incentive Plan, as amended and restated (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on June 15, 2009)
10.8+	Amended Form of Stock Option Agreement for awards under the 2005 Stock Incentive Plan (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on July 30, 2009)
10.9+	Amended Form of Restricted Stock Unit Grant Notice and Agreement (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed on July 30, 2009)
10.10+	Form of Split-Dollar Agreement (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on May 4, 2006)
10.11	Credit Agreement dated as of June 7, 2005 among Encore Capital Group, Inc., the Lenders from time to time parties thereto and JPMorgan Chase Bank, N.A. as Administrative Agent (the "Credit Agreement") (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on June 8, 2005)
10.12	Amendment No. 1 to the Credit Agreement, dated as of August 1, 2005 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on August 1, 2005)
10.13	Amendment No. 2, to the Credit Agreement, dated as of May 3, 2006 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 9, 2006)
10.14	Amendment No. 3, to the Credit Agreement, dated as of February 27, 2007 (incorporated by reference to Exhibit 10.29 to the Company's Annual Report on Form 10-K filed on February 28, 2007)
10.15	Consent and Amendment No. 4 to the Credit Agreement, dated as of May 7, 2007 (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on May 8, 2007)
10.16	Amendment No. 5 to the Credit Agreement, dated as of October 19, 2007 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on October 22, 2007)
10.17	Amendment No. 6 to the Credit Agreement, dated as of December 27, 2007 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 27, 2007)
10.18	Amendment No. 7 to the Credit Agreement, dated as of May 9, 2008 (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed July 7, 2008)
10.19	Amendment No. 8 to the Credit Agreement, dated as of July 3, 2008 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed July 7, 2008)
10.20	Pledge and Security Agreement dated as of June 7, 2005, with respect to the Credit Agreement (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on June 8, 2005)
10.21	Guaranty dated as of June 7, 2005, with respect to the Credit Agreement (incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K filed on June 8, 2005)
10.22+	Severance protection letter agreement dated as of March 11, 2009 between the Company and J. Brandon Black (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on March 13, 2009)
10.23+	Severance protection letter agreement dated as of March 11, 2009 between the Company and Paul Grinberg (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on March 13, 2009)

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<u>Number</u>	<u>Description</u>
10.24	Asset Purchase and Forward Flow Agreement dated as of June 2, 2005 among Jefferson Capital Systems, LLC, Midland Funding LLC and Encore Capital Group, Inc. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on June 8, 2005)
10.25	Acknowledgement Agreement dated as of June 7, 2005 between CompuCredit Corporation and Midland Funding LLC (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on June 8, 2005)
10.26	Asset Purchase Agreement dated as of August 30, 2005 among Ascension Capital Group, Ltd., Ascension Capital Management, L.L.C., The Erich M. Ramsey Trust, Erich M. Ramsey, Leonard R. Oszustowicz, Jeffrey J. Walter, Ascension Acquisition, LP, and Encore Capital Group, Inc. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on September 2, 2005)
10.27	Convertible Note Hedge Confirmation, dated as of September 13, 2005, by and between Encore Capital Group, Inc. and JPMorgan Chase Bank, National Association, an affiliate of J.P. Morgan Securities Inc. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on September 22, 2005)
10.28	Convertible Note Hedge Confirmation, dated as of September 13, 2005, by and between Encore Capital Group, Inc. and Morgan Stanley International Limited, an affiliate of Morgan Stanley & Co. Incorporated. (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on September 22, 2005)
10.29	Convertible Note Hedge Confirmation, dated as of September 30, 2005, by and between Encore Capital Group, Inc. and JPMorgan Chase Bank, National Association, an affiliate of J.P. Morgan Securities Inc. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on October 6, 2005)
10.30	Convertible Note Hedge Confirmation, dated as of September 30, 2005, by and between Encore Capital Group, Inc. and Morgan Stanley International Limited, an affiliate of Morgan Stanley & Co. Incorporated. (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on October 6, 2005)
10.31	Warrant Confirmation, dated as of September 13, 2005, by and between Encore Capital Group, Inc. and JPMorgan Chase Bank, National Association, an affiliate of J.P. Morgan Securities Inc. (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on September 22, 2005)
10.32	Warrant Confirmation, dated as of September 13, 2005, by and between Encore Capital Group, Inc. and Morgan Stanley International Limited, an affiliate of Morgan Stanley & Co. Incorporated. (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on September 22, 2005)
10.33	Warrant Confirmation, dated as of September 30, 2005, by and between Encore Capital Group, Inc. and JPMorgan Chase Bank, National Association, an affiliate of J.P. Morgan Securities Inc. (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on October 6, 2005)
10.34	Warrant Confirmation, dated as of September 30, 2005, by and between Encore Capital Group, Inc. and Morgan Stanley International Limited, an affiliate of Morgan Stanley & Co. Incorporated. (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on October 6, 2005)
10.35	Lease Agreement, dated as of March 24, 2009, between Midland Credit Management India Private Limited, Dinesh Kumar and Manmohan Gaiind, for real property located in Gurgaon, India (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on April 29, 2009)

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<u>Number</u>	<u>Description</u>
10.36	Lease Deed, dated as of April 22, 2009, between Midland Credit Management India Private Limited and R.S. Technologies Private Limited, for real property located in Gurgaon, India (incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q filed on April 29, 2009)
10.37	Sublease, dated as of March 31, 2008, by and between Encore Capital Group, Inc. and FMT Services, Inc., for real property located in St. Cloud, Minnesota (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed on August 4, 2008)
10.38	Multi-Tenant Net Commercial Lease, dated as of February 20, 2008, by and between Encore Capital Group, Inc. and Pranjivan R. Lodhia and Lolita Lodhia, for real property located in Phoenix, Arizona (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on August 4, 2008)
10.39	Sublease, dated as of February 12, 2004, by and between Southwestern Bell Telephone, L.P. and Ascension Capital Group, Inc., as successor in interest to Ascension Capital Group, Ltd., for real property located in Arlington, Texas (filed herewith)
10.40	Assignment and Consent to Assignment of Sublease, dated as of August 18, 2005, by and between DBSI Housing, Inc., Ascension Capital Group, Ltd., Encore Capital Group, Inc., Ascension Acquisition, L.P., now known as Ascension Capital Group, Inc., and Southwestern Bell Telephone, L.P. (filed herewith)
10.41	Credit Agreement dated as of February 8, 2010 by and among Encore Capital Group, Inc., the Lenders from time to time parties thereto, and JPMorgan Chase Bank, N.A., as administrative agent (the "2010 Credit Agreement") (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 8, 2010)
10.42	Pledge and Security Agreement dated as of February 8, 2010 with respect to the 2010 Credit Agreement (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on February 8, 2010)
10.43	Guaranty dated as of February 8, 2010 with respect to the 2010 Credit Agreement (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on February 8, 2010)
21	List of Subsidiaries (filed herewith)
23	Consent of Independent Registered Public Accounting Firm, BDO Seidman, LLP, dated February 8, 2010 to the incorporation by reference of their report dated February 8, 2010, in the Company's Registration Statements on Form S-8 (filed herewith)
24	Power of Attorney (filed herewith)
31.1	Certification of the Principal Executive Officer pursuant to rule 13-14(a) under the Securities Exchange Act of 1934 (filed herewith)
31.2	Certification of the Principal Financial Officer pursuant to rule 13-14(a) under the Securities Exchange Act of 1934 (filed herewith)
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley act of 2002 (furnished herewith)
+	Management contract or compensatory plan or arrangement.

SUBLEASE

THIS SUBLEASE (this "Sublease"), made as of the 12 day of February , 2004, by and between **SOUTHWESTERN BELL TELEPHONE, L.P.**, successor in interest to Southwestern Bell Telephone Company, having an address of 7159 San Pedro, Suite 202, San Antonio, Texas 78216 ("Sublessor") and **ASCENSION CAPITAL GROUP, LTD.**, a Texas limited partnership, having an address of 2201 E. Lamar Blvd., Suite 200, Arlington, TX 76006 ("Sublessee").

WITNESSETH:

WHEREAS, Sublessor leases 85,893 square feet of "Net Rentable Area," as that term is defined in the "Lease," as defined below, on the First (1st) and Second (2nd) floors (the "**Premises**") of the building known as The Arbors of Brookhollow I (the "**Building**") and located at 2201 E. Lamar in Arlington, Texas, (the "**Property**") pursuant to a certain Office Lease dated as of September 26, 2000, (collectively, the "**Lease**"), made by and between The Arbors of Brookhollow Operating Partnership, LTD., a Texas limited partnership, as landlord (the "**Landlord**") and Sublessor, as tenant, which Lease is attached hereto as **Exhibit A** and made a part hereof;

WHEREAS, Sublessee desires to sublet from Sublessor the portion of the Premises located on the Second (2nd) floor, consisting of 28,603 rentable square feet, as shown on **Exhibit B** attached hereto and made a part hereof (the "**Sublet Premises**"); and

WHEREAS, Sublessor desires to sublet the Sublet Premises to Sublessee, and Sublessee desires to Sublet the Sublet Premises from Sublessor, upon the terms and conditions contained herein.

NOW, THEREFORE, the parties hereto, for themselves and their respective successors and assigns, in consideration of the premises and the covenants hereinafter contained and the sum of TEN DOLLARS (\$10.00) to each party paid by the other, the receipt and sufficiency of which is hereby acknowledged, do covenant and agree as follows:

1. **Term.** Provided Landlord consents to this Sublease, as evidenced by the executed Landlord Consent attached hereto as **Exhibit C** and made a part hereof (the "**Landlord Consent**"), Sublessor does hereby sublet to Sublessee the Sublet Premises on the terms and conditions set forth in this Sublease for the term (the "**Term**") commencing on the mutual execution of this Sublease and the receipt of the executed Landlord Consent by the Landlord (the "**Commencement Date**"), and ending on December 31, 2010 (the "**Expiration Date**"), unless sooner terminated under the terms of the Lease or this Sublease. Sublessee and its agents shall have the right of access to the Sublet Premises, subject to all of the provisions of this Sublease other than the payment of Rent (as defined below) on the Commencement Date for the purposes of space planning and construction of Sublessee's improvements to the Sublet Premises, such construction is contingent upon Landlord and Sublessor consenting to the improvements.

So long as Sublessee complies with the terms and conditions of this Sublease, Sublessor shall not (i) commit any act or omission during the Term that would lead to a termination of the Lease by Landlord, (ii) amend any provisions under the Lease to provide for an early termination of the Lease, or (iii) make elections, or give any consent or approval under the Lease to the extent any of the foregoing would have a material adverse affect on Sublessee rights and obligations hereunder. To the extent that Sublessor shall receive any written notice of default from Landlord, Sublessor shall, within ten (10) business days thereafter, deliver to Sublessee a written copy of such notice of default, whereupon Sublessee shall have the option (but not the obligation) to cure any such default by Sublessor under the Lease.

2. **Rent.** (a) The Rent Commencement Date shall be May 1, 2004, Sublessee covenants and agrees to pay Sublessor during the term of this Sublease base rent (the "**Base Rent**"), without deduction or offset and without notice or demand, at the Sublessor's address, as set forth in Paragraph 14 hereof, or to such other entity or at such other place as Sublessor may from time to time designate in writing as follows:

<u>Period</u>	<u>Monthly Base Rent</u>	<u>Annual RSF</u>
82 Months	\$ 24,800.00	\$ 10.40

(b) In addition to Base Rent, Sublessee covenants and agrees to pay Sublessor during the term of this Sublease the following expense items (collectively, the "Additional Rent"): (a) beginning January 1, 2005, thirty three percent (33%) ("**Sublessee's Proportionate Share**") of any increase in the "Operating Expenses," as defined in Section 4 of the Lease, incurred by Sublessor pursuant to the terms of the Lease, over the Operating Expenses incurred by Sublessor for the calendar year 2004, which payments shall payable by Sublessee to Sublessor in such amounts and in the same manner as Sublessor is obligated to Landlord for said expenses as set forth in Section 4 of the Lease; (b) beginning on the Commencement Date, any costs, fees or charges owed or payable by Sublessee pursuant to any services provided to Sublessee by Landlord or Sublessor, whether with or without Sublessor's permission, that are directly related to the Sublet Premises, including, but not limited to electricity, excess electricity or other utilities and any overtime HVAC charges related to the Sublet Premises; and (c) beginning on the Commencement Date, such other sums of money as shall become due and payable by Sublessor to the Landlord pursuant to the Lease due to the actions or inactions of the Sublessee in default of this Sublease or the Lease. The Base Rent and Additional Rent are collectively referred to hereinafter as the "Rent." Notwithstanding anything contained herein to the contrary, although Sublessee shall not be required to pay Sublessee's proportionate share of Operating Expenses until January 1, 2005, Sublessee shall nevertheless be required to pay for any overtime charges, including, without limitation, electricity and HVAC, or any additional services used by it, as of the Commencement Date.

(c) Other than Sublessee's obligation to pay Sublessee's share of Operating Expenses, which obligation shall commence as of January 1, 2005, all other Rent shall be paid to Sublessor in advance, on the first day of each and every month throughout the Term, commencing on the Commencement Date. If the Term shall commence or end on a day other than the first *day* of a month, then the monthly installments of Base Rent for the first and last partial month shall be prorated on a per diem basis. Upon the execution of this Sublease, Sublessee shall pay one monthly installment of Base Rent on account of the first full calendar month of the Term and a prorated monthly installment of Base Rent for any partial month of the Term that may precede such full calendar month, with the first such monthly payment of Rent being due and payable upon the execution and delivery hereof by Sublessee to Sublessor. If Sublessee fails to pay any installment of Rent within ten (10) days after same is due, such unpaid amount shall incur a five (5%) late charge, which amount shall be immediately due and payable to Sublessor. Any sums not paid as required hereunder shall bear interest from the due date until paid in full at a rate equal to the lesser of (a) the highest rate announced from time to time as the prime interest rate by The Wall Street Journal plus three (3) percentage points; or (b) the maximum legal rate allowed by law. If Sublessee makes two (2) consecutive payments of Rent which are returned to Sublessor by Sublessee's financial institution for insufficient funds, Sublessor may require, by giving written notice to Sublessee, that all future payments of Rent shall be made in immediately available funds by cashier's check or by wire transfer. The foregoing is in addition to any other remedies of Sublessor hereunder, at law or in equity.

3. **Personal Property Taxes.** In addition to its obligations for payment of Rent, Sublessee shall pay, prior to delinquency, all taxes assessed against and levied upon trade fixtures, furnishings, equipment and all other personal property of Sublessee contained in the Sublet Premises. Sublessee shall cause said trade fixtures, furnishings, equipment and all other personal property to be assessed and billed in Sublessee's name, separately from the real and/or personal property of Sublessor or Landlord. If any of Sublessee's said personal property shall be assessed with Sublessor's property or Landlord's property, then Sublessee shall pay the taxes attributable to Sublessee's property within ten (10) days after receipt of a written statement setting forth the taxes applicable thereto. Sublessee covenants to promptly furnish to Sublessor proof of the payment of any such personal property taxes which are payable by Sublessee as provided in this Paragraph 3.

4. Security. On the Commencement Date, Sublessee shall deliver to Sublessor, a cash security deposit in the amount of \$49,600.00 (the “**Cash Security Deposit**”). The Cash Security Deposit, as applicable, shall be held by Sublessor as additional security for faithful and prompt performance of Sublessee’s obligations under this Sublease. In the event of a default under this Sublease, beyond all applicable notice and cure periods, Sublessor may, but shall not be obligated to, draw upon the Cash Security Deposit, as applicable, solely to the extent necessary to make good any arrearages in Rent and any other actual damage, injury, expense or liability caused to Sublessor by such default. If Sublessor is holding a Cash Security Deposit and expends all or any part of thereof to cure a default, then on notice from Sublessor to Sublessee, Sublessee shall immediately increase the amount of the Cash Security Deposit in an amount equal to the amount drawn by Sublessor. The Cash Security Deposit shall not be deemed an advance payment of Rent or a measure of Sublessor’s damages for any default hereunder by Sublessee. To the extent Sublessor has not applied all of the Cash Security Deposit, as applicable, to cure one or more defaults under this Sublease then the Cash Security Deposit, as applicable, as the same may have been drawn upon, shall be returned to Sublessee within thirty (30) days after the expiration or earlier termination of this Sublease. If and to the extent that the Cash Security Deposit is not timely returned to Sublessee, then interest thereon shall accrue at the rate of twelve percent (12%) per annum until fully repaid to Sublessee. In the event of any assignment of Sublessor’s interest in the Lease, Sublessor shall have the right to transfer the Cash Security Deposit as applicable, to the assignee and Sublessor shall, thereupon, be released by Sublessee from all liability for the return of the Cash Security Deposit and, in such event, Sublessee agrees to look solely to the new Sublessor for the return of the Cash Security Deposit.

Sublessee further covenants that it will not assign or encumber, or attempt to assign or encumber, its interest in the Cash Security Deposit and that neither Sublessor nor its successors or assigns shall be bound by any such assignment or encumbrance, or attempted assignment or attempted encumbrance.

5. Sublease and Assignment. Sublessee shall not have the right to sublease or assign this Sublease or any part thereof, or suffer or permit the Sublet Premises or any part thereof to be occupied by others, by operation of law or otherwise without the prior written consent of Sublessor and Landlord. Any attempt by Sublessee to sublease or assign its interests under the Sublease in contravention of this Sublease without such prior written consent shall be void, of no effect, and constitute an Event of Default hereunder. Any required consent of Sublessor shall not be unreasonably withheld, conditioned or delayed. If Sublessee should desire to assign this Sublease or sublease the Sublet Premises or any portion thereof, Sublessee shall give Sublessor written notice of such desire to make such assignment or effect such sublease. At the time of giving such notice, Sublessee shall provide Sublessor with a copy of the proposed assignment or sublease document, and such information as Sublessor and Landlord may reasonably request concerning the proposed assignee or sublessee to assist Sublessor and Landlord in making an informed judgment regarding the financial condition, reputation, operation, and general desirability of the proposed assignee or sublessee. Sublessor shall then have a period of twenty (20) days following receipt of such notice and such information within which to notify Sublessee in writing of whether Sublessor approves or disapproves of such request to sublease or assign its interest in the Sublease.

Sublessor and Sublessee agree that, in the event of any approved assignment or subletting, the rights of any such assignee or sublessee of Sublessee herein shall be subject to all of the terms, conditions, and provisions of this Sublease and the Lease. Sublessor may collect Rent directly from such assignee or sublessee and apply the amount so collected to the Rent herein reserved. No such consent to or recognition of any such assignment or subletting shall constitute a release of Sublessee, or any guarantor of Sublessee’s performance hereunder (“Guarantor”), from further performance by Sublessee or such Guarantor of covenants undertaken to be performed by Sublessee herein. Sublessee and/or such Guarantor shall remain liable and responsible for all Rent and other obligations herein imposed upon Sublessee. Sublessee shall pay all of Sublessor’s costs in connection with any such assignment of subletting, including, without limitation, attorneys fees. Consent by Sublessor to a particular assignment, sublease, or other transaction shall not be deemed a consent to any other or subsequent transaction. If any Rent payable to Sublessee by any sublessee, assignee, licensee, or other transferee exceeds the Rent reserved herein, then Sublessee shall be bound and obligated to pay Sublessor fifty percent (50%) of all such excess Rent within ten (10) days following receipt thereof by Sublessee from such sublessee, assignee, licensee, or other transferee, as the case might be, as Additional Rent.

6. **Additional Services.** If, under any provision of the Lease, any additional rent or other charge shall be payable by Sublessor to Landlord because of extra services ordered by or activities undertaken by or on behalf of Sublessee with respect to the Sublet Premises or on account of Sublessee's default hereunder, then Sublessee shall pay to Sublessor such additional rent or other charge on demand by Sublessor. Sublessee hereby agrees that any and all such requests for extra services and/or activities for the benefit of Sublessee shall be made by Sublessee in writing to Landlord, with a copy to Sublessor. In no event shall Sublessor be responsible for any matter associated with the provision, or lack of provision, of any such extra services or activities. Sublessor shall have the right to require that Sublessee provide a reasonable cash security deposit sufficient to cover the cost of such services prior to Landlord's providing such services. To the extent Sublessor has not applied all of such cash security deposit, as applicable, to cover the cost of services being provided hereunder, then the cash security deposit, as applicable, as the same may have been drawn upon, shall be returned to Sublessee within thirty (30) days after the expiration or earlier termination of this Sublease. If and to the extent that the cash security deposit is not timely returned to Sublessee, then interest thereon shall accrue at the rate of twelve percent (12%) per annum until fully repaid to Sublessee.

7. **Alterations.** Sublessee shall not make or suffer to be made any alterations, additions, or improvements, or attach any fixtures or equipment in, on, or to the Sublet Premises or any part thereof ("**Alterations**"), without the prior written consent of Sublessor and Landlord, which shall not be unreasonably withheld, delayed, or conditioned. When applying for such consent, Sublessee shall, at its own expense, if requested by either Sublessor or Landlord, furnish complete plans and specifications for such Alterations.

In connection with any Alterations, Sublessee shall comply with all applicable provisions of the Lease in making any such Alterations, including, but not limited to any restoration obligations imposed thereunder; the same shall be constructed in accordance with all government laws, ordinances, rules and regulations. In addition, prior to construction of any such Alterations, Sublessee shall provide all such assurances to Landlord, including but not limited to, waivers of lien, and surety company performance bonds as Landlord or Sublessor shall require to protect Landlord and the Building and appurtenant land against any loss from any mechanic's, materialmen's or other liens.

8. **Insurance.** Sublessee shall maintain, at its sole cost and expense, insurance coverages in such amounts, and with such an insurer holding such a Best's Rating, which coverages and rating are the lesser of (i) what is required of Tenant in the Lease and (ii) the following:

Coverages with an insurer(s) holding a Best's Rating of A+ or higher with Financial Size of Class X or higher, and reasonably acceptable to Sublessor and Landlord, and in the following coverage amounts:

(i) ISO Simplified Commercial General Liability Insurance. The limits of liability of such insurance shall be an amount not less than Two Million and 00/100 Dollars (\$2,000,000.00) per occurrence, Bodily Injury including death and Two Million and 00/100 Dollars (\$2,000,000.00) per occurrence, Property Damage Liability or Two Million and 00/100 Dollars (\$2,000,000.00) combined single limit for Bodily Injury and Property Damage Liability. Such policies shall name Landlord and Sublessor as additional insureds with respect to this Sublease and the Lease; and

(ii) Property insurance on Sublessee's personal property, on a Special Causes of Loss Replacement Cost basis. This insurance shall include, but shall not be limited to, fire and extended coverage perils. Such property insurance policy shall contain appropriate endorsements waiving the insurer's right of subrogation against Sublessor and Landlord.

Each policy will provide that Landlord and Sublessor shall receive at least thirty (30) days' prior written notice of cancellation or non-renewal of the policy. Concurrently with its execution of this Sublease, Sublessee shall deliver to Sublessor a certificate of insurance evidencing the insurance coverage required hereunder.

9. **Obligations.** Excluding Sections 5, 9, 10, 11, 16, 17, 18, 21, 26, 29, 32, 34, 36, 40(a), and 40(b) of the Lease and the matters contained herein which will be governed by this Sublease, Sublessee agrees (i) to be bound by the terms and conditions of the Lease, (ii) to perform Sublessor's obligations with respect to the Sublet Premises as set forth in the Lease with respect to periods on and after the Commencement Date, and (iii) to be subject to the terms and conditions of any Landlord consent to this Sublease. Sublessor shall in no event be obligated to perform Landlord's obligations under the Lease or to enforce the terms, covenants, obligations and conditions on the part of, or to be performed by, Landlord under the Lease. With respect to the performance of obligations required of Landlord under the Lease, Sublessor's sole obligation with respect thereto shall be to request the same for Sublessee, upon written request from Sublessee, and to use reasonable efforts to obtain the same from Landlord, but in no event shall Sublessor be obligated to incur any expense associated with such effort. Sublessor shall not be liable in damages, nor shall rent abate hereunder, for or on account of any failure by Landlord to perform the obligations and duties imposed on it under the Lease. No rights of Sublessor arising from the Lease are granted or assigned to Sublessee, including, but not limited to, any rights to renew, extend, surrender or terminate the Lease.

10. Condition and Use of the Sublet Premises: Preparation of Sublet Premises.

(a) Sublessee agrees to accept the Sublet Premises in "AS IS" condition, and Sublessee agrees that it has inspected the Sublet Premises and acknowledges that no representations, express or implied, of any kind, with respect to the condition thereof have been made to Sublessee by Sublessor.

(b) The Sublet Premises are to be used solely for general office purposes. Sublessee shall not do or permit anything to be done in or about the Sublet Premises which will in any way obstruct or interfere with the rights of other tenants or occupants of the Building or injure, annoy, or disturb them or allow the Sublet Premises to be used for any improper, immoral, unlawful, or objectionable purpose. Sublessee shall comply with all governmental laws, ordinances and regulations applicable to the use of the Sublet Premises and its occupancy and shall promptly comply with all governmental orders and directions for the correction, prevention and abatement of any violations in or upon, or in connection with, the Sublet Premises, all at Sublessee's sole expense. Sublessee shall not do or permit anything to be done on or about the Sublet Premises or bring or keep anything into the Sublet Premises which will in any way increase the rate of, invalidate or prevent the procuring of any insurance protecting against loss or damage to the Building or any of its contents by fire or other casualty or against liability for damage to property or injury to persons in or about the Building or any part thereof. Sublessee shall use the Sublet Premises and any common areas of the Building in a careful, safe and proper manner and shall keep the Sublet Premises in a neat and sanitary condition and shall not commit or permit any nuisance or waste on or in, or about the Sublet Premises. Sublessee shall dispose of all debris, trash and waste in compliance with all applicable laws and regulations.

11. **Sublessee Default.** In the event that Sublessee (a) fails to pay Rent within ten (10) days after Sublessor has delivered notice to Sublessee that the same is due; however, an event of default shall occur hereunder without any obligation of Sublessor to give any notice if Sublessor has given Sublessee written notice under this Section 11(a) on two (2) occasions during the twelve (12) month interval preceding such failure by Sublessee, (b) fails to cure a default of a non-monetary obligation within ten (10) days after written notice has been received by Sublessee; or (c) shall be adjudged bankrupt or insolvent or shall make an assignment for the benefit of creditors, or if a receiver or trustee of Sublessee's property shall be appointed and not discharged within sixty (60) days, such occurrence shall be an event of default and Sublessor shall have any and all rights and remedies set forth in Paragraph 12 hereof, in addition to all rights and remedies available to it at law and equity, including the rights of Landlord described in the Lease.

12. **Sublessor Remedies Upon Sublessee Default.**

(a) Sublessor shall have all rights and remedies of Landlord set forth in the Lease as against Sublessee, as if Sublessee were tenant under the Lease, and such rights as may be available at law or in equity. In addition to such rights and remedies, and notwithstanding any such rights and remedies which may be contrary to those of Landlord in the Lease, upon the occurrence of any such event of default by Sublessee as described in or referred to in Paragraph 11 hereof ("**Sublessee Default**"), Sublessor, after providing written notice to Sublessee of the nature of the default, shall have the option to pursue any one or more of the following remedies concurrently or consecutively and not alternatively:

(i) Sublessor may, at its election, terminate this Sublease or terminate Sublessee's right to possession only, without terminating the Sublease.

(ii) Upon any termination of this Sublease, whether by lapse of time or otherwise, or upon any termination of Sublessee's right to possession without termination of the Sublease, Sublessee shall surrender possession and vacate the Sublet Premises immediately, and deliver possession thereof to Sublessor, and Sublessee hereby grants to Sublessor full and free license to enter into and upon the Sublet Premises in such event and to repossess Sublessor of the Sublet Premises as of Sublessor's former estate and to expel or remove Sublessee and any others who may be occupying or be within the Sublet Premises and to remove Sublessee's signs and other evidence of tenancy and all other property of Sublessee therefrom without being deemed in any manner guilty of trespass, eviction or forcible entry or detainer, and without incurring any liability for any damage resulting therefrom, Sublessee waiving any right to claim damages for such re-entry and expulsion, and without relinquishing Sublessor's right to rent or any other right given to Sublessor under this Sublease or by operation of law.

(iii) Upon any termination of this Sublease, whether by lapse of time or otherwise, Sublessor shall be entitled to recover as damages, all Rent, including any amounts treated as Additional Rent under this Sublease, and other sums due and payable by Sublessee on the date of termination, plus Sublessor shall also be entitled to recover as liquidated damages and not as a penalty, an amount equal to the sum of: (a) an amount equal to the then present value of the rent reserved in this Sublease for the remainder of the stated Term of this Sublease including any amounts treated as Additional Rent under this Sublease and all other sums provided in this Sublease to be paid by Sublessee, less any rent received from a new sublessee, if any; (b) the value of the time and expense necessary to obtain a replacement tenant or tenants, and the estimated expenses relating to recovery of the Sublet Premises, preparation for reletting and for reletting itself; and (c) the cost of performing any other covenants which would have otherwise been performed by Sublessee.

(iv) Upon any termination of Sublessee's right to possession only without termination of the Sublease:

(A) Neither such termination of Sublessee's right to possession nor Sublessor's taking and holding possession thereof as provided shall terminate the Sublease or release Sublessee, in whole or in part, from any obligation, including Sublessee's obligation to pay the Rent, including any amounts treated as Additional Rent, under this Sublease for the full Term, plus any other sums provided in this Sublease to be paid by Sublessee for the remainder of the Term.

(B) Sublessor shall use reasonable efforts to relet the Sublet Premises or any part thereof for such rent and upon such terms as Sublessor, in its sole discretion, shall determine (including the right to relet the Sublet Premises for a greater or lesser term than that remaining under this Sublease, the right to relet the Sublet Premises as a part of a larger area, and the right to change the character or use made of the Sublet Premises). In connection with or in preparation for any reletting, Sublessor may, but shall not be required to, make repairs, alterations and additions in or to the Sublet Premises and redecorate the same to the extent Sublessor deems necessary or desirable, and Sublessee shall, upon demand, pay Sublessor's expenses of reletting, including, without limitation, any commission incurred by Sublessor. If Sublessor decides to relet the Sublet Premises or a duty to relet is imposed upon Sublessor by law, Sublessor and Sublessee agree that nevertheless Sublessor shall at most be required to use only the same efforts Sublessor then uses to sublease premises in the Building generally and that in any case that Sublessor shall not be required to give any preference or priority to the showing or leasing of the Sublet Premises over any other space that Sublessor may be subleasing or have available and may place a suitable prospective tenant in any such other space regardless of when such other space becomes available. Sublessor shall not be required to observe any instruction given by Sublessee about any reletting or accept a replacement tenant offered by Sublessee unless such offered tenant has a creditworthiness acceptable to Sublessor and leases the entire Sublet Premises upon terms and conditions including a rate of rent (after giving effect to all expenditures by Sublessor for subtenant improvements, broker's commissions and other subleasing costs) all no less favorable to Sublessor than as called for in this Sublease.

(C) Until such time as Sublessor shall elect to terminate the Sublease and shall thereupon be entitled to recover the amounts specified in such case herein, Sublessee shall pay to Sublessor upon demand the full amount of all Rent, including any amounts treated as Additional Rent under this Sublease and other sums reserved in this Sublease for the remaining Term, together with the costs of repairs, and Sublessor's expenses of reletting and the collection of the rent accruing therefrom (including attorney's fees and broker's commissions), as the same shall then be due or become due from time to time, less only such consideration as Sublessor may have received from any reletting of the Sublet Premises; and Sublessee agrees that Sublessor may file suits from time to time to recover any sums falling due under this Paragraph 12 as they become due. Any proceeds of reletting by Sublessor in excess of the amount then owed by Sublessee to Sublessor from time to time shall be credited against Sublessee's future obligations under this Sublease but shall not otherwise be refunded to Sublessee.

(b) If, on account of any breach or default by Sublessee in Sublessee's obligations under the terms and conditions of this Sublease, it shall become necessary or appropriate for Sublessor to employ or consult with an attorney concerning or to enforce or defend any of Sublessor's rights or remedies arising under this Sublease, Sublessee agrees to pay all Sublessor's attorney's fees so incurred. **SUBLESSEE EXPRESSLY WAIVES ANY RIGHT TO TRIAL BY JURY.**

(c) Pursuit of any of the foregoing remedies shall not preclude pursuit of any of the other remedies provided in this Sublease or any other remedies provided by law or in equity (all such remedies being cumulative), nor shall pursuit of any remedy provided in this Sublease constitute a forfeiture or waiver of any Rent due to Sublessor under this Sublease or of any damages accruing to Sublessor by reason of the violation of any of the terms, provisions and covenants contained in this Sublease.

(d) No act or thing done by Sublessor or its agents during the Term shall be deemed a termination of this Sublease or an acceptance of the surrender of the Sublet Premises, and no agreement to terminate this Sublease or accept a surrender of said Sublet Premises shall be valid, unless in writing signed by Sublessor. No waiver by Sublessor of any violation or breach of any of the terms, provisions and covenants contained in this Sublease shall be deemed or construed to constitute a waiver of any other violation or breach of any of the terms, provisions and covenants contained in this Sublease. Sublessor's acceptance of the payment of Rent or other payments after the occurrence of a Sublessee Default shall not be construed as a waiver of such Sublessee Default, unless Sublessor so notifies Sublessee in writing. Forbearance by Sublessor in enforcing one or more of the remedies provided in this Sublease upon the occurrence of a Sublessee Default shall not be deemed or construed to constitute a waiver of such Sublessee Default or of Sublessor's right to enforce any such remedies with respect to such Sublessee Default or any subsequent Sublessee Default.

(e) Any and all property which may be removed from the Sublet Premises by Sublessor pursuant to the authority of this Sublease, the Lease or of law or in equity, to which Sublessee is or may be entitled, may be handled, removed and/or stored, as the case may be, by or at the direction of Sublessor, but at the risk, cost and expense of Sublessee, and Sublessor shall in no event be responsible for the value, preservation or safekeeping thereof. Sublessee shall pay to Sublessor, upon demand, any and all expenses incurred in such removal and all storage charges against such property so long as the same shall be in Sublessor's possession or under Sublessor's control. Any such property of Sublessee not retaken by Sublessee from storage within twenty (20) days after removal from the Sublet Premises shall, at Sublessor's option, be deemed conveyed by Sublessee to Sublessor under this Sublease as by a bill of sale without further payment or credit by Sublessor to Sublessee.

13. **Indemnification.** Sublessee shall indemnify Sublessor and save Sublessor harmless from and against any and all claims, liability and expense for loss or damage suffered by Sublessor because of (i) the negligence, or willful misconduct of Sublessee, its agents, contractors or employees; (ii) any act or occurrence in the Sublet Premises unless caused by the negligence or willful misconduct of Sublessor, its agents, contractors or employees; and (iii) breach of this Sublease by Sublessee, its agents, contractors or employees including, but not limited to, losses caused to Sublessor under the Lease by Sublessee's holdover under the Sublease. Sublessee's obligations under this Paragraph 13 shall survive the termination of the Sublease.

Sublessor shall indemnify, defend (with counsel reasonably satisfactory to Sublessee), protect and hold Sublessee harmless from and against any and all claims, demands, actions, suits, proceedings, liabilities, obligations, losses, damages, judgments, costs, expenses (including, but not limited to, reasonable attorneys', consultants' and expert witness fees) arising out of (i) Sublessor's breach of any representation or warranty contained in this Sublease. The foregoing obligations shall survive the expiration or earlier termination of this Sublease.

14. **Notices.** Any notice, approval, request, consent, bill, statement or other communication required or permitted to be given, rendered or made by either party hereto, shall be in writing and shall be sent to the parties hereto by a nationally recognized overnight courier with proof of delivery at the following addresses:

Sublessor: SBC Services, Inc.
7159 San Pedro, Suite 202
San Antonio, Texas 78216
Attn: Lease Administrator

with a copy to: SBC Communications, Inc.
175 E. Houston
San Antonio, Texas 78205
Attention: General Attorney - Real Estate

Sublessee: Ascension Capital Group, Ltd.
2201 E. Lamar Blvd., Suite 200,
Arlington, TX 76006
Attn: Erich M. Ramsey

With a copy to: Ascension Capital Group, Ltd.
2201 E. Lamar Blvd., Ste 200
Arlington, TX 76006
Attn: General Counsel

Either Sublessor or Sublessee may, by notice to the other, change the address(es) to which notices are to be sent. All notices shall be deemed effective upon receipt or upon refusal to accept delivery.

15. **Consent.** Sublessee acknowledges that where consent of Landlord is required under the Lease, Sublessor's consent is also required, which consent shall not be unreasonably withheld, delayed, or conditioned. To the extent that any of the provisions of the Lease conflict with or are inconsistent with the provisions of this Sublease, whether or not such inconsistency is expressly noted herein, the provisions of the Lease shall in all instances prevail over the Sublease.

16. **Access.** Sublessor shall have the right to enter upon or obtain access to the Sublet Premises or any part thereof without charge at all reasonable times upon reasonable prior notice to inspect the Sublet Premises, or to otherwise exercise or perform any of the rights or obligations of Sublessor under the Lease or this Sublease. At any time during the Term of this Sublease, Sublessor may, at Sublessor's option, enter into and upon the Sublet Premises if Sublessor determines in its sole discretion that Sublessee is not acting within a commercially reasonable time to maintain, repair or replace anything for which Sublessee is responsible under this Sublease, or the Lease, and correct the same after providing written notice, without being deemed in any manner guilty of trespass, eviction or forcible entry and detainer and without incurring any liability for any damage or interruption of Sublessee's business resulting therefrom. If Sublessee shall have vacated the entire Sublet Premises, has not paid Rent and is in default beyond any applicable cure period, Sublessor may at Sublessor's option reenter the Sublet Premises at any time during the last six (6) months of the then current Term of this Sublease and make any and all such changes, alterations, revisions, additions and tenant and other improvements in or about the Sublet Premises as Sublessor shall elect, all without any abatement of any of the Rent otherwise to be paid by Sublessee under this Sublease.

17. **Severability.** If any term or provision of this Sublease or the application thereof to any person or circumstance shall to any extent be invalid or unenforceable, the remainder of this Sublease or the application of such term or provision to persons or circumstances other than those as to which it is invalid or unenforceable, shall not be affected thereby; and each term and provision of this Sublease shall be valid and be enforceable to the fullest extent permitted by law.

18. **Brokers.** Each party represents to the other that, other than CB Richard Ellis, Inc., as Sublessor's broker ("**Sublessor's Broker**") and NAI Stoneleigh Huff Brous McDowell, LP, as Sublessee's broker ("**Sublessee's Broker**"), no broker participated in the negotiations leading to Sublessee's rental of the Sublet Premises from Sublessor. Sublessor agrees to pay a commission to Sublessor's Broker and to Sublessee's Broker pursuant to separate agreements between Sublessor and Sublessor's Broker and between Sublessor and Sublessee's Broker, respectively. Except as specified above, each party agrees to indemnify and hold the other party harmless from and against any claim or demand of any broker or agent who claims that he/she participated with that party in this transaction.

19. **Parking.** Sublessor acknowledges and agrees that Sublessee shall be entitled to 101 parking spaces, of which 40 will be covered of the total Parking allocated to Sublessor as defined in the Lease under Section 40(c) and identified on Exhibit "G", available to "Tenant" under the Lease at no cost.

If, from time to time during the Term, the foregoing allocation of parking spaces to Sublessee shall be less than the Aggregate Employees (as defined below) of Sublessee, then Sublessee shall have the right, from time to time, to notify Sublessor in writing of such parking deficiency ("Parking Notice"), setting forth in such Parking Notice the Aggregate Employees of Sublessee and the total number of parking spaces needed by Sublessee, which shall in no event be greater than the Aggregate Employees of Sublessee. Thereafter, Sublessor shall have thirty (30) days after its receipt of such Parking Notice and a statement signed by the Vice President for Human Resources of Sublessee verifying, to the satisfaction of Sublessor, the Aggregate Employees of Sublessee to attempt to accommodate Sublessee's parking needs. If Sublessor can not provide an additional allocation of parking spaces to be made to Sublessee for the remainder of the Term sufficient for each of Sublessee's Aggregate Employees to have one (1) parking space, then at any time after the thirty sixth (36th) month of the Term, Sublessee may terminate the Sublease by paying to Sublessor One Hundred and Forty Eight Thousand Dollars (\$148,000), an amount approximately equal to six months base rent (the "Parking Termination Option"). Notwithstanding anything in this lease to the contrary, Sublessor may also retain one half of the Sublessee's Security Deposit (the "Retained Security Deposit") until such time as the Sublessee's Proportionate Share for the year in which such termination occurs can be determined. Any deficiencies in Sublessee's Proportionate Share which were not paid by Sublessee during the year of termination may be deducted from the Retained Security Deposit and the remainder will be returned to the Sublessee. For purposes of this paragraph, Aggregate Employees shall mean only eighty five (85) percent of full time employees of Sublessor, who are required to perform their job function solely at the Sublet Premises.

If and to the extent that the Sublease between HOTELS.COM, L.P. and Sublessor shall terminate prior to the end of its stated term (for any reason or no reason), and provided Sublessee is not in default beyond any applicable cure period under the Sublease, then Sublessor hereby agree to allocate to Sublessee an additional one hundred (100) parking spaces located on the Property, at no additional cost to Sublessee. In the event such spaces are allocated to Sublessee, the Parking Termination Option shall be void and Sublessee shall have no further rights to exercise such option.

20. **Holdover.** Notwithstanding anything stated in the Lease to the contrary, if Sublessee remains in possession of the Sublet Premises following the expiration of the term of this Sublease, Sublessee's tenancy shall be deemed a tenancy at sufferance, subject to all of the terms, conditions, provisions and obligations of this Sublease and the Lease, except that during such period of holdover, the annual Base Rent shall be the greater of: (a) one hundred fifty percent (150%) of the amount of holdover rent assessed against Sublessor by Landlord arising out of Sublessee's holdover, which Sublessee hereby acknowledges may include, without limitation, holdover rent assessed against Sublessor for both the Sublet Premises and any other portion of the Premises if, pursuant to the terms and conditions of the Lease, Sublessor is deemed in holdover thereunder due to the holdover of Sublessee in the Sublet Premises; and (b) two hundred percent (200%) of the annual Rent for the Sublet Premises then in effect at the expiration of the Term of this Sublease. Nothing contained in this Paragraph 20 shall affect or limit any of Sublessor's rights or remedies under any provision of this Sublease, with Sublessee being liable for any damages incurred by Sublessor as a result of such holdover, including, without limitation, special and consequential damages.

21. **Environmental.** During the Term of this Sublease, Sublessee shall not use, generate, manufacture, process, treat, store, release, or incorporate "Hazardous Materials" (as defined herein) into the Sublet Premises, the Premises, the Building, or into, on or under the Property or the land surrounding the Property, without prior written disclosure to and approval by Sublessor and Landlord. Sublessee shall also, at its own cost, comply with all "Environmental Laws" (as defined herein) applicable to Sublessee and/or to the Sublet Premises. For the purposes hereof "Environmental Laws" shall mean any applicable federal, state, county, regional or local statutes, laws, regulations, rules, ordinances, codes, standards, orders, licenses and permits of any governmental authorities relating to environmental, health or safety matters (including, without limitation, "Hazardous Materials," as defined herein). For the purposes hereof, "Hazardous Materials" shall mean any chemical, material or substance, exposure to which is prohibited, limited or regulated by any federal, state, county, regional or local authority or which even if not so prohibited, limited or regulated, poses a hazard to the health and safety of the occupants of the Building or the occupants of the area near the Building. During the Term of this Sublease, Sublessee shall promptly provide Sublessor with copies of all summons, citations, directives, information inquiries or requests, notices of potential responsibility, notices of violation or deficiency, orders of decrees, claims, complaints, investigations, judgments, letters, notices of environmental liens or response actions in progress, and other communications, written or oral, actual or threatened, from any federal, state, or local agency or authority, or any other entity or individual, concerning (a) any release of a Hazardous Material; (b) the imposition of any lien on the Sublet Premises, the Premises, the Building, or the Property; or (c) any alleged violation of or responsibility under Environmental Laws.

22. **Surrender of the Premises.** Sublessee, on the Expiration Date, shall peaceably surrender the Sublet Premises, in broom-clean condition and otherwise in as good condition as when Sublessee took possession, and in the condition required by the Lease, except for: (i) reasonable wear and tear, (ii) loss by fire or other casualty, and (iii) loss by condemnation. Sublessee shall remove all of its property from the Sublet Premises on or before the Expiration Date and pay the reasonable cost of repairing all damage to the Sublet Premises or the Building caused by such removal.

23. **Terms.** All capitalized terms used herein and not otherwise defined herein shall have the meanings ascribed to them in the Lease.

24. **Entire Agreement.** This Sublease, the Exhibits attached hereto, and the Lease, which has been incorporated herein by reference, contain the entire agreement between the parties concerning the Sublet Premises and shall supersede any other agreements between the parties concerning this matter, whether oral or written. This Sublease shall not be modified, cancelled or amended except by written agreement, signed by both parties. The submission of this Sublease or some or all of its provisions for examination does not constitute an option or an offer to enter into this Sublease, it being understood and agreed that neither Sublessor nor Sublessee shall be legally bound hereunder unless and until this Sublease has been executed and delivered by both Sublessor and Sublessee, and then subject to the conditions hereof.

25. **Counterparts.** This Sublease may be executed in several counterparts, all of which shall constitute one and the same instrument. For the purposes of execution of this Sublease, a facsimile copy of a signed counterpart shall be deemed an original.

26. **Binding Effect.** This Sublease shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors and assigns.

27. **Governing Law.** This Sublease shall be governed by and construed in accordance with the internal laws of State within which the Sublet Premises is located, except for the portion of such laws having to do with conflicts of laws.

28. **Authority of Sublessee.** Sublessee represents and warrants to Sublessor that (a) it is a valid and existing limited partnership licensed to do business in the State or Commonwealth in which the Sublet Premises is located and (b) it has the power and authority to execute and deliver this Sublease and perform its obligations hereunder.

29. **Waivers.** No waiver by any party of a breach of any provision of this Sublease, and no failure by any party to exercise any right or remedy relating to a breach of any provision of this Sublease, shall (a) constitute a waiver or relinquishment for the future of such provision, (b) constitute a waiver of or consent to any subsequent breach of such provision, or (c) bar any right or remedy of such party relating to any such subsequent breach. The exercise by any party of any right or election under this Sublease shall not preclude such party from exercising any other right or election that it may have under this Sublease.

30. **Time of the Essence.** Time is of the essence with each provision of this Sublease.

31. **Representations and Warranties of Sublessor.** Sublessor represents and warrants, to the Sublessee, as follows:

(a) Sublessor is the "Tenant" under the Lease;

(b) The Lease is in full force and effect and has not been modified, altered or amended except as herein identified, and the copy of the Lease attached hereto is a true, correct and complete copy of the Lease;

(c) Sublessor has not received any written notice of default under the Lease or notice of termination of the Lease from Landlord, nor has Sublessor received any written notice of violation or condemnation from any federal, state, municipal or local governmental authority relating to the Sublet Premises or Building; and

(d) Sublessor has not received a notice of default from Landlord that remains uncured, and to the knowledge of Sublessor, without investigation, there exists under the Lease no default by either Landlord or Sublessor.

32. **Sublessee's Conditions to Closing.** Sublessee's obligations under this Sublease shall be expressly conditioned upon the delivery of the Landlord Consent to Sublessee by Sublessor.

(Remainder of page intentionally left blank; signature page to follow)

IN WITNESS WHEREOF, the parties have hereto executed this Sublease on the date first above written.

Witnesses:

Cheryl M. Gray

Mary Ann Vega

W. A.

Jonathan Finkbeiner

SUBLESSOR:

SOUTHWESTERN BELL TELEPHONE, L.P.

By: J. Stephen Sundry

Its: **Director-Real Estate Transactions**

SUBLESEE:

ASCENSION CAPITAL GROUP, LTD.

By and through its general partner
Ascension Capital Management, L.L.C.

By: [Signature]

Its: **CEO**

EXHIBIT A
LEASE AGREEMENT

STATE OF TEXAS §
COUNTY OF TARRANT §

THIS LEASE AGREEMENT, made and entered into by and between the Landlord and Tenant hereinafter named on this 26 day of September, 2000.

WITNESSETH:

1. DEFINITIONS AND BASIC PROVISIONS. The following definitions and basic provisions shall be used in conjunction with and limited by the reference thereto in the provisions of this Lease:

(a) "Landlord": THE ARBORS OF BROOKHOLLOW OPERATING PARTNERSHIP, LTD., a Texas limited partnership
c/o Stream Realty Partners, L.P.
9100 North Central Expressway, Suite 100
Dallas, Texas 75231

(b) "Tenant": SOUTHWESTERN BELL TELEPHONE COMPANY
1010 N. St. Mary's, Room 515
San Antonio, Texas 78205

(c) "Project": Those certain buildings, parking areas, structures, common areas, and related improvements which are located on the real property at 2201 East Lamar Boulevard, Arlington, Texas 76006, and described on Exhibit A attached hereto and made a part hereof. The total rentable area of the Project is 114,421 square feet.

(d) "Premises": That portion of the Project which is cross-hatched, or outlined in red, on Exhibit A-1 attached hereto and made a part hereof. The Premises consists of approximately 85,893 square feet of rentable area (as determined in accordance with BOMA ANSI Z65.1 1996 standards) and verified by the final space plan.

(e) "Lease Term": A primary period of one hundred twenty (120) months commencing on the later to occur of (i) January 1, 2001 or (ii) 90 days after this Lease is fully executed by Landlord and Tenant (the "Commencement Date") and ending on the date which is the last day of one hundred twentieth (120th) full calendar month following the Commencement Date, subject to the renewal options provided in Section 40(a) below (the Primary Term and "Renewal Term" as defined in Section 40(a), if applicable, may be collectively referred to herein as the "Lease Term").

(f) "Common Areas": All building lobbies, corridors, elevators, restrooms, landscaped areas, parking areas, service roads, loading facilities, sidewalks and other improvements and facilities in the Project, if any, which are shown on Exhibit A attached hereto and made a part hereof for all purposes or are designated by Landlord from time to time for the common use and enjoyment of Tenant and all tenants in the Project.

(g) "Environmental Law": Any federal, state, or local law, statute, ordinance, or regulation pertaining to health, industrial hygiene, or the environmental conditions on, under, or about the Project, including without limitation, the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA") as amended, 42 U.S.C. § 9601 et seq. ("RCRA"), the Texas Water Code ("TWC"), the Texas Solid Waste Disposal Act, Texas Health & Safety Code ("THSC") § 361.001 et seq. and regulations, rules, guidelines, or standards promulgated pursuant to such laws, as such statutes, regulations, rules, guidelines, and standards are amended from time to time.

(h) "Hazardous Substance": Hazardous Substance is any substance, product, waste, or other material which is or becomes listed, regulated, or addressed as being a toxic, hazardous, polluting, or similarly harmful substance under any Environmental Law, including without limitation: (i) any substance included within the definition of "hazardous waste" pursuant to Section 1004 of RCRA; (ii) any substance included within the definition of "hazardous substance" pursuant to Section 101 of CERCLA; (iii) any substance included within (1) the definition of "regulated substance" pursuant to Section 26.342(9) of TWC or (2) the definition of "hazardous substance" pursuant to Section 361.003(13) of THSC; (iv) asbestos; (v) polychlorinated biphenyls; (vi) petroleum products; and (vii) underground storage tanks, whether empty, filled or partially filled with any substance.

(i) "Basic Rent": \$161,765.15 per month for months one (1) through sixty (60) and \$168,922.90 per month for months sixty-one (61) through the end of the Lease Term (which Basic Rent could be adjusted as is otherwise provided in this Section 1 or Section 40(a) below).

(j) "Base Year": The year 2000.

(k) "Monthly Rent": The sum of the Basic Rent, Tenant's Prorata Share of Electrical Costs and Tenant's Prorata Share of Excess Operating Expenses.

(l) "Rent": The sum of all Monthly Rent and other amounts which Tenant is obligated to pay to Landlord over the Lease Term.

(m) "Permitted Use": General Office and Customer Service Center.

(n) "Tenant's Prorata Share": 85,893 square feet + 114,421 square feet = 75.0675%.

(o) "Delivery Date": The date that this Lease is fully executed by Landlord and Tenant.

As is reflected on Page 1, the exact amount of rentable area that will constitute the Premises has not been determined. The "Basic Rent", "Tenant's Prorata Share" and "Premises" reflected in this Lease are estimates, which will, therefore, be adjusted and finalized prior to Tenant's occupancy. At that time, the parties will execute an Addendum to this Lease reflecting the precise square footage contained within the Premises and shall, to the extent necessary, adjust the "Basic Rent" and "Tenant's Prorata Share" to reflect the exact rentable area of the Premises and the Building. The parties acknowledge that the Basic Rent for months one (1) through sixty (60) shall be based on \$22.60 per square foot of rentable area per annum and months sixty-one (61) through the end of the Lease Term shall be based on \$23.60 per square foot of rentable area per annum.

2. LEASE GRANT. Landlord, in consideration of the Rent to be paid and the other covenants and agreements to be performed by Tenant and upon the terms and conditions hereinafter stated, does hereby lease, demise and let unto Tenant the Premises commencing on the Commencement Date as defined in Section 1(e) hereof, or as adjusted as hereinafter provided) and ending on the last day of the Lease Term, unless sooner terminated or extended, as hereinafter provided. Landlord agrees to deliver the Premises in its "as is" condition to Tenant on the Delivery Date, fully vacated and in "broom clean" condition to allow Tenant to commence the construction of the Tenant Improvements in accordance with the Work Letter set forth in Exhibit B attached hereto. For every day following the Delivery Date that Landlord has failed to deliver the Premises to Tenant in fully vacated and "broom clean" condition, the date provided for in Section 1(e) shall be extended one (1) day. Landlord agrees that Tenant may occupy the Premises prior to the Commencement Date for the purpose of constructing the Tenant Improvements pursuant to the Work Letter without payment of Rent but otherwise in accordance with the terms and conditions of this Lease. By commencing construction of the Tenant Improvements, Tenant shall be deemed to have accepted the same as suitable for the purposes herein intended and to have acknowledged that the same comply fully with Landlord's covenants and obligations except as stated in writing by Tenant. Tenant's acceptance of the Premises shall not in any way relieve Landlord of its responsibilities as set forth in Section 40 hereof. After the Commencement Date of this Lease, Tenant shall, within ten (10) days after request from Landlord, execute and deliver to Landlord a letter of acceptance of delivery of the Premises, which letter shall also state the Commencement Date, the Expiration Date, the size of the Premises, the Basic Rent and Tenant's Prorata Share.

3. RENT. In consideration of this Lease, Tenant promises and agrees to pay Landlord the Monthly Rent, without deduction or set off, except as otherwise expressly provided for herein, for each month of the entire Lease Term. One such monthly installment shall be payable by Tenant to Landlord contemporaneously with the execution hereof, and a like monthly installment shall be due and payable without demand on or before the first day of each succeeding calendar month during the term hereof. Monthly Rent for any fractional month at the beginning or end of the Lease Term shall be prorated.

4. OPERATING EXPENSES AND ELECTRICAL COSTS.

(a) Tenant agrees to pay, as a part of Rent, Tenant's Prorata Share of the excess from time to time of all Operating Expenses (hereinafter defined) incurred during a calendar year over the Operating Expenses for the Base Year (the "Excess"). Landlord may collect such amount in a lump sum, to be due within thirty (30) days after Landlord furnishes to Tenant the Reconciliation Statement (hereinafter defined). Alternatively, Landlord may make a good faith estimate of the Excess (the "Estimated Excess") to be due by Tenant for any calendar year or part thereof during the Term, and, unless Landlord delivers to Tenant a revision of the Estimated Excess as provided in Section 41(e) below, Tenant shall pay to Landlord, on the Commencement Date and on the first day of each calendar month thereafter, an amount equal to the Estimated Excess for such calendar year or part thereof divided by the number of months in such calendar year during the Lease Term. Any amounts paid based on such an estimate shall be subject to adjustment pursuant to Section 4(d) when actual Operating Expenses are available for each calendar year.

(b) In the event the present method of taxation shall be changed so that in lieu of the whole or any part of any taxes, assessments or governmental charges levied, assessed or imposed on real estate and the improvements thereon, there shall be levied, assessed or imposed on Landlord a capital levy or other tax directly on the rents received therefrom and/or a franchise tax assessment, levy or charge measured by or based, in whole or in part, upon such rents for the present or any future building and real property described on Exhibit A, then all such taxes, assessments, levies or charges, or the part thereof so measured or based, shall be deemed to be included within the term "Taxes" for the purposes hereof. Landlord shall have the exclusive right to dispute and contest any Taxes by appropriate proceedings. Tenant shall receive a credit in the amount of Tenant's Prorata Share of any net tax refunds (meaning after Landlord has recouped its reasonable expenses of disputing and contesting such Taxes) received by Landlord.

(c) For purposes of this Lease, the term "Operating Expenses" means (i) all taxes, assessments, including all assessments made pursuant to restrictions and covenants applicable to the Project, and governmental charges of any kind and nature whatsoever (hereinafter collectively referred to as "Taxes") lawfully levied or assessed against the Project and real property described on Exhibit A, (ii) all insurance obtained by Landlord pursuant to the terms of this Lease, (iii) management fees not to exceed 4% of Gross Receipts exclusive of tenant reimbursements, security deposits and interest thereon, for the relevant calendar year and (iv) all reasonable, actual expenses of operating, maintaining and repairing the Project including the Common Areas in accordance with the terms of this Lease. The term "Operating Expenses" shall not include (i) costs of a capital nature, including, but not limited to, capital improvements, capital repairs, capital equipment, and capital tools, all as determined in accordance with generally accepted accounting principles and sound management practices consistently applied, except for capital costs incurred by reason of governmental requirement enacted after the date of this Lease, or to reduce Operating Expenses, provided, however, that capital expenditures incurred to reduce Operating Expenses shall be amortized on a straight-line basis over their anticipated useful life in accordance with generally accepted accounting principles and further provided that such amortized amount shall be included in Operating Expenses only to the extent of the saving actually realized in the applicable calendar year as a result of such capital expenditure; (ii) advertising and promotional costs including tenant relation programs and events; (iii) Landlord's gross receipts taxes (other than those applicable to rental receipts from the Project in lieu of or in addition to property taxes), personal and corporate income taxes, inheritance and estate taxes, other business taxes and assessments, franchise, gift and transfer taxes, and all other real estate taxes relating to a period outside the term of the Lease; (iv) brokerage fees and commissions incurred in connection with leasing or selling the Project or (v) payments of principal or interest on "Landlord's Building Debt" or any underlying or ground lease payments (herein so called); (vi) depreciation and amortization except as provided above; (vii) expenses incurred by Landlord to prepare, renovate, repaint, redecorate or perform any other work in any space leased to an existing tenant or prospective tenant of the Building; (viii) expenses incurred by Landlord for repairs or other work occasioned by fire, windstorm or other insurable casualty or condemnation except for the deductibles up to \$25,000.00; (ix) expenses incurred by Landlord to resolve disputes, enforce or negotiate lease terms with prospective or existing tenants or in connection with any financing, sale or syndication of the Project; (x) cost of repairs necessitated by Landlord's gross negligence or willful misconduct; (xi) cost of correcting any latent defects or original design defects in the Project construction, materials or equipment; (xii) expenses for any item or service which Tenant pays directly to a third party or separately reimburses Landlord and expenses incurred by Landlord to the extent the same are reimbursable or reimbursed from any other tenants, occupants of the property or third parties; (xiii) expenses for any item or service not provided to Tenant, but provided exclusively to certain other tenants within the Project; (xiv) salaries of employees not involved in the operation of the Project; (xv) the portion of the employee expenses which reflects that portion of such employee's time which is not spent directly in the operation of the Project; (xvi) Landlord's general corporate overhead and administrative expenses except those spent directly and solely in the operation of allocable to the Project; (xvii) expenses incurred by Landlord in order to comply with its obligations set forth in Section 40(c) and (d)(2) hereof; (xviii) reserves; (xix) fees paid to affiliates of Landlord to the extent that such fees exceed the customary amount charged for the services provided, (xx) the operating expenses incurred by Landlord relative to retail stores, hotels and any specialty service within the Project, (xxi) costs of sculptures, paintings, and other objects of art; (xxii) costs associated with the removal of Hazardous substances and all other substances considered to be detrimental to the environment or the health of occupants of the Project as such condition exists prior to the date of this Lease; (xxiii) other items not customarily included as operating expenses for similar multi-tenant, office buildings in the Arlington, Texas market; (xxiv) any fines, penalties, costs or interest resulting from the negligence or willful misconduct of the Landlord or its agents, contractors or employees or arising from Landlord's violation of any federal, state or local law or regulation and (xxv) the cost of items covered under warranty, however, the cost of the labor incurred by Landlord for the repair or replacement of such item which cost is not paid for or reimbursed pursuant to said warranty shall be considered an Operating Expense.

(d) Within one hundred twenty (120) days after the end of the Base Year, or as soon as reasonably possible thereafter, but not later than one hundred eighty (180) days after the end of the Base Year, Landlord shall provide Tenant a detailed statement showing the Operating Expenses actually incurred by Landlord for the Base Year, prepared in accordance with generally accepted accounting principals consistently applied. In addition, within one hundred twenty (120) days after the end of each calendar year during the Lease Term, or as soon as reasonably possible thereafter, but not later than one hundred eighty (180) days after the end of each calendar year during the Lease Term, Landlord shall provide Tenant a detailed statement showing the Operating Expenses actually incurred by Landlord for such calendar year, prepared in accordance with generally accepted accounting principles consistently applied, and a statement prepared by Landlord comparing the Estimated Excess (if any) paid by Tenant during such calendar year to Tenant's Prorata Share of the Excess, which statements (collectively, "Reconciliation Statement") shall include any receipted tax bills, if available, for such calendar year and such supporting documentation as to Operating Expenses as Tenant shall reasonably require. If the Estimated Excess paid by Tenant exceeds Tenant's Proportionate Share of the Excess for such calendar year, Landlord shall pay Tenant an amount equal to such excess at Landlord's option, by either giving a credit against Monthly Rent next due, if any, or by direct payment to Tenant within thirty (30) days after the date of such statement. If the Estimated Excess paid by Tenant is less than Tenant's Pro Rata Share of the Excess for such calendar year, Tenant shall pay to Landlord, within thirty (30) days after receipt of the statement, an amount equal to such difference. Tenant, at its expense, shall have the right, within twenty four (24) months after receiving Landlord's statement of Operating Expenses for a particular calendar year, to audit Landlord's books and records, respectively, relating to Operating Expenses for such calendar year, failing which Tenant waives any rights to audit and accepts the calculations set forth by Landlord.

Notwithstanding the foregoing, Tenant shall not have the option to review or audit Landlord's records for periods of time preceding the Commencement Date.

If an audit determines that Tenant has made an underpayment, Tenant shall pay to Landlord the amount of the underpayment within thirty (30) days following such determination. If an audit determines that Tenant has made an overpayment, Landlord shall reimburse Tenant for the amount of the overpayment within thirty (30) days following such determination.

Any audit conducted at the request of Tenant, shall take place within the office of the Landlord and be conducted on a non-contingent fee basis by a certified professional accountant with one of the "big six" accounting firms selected by Tenant. The determination of said audit shall be final and binding upon both Landlord and Tenant. Tenant shall be responsible for the cost of the audit unless such audit determines that Tenant has made an overpayment of Operating Expenses by 5% or more, in which case, Landlord shall pay the reasonable cost of such audit.

(e) In the event Landlord's reasonable estimate of Operating Expenses which will be incurred for any calendar year is revised, which revision shall not occur more than two (2) times per calendar year, then Landlord shall be permitted, upon thirty (30) days prior written notice to Tenant, to reasonably change the amount of Estimated Excess payable by Tenant each month, it being the intent of both Landlord and Tenant to attempt to cause the amount of Estimated Excess payable each month to be approximately one-twelfth of Tenant's Prorata Share of the Excess.

(f) If the Building is not at least 95% occupied during any calendar year of the Lease Term (including the Base Year), Operating Expenses shall be "grossed up" by increasing in the variable components of Operating Expenses to the amount which Landlord projects would have been incurred had the Building been 95% occupied during such year, such amount to be annualized for any partial year.

(g) Notwithstanding anything to the contrary set forth in this Lease, Tenant's obligation to pay the Controllable Operating Expenses (hereinafter defined) component of Tenant's Prorata Share of the Excess for any given calendar year shall be limited to an increase not to exceed 5% per year on a cumulative and compounded basis. For purposes hereof, the term "Controllable Operating Expenses" means all Operating Expenses except utility costs, Taxes and insurance premiums.

(h) Tenant further agrees to pay, as part of Rent, an amount equal to the product of (i) the cost of all electricity used by the Building ("Electrical Costs"), multiplied by (ii) Tenant's Prorata Share (collectively, "Tenant's Prorata Share of Electrical Costs"). Such amount shall be payable in monthly installments on the Commencement Date and on the first day of each calendar month thereafter. Each installment shall be based on Landlord's estimate of the amount due for each month. Once during a calendar year, Landlord may estimate the Electrical Costs to be due by Tenant for that calendar year and deliver a copy of the estimate to Tenant. Thereafter, the monthly installments of Electrical Costs payable by Tenant shall be appropriately adjusted in accordance with the estimations so that, by the end of the calendar year in question, Tenant shall have paid all of Tenant's Prorata Share of Electrical Costs as estimated by Landlord.

(i) The rights and obligations of Tenant and Landlord under this Section 4 shall survive the expiration or earlier termination of the Lease, provided that Operating Expense and Electrical Cost payments may be prorated to reflect any partial final year of the Lease.

5. LEASEHOLD IMPROVEMENTS. Tenant agrees to construct on the Premises those improvements which are generally described on the Work Letter attached hereto as Exhibit B and made a part hereof. The cost of such construction shall be allocated between Landlord and Tenant in the manner set forth on Exhibit B. Promptly after the execution hereof Landlord and Tenant will cooperate with one another to prepare final plans and specifications for the construction of such improvements and Landlord agrees not to unreasonably withhold, condition or delay Landlord's approval of Tenant's plans and specifications. Landlord shall, within five (5) business days of its receipt of Tenant's plans and specifications, notify Tenant in writing of its approval, or a detailed reason for its disapproval. If Landlord fails to deliver said notice within five (5) business days, then Tenant's plans and specifications shall be deemed approved. Such final plans and specifications, when approved in writing by Landlord and Tenant, shall be attached to this Lease as Exhibit B-1 and shall become a part hereof. Landlord agrees to cooperate with Tenant in order to allow Tenant to construct such improvement as expeditiously as possible.

6. UTILITIES. Landlord, at Landlord's sole cost, agrees to provide Building standard water, electricity, and telephone service connections to the Premises; but Tenant shall pay for all water, gas, heat, light, power, telephone, sewer, sprinkler charges and other utilities and services used exclusively on or from the Premises (together with Tenant's Prorata Share for such charges associated with the Common Areas), together with any taxes, penalties, surcharges or the like pertaining thereto and any maintenance charges for utilities, except with regard to charges associated with the connections of said utilities to the Premises, and Landlord shall furnish all electric light bulbs and tubes. Landlord shall provide all Building standard utility services during normal business hours which, for purposes of this Lease, means 7:00 a.m. to 7:00 p.m. on Monday through Friday and 8:00 a.m. to 1:00 p.m. on Saturday. If Tenant desires any of the services specified in this Section 6 at any time other than normal business hours, said services shall be supplied to Tenant upon the written request of Tenant delivered to Landlord before 3:00 p.m. on the business day preceding such extra usage, and Tenant shall pay to Landlord the cost of such services (prorated among other tenants' requests for the same zone of the Building) within ten (10) days after Landlord has delivered to Tenant an invoice therefor. At Landlord's option, Landlord may cause the Premises to be separately metered for utilities, in which event Tenant shall be responsible for paying directly to the appropriate utility provider all charges for services consumed on the Premises. Landlord shall in no event be liable for any interruption or failure of utility services on the Premises unless such interruption is caused solely by Landlord's failure to provide the required service connections or an uncured default by Landlord of its construction, maintenance or repair obligations hereunder, or if such interruption or failure is caused by the willful misconduct or gross negligence of Landlord, its agents, employees, contractors or invitees.

7. USE.

(a) Tenant shall use the Premises only for the Permitted Use. Tenant will not occupy or use the Premises, or permit any portion of the Premises to be occupied or used, for any business or purpose other than the Permitted Use or for any use or purpose which is unlawful in part or in whole or deemed to be disreputable in any manner or extra hazardous on account of fire, nor permit anything to be done which will in any way increase the rate of fire insurance on the Project or contents; and in event that, by reason of acts of Tenant, there shall be any increase in rate of insurance on the Project or contents created by Tenant's acts or conduct of business then Tenant shall be deemed to be an Event of Default hereunder and Tenant hereby agrees to pay to Landlord the amount of such increase within thirty (30) days of demand unless Tenant can cause, at its sole cost, the insurance increase to be fully eliminated, and acceptance of such payment shall not constitute a waiver of any of Landlord's other rights provided herein. Landlord hereby agrees and acknowledges that based on what Landlord knows of Tenant's intended use of the Premises, the Permitted Use shall not increase Landlord's fire insurance rates. Tenant will conduct its business and control its agents, employees and invitees in such a manner as not to create any nuisance, nor interfere with, annoy or disturb other tenants or Landlord in management of the Project. Tenant will maintain the Premises in a clean and safe condition and will comply with all laws, ordinances, order, rules and regulations (state, federal, municipal and other agencies or bodies having any jurisdiction thereof) with reference to its specific manner of use of the premises. Tenant will not, without the prior written consent of Landlord, which consent shall not be unreasonably withheld, conditioned or delayed, paint, install lighting or decoration, or install any signs, window or door lettering or advertising media of any type on or about the exterior of the Premises or any part thereof. Should Landlord agree in writing to any of the foregoing items in the preceding sentence, Tenant will maintain such permitted item in good condition and repair at all times. Outside storage, including but not limited to trucks or other vehicles or equipment shelter, is prohibited without Landlord's prior written consent, which consent shall not be unreasonably withheld, conditioned or delayed.

(b) Tenant shall not permit its employees or invitees to transport or store any Hazardous Substance, except for standard office supplies and cleaning products, to, on or from the Project and/or Premises except in strict compliance with Environmental Law and shall promptly report to Landlord any spill or other discharge of any Hazardous Substance caused by Tenant, its employees or invitees which occurs (i) on the Premises or (ii) in the Project. Tenant shall, promptly, following the occurrence of any such spill or discharge caused by Tenant, its employees or invitees, commence all such containment and remediation activities as may be necessary to comply with Environmental Law. Tenant shall continue such remediation activities until the Premises have been restored to the condition in which they existed on the Commencement Date.

8. REPAIRS AND MAINTENANCE.

8.1 By Tenant.

Tenant shall at its own cost and expense keep and maintain all nonstructural components of the Premises in good condition, promptly making all reasonably necessary repairs and replacements, ordinary and extraordinary, including but not limited to, windows, glass and plate glass door, and any special office entry, interior walls and finish work, floor covering, above Building standard heating and air conditioning systems, if applicable, plumbing work which serves only the Premises and fixtures, pest extermination, lighting, and the whole of the Premises in a clean and sanitary condition.

8.2 By Landlord.

Landlord shall, with respect to the Project, and as a part of Operating Expenses, maintain all structural components of the Premises and Project, including the roof, foundation, underground or otherwise concealed plumbing, the structural soundness of the exterior walls and interior columns (excluding all windows, window glass, plate glass, and all doors) of the Premises, and the Common Areas owned by Landlord including all landscaped areas and parking areas, in good repair and condition, except for reasonable wear and tear. Landlord shall be responsible for termite eradication. Tenant shall give prompt written notice to Landlord of the need for repairs or corrections and Landlord shall proceed with reasonable diligence to make such repairs or corrections. Landlord's liability hereunder shall be limited to the reasonable and necessary cost of such repairs or corrections. In making any such repairs or corrections, Landlord shall use all commercially reasonable efforts to protect Tenant's property and personnel from loss and injury and to avoid interfering with the conduct of Tenant's business. Landlord shall have no obligations to repair or maintain the Project or any part thereof, except as expressly set forth in this Lease.

9. ALTERATIONS AND IMPROVEMENTS.

(a) At the end or other termination of this Lease, Tenant shall deliver up the Premises with all improvements located thereon (except as otherwise herein provided) in good repair and condition, reasonable wear and tear excepted, and shall deliver to Landlord all keys to the Premises. The cost and expense of any repairs necessary to restore the condition of the Premises to said condition in which they are to be delivered, reasonable wear and tear excepted, to Landlord shall be borne by Tenant. Tenant will not make or allow to be made any alterations, physical additions or improvements in excess of an aggregate amount of twenty five thousand and 00/100 dollars (\$25,000.00) in any twelve (12) month period in or to the interior of the Premises without the prior written consent of Landlord, which consent shall not be unreasonably withheld as to non-structural alterations or improvements. All alterations, additions or improvements made in or upon the Premises, either by Landlord or Tenant, shall be Landlord's property on termination of this Lease and shall remain on the Premises without compensation to Tenant. All furniture, movable trade fixtures and personal property of Tenant may be removed by Tenant at the termination of this Lease if Tenant so elects, and shall be so removed if required by Landlord, or if not so removed shall, at the option of Landlord, become the property of Landlord. All such installations, removals and restoration shall be accomplished in a good workmanlike manner so as not to damage the Premises or the primary structure or structural qualities of any building improvements or the plumbing, electrical lines or other utilities.

(b) Tenant shall indemnify and hold harmless Landlord from and against all costs (including attorneys' fees and costs of suit), losses, damages, claims, demands, liabilities, or causes of action arising out of or relating to any alterations, additions or improvements made by Tenant to the Premises, including but not limited to any mechanics' or materialmen's liens asserted in connection therewith. The indemnity obligations of Tenant set forth herein shall survive the expiration or earlier termination of this Lease, provided, however, in the event Landlord has not commenced litigation against Tenant regarding the indemnity obligations of Tenant set forth herein within two (2) years after the expiration or earlier termination of this Lease, this indemnity shall survive such expiration or earlier termination of this Lease for a period of two (2) years.

10. ASSIGNMENT AND SUBLETTING.

(a) Tenant shall not grant any license or other concession, or otherwise permit any person other than Tenant, its officers and employees (and, only on a periodic and temporary basis, its clients or consultants), to occupy any part of the Premises, except as hereinafter provided. If Tenant should desire to assign this Lease or sublet the Premises or any part thereof, Landlord shall not unreasonably withhold its consent so long as the proposed assignee or sublessee is (i) reasonably creditworthy, and (ii) agrees in writing that it will comply with the use provisions and obligations contained herein, and Tenant shall give Landlord written notice of such desire at least twenty (20) days in advance of the date on which Tenant desires to make such assignment or sublease. Landlord shall then have a period of ten (10) days following receipt of such notice within which to notify Tenant in writing that Landlord elects either (i) to permit Tenant to assign this Lease or sublet such space, subject, however, to prior written approval by Landlord of the proposed assignee or sublessee, (ii) to refuse to permit Tenant to make such assignment or subletting and to continue this Lease in full force as to the entire Premises, or (iii) to refuse to consent to the proposed sublease or assignment and to terminate this Lease as to the space proposed to be subleased or assigned as of the date so specified by Tenant, in which event, Tenant will be relieved of all further obligations hereunder as to such space. Notwithstanding the foregoing, Landlord will not have the option of terminating this Lease if the proposed sublessee is a subsidiary or Affiliate of Tenant. See Section 10(f) of this Lease. As used herein, "Affiliate" means any person or entity that directly or indirectly Controls, is Controlled by, or is under Common Control with, the entity in question; and the term "Control" means possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of an entity, whether through ownership through voting securities, by contract or otherwise. If Landlord should fail to notify Tenant in writing of such election within such ten (10) day period, Landlord shall be deemed to have elected option (i) above. If the Monthly Rent or other consideration due under the assignment or sublease exceeds the Monthly Rent for the subject space, then Tenant shall pay Landlord as Additional Rent hereunder fifty percent (50%) of the amount of all such excess Monthly Rent, net of the reasonable costs to Tenant associated with said assignment or sublease, including, but not limited to, legal fees, commissions (not to exceed 6.5%) and alterations (not to exceed \$7.00/SF), and other consideration, said payment to Landlord to be made promptly upon Tenant's receipt thereof. In no event shall Landlord ever receive less than the Monthly Rent.

(b) No assignment or subletting by Tenant shall relieve Tenant of any obligation under this Lease or alter, modify or amend any provision of this Lease and such assignee or sublessee shall assume all obligations under this Lease. Any attempted assignment or sublease by Tenant in violation of the terms and covenants of this Section 10(b) shall be void.

(c) No assignment or subletting by Tenant to any person or entity shall be effective unless Tenant shall execute, have acknowledged and deliver to Landlord, and cause each sublessee or assignee to execute, have acknowledged and deliver to Landlord, an instrument in form and substance reasonably acceptable to Landlord in which (i) such sublessee or assignee adopts this Lease and assumes and agrees to perform jointly and severally with Tenant, all of the obligations of Tenant under this Lease, as to the space transferred to it, (ii) Tenant subordinates to Landlord's statutory lien, any liens, security interests or other rights which Tenant may claim with respect to any property of such sublessee or assignee, (iii) such sublessee or assignee agrees to use and occupy the transferred space solely for the purpose permitted by this Lease and otherwise in strict accordance with this Lease and (iv) Tenant acknowledges and agrees that, notwithstanding such subletting or assignment, Tenant remains directly and primarily liable for the performance of all the obligations of Tenant hereunder (including, without limitation, the obligation to pay Monthly Rent), and Landlord shall be permitted to enforce this Lease against Tenant or such sublessee or assignee, or both, without prior demand upon or proceeding in any way against any other persons. Tenant will be required to submit a written request to Landlord outlining Tenant's desire for Landlord to receive Rent payments directly from the assignee. Landlord's approval of such payment procedure shall not be unreasonably denied.

(d) No consent by Landlord to an assignment or sublease shall be deemed in any manner to be a consent to a use not permitted under this Lease unless otherwise agreed to in writing by Landlord. Any consent by Landlord to a particular assignment or sublease shall not constitute Landlord's consent to any other or subsequent assignment or sublease. The prohibition against an assignment or sublease described in this Section 10 shall be deemed to include a prohibition against Tenant's mortgaging or otherwise encumbering its leasehold estate, as well as against an assignment or sublease which may occur by operation of law, each of which shall be ineffective and void and shall constitute an Event of Default under this Lease unless consented to by Landlord in writing in advance.

(e) In any situation in which Landlord consents to an assignment or sublease hereunder, Tenant shall promptly deliver to Landlord a fully executed copy of the final sublease agreement or assignment instrument and all ancillary agreements relating thereto.

(f) Notwithstanding the provisions of this Section 10 to the contrary, Tenant shall have the right, upon written notice to Landlord, to assign or sublet all or a part of the Premises to any subsidiary or Affiliate of Tenant or of Tenant's parent company, SBC Communications, Inc., without the requirement of the consent of Landlord. Provided, however, that no such assignment or subletting shall be effective unless Tenant agrees to remain responsible for the obligations of such subsidiary or Affiliate, and Landlord is provided with written documentation evidencing the assignment or subletting in question. In the event Tenant is a corporation, partnership or other business entity, any change in the ownership of more than fifty percent (50%) of the controlling interests in Tenant shall, for the purposes of the foregoing covenants, be deemed an Assignment by Tenant. In the event that the change in ownership of the controlling interest in Tenant is the result of a merger or sale of substantially all of the assets of Tenant to another entity, such conveyance shall not be effective and binding upon Landlord unless the successor entity, if it satisfies the requirements of this subparagraph (f), assumes all of the obligations of Tenant under this Lease, or Landlord shall be entitled to declare Tenant in default hereunder. Notwithstanding the foregoing, Landlord agrees to consent to any change in ownership of Tenant or any merger or sale of substantially all of Tenant's assets provided that (x) the successor or reconstituted entity is of equal or greater financial strength to Tenant as of the date of this Lease or the successor or reconstituted entity has net worth computed in accordance with GAAP greater than \$10,000,000.00 and (y) that such successor or reconstituted entity formally assumes this Lease in a written instrument reasonably satisfactory to Landlord. Landlord also agrees to not unreasonably withhold its consent to any change in ownership of Tenant or any merger or sale of substantially all of Tenant's assets.

(g) Landlord shall have the right to transfer and assign, in whole or in part, all its rights and obligations hereunder and in the Project, and upon any such transfer or assignment in which the transferee or assignee assumes the obligations of Landlord under this Lease, no further liability or obligation shall thereafter accrue against Landlord hereunder.

11. LIABILITY.

(a) Landlord shall not be liable to Tenant or Tenant's employees, agents, patrons or visitors, or to any other person whomsoever, for any injury to person or damage to property on or about the Premises, resulting from and/or caused in part or whole by the negligence or misconduct of Tenant, its agents, servants or employees, or of any other person entering upon the Premises, or caused by leakage of gas, oil, water of steam or by electricity emanating from the Premises, and Tenant hereby covenants and agrees that it will at all times indemnify and hold safe and harmless the Premises, the Landlord, Landlord's agents and employees from any loss, liability, claims, suits, costs, expenses, including without limitation attorneys' fees and damages, both real and alleged, arising out of any such damage or injury caused by Tenant, except injury to persons or damage to property the sole cause of which is the negligence or willful misconduct of Landlord, its agents or employees.

(b) Tenant shall procure and maintain throughout the term of this Lease a policy or policies of insurance, at its sole cost and expense, insuring Tenant (with Landlord and its agents named as additional insured) against all claims, demands or actions arising out of or in connection with property, personal injury or death occurring in, about or from: (i) the Premises including leasehold improvements; (ii) the condition of the Premises; (iii) Tenant's operations in and maintenance and use of the Premises; and (iv) Tenant's liability assumed under this Lease, the limits of such policy or policies to be in the amount of not less than \$2,000,000.00 combined limit general aggregate; \$2,000,000.00 products/completed operations aggregate \$1,000,000.00 per occurrence limit; personal injury/advertising injury per occurrence limited \$1,000,000.00; fire damage liability \$500,000.00; and medical expense limit \$50,000.00. In addition, Tenant shall procure an umbrella liability policy with limits of not less than \$2,000,000.00. Such policies shall be procured by Tenant from responsible insurance companies reasonably satisfactory to Landlord and Landlord shall be named an additional insured thereunder. Copies of such policies, together with receipt evidencing payment of premiums therefor, shall be delivered to Landlord prior to the Commencement Date of this Lease. Not less than fifteen (15) days prior to the expiration date of any such policies, copies of the renewals thereof (bearing notations evidencing the payment of renewal premiums) shall be delivered to Landlord. Such policies shall further provide that not less than thirty (30) days written notice shall be given to Landlord before such policy may be canceled or changed to reduce insurance provided thereby. Tenant may provide to Landlord evidence of a self-insurance program, which if satisfactory to Landlord, may be substituted for the insurance requirements otherwise set forth in this Section 11. Landlord is, however, under no obligation to accept a self-insurance program unless it determines in its reasonable judgment that the parameters of the proposed self-insurance program provide a sufficient alternative creditworthy and a claims adjustment process by which casualty occurrences can be properly and timely adjusted and claims paid under this Lease. Tenant further reserves the right, subject to the requirements of this Lease, to provide insurance coverage through a blanket policy so long as the terms and provisions of the blanket policy are acceptable to Landlord in its reasonable discretion and otherwise consistent with the requirements of this Section 11.

(c) Landlord shall maintain a policy of general liability insurance covering the Project in the amount of not less than \$2,000,000.00 combined limit general aggregate; \$2,000,000.00 products/completed operations aggregate \$1,000,000.00 per occurrence limit; personal injury/advertising injury per occurrence limited \$1,000,000.00; fire damage liability \$50,000.00; and medical expense limit \$5,000.00. In addition, Landlord shall procure an umbrella liability policy with limits of not less than \$2,000,000.00.

(d) Tenant shall not be liable to Landlord or Landlord's employees, agents, patrons or visitors, or to any other person whomsoever, for any damage to property on or about the Premises, the Common Areas or the Project, resulting from and/or caused by the negligence or misconduct of Landlord, its agents, servants or employees. Landlord hereby covenants and agrees that it will at all times indemnify and hold safe and harmless the Tenant, Tenant's agents and employees from any loss, damage, liability, claims, suits, costs, expenses, including without limitation reasonable attorneys' fees, arising out of any damage or injury caused by Landlord, except in all of the foregoing cases where the injury to persons or damage to property the sole cause of which is the negligence or willful misconduct of Tenant.

(e) Nothing in this Section 11 is intended to require indemnification for any property claim for which insurance is required to be maintained under the terms of this Lease. The rights and obligations of Landlord and Tenant under this Section 11 shall survive the expiration or earlier termination of this Lease.

12. SUBORDINATION AND ATTORNMENT.

12.1 General. This Lease, Tenant's leasehold estate created hereby and all of Tenant's rights, titles and interests hereunder and in and to the Premises are subject and subordinate to any Mortgage presently existing or hereafter placed upon all or any portion of the Project. However, Landlord and Landlord's Mortgagee may, at any time upon the giving of written notice to Tenant and without any compensation or consideration being payable to Tenant, make this Lease, and the aforesaid leasehold estate and rights, titles and interests, superior to any Mortgage. Upon the written request by Landlord or by Landlord's Mortgagee to

Tenant, and within fifteen (15) days of the date of such request, and without any compensation or consideration being payable to Tenant, Tenant shall execute, have acknowledged and deliver a recordable instrument in a form reasonably acceptable to Landlord, confirming that this Lease, Tenant's leasehold estate in the Premises and all of Tenant's rights, titles and interests hereunder are subject and subordinate (or, at the election of Landlord or Landlord's Mortgagee, superior) to the Mortgage benefiting Landlord's Mortgagee.

12.2 Attornment. Upon the written request of any person or party succeeding to the interest of Landlord under this Lease, and subject to Tenant's receipt of the "SNDA" as the term is defined below, Tenant shall automatically become the tenant of and attorn to such successor in interest without any change in any of the terms of this Lease. No successor in interest shall be (a) bound by any payment of Rent for more than one month in advance, except payments of security for the performance by Tenant of Tenant's obligations under this Lease, (b) subject to any offset, defense or damages arising out of a default or any obligations of any preceding Landlord except for ongoing defaults or those for which the successor has received prior notice, or (c) bound by any amendment of this Lease entered into after Tenant has been given written notice of the name and address of Landlord's Mortgagee and without the written consent of Landlord's Mortgagee or such successor in interest. The subordination, attornment and mortgage protection clauses of this Section 12 shall be self-operative and, except for the "SNDA", no further instruments of subordination, attornment or mortgagee protection need be required by any Mortgagee or successor in interest thereto. Nevertheless, upon the written request therefor and without any compensation or consideration being payable to Tenant, Tenant agrees, within fifteen (15) days of request therefor, to execute, have acknowledged and deliver such instruments as may be reasonably requested to confirm the same.

12.3 Existing Encumbrances. Simultaneously with the execution and delivery of this Lease, Landlord shall deliver to Tenant executed originals of subordination, non-disturbance and attornment agreements with respect to this Lease, substantially in the form attached hereto as Exhibit C (the "SNDA"), from all existing mortgage holders, ground lessors and other parties, if any, holding an interest in the Project or the real property described on Exhibit A attached hereto which may take precedence over Tenant's interest in the Project. Failure by Landlord to deliver any subordination, non-disturbance and attornment agreement required under this Lease shall entitle Tenant, at Tenant's option, to terminate this Lease at any time and to obtain a refund of all rent and any other amount paid to Landlord. In any case, Tenant shall have no obligation to pay rent or other amounts under this Lease until Landlord delivers all such executed subordination, non-disturbance and attornment agreements. Further, the provisions of this Section 12.3 shall also apply to all parties seeking an attornment under Sections 12.1 and 12.2.

13. INSPECTION. Landlord and Landlord's agents and representatives shall have the right at any time to enter upon the Premises in the event of an emergency (without prior notice to Tenant) and with reasonable prior verbal notice to Tenant to enter upon and inspect the Premises, for the purpose of ascertaining the condition of the Premises or in order to make such repairs as may be permitted to be made by Landlord. Landlord's agents and representatives shall, with prior verbal notice, have the right to enter upon the Premises at any reasonable time during business hours during the last six (6) months of the Lease Term for the purpose of showing the Premises and during the last six (6) months of the Lease Term shall have the right to erect on the Premises a suitable sign not to exceed three (3) feet by three (3) feet in size, indicating the Premises are available for lease or for sale. In making any inspection of the Premises, Landlord shall use all commercially reasonable efforts to avoid interfering with Tenant's business or Tenant's use of the Premises.

14. CONDEMNATION. If the whole or any substantial part of the Premises should be taken for any public or quasi-public use under governmental law, ordinance or regulation, or by right of eminent domain, or by private or governmental purchase in lieu thereof and the taking would prevent or materially interfere with the use of the Premises for the purposes contemplated by the Permitted Use, as reasonably determined by Tenant and Landlord, this Lease shall terminate and the Monthly Rent shall be abated during the unexpired portion of this Lease, effective when the physical taking of said Premises shall occur.

If less than a substantial part of the Premises shall be taken for any public or quasi-public use under any governmental law, ordinance or by right of eminent domain, or by private purchase in lieu thereof, and this Lease is not terminated as provided in the subparagraph above, Landlord shall proceed with due diligence to make all repairs necessary to restore the Project to as near its former condition as circumstances will permit and the Lease shall remain in full force and effect, except that, effective on the date of taking or conveyance, the Premises shall be reduced by the portion of the Premises so taken or conveyed, and Rent shall be (a) proportionately reduced by the portion of the Premises taken or conveyed, and (b) equitably reduced to the extent that such taking or conveyance of other portions of the Premises or the Project materially and adversely interferes with the conduct of Tenant's business.

In the event of any such taking or private purchase in lieu thereof, Landlord and Tenant shall each be entitled to receive and retain such separate awards and/or portion of lump sum awards as may be allocated to their respective interests in any condemnation proceedings.

15. INSURANCE, FIRE OR OTHER CASUALTY. Landlord agrees to maintain fire and extended coverage insurance covering the Project in an amount not less than 80% of the "replacement cost" thereof as such term is defined in the Replacement Cost Endorsement to be attached thereto, insuring against the perils of fire, lightning, vandalism, malicious mischief and loss of rental, extended by Special Extended Coverage Endorsement to insure against all other risks of direct physical loss, such coverages and endorsements to be as defined, provided and limited in the standard bureau forms prescribed by the insurance regulatory authority for the state in which the Premises are situated for use by insurance companies admitted in such state for the writing of such insurance on risks located within such state. Subject to the provisions of this Section 15, such insurance shall be for the sole benefit of Landlord and under its sole control. Landlord shall also maintain commercial general liability insurance, with policy limited acceptable to Landlord, with respect to Landlord's activities and operations at the Project. Tenant agrees to maintain a policy or policies of "all risk" extended coverage insurance on all of its personal property, including removable trade fixtures, office supplies and movable office furniture and equipment, located on the Premises, in an amount equal to full replacement cost and endorsed to provide that Tenant's insurance is primary in the event of any overlapping covering with the insurance carried by Landlord. Such insurance shall be maintained at the expense of Tenant and payment for losses thereunder shall be made solely to Tenant or the mortgagees of Tenant as their interests appear. Tenant shall, prior to occupancy of the Premises and at Landlord's request from time to time, provide Landlord with a current certificate of insurance evidencing Tenant's compliance with this Section 15. Tenant shall obtain the agreement of Tenant's insurers to notify Landlord that a property insurance policy is due to be canceled or expired at least thirty (30) days prior to such cancellation or expiration.

In the event that the Premises should be damaged or destroyed by fire, tornado or other casualty to such an extent that rebuilding or repairs cannot be completed within one hundred eighty (180) days after the date on which such repairs commence, then Landlord or Tenant may at its option terminate this Lease, in which event the rent shall be abated during the unexpired portion of this Lease effective with the date of such damage. Landlord shall notify Tenant (the "Casualty Notice") in writing within thirty (30) days of the occurrence of such damage as to whether the damage is capable of being completely repaired within one hundred eighty (180) days of the occurrence. If the Casualty Notice indicates that such repair and restoration will require in excess of one hundred eighty (180) days, then such notification must be accompanied by a certification by an independent licensed architect having significant experience in the design and construction of office/tech buildings in the Dallas, Texas area (an "Architect"), which certification must state the estimated period required to repair or restore such damage (the "Estimated Repair/Restoration Period"). If such damage to the Property or any portion thereof shall materially and adversely interfere with the conduct of Tenant's business, as reasonably determined by Tenant and Landlord, and the Estimated Repair/Restoration Period is in excess of one hundred eighty (180) days after the occurrence of such casualty, Tenant or Landlord may, by written notice to the other within forty five (45) days after the date of such casualty, terminate this Lease as of the date of occurrence of such damage. In the event the Premises should be damaged by fire, tornado or other casualty, but only to such extent that rebuilding or repairs can be completed within one hundred eighty (180) days after the date of such damage, or if the damage should be more serious but Landlord or Tenant does not elect to terminate this Lease, in either such event Landlord shall, at its sole cost and expense, rebuild or repair the Premises and shall proceed with reasonable diligence to restore the Premises to substantially the same condition in which they were immediately prior to the happening of the casualty, except that Landlord shall not be required to rebuild, repair or replace any part of the furniture, equipment, fixtures and other improvements which may have been placed by Tenant or other tenants within the Project or the Premises. In the event that the Premises are totally untenantable, Landlord shall abate the rent during the time the Premises are unfit for occupancy. If the Premises are not totally untenantable, Landlord shall allow Tenant a fair diminution of rent during the time the Premises are partially unfit for occupancy. If such damage can be repaired within one hundred eighty (180) days and Landlord fails to repair or restore such damage within such period, then Tenant may terminate this Lease by giving thirty (30) days' prior written notice to Landlord.

Notwithstanding anything herein to the contrary, in the event the holder of any indebtedness secured by a mortgage or deed of trust covering the Premises or any Improvements located thereon requires that the insurance proceeds be applied to such indebtedness, then Landlord shall have the right to terminate this Lease by delivering written notice of termination to Tenant within fifteen (15) days after such requirement is made by any such holder, whereupon all rights and obligations hereunder shall cease and terminate.

Landlord and Tenant do each hereby release and discharge the other party and any officer, agent, employee and representative of such party from any liability for loss or damage to property caused by fire or other casualty for which insurance is required to be carried by the injured party under the terms of this Lease.

16. HOLDING OVER. Should Tenant, or any of its successors in interest, hold over the Premises, or any part thereof, after the expiration of the term of this Lease, unless otherwise agreed in writing, such holding over shall constitute and be construed as tenancy from month to month only, at a rental equal to one hundred fifty percent (150%) for the first thirty (30) days and two hundred percent (200%) thereafter of the Monthly Rent payable for the last month of the term of this Lease. The holding over by Tenant for any part of a month shall entitle Landlord to collect the Rent called for under this Section 16 for the entirety of such month. The inclusion of this Section 16 shall not be construed as Landlord's consent for the Tenant to hold over. Notwithstanding the foregoing, in the event that Tenant holds over for a period that is less than thirty (30) days, Landlord agrees that the holdover rental amount for that limited period of time shall be Landlord's exclusive right and remedy against Tenant and shall be deemed to cover all liabilities, obligations or charges which may be incurred by Landlord because of hold over by Tenant.

17. TAXES ON TENANT'S PROPERTY. Tenant shall be liable for all taxes levied or assessed against personal property, furniture or fixtures placed by Tenant in the Premises. If any such taxes for which Tenant is liable are levied or assessed against Landlord or Landlord's property and if Landlord elects, after written notice to Tenant and Tenant's failure to pay the full amount within ten (10) days of such notice, to pay the same or if the assessed value of Landlord's property is increased by inclusion of personal property, furniture or fixtures placed by Tenant in the Premises, and Landlord elects to pay the taxes based on such increase, Tenant shall pay to Landlord upon demand that part of such taxes for which Tenant is primarily liable hereunder.

18. EVENTS OF DEFAULT. The following events shall be deemed to be Events of Default by Tenant under this Lease:

(a) The failure of Tenant to pay Rent as and when due hereunder and the continuance of such failure for a period of seven (7) days after written notice from Landlord to Tenant specifying the failure; provided, however, after Landlord has given Tenant written notice pursuant to this clause (a) on two separate occasions in any one (1) calendar year Landlord shall not be required to give Tenant any further notice under this clause (a);

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- (b) The failure of Tenant to perform, comply with or observe any other agreement, obligation or undertaking of Tenant, or any other term, condition or provision, in this Lease, and the continuance of such failure for a period of thirty (30) days after written notice from Landlord to Tenant specifying the failure;
 - (c) The failure of Tenant to initially occupy the Premises prior to May 1, 2001;
 - (d) The filing of a petition by or against Tenant (the term "Tenant" also meaning, for the purpose of this clause (d), any guarantor of the named Tenant's obligations hereunder) (i) in any bankruptcy or other insolvency proceeding, (ii) seeking any relief under the Bankruptcy Code or any similar debtor relief law, (iii) for the appointment of a liquidator or receiver for all or substantially all of Tenant's property or for Tenant's interest in this Lease or (iv) to reorganize or modify Tenant's capital structure not discharged within sixty (60) days of the filing of any such petition;
 - (e) Tenant shall make an assignment for the benefit of creditors; and
 - (f) The admission by Tenant in writing that it cannot meet its obligations as they become due or the making by Tenant of an assignment for the benefit of its creditors.

19. REMEDIES. Upon any Event of Default, Landlord may exercise any one or more of the following described remedies, in addition to all other rights and remedies provided at law or in equity;

- (a) Terminate this Lease by written notice to Tenant and forthwith repossess the Premises and be entitled to recover forthwith as damages a sum of money equal to the total of (i) the cost of recovering the Premises (including reasonable attorneys' fees and costs of suit), (ii) the cost of removing and storing any personal property, (iii) the unpaid Rent earned at the time of termination, plus interest thereon at the rate of twelve percent (12%) per annum, (iv) the present value (discounted at the rate of six percent (6%) per annum) of the balance of the Rent for the remainder of the Lease Term less the present value (discounted at the same rate) of the fair market rental value of the Premises for such period, taking into account the period of time the Premises will remain vacant until a new tenant is obtained, and the cost to prepare the Premises for occupancy and the other costs (such as leasing commissions and attorneys' fees) to be incurred by Landlord in connection therewith, and (v) any other sum of money and damages owed by Tenant to Landlord under this Lease.
- (b) Terminate Tenant's right of possession (but not this Lease) and repossess the Premises by forcible entry and detainer suit or otherwise, without thereby releasing Tenant from any liability hereunder and without demand or notice of any kind to Tenant and without terminating this Lease. Landlord shall use reasonable efforts under the circumstances to relet the Premises on such terms and conditions as Landlord in its sole discretion may determine (including a term different than the term of this Lease, rental concessions, alterations and repair of the Premises); provided, however, Landlord hereby reserves the right (i) to lease any other comparable space available in the Project prior to offering the Premises for lease, and (ii) to refuse to lease the Premises to any potential tenant which does not meet Landlord's standards and criteria for leasing other comparable space in the Project. Landlord shall not be liable, nor shall Tenant's obligations hereunder be diminished because of Landlord's failure or refusal to relet the Premises or collect rent due in respect of such reletting. For the purpose of such reletting Landlord shall have the right to decorate or to make any repairs, changes, alterations or additions in or to the Premises as may be reasonably necessary or desirable, if (i) Landlord shall fail or refuse to relet the Premises, or (ii) the Premises are relet and a sufficient sum shall not be realized from such reletting (after first deducting therefrom, for retention by Landlord, the unpaid rent due hereunder earned but unpaid at the time of reletting plus interest thereon at the rate twelve percent (12%) per annum, the unrecovered cost of recovering possession (including attorneys' fees and costs of suit), all of the costs and expenses of such decorations, repairs, changes, alterations and additions, the expense of such reletting and the cost of collection of the rent accruing therefrom) to satisfy the Rent, then Tenant shall pay to Landlord as damages a sum equal to the amount of such deficiency. For purposes of this provision, it is acknowledged and agreed that Landlord shall have the right to refuse to accept an offer to re-let the Premises in order to mitigate damages which Landlord would otherwise refuse to accept for vacant space in this Project. No delivery to or recovery by Landlord of any portion due Landlord hereunder shall be any defense in any action to recover any amount not theretofore reduced to judgment in favor of Landlord, nor shall such reletting be construed as an election on the part of Landlord to terminate this Lease unless a written notice of such intention be given to Tenant by Landlord. Notwithstanding any such termination of Tenant's right of possession of the Premises, Landlord may at any time thereafter elect to terminate this Lease. In any proceedings to enforce this Lease Landlord shall be presumed to have used its reasonable efforts to relet the Premises, and Tenant shall bear the burden of proof to establish that such reasonable efforts were not used.

(c) Landlord may, and is hereby entitled and authorized, without any notice to Tenant whatsoever, to enter upon the Premises by use of a master key, a duplicate key, or other peaceable means, and to change, alter, and/or modify the door locks on all entry doors of the Premises, thereby permanently excluding Tenant, and its officers, principals, agents, employees, and representatives therefrom. If Landlord has either permanently repossessed the Premises pursuant to the foregoing provisions of this Lease, or has terminated this Lease by reason of Tenant's default, Landlord shall not thereafter be obligated to provide Tenant with a key to the Premises at any time; provided, however, that in any such instance, during Landlord's, normal business hours and at the convenience of Landlord, and upon the written request of Tenant accompanied by such written waivers and releases as Landlord may require. Landlord will escort Tenant, its authorized personnel, and its employees to the Premises to retrieve any personal belongings or other property of Tenant other than the Encumbered Property. If Landlord elects to exclude Tenant from the Premises without permanently repossessing or terminating pursuant to the foregoing provisions of this Lease, then Landlord (at any time prior to actual repossession or termination) shall not be obligated to provide Tenant a key to re-enter the Premises until such time as all delinquent rental and other amounts due under this Lease have been paid in full (and all other defaults, if any, have been completely cured to Landlord's satisfaction), and Landlord has been given assurance reasonably satisfactory to Landlord evidencing Tenant's ability to satisfy its remaining obligations under this Lease. During any such temporary period of exclusion, Landlord will, during Landlord's normal business hours and at Landlord's convenience, upon written request by Tenant, escort Tenant, its authorized personnel, and its employees to the Premises to retrieve personal belongings of Tenant or its employees, and such other property of Tenant other than the Encumbered Property. This remedy of Landlord shall override and control any conflicting provisions of the Texas Property Code.

(d) In the event Tenant fails to pay any Monthly Rent or other Rent hereunder within Five (5) days of the date due, to help defray the additional cost to Landlord for processing such late payments, Tenant shall pay to Landlord on written demand a late charge in an amount equal to five percent (5%) of such Monthly Rent or Rent, and the failure to pay such late charge, within ten (10) days after demand therefore, shall be an Event of Default hereunder. The provision for such late charge shall be in addition to all of Landlord's other rights and remedies hereunder or at law and shall not be construed as liquidated damages or as limiting Landlord's remedies in any manner.

20. LANDLORD EVENTS OF DEFAULT.

The following events shall be deemed to be Events of Default by Landlord under this Lease:

(a) If Landlord shall file or have filed against it a petition or case under any section or chapter of the United States Bankruptcy Code, as amended, or under any similar law or statute of the United States or any state and such petition or case is not discharged within sixty (60) days; or

(b) If Tenant shall ever be deprived of the beneficial occupancy and use of the Premises or any portion thereof, for a period of more than seven (7) business days after written notice to Landlord, as a result of the act or omission of Landlord, or as a result of the breach of Landlord under the express terms of this Lease, then the Basic Rent and any and all additional rent due hereunder shall immediately abate hereunder for the portion of the Premises affected until such time as Tenant's beneficial use and occupancy of the Premises is restored;

(c) If Landlord violates or fails to perform any obligation of Landlord under this Lease and such violation or failure continues for thirty (30) days after written notice to Landlord, Tenant may, in addition to any other remedies available to it, perform such obligation, and Landlord agrees upon completion of such obligation and receipt of an invoice to pay all reasonable third party costs actually incurred by Tenant to perform such obligation.

21. SURRENDER OF PREMISES. No act or thing done by the Landlord or its agents during the term hereby granted shall be deemed an acceptance of a surrender of the Premises, and no agreement to accept a surrender of the Premises shall be valid unless the same be made in writing and subscribed by the Landlord.

22. ATTORNEYS' FEES. If, on account of any breach or default by any party hereto of its obligations under this Lease, it should be necessary or appropriate for the other party to bring any action under this Lease or to enforce or defend any of its rights hereunder, then the defaulting party agrees in each and any such case to pay to the non-defaulting party a reasonable attorneys' fees in the event that the non-defaulting party prevails in such action.

23. MECHANIC'S LIEN. Tenant shall not be deemed to be the agent or representative of Landlord in making any alterations, physical additions or improvements to the Premises, and shall have no right, power or authority to encumber any interest in the Project in connection therewith other than Tenant's leasehold estate under this Lease. However, should any mechanics' or other liens be filed against any portion of the Project or any interest therein (other than Tenant's leasehold estate hereunder) by reason of Tenant's acts or omissions or because of a claim against Tenant or its contractors, Tenant shall cause the same to be canceled or discharged of record by bond or otherwise within thirty (30) days after receipt of written notice by Landlord. If Tenant shall fail to cancel or discharge such lien or liens, within such thirty (30) day period, which failure shall be deemed to be a default hereunder, Landlord may, at its sole option and in addition to any other remedy of Landlord hereunder, cancel or discharge the same and, upon Landlord's demand, Tenant shall promptly reimburse Landlord for all costs incurred in canceling or discharging such lien or liens.

24. WAIVER OF SUBROGATION. Anything in this Lease to the contrary notwithstanding, the parties hereto waive any and all rights of recovery, claim, action or cause of action, against each other, their agents, officers, and employees, for any loss or damage that may occur to the Premises hereby demised, or any improvements thereto, the Project or any improvements thereto, by reason of fire, the elements, or any other cause which are required to be insured against under the terms hereof, regardless of cause or origin, including negligence of the parties hereto, their agents, officers, and employees.

25. SIGNS. Tenant shall have the right to install signs in the Premises only when first approved in writing by Landlord, which shall not be unreasonably withheld and subject to any applicable governmental laws, ordinances, regulations and other requirements. Tenant shall also have the right to place one sign on the existing main monument sign in front of the Building, subject to Landlord's approval (which approval shall not be unreasonably withheld). Tenant shall remove all such signs upon the termination of this Lease. Such installations and removals shall be made in such manner as to avoid injury to or defacement of any buildings or other improvements on the Premises, and Tenant shall repair any injury or defacement, including without limitation discoloration, caused by such installation or removal. Tenant shall not inscribe, paint, affix or display any signs, advertisements or notices on the Project, except for such Tenant signage as Landlord permits in writing. Tenant signage shall be limited to the outer facade of the Project and shall also be subject to the City of Arlington's signage codes. Tenant shall be required to first submit to Landlord a detailed diagram showing Tenant's signage request by which Landlord shall give written approval to Tenant, which approval shall not be unreasonably withheld, conditioned or delayed. Notwithstanding the foregoing, Landlord approval shall not be considered unreasonably withheld, if approval is denied because signage proposed by Tenant is not of a size, placement, material or is otherwise not in general conformance with other signage on the Project. All signage costs, including the repair or removal of such Tenant signage, shall be at the sole cost of Tenant.

26. NOTICES. Each provision of this Agreement, or of any applicable governmental laws, ordinances, regulations, and other requirements with reference to the sending, mailing or delivery of any notice, or with reference to the making of any payment by Tenant to Landlord, shall be deemed to be complied with when and if the following steps are taken:

(a) All Rent and other payment required to be made by Tenant to Landlord hereunder shall be payable to Landlord in Dallas County, Texas, at the address herein below set forth, or at such other address as Landlord may specify from time to time by written notice delivered in accordance herewith.

(b) Any notice or document required to be delivered hereunder shall be in writing and shall be deemed to be delivered whether or not received when deposited in the United States mail, postage prepaid, certified or registered mail (with return receipt requested) or by nationally recognized overnight carrier, addressed to the parties hereto at the respective addresses set out opposite their names below, or at such other address as they have theretofore specified by written notice delivered in accordance herewith:

LANDLORD: THE ARBORS OF BROOKHOLLOW OPERATING
PARTNERSHIP, LTD.
c/o Stream Realty Partners, L.P.
9100 North Central Expressway, Suite 100
Dallas, Texas 75231
Attn: Property Manager of The Arbors of Brookhollow

WITH A COPY TO: Cross Timbers Capital, Inc.
2201 West Royal Lane, Suite 220
Irving, Texas 75063

TENANT: Southwestern Bell Telephone Company
1010 N. St. Mary's, Room 515
San Antonio, Texas 78205
Attn: Janie Bell

WITH A COPY TO: SBC Services, Inc.
175 E. Houston, 2nd Floor
San Antonio, Texas 78205
Attn: Ken Gitter

27. FORCE MAJEURE. Whenever a period of time is herein prescribed for action to be taken by a party hereto, that party shall not be liable or responsible for, and there shall be excluded from the computation for any such period of time, any delays due to strikes, riots, acts of God, shortages of labor or materials, war, governmental laws, regulations or restrictions or any other causes of any kind whatsoever which are beyond the control of such party.

28. ESTOPPEL CERTIFICATE. Tenant agrees periodically, but not more than two (2) times per year, to furnish within twenty (20) days after written request by Landlord or the holder of any deed of trust, mortgage or security agreement covering the Project or any interest of Landlord therein, a certificate signed by a Tenant certifying (a) that this Lease is in full force and effect and unmodified (or if there have been modifications, that the same is in full force and effect as modified and stating the modifications), (b) as to the Commencement Date and the date through which Monthly Rental has been paid, (c) that Tenant has accepted possession of the Premises and that any improvements required by the terms of this Lease to be made by Landlord have been completed to the satisfaction of Tenant, or if Tenant has not accepted or if Landlord's work is not complete, stating same, (d) that except as stated in the certificate no Rent has been paid more than thirty (30) days in advance of its due date, (e) that the address for notices to be sent to Tenant is as set forth in this Lease (or has been changed by notice duly given and is as set forth in the certificate), (f) that except as stated in the certificate, Tenant, as of the date of such certificate, has, to the best of Tenant's current actual knowledge, no charge, lien, or claim of offset against Rent due or to become due, (g) that except as stated in the certificate. Landlord is not then, to the best of Tenant's current actual knowledge, in default under this Lease, (h) that there are no renewal or extension options, purchase options, rights of first refusal or the like in favor of Tenant except as set forth in this Lease and (i) as to such other matters as may be reasonably requested by Landlord or the holder of any such deed of trust, mortgage or security agreement. Any such certificate may be relied upon by any ground lessor, prospective purchaser, secured party, mortgagee or any beneficiary under any mortgage, deed of trust on the Project or any part thereof or interest of Landlord therein.

29. LIMITATION OF LIABILITY. Tenant specifically agrees to look solely to Landlord's interest in the Project (which includes Landlord's equity in the Project and its interest in rents, insurance and condemnation proceeds, etc.) for the recovery of any judgment against Landlord, it being agreed that Landlord, its partners, officers, directors and employees shall never be personally liable for any such judgment. The provision contained in the foregoing sentence is not intended to, and shall not, limit any right that Tenant might otherwise have to obtain injunctive relief against Landlord or Landlord's successors in interest or any suit or action in connection with enforcement or collection of amounts which may become owing or payable under or on account of insurance maintained by Landlord.

30. BANKRUPTCY. If a petition is filed by or against Tenant for relief under Title II of the United States Code, as amended (the "Bankruptcy Code"), and Tenant (including for purposes of this Section 30, Tenant's successor in bankruptcy, whether a trustee or Tenant as debtor in possession) assumes and proposes to assign, or proposes to assume and assign, this Lease pursuant to the provisions of the Bankruptcy Code to any person or entity who has made or accepted a bona fide offer to accept an assignment of this Lease on terms acceptable to Tenant, then notice of the proposed assignment setting forth (i) the name and address of the proposed assignee, (ii) all of the terms and conditions of the offer and proposed assignment, and (iii) the adequate assurance to be furnished by the proposed assignee of its future performance under the Lease, shall be given to Landlord by Tenant no later than twenty (20) days after Tenant has made or received such offer, but in no event later than ten (10) days prior to the date on which Tenant applies to a court of competent jurisdiction for authority and approval to enter into the proposed assignment. Landlord shall have the prior right and option, to be exercised by notice to Tenant given at any time prior to the date on which the court order authorizing such assignment becomes Final and non-appealable, to receive an assignment of this Lease upon the same terms and conditions, and for the same consideration, if any, as the proposed assignee, less any brokerage commissions which may otherwise be payable out of the consideration to be paid by the proposed assignee for the assignment of this Lease. If this Lease is assigned pursuant to the provisions of the Bankruptcy Code, Landlord: (i) may require from the assignee a deposit or other security for the performance of its obligations under the Lease in an amount substantially the same as would have been required by Landlord upon the initial leasing to a tenant similar to the assignee; and (ii) shall receive, as additional rent any and all sums received in excess of the Rent payable under this Lease. Any person or entity to which this Lease is assigned pursuant to the provisions of the Bankruptcy Code shall be deemed, without further act or documentation, to have assumed all of the Tenant's obligations arising under this Lease on and after the date of such assignment. Any such assignee shall, upon demand, execute and deliver to Landlord an instrument confirming such assumption. No provision of this Lease shall be deemed a waiver of Landlord's rights or remedies under the Bankruptcy Code to oppose any assumption and/or assignment of this Lease, to require a timely performance of Tenant's obligations under this Lease, or to regain possession of the Premises if this Lease has neither been assumed or rejected within sixty (60) days after the date of the order for relief or within such additional time as a court of competent jurisdiction may have fixed. Notwithstanding anything in this Lease to the contrary, all amounts payable by Tenant to or on behalf of Landlord under this Lease, whether or not expressly denominated as Rent, shall constitute rent for the purposes of Section 502(b)(6) of the Bankruptcy Code.

31. NO RECORDING. Neither this Lease (including any Exhibits hereto) nor any memorandum hereof shall be recorded without the prior written consent of Landlord, which consent shall not be unreasonably withheld, conditions or delayed.

32. FINANCIAL STATEMENTS. Intentionally Deleted.

33. SEPARABILITY. If any clause or provision of this Lease is illegal, invalid or unenforceable under present or future laws, then and in that event, it is the intention of the parties hereto that the remainder of this Lease shall not be affected thereby, and it is also the intention of the parties to this Lease that in lieu of each clause or provision of this Lease that is illegal, invalid, or unenforceable, there be added as a part of this Lease a clause or provision as similar in terms to such illegal, invalid or unenforceable clause or provision as may be possible and be legal, valid and enforceable.

34. ENTIRE AGREEMENT; AMENDMENTS; BINDING EFFECT. This Lease contains the entire agreement between the parties and may not be altered, changed or amended, except by instrument in writing signed by both parties hereto. No provision of this Lease shall be deemed to have been waived by Landlord unless such waiver be in writing signed by Landlord and addressed to Tenant, nor shall any custom or practice which may grow up between the parties in the administration of the terms hereof be construed to waive or lessen the right of Landlord to insist upon the performance by Tenant in strict accordance with the terms hereof. The terms, provisions, covenants and conditions contained in this Lease shall apply to, inure to the benefit of, and be binding upon the parties hereto, and upon their respective successors in interest and legal representatives, except as otherwise herein expressly provided.

35. QUIET ENJOYMENT. Provided Tenant has performed all of the terms, covenants, agreements and conditions of this Lease, including the payment of Rent, to be performed by Tenant, Tenant shall peaceably and quietly hold and enjoy the Premises for the term hereof, without hindrance from Landlord, subject to the terms and conditions of this Lease.

36. EXISTENCE OF BROKER. Tenant represents and warrants that it has not contacted or dealt with any real estate broker or agent in connection with the execution of this Lease, except as listed below, and Tenant agrees to indemnify and hold harmless Landlord against all liabilities and costs (including but not limited to attorneys' fees) incurred by Landlord as a result of Tenant's breach of the warranties and representations contained herein.

TENANT'S BROKER: CB Richard Ellis
5400 LBJ Freeway, Suite 100
Dallas, Texas 75240
Attn: Peter Dana

Landlord represents and warrants that it has not contacted or dealt with any real estate broker or agent in connection with the execution of this Lease, except as listed below, and Landlord agrees to indemnify and hold harmless Tenant against all liabilities and costs (including but not limited to attorneys' fees) incurred by Tenant as a result of Landlord's breach of the warranties and representations contained herein.

LANDLORD'S BROKER: Stream Realty Partners, L.P.
9101 N. Central Expressway, Suite 100
Dallas, Texas 75231
Attention: Michael J. McVean

Landlord agrees to pay Tenant's Broker and Landlord's Broker any commissions due to either of them pursuant to a separate agreement or agreements executed by Landlord, Tenant's Broker and Landlord's Broker.

37. GENDER. Words of any gender used in this Lease shall be held and construed to include any other gender, and words in the singular number shall be held to include the plural, unless the context otherwise requires.

38. JOINT AND SEVERAL LIABILITY. If there be more than one Tenant, the obligations hereunder imposed upon Tenant shall be joint and several. If there be a guarantor of Tenant's obligations hereunder, the obligations hereunder imposed upon Tenant shall be the joint and several obligations of Tenant and such guarantor and Landlord need not first proceed against the Tenant hereunder before proceeding against such guarantor, nor shall any such guarantor be released from its guaranty for any reason whatsoever, including without limitation, in case of any amendments hereto, waivers hereof or failure to give such guarantor any notices hereunder.

39. CAPTIONS. The captions contained in this Lease are for convenience of reference only, and in no way limit or enlarge the terms and conditions of this Lease.

40. SPECIAL PROVISIONS.

- (a) Renewal Option. See Exhibit D attached hereto and made a part hereof.
- (b) Right of First Refusal. See Exhibit E attached thereto and made a part hereof.

(c) Parking. At all times during the Lease Term, at no cost to Tenant, Landlord shall make available to Tenant on a non-exclusive basis, in the areas shown on Exhibit G attached hereto and made a part hereof for all purposes, a total of 7 spaces per every thousand rentable square feet of the Premises which based on 85,893 square feet, equals 601 parking spaces, of which 120 of such spaces shall be covered. In addition, Landlord reserves the right to reasonably reconfigure the parking area, provided that the total number of parking spaces (including covered parking spaces) available for Tenant's use remains the same.

(d) ADA Compliance. Notwithstanding any other statement in this Lease, the following provisions shall govern the parties' compliance with the Americans With Disabilities Act of 1990, as amended from time to time. Public Law 101-336, 42 U.S. C. §§12101, et seq. (the "ADA"):

(1) To the extent governmentally required as of the Commencement Date of this Lease, Landlord shall be responsible for compliance with Title III of the ADA, at its expense, and such expense shall not be included as an Operating Expense of the Project, with respect to any repairs, replacements or alterations to the Common Area and rentable areas of the Project specifically excluding the Premises.

(2) To the extent governmentally required subsequent to the Commencement Date of this Lease as a result of an amendment to Title III of the ADA subsequent to the Commencement Date of this Lease, Landlord shall be responsible for compliance with Title III of the ADA with respect to any repairs, replacements or alterations to the Common Area of the Project, and such expense shall be included as an Operating Expense of the Project.

(3) Landlord shall indemnify, defend and hold harmless Tenant and its Agents from all fines, suits, procedures, penalties, claims, liability, losses, expenses and actions of every kind, and all costs associated therewith (including, without limitation, reasonable attorneys' and consultants' fees) arising out of or in any way connected with Landlord's failure to comply with Title III of the ADA as required above.

(4) To the extent governmentally required, Tenant shall be responsible for compliance, at its expense, with Titles I and III of the ADA with respect to its specific manner of use of the Premises and its leasehold improvements within the Premises.

(5) Tenant shall indemnify, defend and hold harmless Landlord and its Agents from all fines, suits, procedures, penalties, claims, liability, losses, expenses and actions of every kind, and all costs associated therewith (including, without limitation, reasonable attorneys' and consultants' fees) arising out of or in any way connected with Tenant's failure to comply with Titles I and III of the ADA as required above.

(e) Additional Landlord Obligations and Representations:

(1) To the best of Landlord's knowledge, Landlord represents that the Project and its existing uses and, after due investigation, its prior uses, comply with, and Landlord is not in violation of, and has not violated, in connection with the ownership, use, maintenance or operation of the Project and the conduct of the business related thereto, any applicable federal, state, county, regional or local statutes, laws, regulations, rules, ordinances, codes, standards, orders, licenses and permits of any governmental authorities relating to environmental, health or safety matters, including any Hazardous Substance or Environmental Law. Landlord shall promptly observe and comply, with all present and future Environmental Laws, including, and without limitation, the Clean Air Act Amendments of 1990 and any regulations (as amended) and all regulations or standards as are or may be promulgated thereunder.

(2) Landlord represents, to the best of Landlord's knowledge, that Landlord, its agents, contractors and employees (a) have operated the Project and have at all times received, handled, used, stored, treated, transported and disposed of any chemical, material or substance, exposure to which is prohibited, limited or regulated by any federal, state, county, regional or local authority or which even if not so prohibited, limited or regulated, poses a hazard to the health and safety of the occupants of the Project or the occupants of the area near the Project in strict compliance with all Environmental Laws, and (b) have removed (or will remove prior to the Commencement Date) from the Project and from the real property on which it is located, all Hazardous Materials (excluding products which are used commercially for cleaning and maintenance).

(3) Landlord represents, to the best of Landlord's knowledge, that there is no fact pertaining to the physical condition of the Project or the area surrounding the Project which (a) materially and adversely affects, or materially and adversely will affect the Project, or the use, enjoyment or value thereof, or Landlord's ability to perform the obligations contained in this Lease, and (b) which Landlord has not disclosed to Tenant in writing prior to the date of the Lease.

(f) Antenna(e) Installation. Subject to the following provisions of this subparagraph 40(f), Landlord grants Tenant the right, in common with Landlord and other tenants, to install (subject to Landlord's approval of size and number), operate and maintain, at Tenant's expense (including the then prevailing market rent for rooftop space) and risk, a lawfully permitted antenna(e), satellite dish and associated equipment (the "Antenna Equipment") at a location on the Property to be determined by Landlord and reasonably acceptable to Tenant (the "Antenna Premises").

(1) Tenant shall submit to Landlord for its approval, a full set of engineering plans and specifications for the proposed Antenna Equipment installation;

(2) Tenant shall make all required conduit or cable connections between Tenant's equipment in the Premises and the Antenna Equipment utilizing Building services, subject to (i) Tenant's payment of reasonable costs for such services, and (ii) approval of such connections by Landlord, which approval shall not be unreasonably withheld, conditioned or delayed;

(3) Any Antenna Equipment installed by Tenant shall be erected so as not to interfere with the operation of any previously erected communications equipment, and Landlord shall not erect or permit the erection of any communications equipment following the installation thereof so as to interfere with the operation of any Antenna Equipment previously erected by Tenant. Landlord shall have the right to relocate the Antenna Premises at any time during the Lease so long as Landlord pays for the expense of relocation and reception by the antenna is maintained;

(4) Tenant, its employees, agents and contractors shall, at all reasonable times, have the restricted right to enter or lease the Antenna Premises during the Term of this Lease;

(5) Tenant shall obtain all necessary municipal, state and federal permits and authorizations required to install, maintain and operate the Antenna Equipment and pay any charges levied by government agencies which are the sole result of Tenant having the Antenna Equipment. Landlord agrees to fully cooperate with Tenant in obtaining all such permits and authorizations, at no cost or expense to Landlord;

(6) Tenant agrees to maintain the Antenna Equipment and Antenna Premises in a good state of repair and to save Landlord harmless from any claims, liability or expenses resulting from the erection, maintenance, existence or removal of the Antenna Equipment;

(7) At the conclusion of the Term, Tenant shall remove the Antenna Equipment and surrender and restore the Antenna Premises to Landlord in substantially as good condition as when entered, except for loss or damages resulting from casualty, condemnation, act of God or ordinary wear and tear; and

(8) The liability insurance to be carried by Tenant pursuant to the provisions of this Lease shall include coverage for Tenant's activity on the Antenna Premises;

(g) Tenant shall comply with the rules and regulations of the Building which are attached hereto as Exhibit E. Landlord may, from time to time, change such rules and regulations for the safety, care or cleanliness of the Building and related facilities, provided that such changes are applicable to all tenant's of the Building and will not unreasonably interfere with Tenant's use of the Premises.

41. EXHIBITS.

Project	Exhibit A
Premises	Exhibit A-1
Work Letter Agreement	Exhibit B
Subordination, Non-Disturbance Agreement	Exhibit C
Renewal Option	Exhibit D
Right of First Refusal	Exhibit E
Building Rules and Regulations	Exhibit F
Parking Site Plan	Exhibit G

[THE REMAINDER OF THIS PAGE HAS BEEN INTENTIONALLY LEFT BLANK.]

Executed by Landlord this 26 day of September, 2000.

LANDLORD:
THE ARBORS OF BROOKHOLLOW OPERATING PARTNERSHIP, LTD., a Texas limited partnership.

By: Arbors of Brookhollow Management, Ltd.
a Texas limited partnership,
its general partner

By: Arbors of Brookhollow L.L.C.,
a Texas limited liability company,
its general partner

By: /s/ David R. Cunningham
David R. Cunningham
President

Executed by Tenant this 25 day of Sept., 2000.

ATTEST:

TENANT:
SOUTHWESTERN BELL TELEPHONE COMPANY, a Missouri corporation

By: /s/ J. Mark Schleyer
Name: J. Mark Schleyer
Title: Managing Director-CRE P&T



EXHIBIT A

PROJECT

BEING A 10.549 ACRE TRACT OF LAND SITUATED IN THE J. WILSON SURVEY, ABSTRACT NO. 1631, TARRANT COUNTY, TEXAS AND BEING ALL OF SITE 2R-2, BLOCK 6, SECTION 4 OF THE FINAL PLAT OF BROOKHOLLOW/ARLINGTON, AN ADDITION TO THE CITY OF ARLINGTON AS RECORDED IN VOLUME 388-185, PAGE 53 OF THE DEED RECORDS OF TARRANT COUNTY, TEXAS (DRTCT). BEARING BASIS FOR THIS PLAT OF SURVEY IS THE STATE PLANE COORDINATE SYSTEM NORTH CENTRAL ZONE (N.A.D. 83) AS DERIVED FROM THE CITY ARLINGTON MONUMENTS AR02,04 16&14. SAID 10.549 ACRE TRACT BEING MORE PARTICULARLY DESCRIBED BY MEETS AND BOUNDS AS FOLLOWS.

BEGINNING AT A 3/8" IRON ROD FOUND BEING THE SOUTHEAST CORNER OF THE SAID SITE 2R-2 AND THE SOUTHWEST CORNER OF THE FINAL PLAT OF SITE 2R-1, BLOCK 6, SECTION 4 BROOKHOLLOW/ARLINGTON RECORDED IN VOLUME 388-185, PAGE 53 DRTCT, SAID ROD ALSO BEING IN THE NORTH RIGHT-OF-WAY OF EAST LAMAR BOULEVARD (VARIABLE WIDTH R.O.W.);

THENCE ALONG THE SAID NORTH RIGHT-OF-WAY OF EAST LAMAR BOULEVARD THE FOLLOWING 3 COURSES AND DISTANCES:

S 89 DEGREES 28' 59" W, 122.30 FEET TO 5/8" IRON ROD CAPPED "CARTER & BURGESS" SET;

ALONG A CURVE TO THE RIGHT HAVING A RADIUS OF 989.00 FEET, A DELTA ANGLE OF 29 DEGREES 59' 59", A LONG CHORD THAT BEARS N 75 DEGREES 31' 06" W, A DISTANCE OF 511.94 FEET, AN ARC DISTANCE OF 517.84 FEET TO A 5/8" IRON ROD CAPPED "CARTER & BURGESS" SET;

N 60 DEGREES 31' 01" W, 194.50 FEET TO A 3/8" IRON ROD FOUND BEING THE SOUTHWEST CORNER OF THE SAID SITE 2R-2 AND THE SOUTHEAST CORNER OF SITE 3, BLOCK 6, SECTION 4 OF THE FINAL PLAT OF BROOKHOLLOW/ARLINGTON AS RECORDED IN VOLUME 388-185, PAGE 53 DRTCT;

THENCE N 01 DEGREES 23' 30" W, LEAVING THE SAID NORTH RIGHT-OF-WAY OF EAST LAMAR BOULEVARD AND ALONG THE WEST LINE OF SITE 2R-2 AND THE EAST LINE OF SITE 3, 466.00 FEET TO A POINT FROM WHICH A 5/8" IRON ROD FOUND BEARS S 19 DEGREES 01' 18" W, 0.54 FEET, SAID IRON ROD BEING IN THE SOUTH RIGHT-OF-WAY OF BROOKHOLLOW PLAZA DRIVE (60' R.O.W);

THENCE ALONG THE SAID SOUTH RIGHT-OF-WAY OF BROOKHOLLOW PLAZA DRIVE THE FOLLOWING 2 COURSES AND DISTANCES;

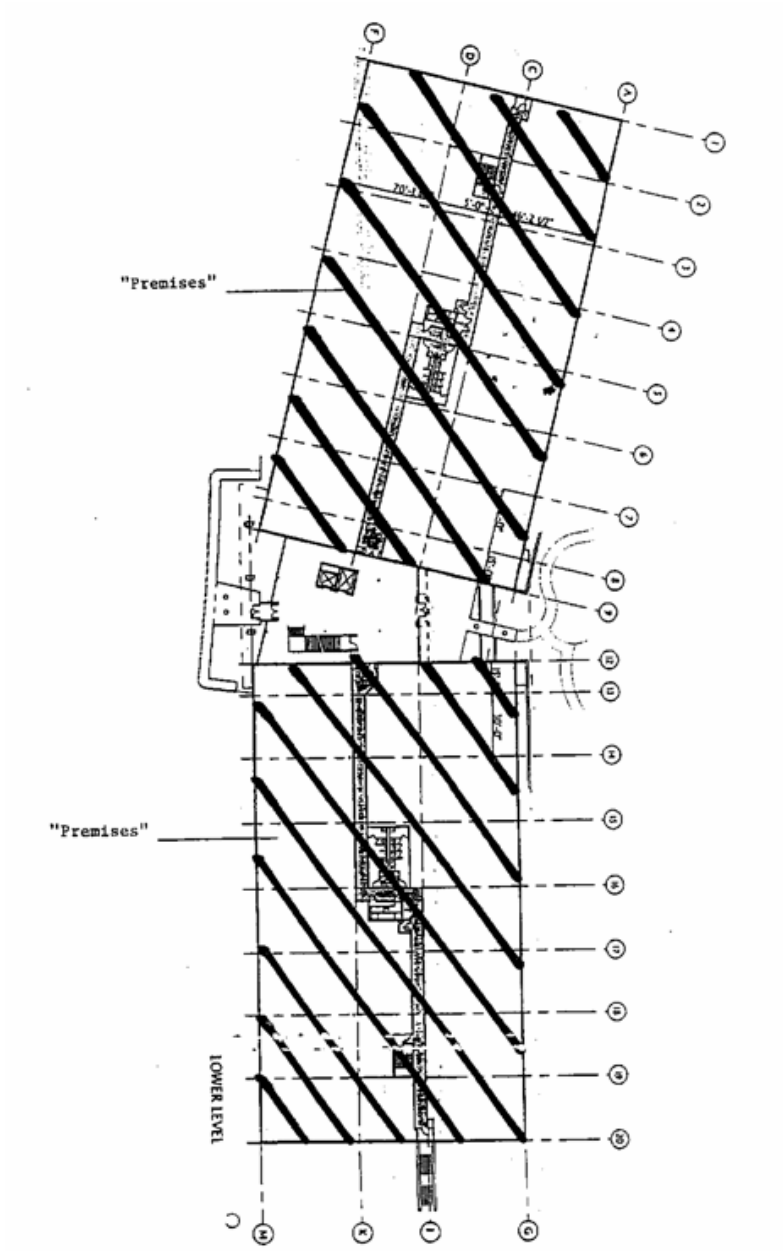
ALONG A CURVE TO THE LEFT HAVING A RADIUS OF 630.00 FEET, A DELTA ANGLE OF 23 DEGREES 45' 35", A LONG CHORD THAT BEARS S 78 DEGREES 22' 11" E. A DISTANCE OF 259.39 FEET, AN ARC DISTANCE OF 261.25 FEET TO A POINT FROM WHICH 5/8" IRON ROD FOUND BEARS S 19 DEGREES 37' 07" E, 0.41 FEET;

N 89 DEGREES 45' 02" E, 547.02 FEET TO A 3/8" IRON ROD FOUND FOR THE NORTHEAST CORNER OF SITE 2R-2 AND THE NORTHWEST CORNER OF SITE 24-1;

THENCE S 00 DEGREES 13' 19" W, ALONG THE EAST LINE OF SITE 2R-2 AND THE WEST LINE OF SITE 2R-1, 638.60 FEET TO THE POINT OF BEGINNING, AND CONTAINING 10.549 ACRES OF LAND, MORE OR LESS.

EXHIBIT A-1

[Outline of Premises]



A-1-1

EXHIBIT B

WORK LETTER AGREEMENT

This Work Letter Agreement is attached to and made a part of the Lease. All terms used in this Work Letter Agreement which have been defined in the Lease have the same meaning as set forth in the Lease. This Work Letter Agreement shall set forth the terms and conditions relating to the construction of Tenant Improvements in the Premises.

I. Landlord and Tenant Construction Obligations

A. Space Plan Preparation. Tenant shall designate the space planner/architect (the "Space Planner") to prepare a detailed space plan ("Space Plan") containing all information listed in Section II of this Work Letter Agreement for all tenant improvements ("Tenant Improvements") proposed by Tenant in the Premises.

B. Space Plan Approval. Landlord will review the Space Plan upon receipt from Tenant and shall thereafter meet with Tenant no later than five (5) business days after Landlord's receipt of the Space Plan and advise Tenant as to the matters set forth in Section II below. If the Landlord reasonably determines that the Space Plan does not conform to the requirements of Section II below, the Space Plan will be returned to Tenant with specific written comments describing Landlord's corrections or revisions for review by Tenant with the Space Planner for the adoption of such corrections or revisions. The cost of any correction or revision to the Space Plan shall be borne by Tenant. Tenant will deliver a corrected Space Plan to Landlord for review and approval before working drawings may be prepared. This process will be repeated, as required, until mutual approval of Tenant's Space Plan, but Landlord will return any subsequent corrections or revisions no later than five (5) business days after Landlord's receipt of corrected space plans. Upon approval of the final Space Plan, which shall not be unreasonably withheld, Landlord will notify Tenant in writing of such approval within five (5) business days of Landlord's receipt of the final Space Plan and that the preparation of working drawings may commence.

Notwithstanding the provisions of Sections I (A) and (B) above, Tenant may elect to present Working Drawings in lieu of a Space Plan.

C. Preparation of Working Drawings. Upon final approval of the Space Plan and estimated Tenant Improvement costs, Tenant shall direct its Space Planner to prepare working drawings ("Working Drawings") based on the approved Space Plan. When prepared, the Working Drawings consistent with the Space Plan shall be delivered by the Space Planner to the Tenant and Landlord for approval. Tenant shall deliver the Working Drawings for Landlord's approval which shall not be unreasonably withheld. Landlord will notify Tenant in writing of such approval within five (5) business days of Landlord's receipt of the Working Drawings.

D. Installation of Tenant Improvements. Upon approval of the Working Drawings by Landlord and Tenant, Tenant and Tenant's designee shall install the Tenant Improvements in the Premises in accordance with the Lease Agreement, this Work Letter Agreement, and the Working Drawings. Tenant's Work will be performed in a good workmanlike manner, in compliance with all applicable laws, and will be adequate for the Premises to be substantially completed as provided in this Work Letter Agreement. Unless otherwise agreed to in writing by Landlord and Tenant, all work involved in the construction of the Tenant Improvements shall be carried out by Tenant's contractor in accordance with AIA Document, "General Conditions of the Contract for Construction," Standard Form A201-1997 and in such a manner so as not to unreasonably interfere with or disturb the operation, business, use and enjoyment of the Project by other tenants of the Project.

E. Selection of Contractors. All contractors, subcontractors and materialmen hired by Tenant to install the Tenant Improvements shall be first approved in writing by Landlord, which such approval not to be unreasonably withheld, conditioned or delayed.

F. Payment by Tenant of Tenant Improvements. Tenant shall pay all costs incurred in connection with the Tenant Improvements including, without limitation, (i) the cost of materials, labor and other costs related to the construction of the Tenant Improvements, including the Project Standard blinds specified by Landlord (ii) the cost of preparation and, if any, modifications of the Space Plan, (iii) the cost of the preparation and, if any, modification of construction plans or Working Drawings, (iv) the cost of providing and installing Tenant's name and suite number adjacent to Tenant's entry door, and (v) payment of architectural and engineering fees incurred by Tenant and associated with the Space Plan and Working Drawings not otherwise included within the items specified above. In connection with construction of the Tenant Improvements and all costs described above, Tenant shall be entitled to a one-time tenant reimbursement of the tenant improvement costs (the "Tenant Improvement Allowance"), not to exceed \$20.00 per square foot contained in the Premises which based on 85,893 square feet equals the sum of \$1,717,220.00 for space planning, construction documentation and hard costs of constructing the Tenant Improvements (including cabling costs as provided herein). Notwithstanding the foregoing, upon request of Tenant, Landlord shall increase the amount of the Tenant Improvement Allowance by an additional \$5.00 per square foot of rentable area (the "Additional Allowance"), provided that the Additional Allowance shall be amortized as a loan into the Basic Rent utilizing an 11% annual interest rate. In the event Tenant requests such Additional Allowance, Landlord and Tenant shall execute an amendment to the Lease increasing the Basic Rent accordingly. In no event shall Landlord be obligated to make disbursements for Tenant Improvements in excess of the Tenant Improvement Allowance and, if applicable, the Additional Allowance. Any unused Tenant Improvement Allowance (but not the Additional Allowance) may be applied as a credit against Rent.

G. Tenant Improvements Costs. All costs of constructing and installing the Tenant Improvements shall be paid by Tenant in a timely fashion so as not to allow any mechanic's or other liens to be filed against the Project and if any such liens are filed, Tenant shall cause same to be removed in accordance with Section 23 of the Lease.

H. Tenant Improvement Allowance. Landlord agrees to pay such Tenant Improvement Allowance to Tenant within thirty (30) days following satisfaction or completion of the following events:

- a. substantial completion of all Tenant Improvements in accordance with the Working Drawings;
- b. Tenant's delivery to Landlord of a copy of its Certificate of Occupancy (or similar governmental occupancy permit);
- c. Landlord's reasonable satisfaction that all bills have been paid to Tenant's contractor, subcontractors and material suppliers, including appropriate lien waivers from said persons; and
- d. Tenant's commencement of business in the Premises.

As used above, Substantial Completion means the Tenant Improvements have been completed in accordance with this Exhibit B and have passed all final inspections by the City of Arlington.

I. Change Orders. Changes which materially alter the existing plans in Tenant's work will be authorized only by mutual written agreement between the parties setting forth any additional changes, modifications or alterations required to complete the Premises as a result thereof. Landlord agrees not to unreasonably withhold or delay consent of said changes. In the event that Tenant desires to change the Tenant Improvements as provided in the approved Working Drawings, Tenant shall deliver notice of the same to Landlord, setting forth in detail the changes Tenant desires to make. Landlord may disapprove of said Tenant Changes (within ninety six (96) hours of notification of said Tenant Changes) in the event that Landlord, in its reasonable discretion, determines that the changes would constitute design problems for the Premises or Project provided Landlord informs Tenant in writing as to the design problem. In the event that Landlord approves of the proposed Tenant Changes, Tenant shall bear the full costs for any and all such changes in the Tenant Improvements.

J. Waiver and Release. Tenant hereby waives, releases and agrees to indemnify Landlord from all loss, damages, delays and claims relating to, or arising out of (i) the design, code compliance, quality, omissions or errors and other like matters contained in the Working Drawings, and (ii) the construction of the Tenant Improvements, including, without limitation, lost profits and all incidental or consequential damages.

K. Insurance and Indemnity. The insurance and indemnity requirements under Section 11 of the Lease shall apply during the construction contemplated by this Work Letter Agreement, and Tenant shall provide evidence of appropriate insurance coverage prior to beginning of construction. In addition, and without limiting the generality of the immediately preceding sentence, at Landlord's option, Landlord may require that prior to beginning any construction, Tenant shall provide Landlord with evidence of insurance covering Tenant and all of Tenant's contractors against damage to their personal property, as well as against third party liability and claims arising out of all construction and associated activities.

L. Staging Area. Tenant's contractor shall contain his storage of materials and his operations within the Premises and such other space as may be assigned in writing by Landlord. Should Tenant's contractor be assigned space outside of the Premises, he shall move to such other space as Landlord shall reasonably direct in writing from time to time to avoid interference or delays with other work.

M. Trash. All trash and surplus construction materials shall be stored within the Premises and Tenant's contractor shall promptly remove same from the Premises and Project. Tenant's contractor shall not place trash in trash dumpsters on the Project.

N. Temporary Utilities. Tenant shall be responsible for the cost and Tenant's contractor shall be responsible for providing any temporary utilities, portable toilet facilities and portable drinking water, etc. as may be required for his work within the Premises.

O. After Hours Work. Tenant's contractor shall notify Landlord of any planned work to be done on weekends or other than normal job hours.

P. Ordinances, Codes and Regulations. Tenant and Tenant's contractor are responsible for the cost and compliance with all applicable codes and regulations of duly constituted authorities having jurisdiction insofar as the performance of the work and completed improvements are concerned for all work performed by Tenant or Tenant's contractor.

Q. Ceiling Tile and Light Fixture Allowance. If Tenant does not use the Building standard ceiling tile and/or light fixtures, Landlord shall credit the Construction Allowance by an amount equal to the cost of the Building standard ceiling tile and/or light fixtures, less any restocking fee charged. Such amount shall be deemed part of the Construction Allowance for all purposes under this Lease.

II. Tenant Space Plan Must Contain, as a Minimum, the Following Information:

A. Floor plan showing.

1. Partitions: indicate location and type of all partitions.
2. Doors: indicate location, swing and type of all doors. Also indicate hardware.
3. Standard Electrical Items: indicate the location of all building standard electrical items listed herein (wall-mounted 110 volt duplex outlets, single-pole light switches and building standard light fixtures).
4. Standard Telephone Outlets: indicate the location of all building standard telephone wall outlets, as listed herein.
5. "Above Standard" Electrical Items: indicate the location and type of all "above standard" electrical items, including lighting.

-
6. Special Electrical Equipment and Requirements: indicate the location and type of equipment that will have special requirements and indicate the location and type of special electrical equipment to be purchased.
 7. Telephone and Data Equipment Location: indicate location of telephone equipment room, if any.
 8. Glass Items: indicate location, dimensions and type of glass partitions, windows and doors. Include details if not building standard.
 9. Heavy Items: indicate location, dimensions, weight per square foot and description of any heavy equipment or filing system exceeding fifty (50) pounds per square foot live load.
 10. Special HVAC Requirements: Indicate location and specific requirements for any special and/or concentrated heating and/or air conditioning requirements beyond that provided by the building HVAC system and/or distribution network.
 11. Floor Covering: indicate location, type and color of all floor covering.
 12. Wall Covering: indicate location, type and color of all wall coverings.
 13. Paint: indicate location, type and color of paint finishes.
 14. Millwork: indicate location, type and basic dimensions of all cabinets, shelving and other millwork items.
 15. Plumbing: indicate location and type of all plumbing items.
 16. Appliances: indicate location, type, dimensions and special requirements of all appliances.
 17. Critical Dimensions: indicate all critical dimensions necessary for construction.
 18. Fire Sprinkler Requirements: indicate location and type of all fire sprinkling and/or special fire suppression requirements.
 19. Ceiling System and Finishes: indicate location, type and color of all ceiling finishes and/or systems.
 20. Security Requirements: indicate the location, type and special requirements for any security system and/or requirements.
 21. Furniture System Requirements: indicate all interfacing requirements with furniture systems (i.e., electrical, telephone, data, anchoring, etc.).

EXHIBIT C

SUBORDINATION, NONDISTURBANCE AND ATTORNMENT AGREEMENT

THIS SUBORDINATION, NONDISTURBANCE AND ATTORNMENT AGREEMENT (this "Agreement") is made this 26 day of September, 2000, by and among BANK ONE (hereinafter called "Mortgagee"), , (hereinafter called "Tenant") and THE ARBORS OF BROOKHOLLOW OPERATING PARTNERSHIP, LTD., a Texas limited partnership (hereinafter called "Landlord").

WITNESSETH:

WHEREAS, Mortgagee is or will be the owner and holder of a Deed of Trust and Security Agreement and UCC Financing Statement for Fixture Filing executed as of July 9, 1998, and recorded at Volume 98133, Page 05253 of the Real Property Records of Dallas County, Texas (hereinafter called the "Mortgage"), covering the real property described in Exhibit "A" attached hereto and made a part hereof and the buildings and improvements thereon (hereinafter collectively called the "Property") securing the payment of a promissory note in the stated principal amount of \$11,461,500, executed by Landlord and payable to the order of Mortgagee; and

WHEREAS, Tenant is the holder of a lease (hereinafter called the "Lease") dated September 26, 2000, by and between Landlord, as the landlord, and Tenant, as the tenant, covering that portion of the Property described therein (hereinafter called the "Leased Premises"); and

WHEREAS, Landlord, Tenant and Mortgagee desire to confirm and agree upon certain of their rights and obligations with respect to the Lease and the Mortgage;

NOW, THEREFORE, in consideration of the mutual covenants and agreements herein contained, Landlord, Tenant and Mortgagee hereby agree and covenant as follows:

1. Subordination. The Lease now is, and shall at all times continue to be, subject and subordinate in each and every respect, to the Mortgage and to any and all increases, renewals, modifications, extensions, substitutions, replacements and/or consolidations of the Mortgage.

2. Nondisturbance. So long as Tenant is not in default (beyond any period given Tenant in the Lease to cure such default) in the payment of rent or in the performance of any of the terms, covenants or conditions of the Lease on Tenant's part to be performed, (i) Tenant's possession of the Leased Premises and Tenant's rights and privileges under the Lease, or any extensions or renewals thereof, or expansions into additional space within the Property which may be effected in accordance with the terms of the Lease, shall not be diminished or interfered with by Mortgagee in the exercise of any of its rights under the Mortgage, (ii) Tenant's occupancy of the Leased Premises or any such expansion space shall not be disturbed by Mortgagee in the exercise of any of its rights under the Mortgage during the term of the Lease or any such extensions or renewals thereof, and (iii) Mortgagee will not join Tenant as a party defendant in any action or proceeding for the purpose of terminating Tenant's interest and estate under the Lease because of any default under the Mortgage.

3. Attornment. In the event any proceedings are brought for the foreclosure of the Mortgage or if the Property be sold pursuant to a trustee's sale under the Mortgage, or upon a transfer of the Property by conveyance in lieu of foreclosure, Tenant shall attorn to the purchaser upon any such foreclosure sale or trustee's sale or transfer in lieu thereof and shall recognize such purchaser as the Landlord under the Lease. Such attornment shall be effective and self-operative without the execution of any further instrument on the part of any of the parties hereto. Tenant agrees, however, to execute and deliver at any time and from time to time, upon the request of Landlord or of any holder(s) of any of the indebtedness or other obligations secured by the Mortgage or any such purchaser, any instrument or certificate which, in the reasonable judgment of Landlord or of such holder(s) or such purchaser, may be necessary or appropriate in any such foreclosure proceeding or otherwise to evidence such attornment. In the event of any such attornment, Tenant further waives the provisions of any statute or rule of law, now or hereafter in effect, which may give or purport to give Tenant any right or election to terminate or otherwise adversely affect the Lease and the obligations of Tenant thereunder as a result of any such foreclosure proceeding, trustee's sale or conveyance in lieu thereof.

4. Foreclosure and Sale. If Mortgagee shall succeed to the interest of Landlord under the Lease in any manner, or if any purchaser acquires the Leased Premises upon any foreclosure of the Mortgage or any trustee's sale under the Mortgage, Mortgagee or such purchaser, as the case may be, shall have the same remedies by entry, action or otherwise in the event of any default by Tenant (beyond any period given to Tenant in the Lease to cure such default) in the payment of rent or additional rent or in the performance of any of the terms, covenants and conditions of the Lease on Tenant's part to be performed- that Landlord had or would have had if Mortgagee or such purchaser had not succeeded to the interest of Landlord. From and after attornment by Tenant, Mortgagee or such purchaser shall be bound to Tenant under all of the terms, covenants, and conditions of the Lease, and Tenant shall, from and after the succession to the interest of Landlord under the Lease by Mortgagee or such purchaser, have the same remedies against Mortgagee or such purchaser for the breach of an agreement contained in the Lease that Tenant might have had under the Lease against Landlord if Mortgagee or such purchaser had not succeeded to the interest of Landlord, provided further, however, that Mortgagee or such purchaser shall not in any event be:

- a. liable for any act or omission of any prior landlord (including Landlord); or
- b. subject to any offsets or defenses which Tenant might have against any prior landlord (including Landlord); or
- c. bound by any rent or additional rent which Tenant might have paid for more than the current month to any prior landlord (including Landlord), or by any security deposit, cleaning deposit or other prepaid charge which Tenant might have paid in advance to any prior landlord (including Landlord), unless actually received by Mortgagee or such purchaser; or
- d. bound by or liable for any obligation of the landlord to pay any sums of money to or for the benefit of or on behalf of Tenant for concessions or inducements granted to Tenant by the landlord (including Landlord) except as expressly set forth in the Lease; or
- e. bound by any amendment or modification of the Lease made without its consent.

5. Acknowledgment and Agreement by Tenant. Tenant acknowledges and agrees that:

- a. Mortgagee, in making any disbursements to Landlord, is under no obligation or duty to oversee or direct the application of the proceeds of such disbursements, and such proceeds may be used by Landlord for purposes other than improvement of the Property.
- b. From and after the date hereof, in the event of any act or omission by Landlord which would give Tenant the right, either immediately or after the lapse of time, to cease paying rent or terminate the Lease or to claim a partial or total eviction, Tenant will not exercise any such right:
 - (i) until it has given written notice of such act or omission to Mortgagee; and
 - (ii) if Landlord shall have failed to cure such default within the time provided for in the Lease, then the Mortgagee shall have an additional thirty (30) days within which to cure such default or if such default cannot be cured within that time, then such additional time as may be necessary to cure such default shall be deemed granted to Mortgagee if within such thirty (30) days Mortgagee has commenced and is diligently pursuing the remedies necessary to cure such default (including, but not limited to, commencement of foreclosure proceedings, if necessary to effect such cure), in which event the Lease shall not be terminated while such remedies are being so diligently pursued.

-
- c. It has notice that the Lease and the rent and all other sums due thereunder have been assigned or are to be assigned to Mortgagee as security for the Loan secured by the Mortgage. In the event that Mortgagee notifies Tenant of a default under the Mortgage and demands that Tenant pay its rent and all other sums due under the Lease to Mortgagee, Tenant shall honor such demand and pay its rent and all other sums due under the Lease directly to Mortgagee or as otherwise required pursuant to such notice.
 - d. It shall send a copy of any notice or statement claiming a default by Landlord under the Lease to Mortgagee at the same time such notice or statement is sent to Landlord.
 - e. This Agreement satisfies any condition or requirements in the Lease relating to the granting of a non-disturbance agreement.

6. Acknowledgment and Agreement by Landlord. Landlord, as landlord under the Lease and mortgagor or grantor under the Mortgage, acknowledges and agrees for itself and its successors and assigns, that:

- a. This Agreement does not:
 - (i) constitute a waiver by Mortgagee of any of its rights under the Mortgage; and/or
 - (ii) in any way release Landlord from its obligations to comply with the terms, provisions, conditions, covenants, agreements and clauses of the Mortgage;
- b. The provisions of the Mortgage remain in full force and effect and must be complied with by Landlord; and
- c. In the event of a default under the Mortgage, Tenant may pay all rent and all other sums due under the Lease to Mortgagee as provided in this Agreement.

7. Notice. All notices to be delivered hereunder to Mortgagee shall be deemed to have been duly given if mailed under United States registered or certified mail, with return receipt requested, postage prepaid to Mortgagee at 1700 Pacific, Suite 2100, Dallas, Texas 75201 (or at such other address as shall be given in writing by Mortgagee to Tenant) and shall be deemed complete upon any such mailing.

8. Miscellaneous.

- a. This Agreement supersedes any inconsistent provision of the Lease.
- b. Mortgagee shall have no obligations nor incur any liability with respect to any warranties of any nature whatsoever, whether pursuant to the Lease or otherwise, including, without limitation, any warranties respecting use, compliance with zoning, Landlord's title, Landlord's authority, habitability, fitness for purpose or possession.
- c. This Agreement shall inure to the benefit of the parties hereto, their respective successors and permitted assigns, provided, however, that in the event of the assignment or transfer of the interest of Mortgagee, all obligations and liabilities of Mortgagee under this Agreement shall terminate, and thereupon all such obligations and liabilities shall be the responsibility of the party to whom Mortgagee's interest is assigned or transferred.
- d. This Agreement shall be governed by and constructed in accordance with the laws of the State of Texas.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first written above.

Address:

1700 Pacific Avenue
Suite 2100
Dallas, Texas 75201

MORTGAGEE:

BANK ONE TEXAS, N.A.

By: /s/ Jeffrey A. Etter
Name (printed): Jeffrey A. Etter
Title: First Vice President

Address:

1010 N. St. Mary's
Room 515
San Antonio, Texas 78205

TENANT:

SOUTHWESTERN BELL TELEPHONE COMPANY

By: /s/ J. Mark Schleyer
Name (printed): J. Mark Schleyer
Title: Managing Director – CRE P&T

Address:

2201 Royal Lane
Suite 220
Irving, Texas 75063

LANDLORD:

ARBORS OF BROOKHOLLOW
OPERATING PARTNERSHIP, LTD.,
a Texas limited partnership

By: Arbors of Brookhollow Management, Ltd.
a Texas limited partnership,
its general partner

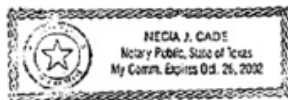
By: /s/ David R. Cunningham
David R. Cunningham
President

STATE OF TEXAS §
 §
COUNTY OF DALLAS §

This instrument was acknowledged before me on this 26 day of Sept, 2000, by Jeff Etter of Bank One Texas, N.A., on behalf of said bank.

Notary Public, State of Texas

[SEAL]



STATE OF TEXAS §
 §
COUNTY OF DALLAS §

This instrument was acknowledged before me on this 26th day of September, 2000, by J. Mark Schleyer a Managing Director of Southwestern Bell Telephone Company, a Missouri Corporation, on behalf of said Tenant.

[SEAL]

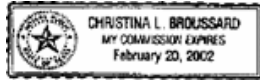


Jewelene D. Trim

Notary Public, State of Texas

This instrument was acknowledged before me on this 26th day of September, 2000, by David R. Cunningham, President of Arbors of Brookhollow, L.L.C., a Texas limited liability company, the general partner of Arbors of Brookhollow Management, Ltd., a Texas limited partnership, the general partner of Arbors of Brookhollow Operating Partnership, Ltd., a Texas limited partnership on behalf of said entities.

[SEAL]



Christina L. Broussard

Notary Public, State of Texas

EXHIBIT D

RENEWAL OPTION

Provided that Tenant is not in Default under any term or provision contained in this Lease beyond any applicable period to cure and no condition exists which with the passage of time or the giving of notice or both would constitute an event of default pursuant to this Lease and provided that Tenant has continuously occupied the Premises for the Permitted Use during the Lease Term, Tenant (but not any assignee or subtenant other than an Affiliate) shall have two (2) rights and the options (the "Renewal Options") to renew this Lease, by written notice delivered to Landlord no later than twelve (12) months prior to the expiration of the Lease Term, for a period of sixty (60) months each ("Renewal Term"), at the then Prevailing Market Rent and under the same terms, conditions, and covenants contained in the Lease, except that (a) no abatements or other concessions, if any, applicable to the initial Lease Term shall apply to the Renewal Term; (b) Tenant shall have no option to renew this Lease beyond the expiration of the second Renewal Term; and (c) all leasehold improvements within the Premises shall be provided in their then existing condition (on an "as is" basis) at the time the Renewal Term commences. Failure by Tenant to notify Landlord in writing of Tenant's election to exercise the Renewal Options herein granted within the time limits set forth for such exercise shall constitute a waiver and termination of such Renewal Option and any and all subsequent Renewal Options.

As used herein, the term "Prevailing Market Rent" means what a non-equity tenant would pay and receive and what a landlord of a comparable office building within the Arlington, Texas submarket (with similar amenities) would accept and give at arm's length as rent concessions, expense escalations, tenant improvement allowances, refurbishment allowances, other allowances, brokerage commissions, inducements and other economic conditions for the lease of space comparable to the Premises taking into consideration location of the Premises within the Building and existing overall parking ratio and leasehold improvements. The determination of such Prevailing Market Rent shall, for all applications in this Lease, be made using the following procedure:

1. Whenever, pursuant to the terms of this Lease, a determination must be made of Prevailing Market Rent, Landlord shall provide to Tenant in writing Landlord's reasonable determination of such Prevailing Market Rent within fifteen (15) days after receipt of Tenant's written request therefor. If Tenant accepts such determination by Landlord in writing, or if Tenant shall not have notified Landlord of its objection to such determination in writing, both within fifteen (15) days following Tenant's receipt of such determination, then such determination by Landlord of Prevailing Market Rent for that applicable portion of the Lease shall irrevocably become the Prevailing Market Rent.
2. If Tenant notifies Landlord, within fifteen (15) days following its receipt of Landlord's determination of Prevailing Market Rent, that it objects to such determination as not accurately reflecting such prevailing market rental rate ("Tenant's Notice of Objection"), then Landlord's determination of Prevailing Market Rent referred to in paragraph 1 above shall thereafter not be effective, and instead the following procedure shall be implemented to determine Prevailing Market Rent:
 - a. Within fifteen (15) days following Landlord's receipt of Tenant's Notice of Objection, Landlord shall select and notify Tenant of its selection of, an independent real estate broker from a recognized commercial real estate brokerage firm knowledgeable in the commercial real estate market of the Arlington submarket in Arlington, Texas (the "Landlord's Market Broker"). Within fifteen (15) days following Landlord's selection of Landlord's Market Broker, Landlord shall cause such broker to analyze the then-existing market conditions, prepare and deliver to Landlord and Tenant such broker's determination of the Prevailing Market Rent for the space to be leased by Tenant within the Building to which such Prevailing Market Rate shall apply. If Tenant accepts in writing such determination of Prevailing Market Rate presented by Landlord's Market Broker, or if Tenant shall not have notified Landlord of its objection to such determination, in writing, both within fifteen (15) days following Tenant's receipt of such determination by Landlord's Market Broker, then such determination by Landlord's Market Broker of the Prevailing Market Rent for that applicable portion of the Lease shall irrevocably become the Prevailing Market Rent.

-
- b. If Tenant notifies Landlord, within fifteen (15) days following its receipt of Landlord's Market Broker's determination of the Prevailing Market Rent, that it objects to such determination as not accurately reflecting such prevailing market rental rate ("Tenant's Notice of Objection to Landlord's Market Broker's Determination"), then the following procedure shall be implemented to determine Prevailing Market Rent and the results shall be binding by both parties; and requiring both Landlord and Tenant to proceed with the Renewal Option based on the outcome of the following process:
- (i) Within fifteen (15) days following Tenant's giving or delivering to Landlord the Tenant's Notice of Objection to Landlord's Market Broker's Determination, Tenant shall select, and notify Landlord of its selection of, an independent real estate broker from a recognized commercial real estate brokerage firm knowledgeable in the commercial real estate market of the Arlington submarket in Arlington, Texas (the "Tenant's Market Broker"). Within fifteen (15) days following Tenant's selection of Tenant's Market Broker, Tenant shall cause such broker to analyze the then-existing market conditions, and prepare and deliver to Landlord and Tenant such broker's determination of the Prevailing Market Rent for the space to be leased by Tenant within the Building to which such Prevailing Market Rate shall apply. If Landlord accepts in writing such determination of Prevailing Market Rent presented by Tenant's Market Broker, or if Landlord shall not have notified Tenant of its objection to such determination, in writing, both within fifteen (15) days following Landlord's receipt of such determination by Tenant's Market Broker, then such determination by Tenant's Market Broker of the Prevailing Market Rent for that applicable portion of the Lease shall irrevocably become the Prevailing Market Rent
- (ii) If Landlord notifies Tenant, within fifteen (15) days following its receipt of Tenant's Market Broker's determination of the Prevailing Market Rent, that it objects to such determination as not accurately reflecting such prevailing market rental rate ("Landlord's Notice of Objection to Tenant's Market Broker's Determination"), then Landlord shall, within five (5) days thereafter, direct both Landlord's Market Broker and Tenant's Market Broker to select within ten (10) days thereafter, and notify Landlord and Tenant of their selection of, a third independent real estate broker from a recognized commercial real estate broker firm knowledgeable in the commercial real estate market of the Arlington submarket in Arlington, Texas (the "Third Market Broker"). Within fifteen (15) days following such selection of the Third Market Broker, such Broker shall analyze the then-existing market conditions, prepare and deliver to Landlord, Tenant, Landlord's Market Broker and Tenant's Market Broker such Third Market Broker's determination of the Prevailing Market Rent for the space to be leased to Tenant within the Building to which such Prevailing Market Rate shall apply. If the Third Market Broker's determination of Prevailing Market Rent is a number between (x) the rental rate determined by Landlord's Market Broker, augmented five percent (5%) both higher and lower from such rental rate, and (y) the rental rate determined by Tenant's Market Broker, augmented five percent (5%) both higher and lower from such rental rate, then such Third Market Brokers determination of Prevailing Market Rent shall be irrevocably binding upon both Landlord and Tenant. However, if the Third Market Broker's determination of Prevailing Market Rent is a number not between (x) and (y) from the previous sentence, then the final, irrevocable determination of Prevailing Market Rent which shall be binding upon both Landlord and Tenant, will be calculated by adding together the two closest appraisals of the three determinations from the three brokers, and dividing such sum by two. Both Landlord and Tenant acknowledge that the determination of Prevailing Market Rent which is derived from such procedure shall be irrevocably binding upon both Landlord and Tenant.
- c. Notwithstanding any provisions elsewhere in this Lease allocating the payment of expenses, Landlord agrees to pay the expenses associated with the services of Landlord's Market Broker, Tenant agrees to pay the expenses associated with the services of Tenant's Market Broker, and both Landlord and Tenant agree to jointly and equally pay the expenses associated with the services of the Third Market Broker.

Upon exercise of the Renewal Option by Tenant and subject to the conditions set forth hereinabove, the Lease shall be extended for the period of such Renewal Term without the necessity of the execution of any further instrument or document, although if requested by either party, Landlord and Tenant shall enter into a written agreement modifying and supplementing the Lease in accordance with the provisions hereof. Any termination of the Lease during the initial lease Term shall terminate all renewal rights hereunder. The renewal rights of Tenant hereunder shall not be severable from the Lease, nor may such rights be assigned or otherwise conveyed in connection with any permitted assignment of the Lease. Landlord's consent to any assignment of the Lease shall not be construed as allowing an assignment of such rights to any assignee.

EXHIBIT E

RIGHT OF FIRST REFUSAL

If, Landlord shall receive an offer which Landlord is willing to accept (the "Offer") to lease all or any portion of (i) the space within the area outlined on Exhibit "A-1" attached hereto (the "Phase I Refusal Space") or (ii) the Phase II building of The Arbors at Brookhollow (if and when built by Landlord or any affiliate of Landlord) (the "Phase II Refusal Space") (the Phase I Refusal Space and Phase II Refusal Space being hereinafter referred to collectively as the "Refusal Space") and provided that the Lease is in full force and effect and there is no uncured Event of Default under the Lease, Tenant shall have a one-time right of first refusal ("Right of First Refusal") to lease all (but not part) of the space that is the subject of the Offer (the "Subject Space") upon the same terms and conditions contained in the Offer; provided, however, the lease term for the Subject Space shall be the same as the remaining Lease Term of the Lease, and if the remaining Lease Term is shorter than the lease term stated in the Offer, all allowances, concessions or other costs to be paid by Landlord shall be proportionately reduced. If, within five (5) days after Tenant receives written notice of the Offer (including a statement of the material terms and conditions thereof). Tenant does not notify Landlord in writing that Tenant elects to lease the Subject Space, then Landlord may enter into a lease with the prospective tenant who made the Offer on substantially the same terms and conditions contained therein. In addition, if the Subject Space is less than all of the Refusal Space, and the remainder of the Refusal Space is adjacent to the Premises, Tenant's failure to exercise the Right of First Refusal with respect to the Subject Space shall not prejudice its Right of First Refusal with respect to the remainder of the Refusal Space. Except as provided in the preceding two sentences, the failure of Tenant to exercise the Right of First Refusal within the time period set forth herein shall constitute a waiver and termination of the Right of First Refusal. If Tenant timely notifies Landlord of its intention to lease the Subject Space, Landlord and Tenant shall promptly enter into an amendment to this Lease adding the Subject Space to the Premises and otherwise incorporating the terms and conditions of the Offer. This Right of First Refusal is personal to Tenant and is not assignable to any third parties, including, but not limited to, any assignee or sublessee of Tenant.

Notwithstanding anything to the contrary set forth herein, the Right of First Refusal with respect to the Phase I Refusal Space shall terminate on the date which is eighteen (18) months from the date of this Lease.

Any capitalized terms not defined in this Exhibit E shall have the meaning set forth in the Lease to which this Exhibit E is attached.

EXHIBIT F

BUILDING RULES AND REGULATIONS

The following rules and regulations shall apply to the Premises, the Project, the parking areas associated therewith, and the appurtenances thereto:

1. Sidewalks, doorways, vestibules, halls, stairways, and other similar areas shall not be obstructed by tenants or used by any tenant for purposes other than ingress and egress to and from their respective leased premises and for going from one to another part of the Building.
2. Plumbing, fixtures and appliances shall be used only for the purposes for which designed, and no sweepings, rubbish, rags or other unsuitable material shall be thrown or deposited therein. Damage resulting to any such fixtures or appliances from misuse by a tenant or its agents, employees or invites, shall be paid by such tenant.
3. No signs, advertisements or notices shall be painted or affixed on or to any windows or doors or other part of the Project without the prior written consent of Landlord. No nails, hooks or screws shall be driven or inserted in any part of the Building except by Building maintenance personnel. No curtains or other window treatments shall be placed between the glass and the Building standard window treatments.
4. Landlord shall provide and maintain an alphabetical directory for all tenants in the main lobby of the Building.
5. Landlord shall provide all door locks in each tenant's leased premises, at the cost of such tenant, and no tenant shall place any additional door locks in its leased premises without Landlord's prior written consent. Landlord shall furnish to each tenant a reasonable number of keys to such tenant's leased premises, at such tenant's cost, and no tenant shall make a duplicate thereof.
6. Movement in or out of the Building of furniture or office equipment, or dispatch or receipt by tenants of any bulky material, merchandise or materials which require use of elevators or stairways, or movement through the Building entrances or lobby shall be conducted under Landlord's supervision at such times and in such a manner as Landlord may reasonably require. Each tenant assumes all risks of and shall be liable for all damage to articles moved and injury to persons or public engaged or not engaged in such movement, including equipment, property and personnel of Landlord if damaged or injured as a result of acts in connection with carrying out this service for such tenant.
7. Landlord may prescribe weight limitations and determine the locations for safes and other heavy equipment or items, which shall in all cases be placed in the Building so as to distribute weight in a manner acceptable to Landlord which may include the use of such supporting devices as Landlord may require. All damages to the Building caused by the installation or removal of any property of a tenant, or done by a tenant's property while in the Building, shall be repaired at the expense of such tenant.
8. Corridor doors, when not in use, shall be kept closed. Nothing shall be swept or thrown into the corridors, halls, elevator shafts or stairways. No birds or animals shall be brought into or kept in, on or about any tenant's leased premises. No portion of any tenant's leased premises shall at any time be used or occupied as sleeping or lodging quarters.
9. Tenant shall cooperate with Landlord's employees in keeping its leased premises neat and clean. Tenants shall not employ any person for the purpose of such cleaning other than the Building's cleaning and maintenance personnel.
10. To ensure orderly operation of the Building, no ice, mineral or other water, towels, newspapers, etc. shall be delivered to any leased area except by persons approved by Landlord.
11. Tenant shall not make or permit any vibration or improper, objectionable or unpleasant noises or odors in the Building or otherwise interfere in any way with other tenants or persons having business with them.

12. No machinery of any kind (other than normal office equipment) shall be operated by any tenant on its leased area without Landlord's prior written consent, nor shall any tenant use or keep in the Building any flammable or explosive fluid or substance.

13. Landlord will not be responsible for lost or stolen personal property, money or jewelry from tenant's leased premises or public or common areas regardless of whether such loss occurs when the area is locked against entry or not.

14. No vending or dispensing machines of any kind may be maintained in any leased premises without the prior written permission of Landlord.

15. Tenant shall not conduct any activity on or about the Premises or Building which will draw pickets, demonstrators, or the like.

16. All vehicles are to be currently licensed, in good operating condition, parked for business purposes having to do with Tenant's business operated in the Premises, parked within designated parking spaces, one vehicle to each space. No vehicle shall be parked as a "billboard" vehicle in the parking lot. Any vehicle parked improperly may be towed away. Tenant, Tenant's agents, employees, vendors and customers who do not operate or park their vehicles as required shall subject the vehicle to being towed at the expense of the owner or driver.

EXHIBIT G

PARKING SITE PLAN

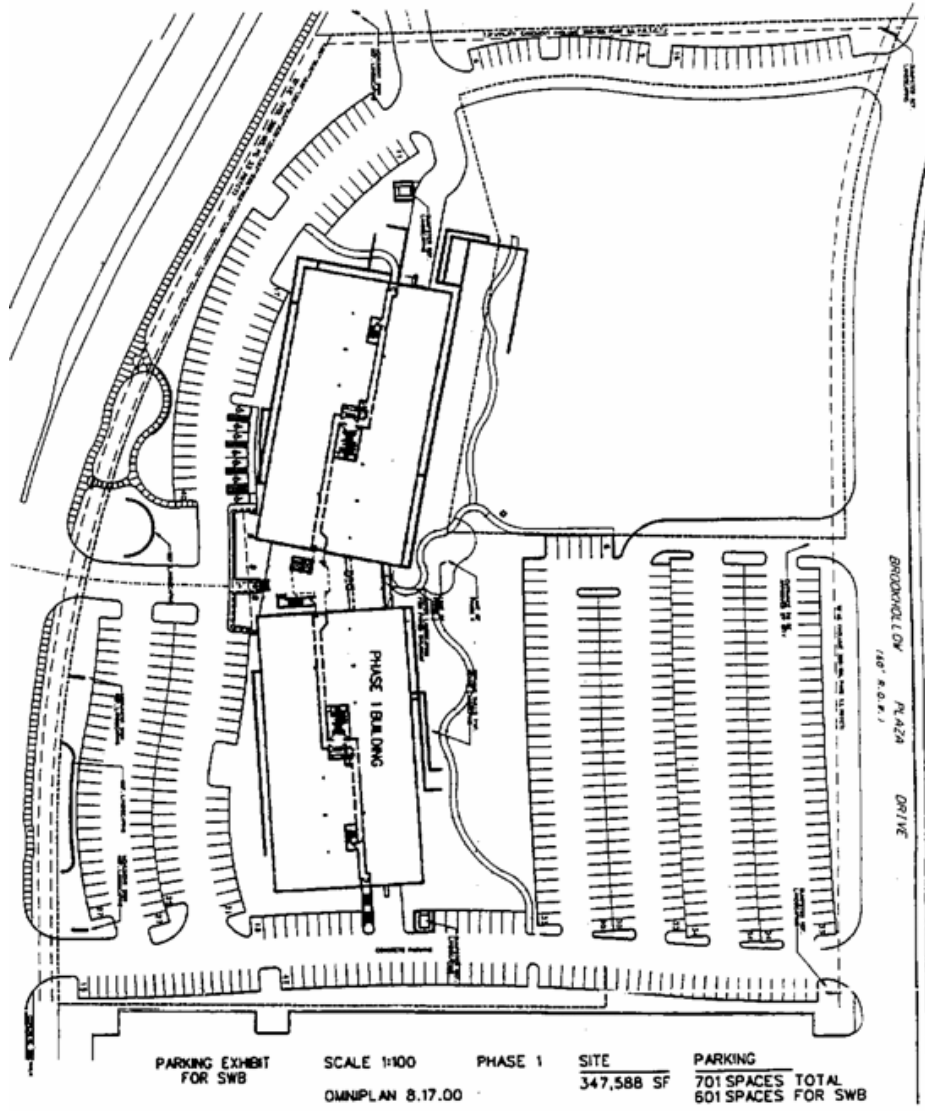


EXHIBIT B

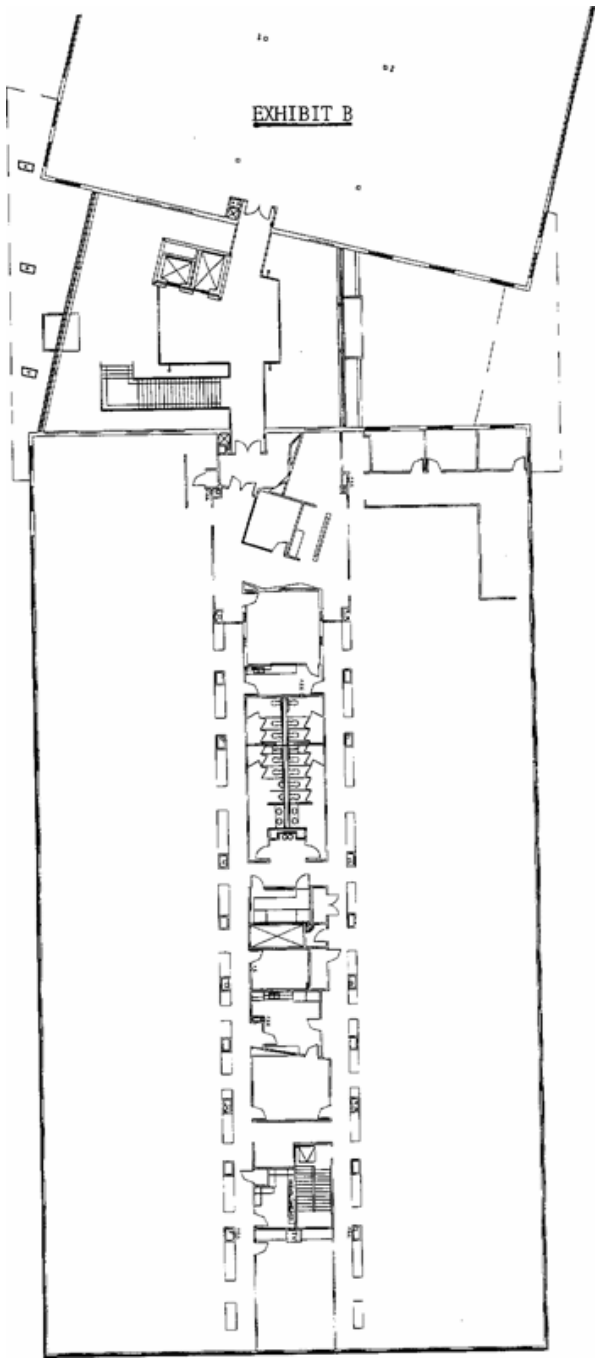


EXHIBIT "C"

CONSENT TO SUBLEASE

(2201 East Lamar Boulevard – Arlington, Texas)

THIS **CONSENT TO SUBLEASE** (this "Consent") is made as of February , 2004, by and among **THE ARBORS OF BROOKHOLLOW OPERATING PARTNERSHIP, LTD.**, a Texas limited partnership ("Landlord"), **SOUTHWESTERN BELL TELEPHONE, L.P.**, a Texas limited partnership ("Tenant"), successor-in-interest to Southwestern Bell Telephone Company, a Missouri corporation ("Original Tenant"), and **ASCENSION CAPITAL GROUP, LTD.**, a Texas limited partnership ("Subtenant"), with reference to the following Recitals:

RECITALS

A. Landlord and Tenant are parties to that certain Lease Agreement, dated September 26, 2000 (the "Lease"). Terms not otherwise defined in this Consent are defined in the Lease.

B. Landlord leases to Tenant certain premises consisting of approximately 85,893 rentable square feet (the "Tenant's Premises") of that certain building located at 2201 East Lamar Boulevard, Arlington, Texas (the "Building").

C. Tenant has asked Landlord to consent to the subletting of approximately 28,603 rentable square feet on the second floor of the Building (the "Premises"), located within the Tenant's Premises, to Subtenant, pursuant to the Sublease dated as of February , 2004, by and between Tenant and Subtenant (the "Sublease") attached hereto as Exhibit "A".

NOW, THEREFORE, Landlord hereby consents to the Sublease of the Premises to Subtenant, such consent being subject to and upon the following terms and conditions, to each of which Tenant and Subtenant expressly agree:

1. NO WAIVER. Neither the giving of this Consent nor anything contained herein or in the Sublease executed by Tenant shall be construed to modify, waive, impair or affect any of the covenants, agreements, terms, provisions, obligations or conditions contained in the Lease (except as may be herein expressly provided), or to waive any breach thereof, or any rights of Landlord against any person or entity liable or responsible for the performance thereof, or to increase the obligations or diminish the rights of Landlord under the Lease, or to increase the rights or diminish the obligations of Tenant thereunder, or to, in any way, be construed as giving Subtenant any greater rights than the original Tenant named in the Lease would be entitled to, and all covenants, agreements, terms, provisions and conditions of the Lease are hereby mutually declared to be in full force and effect.

2. NO FURTHER CONSENT. This Consent shall not be construed either as a consent by Landlord to, or as permitting, any other or further subletting of the Premises, whether in whole or in part, or any assignment of the Lease, or as a waiver of the requirement of obtaining Landlord's consent thereto; and notwithstanding anything to the contrary contained in the Lease, Subtenant shall not, without the prior written consent of Landlord, which consent shall not be unreasonably withheld or delayed, assign the Lease or this Consent or sublet the Premises or any part thereof. Landlord's consent to any future assignment or sublease shall be conditioned and subject to the rights, obligations, restrictions and conditions that are applicable to an assignment or sublease by Tenant pursuant to the Lease.

3. BINDING AGREEMENT. Landlord, Tenant and Subtenant hereby agree that the provisions of Section 10 of the Lease, shall, notwithstanding this Consent, continue to be binding upon Landlord, Tenant and Subtenant with respect to all future assignments and transfers of the Lease and sublettings of the Premises, with the same effect as if Subtenant had been the Original Tenant named in the Lease.

4. NO DISCHARGE OF OBLIGATIONS; PAYMENT OF SUBLEASE RENT. Tenant hereby agrees that the obligations of Tenant under the Lease and this Consent shall not be discharged or otherwise affected by reason of the giving or withholding of any consent or approval for which provision is made in the Lease, or by reason of any amendment or modification of the Lease hereafter entered into by Landlord and Subtenant. Tenant further agrees that it shall be liable for holdover rent under the Lease if Subtenant holds over in the Premises after the Lease Term.

5. SUBTENANT'S OBLIGATION. Subtenant, for Subtenant and its successors and assigns, hereby (a) accepts the Sublease, by Tenant, of a portion of Tenant's interest in and to the Lease, (b) recognizes all of the covenants, agreements, terms, provisions, obligations and conditions contained in the Lease, excluding the payment of Rent (other than overtime HVAC (hereinafter defined)), and hereby assumes, in writing, all of said terms, provisions, agreements, covenants, obligations and conditions of the Lease on the part of the Tenant to be kept, observed and performed with respect to the Premises, (c) agrees to keep and perform, and to permit no violation beyond the expiration of applicable periods of notice and grace of, each and every covenant, agreement, term, provision, obligation and condition therein set forth on the part of Tenant with respect to the Premises to be kept, observed and performed, excluding the payment of Rent (other than overtime HVAC), and (d) acknowledges, confirms and agrees that the Right of First Refusal is not assignable or conveyed to Subtenant.

6. NO RELEASE. The giving of this Consent shall not be deemed or serve to release Tenant or any successor in interest to said Tenant from any liability, obligation or duty, which such Tenant or such successor in interest may have.

7. NO BREACH OR DEFAULT. Landlord and Tenant hereby confirm that the Lease and all terms and conditions thereof is in full force and effect and further confirm that neither has knowledge of any breach or default existing under the Lease as of the date hereof. In the event of any default under the Lease, Landlord may proceed directly against Tenant or anyone else liable under the Lease without first exhausting Landlord's remedies against any other person or entity liable therein to Landlord.

8. INDEMNIFICATION. Landlord shall not be responsible for the payment of any commissions or fees in connection with the subletting of the Premises, and Subtenant and Tenant jointly and severally agree to indemnify and hold Landlord harmless from and against any claims, liability, losses or expenses, including reasonable attorneys' fees, incurred by Landlord in connection with any claims for a commission by any broker or agent in connection with the subletting of the Premises.

CONSENT TO SUBLEASE - Page 2

9. NO IMPROVEMENTS. Tenant and Subtenant hereby agree that Landlord is not obligated to perform any work of any kind to prepare the Premises for Subtenant's occupancy. Except as permitted under the Lease, no alterations, improvements, additions (electrical, mechanical or otherwise) or physical changes shall be made in the Premises, or any part thereof, without Landlord's prior written consent in each instance. Subtenant agrees to comply with all applicable laws, rules and regulations relating to construction of any improvements within the Premises.

Landlord agrees, to send any bills for utility charges incurred after the normal business hours in Section 6 of the Master Lease directly to Subtenant with a copy to Tenant. Subtenant agrees to pay Landlord directly for any invoices for utility charges incurred after the normal business hours in Section 6 of the Master Lease directly to Landlord within ten days of receipt of the invoice. Tenant shall remain obligated to Landlord to pay such charges if Subtenant defaults in its obligations.

Tenant and Subtenant hereby acknowledge, confirm and agree that Tenant currently pays Landlord an overtime hourly charge for heating, ventilation and air conditioning ("HVAC") used in the Premises outside normal business hours and that such hourly overtime HVAC charge may be adjusted from time to time in Landlord's reasonable discretion to reflect the cost of such services.

10. NOTICES. Landlord's mailing address for purposes of notice under this Consent or the Lease is:

The Arbors of Brookhollow Operating Partnership, Ltd.
5950 Berkshire Lane, Suite 530
Dallas, Texas 75225
Attention: Michael Broder

With a mandatory copy to:

Bell Nunnally & Martin LLP
1400 One McKinney Plaza
3232 McKinney Avenue
Dallas, Texas 75204
Attention: Larry L. Shosid, Esq.

Tenant's mailing address for purposes of notice under this Consent or the Lease is:

SBC Services, Inc.
7159 San Pedro, Suite 202
San Antonio, Texas 78216
Attention: Lease Administrator

With a mandatory copy to:

SBC Communications, Inc.
175 East Houston
San Antonio, Texas 78205
Attention: Kenneth H. Gitter, General Attorney

Subtenant's mailing address for purposes of notice under this Consent or the Lease is as follows:

Ascension Capital Group, Ltd.
2201 East Lamar Boulevard, Suite 200
Arlington, Texas 76006
Attention: Erich M. Ramsey

With a mandatory copy to:

Ascension Capital Group, Ltd.
2201 East Lamar Boulevard, Suite 200
Arlington, Texas 76006
Attention: General Counsel

11. FAILURE TO GIVE NOTICE NOT A RELEASE. Notwithstanding anything in the Lease or this Consent to the contrary, Landlord's failure to give a notice of any breach or default under the Lease or this Consent to Tenant or Subtenant shall not be construed to release Tenant or Subtenant from any of the covenants, agreements, terms, provisions and conditions of the Lease or this Consent.

12. COSTS AND FEES. Tenant hereby agrees to pay \$1,000.00 to Landlord to compensate Landlord for its attorneys' fees, costs and expenses (collectively, "Legal Fees") incurred by Landlord in connection with this sublease transaction. Such Legal Fees will be paid by Tenant prior to Landlord's execution of this Consent and this Consent shall not be effective until such Legal Fees have been received by Landlord.

13. SUBLEASE AGREEMENT. Tenant and Subtenant hereby agree that Landlord is not a party to the Sublease and is not bound by the provisions thereof, including, without limitation, any modifications or amendments thereof, and Tenant and Subtenant recognize that accordingly Landlord has not, and will not, review or pass upon any of the provisions of the Sublease.

14. PROCEEDINGS. Landlord shall be under no obligation to commence proceedings or exhaust any of its remedies against Subtenant before proceeding against Tenant, or against Tenant before proceeding against Subtenant, for any redress provided for in the Lease or this Consent, or at law or equity.

15. ATTORNEYS' FEES. If any party hereto commences a legal action or proceeding against another party hereto arising out of or in connection with this Consent, the prevailing party shall be entitled to recover reasonable attorneys' fees and costs incurred in such action. Notwithstanding the foregoing, Tenant hereby agrees to indemnify, defend and hold harmless Landlord from and against any claims, liabilities or causes of action brought or asserted by Subtenant against Landlord.

16. CONFLICT. In the event of any conflict between the provisions of (i) either the Lease or this Consent, and (ii) the Sublease, the provisions of the Lease or this Consent shall prevail unaffected by the provisions of the Sublease. In the event of any conflict between the provisions of this Consent and the provisions of the Lease, the provisions of the Lease shall prevail unaffected by the provisions of this Consent.

17. NO ORAL MODIFICATION. This Consent may not be changed orally, but only by an agreement in writing signed by the party against whom enforcement of any change is sought.

18. SEVERABILITY. If any of the provisions of this Consent shall be held by any court of competent jurisdiction to be unenforceable for any reason, such provision or provisions shall be deemed severable from and shall in no way affect the enforceability and validity of the remaining provisions of this Consent.

19. COUNTERPARTS. This Consent may be executed in any number of counterparts, each of which shall be deemed an original, but all of which when taken together shall constitute but one and the same instrument.

20. EXECUTION BY ALL PARTIES. Submission of this instrument for examination or signature by Tenant or Subtenant is not effective as a consent or otherwise until execution and delivery by Landlord, Tenant, and Subtenant.

21. AUTHORIZATION. Tenant and Subtenant each represent that each of the individual(s) executing this Consent has all requisite power and authority to execute and deliver this Lease on behalf of the entity for which it is signing, and by his or her signature, will bind such party to the terms of this Consent.

Signature Page Follows

CONSENT TO SUBLEASE - Page 5

IN WITNESS WHEREOF, the parties hereto have caused this Consent to be duly executed as of the date first above written.

LANDLORD:

THE ARBORS OF BROOKHOLLOW OPERATING PARTNERSHIP, LTD.,
a Texas limited partnership

By: Arbors of Brookhollow Management, Ltd., a Texas limited partnership
General Partner

By: Arbors of Brookhollow, L.L.C., a Texas limited liability company
General Partner

By: _____
Printed Name: _____
Title: _____

TENANT:

SOUTHWESTERN BELL TELEPHONE, L.P.,
a Texas limited partnership

By: SWBT Texas LLC, a Texas limited liability company
General Partner

By: _____
Printed Name: _____
Title: _____

SUBTENANT:

ASCENSION CAPITAL GROUP, LTD.,
a Texas limited partnership

By: Ascension Capital Management, L.L.C., a Texas limited liability company
General Partner

By: _____
Printed Name: _____
Title: _____

EXHIBIT "A"

Sublease

[SEE ATTACHED]

EXHIBIT "A" TO CONSENT TO SUBLEASE - Page Solo

EXHIBIT D

OPTIONS TO TERMINATE

1. Sublessee shall have the options to terminate the Term of the Sublease effective as of the last day of any of the full calendar months following the Commencement Date indicated in the table below by (a) giving notice to Sublessor, designating the effective date of termination selected by Sublessee (the "Early Termination Date"), at least three hundred sixty (360) days before the Early Termination Date and (b) paying to Sublessor on or before the Early Termination Date a termination fee in the amount set forth in the table below opposite the applicable Early Termination Date:

Early Termination Date	Termination Fee
February 28, 2007	\$139,940.53

2. If the Term of the Sublease is terminated pursuant to this Rider, the Sublease shall be deemed to have expired by lapse of time effective as of the Early Termination Date, and Sublessee shall return the Premises to Sublessor in accordance with the requirements of the Sublease. All obligations of either party to the other which accrue under the Sublease on or before the later of the Early Termination Date and the date on which Sublessee surrenders possession of the Premises shall survive such termination and neither the exercise of such right to terminate nor such termination shall affect Sublessor's remedies on account of any default by Sublessee.

3. Notwithstanding any provision herein to the contrary, Sublessee may only exercise the Termination Option if an third party corporation unrelated to, and not affiliated with, Sublessee, nor owned in any part by any of Sublessee's shareholders, owners, principals, officers, employees or agents, shall purchase more than fifty percent of the stock of Sublessee or substantially all of the assets of Sublessee.

**ASSIGNMENT AND
CONSENT TO ASSIGNMENT OF SUBLEASE**

THIS ASSIGNMENT AND CONSENT TO ASSIGNMENT OF SUBLEASE (this "Consent") is made as of the 18th day of August, 2006, by and among **DBSI HOUSING, INC.**, as successor in interest to The Arbors of Brookhollow Operating Partnership, LTD ("Landlord"); **ASCENSION CAPITAL GROUP, LTD.**, ("Assignor"); **ENCORE CAPITAL GROUP, INC.** ("Encore"); **ASCENSION ACQUISITION, L.P.** ("Assignee"); and **SOUTHWESTERN BELL TELEPHONE, L.P.** ("Tenant").

RECITALS:

A. WHEREAS, Landlord and Tenant, successor in interest to Southwestern Bell Telephone Company ("Original Tenant"), are parties to that certain Lease Agreement dated September 26, 2000 (the "Lease"). Terms not otherwise defined in this Consent are defined in the Lease; and

B. WHEREAS, Landlord lease to Tenant certain premises consisting of approximately 85,893 rentable square feet (the "Tenant's Premises") of that certain building located at 2201 East Lamar Boulevard, Arlington, Texas, attached hereto as Exhibit "A"; and

C. WHEREAS, Tenant subleased approximately 28,603, rentable square feet on the second floor of the Building (the "Premises"), located within the Tenant's Premises, to Assignor, pursuant to the Sublease dated as of February 12, 2004, by and between Tenant and Assignor (the "Sublease"), attached hereto as Exhibit "B"; and

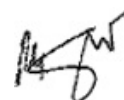
D. WHEREAS, Assignor and Assignee intend to enter into an Asset Purchase Agreement ("the Purchase Agreement"), pursuant to which Assignor will transfer substantially all of its assets to Assignee, the consummation of which (the "Closing") is scheduled to occur on or about August 17, 2005; and

E. WHEREAS, in connection with the purchase Agreement, Assignor wishes to assign to Assignee and Assignee wishes to assume from Assignor the Sublease as of Closing, which assignment and assumption is conditioned upon and shall be effective only in the event of the Closing; and

F. WHEREAS, Assignor has asked Landlord and Tenant to consent to the assignment of the Sublease ("Assignment to Sublease") to Assignee.

NOW, THEREFORE, Landlord and Tenant each hereby consents to the Assignment of Sublease of the Premises to Assignee, such consent being subject to and upon the following terms and conditions to each of which Assignor and Assignee expressly agree.

1. Assignment of Sublease. Assignor hereby transfers and assigns to Assignee all of its right, title, and interest to and under the Sublease effective as of the date of the Closing, to have and to hold the same for and during the remainder of the term(s) mentioned in such Sublease, subject to the covenants and conditions therein mentioned. Rents and other charges paid or due under the Sublease shall be presented between Assignor and Assignee as of the Closing Date.



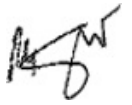
2. No Waiver. Neither the giving of this Consent our anything herein, in the Assignment to Sublease shall be consumed to modify, waive, impair or affect any of the covenants, agreements, terms, provisions, obligations or conditions contained in the Lease or Sublease (except as may be herein expressly provided), or to waive any breach thereof, or any rights of Landlord or Tenant against any person or entity liable or responsible for the performance thereof or to increase the obligations or diminish the rights of Landlord under the Lease, or to increase rights or diminish the obligations of Tenant thereunder, or to, in any way, be existed as giving Assignee any greater rights than the Original Tenant extend in the Lease would be entitled to, and all covenants, agreements, terms, provisions and conditions of the Lease and Sublease are hereby mutually declared to be in full force and effect.

3. No Further Consent. This Consent shall not be construed either as a consent by Landlord or Tenant to, or as permitting any other or further subletting of the Premises, whether in whole or in part, or any further assignment of the Sublease or Lease, or as a wavier of the requirement of obtaining Landlord's and Tenant's consent thereto, and notwithstanding anything to the contrary contained in the Lease or Sublease, Assignee shall not, without the prior written consent of Landlord and Tenant, which consent shall not be unreasonably withheld, assign the Lease, Sublease, or this Consent or sublet the Premises or any part thereof. Landlord's and Tenant's consent to any future assignment or sublease shall be conditioned and subject to the rights, obligations, restrictions and conditions that are applicable to an assignment or sublease by Tenant pursuant to the Lease.

4. No Release. The giving of this Consent shall not be deemed or serve to release Assignor from any liability, obligation or duty, which such Tenant or such successor in interest may have under the Sublease. The giving of this Consent shall not be deemed to constitute a release of Assignor, or any guarantor of Assignor's performance hereunder ("Guarantor"), from further performance by Assignor or such Guarantor of covenants undertaken to be performed by Assignor in the Sublease. Assignor and/or such Guarantor shall remain liable and responsible for all rent and other obligations imposed upon Assignor in the Sublease.

5. Assignee's Obligation. Assignee, for Assignee and its successors and assigns hereby (a) accepts the Sublease for a portion of Tenant's interest in and to the Lease, (b) recognizes all of the covenants, agreements, terms, provisions, obligations and conditions contained in the Lease, and hereby assumes all of said terms, provisions, agreements, covenants, obligations and conditions of the Lease on the part of the Tenant to be kept, observed and performed with respect to the Premises, (c) agrees to keep and perform, and to permit no violation beyond the expiration of applicable periods of notice and grace of, each and every covenant, agreement, term, provision, obligation and condition therein set forth on the part of Tenant with respect to the Premises to be kept, observed and performed, and (d) acknowledges, confirms and agrees that the Right of First refused and renewal options are not assignable or conveyed to Assignee.

6. Default. In the event of any default under the Lease, Landlord may proceed directly against Tenant or anyone else liable under the Lease without first exhausting Landlord's remedies against any other person or entity liable therein to Landlord. In the event of any default under the Sublease, Tenant may proceed directly against Assignor or anyone else liable under the Sublease without first exhausting Tenant's remedies against any other person or entity liable therein to Tenant.



7. Indemnification. Neither Landlord nor Tenant shall be responsible for the payment of any commissions or fees in connection with the Assignment of Sublease, and Assignor and Assignee, jointly and severally agree to indemnify and hold Landlord and Tenant harmless from and against any claims, liability, losses or expenses, including reasonable attorneys' fees incurred by Landlord or Tenant in connection with any claims for commission by any broker or agent in connection with the Assignment of Sublease.

8. Notices. Landlord's mailing address for purposes of notice under this Consent or the Lease is:

DBSI-Discovery Real Estate Services, LLC
Attn: Vice President of Leasing
12426 W. Explorer Drive, Suite 100
Boise, ID 83713

with a copy to:

DBSI Group of Companies
Attn: General Counsel
1550 S. Tech Lane
Meridian, ID 83642

Assignor's mailing address:

Ascension Capital Group, Ltd.
Attn: Erich M. Ramsey
2201 E. Lamar Boulevard, Suite 200
Arlington, TX 76006

Assignee's mailing address:

Encore Capital Group, Inc.
8875 Aero Drive
San Diego, CA 92123

Ascension Capital, L.P.
8875 Aero Drive
San Diego, CA 92123

9. Conditions Precedent. Each of the parties hereto agrees that this Consent is conditioned upon and shall be effective only in the event of the Closing. If the Closing occurs, this Consent shall be in full force and effect and shall be binding and enforceable against the parties hereto, without any further action on behalf of the parties.

10. Execution of Consent. The parties hereto agree that this Consent may be signed and delivered by facsimile signature and counterparts.



Executed as of the 18th day of August, 2005.

LANDLORD:
DBSI Housing, Inc.

By: /s/ Steven P. Winger
Name: Steven P. Winger
Title: Vice President of Leasing

TENANT:
Southwestern Bell Telephone, L.P.

By: SWBT TEXAS, LLC, its General Partner

By: /s/ J. Stephen Sandly
Name: J. Stephen Sandly
Title: Director—Real Estate Transactions

ASSIGNOR:
Ascension Capital Group, Ltd.

By: Ascension Capital Management, LLC,
its General Partner

By: /s/ Erich M. Ramsey
Name: Erich M. Ramsey
Title: Chief Executive Officer

ASSIGNEE:
Encore Capital Group, Inc.

By: /s/ Paul Gromberg
Name: Paul Gromberg
Title: EVP & CFO

Ascension Acquisition, L.P.

By: ACG Holding, Inc., its General Partner

By: /s/ Paul Gromberg
Name: Paul Gromberg
Title: Treasurer

Subsidiaries

Name	Jurisdiction of Incorporation or Formation
Midland Credit Management, Inc.	Kansas
MRC Receivables Corporation	Delaware
Midland Funding NCC-2 Corporation	Delaware
Midland Portfolio Services, Inc.	Delaware
Midland Funding LLC	Delaware
Ascension Capital Group, Inc.	Delaware
Midland India LLC	Minnesota
Midland Credit Management India Private Limited	Delhi, India
Midland International LLC	Delaware
Midland Credit Management (Mauritius) Ltd	Mauritius

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (Nos. 333-130362 and 333-163876) and Form S-8 (Nos. 333-125340, 333-125341, 333-125342 and 333-160042), pertaining to the Encore Capital Group, Inc. 1999 Equity Participation Plan, the Midland Credit Management, Inc. Executive Nonqualified Excess Plan and the Encore Capital Group 2005 Stock Incentive Plan, as well as our reports dated February 8, 2010, relating to the consolidated financial statements of Encore Capital Group, Inc. and the effectiveness of Encore Capital Group, Inc.'s internal control over financial reporting which appears in this Form 10-K.

/s/ BDO Seidman, LLP

San Diego, California
February 8, 2010

SPECIAL POWER OF ATTORNEY

The undersigned constitutes and appoints J. Brandon Black and Paul Grinberg, and each of them, his true and lawful attorney-in-fact and agent with full power of substitution and re-substitution, for him and in his name, place and stead, in any and all capacities, to sign the Annual Report on Form 10-K for the fiscal year ended December 31, 2009, for filing with the Securities and Exchange Commission by Encore Capital Group, Inc., a Delaware corporation, together with any and all amendments to such Form 10-K, and to file the same with all exhibits thereto, and all documents in connection therewith, with the Securities and Exchange Commission, granting to such attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully and to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or each of them, may lawfully do or cause to be done by virtue hereof.

January 21, 2010	<hr/> <p style="text-align: center;">/S/ GEORGE LUND George Lund</p>
January 22, 2010	<hr/> <p style="text-align: center;">/S/ TIMOTHY J. HANFORD Timothy J. Hanford</p>
January 21, 2010	<hr/> <p style="text-align: center;">/S/ RICHARD A. MANDELL Richard A. Mandell</p>
January 22, 2010	<hr/> <p style="text-align: center;">/S/ WILLEM MESDAG Willem Mesdag</p>
January 21, 2010	<hr/> <p style="text-align: center;">/S/ JOHN J. OROS John J. Oros</p>
January 18, 2010	<hr/> <p style="text-align: center;">/S/ J. CHRISTOPHER TEETS J. Christopher Teets</p>
January 22, 2010	<hr/> <p style="text-align: center;">/S/ H RONALD WEISSMAN H Ronald Weissman</p>
January 22, 2010	<hr/> <p style="text-align: center;">/S/ WARREN WILCOX Warren Wilcox</p>

ENCORE CAPITAL GROUP, INC.

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Encore Capital Group, Inc. (the "Company") on Form 10-K for the year ended December 31, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of the undersigned certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of his knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the consolidated financial condition and results of operations of the Company.

/s/ J. BRANDON BLACK

J. Brandon Black
President and Chief Executive Officer

February 8, 2010

/s/ PAUL GRINBERG

Paul Grinberg
Executive Vice President,
Chief Financial Officer and Treasurer

February 8, 2010

This certification accompanies the above described Report and is being furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall be not be deemed filed as part of the Report.