



UNITED STATES DEPARTMENT OF EDUCATION  
THE SECRETARY

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In Re: Puerto Rico Technology  
and Beauty College;

Docket Numbers: 90-34-ST  
90-38-ST

Lamec, Inc.  
d/b/a Puerto Rico Barber  
and Technical College

Student Financial  
Assistance Proceeding

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DECISION OF THE SECRETARY

This matter comes before the Secretary on appeal of the May 6, 1991, Decision (Decision) of Administrative Law Judge Daniel R. Shell (ALJ) by the United States Department of Education, Office of Student Financial Assistance (OSFA). The ALJ's review was initiated when OSFA issued letters to Puerto Rico Technology and Beauty College (PR Tech) and Lamec, Inc. d/b/a Puerto Rico Barber and Beauty College (Lamec) to terminate each school's eligibility to participate in Title IV, HEA programs and to fine each school.

OSFA based its action on the findings of the U.S. Department of Education, Office of Inspector General, audit of PR Tech's administration of Title IV, HEA funds for the award years of 1984-85 through 1987-88. The audit found that PR Tech had transferred ownership of its Mayaguez facility to Lamec. The audit further found that subsequent to the transfer of ownership, PR Tech had unlawfully transferred Pell Grant program funds to Lamec on 18 separate occasions.

At the hearing before the ALJ, OSFA argued that the violations and the breach of PR Tech and Lamec's fiduciary duties to properly administer program funds justified the fines and termination of both institutions from participation in Title IV, HEA programs. The ALJ found that there had been no change in ownership and no breach of fiduciary duty by either PR Tech or

Lamec. Therefore, the ALJ held that PR Tech and Lamec should not be terminated or fined.

On appeal, OSFA challenges the ALJ's holdings. The issues to be considered on appeal may be summarized as follows:

1. Was a "change in ownership" created by the June 30, 1987 transaction between PR Tech and Lamec?
2. Is a finding that an institution did not use federal funds for the intended purpose required to prove a breach of fiduciary duty?

### DISCUSSION

#### **1. Was a "change in ownership" created by the June 30, 1987 transaction between PR Tech and Lamec?**

In his Decision, the ALJ framed the issues regarding the June 30, 1987 transaction and the alleged "change in ownership." The relevant passages are as follows--

There is no dispute that Lamec did not have a participation agreement with Education. PR Tech had a participation agreement with Education as required by 34 C.F.R. § 668.11. Without licensure from the Commonwealth of Puerto Rico and/or without a participation agreement, the disbursement of funds by Lamec would be a violation of 34 C.F.R. § 668.4 and/or § 668.11 (1987). As stated above, if PR Tech no longer owned the Mayaguez school, it would be improper to give funds to students attending a school with no participation agreement with Education. Lamec was not an eligible institution to disburse federal funds because it had no authority from Puerto Rico and no participation agreement with Education.

Therefore, the question to decide is - what was the result of the contractual transaction that took place on June 30, 1987? Did PR Tech own the Mayaguez facility or did Lamec own the facility? The terms of the contract appear to be fulfilled in that money passed from buyer to seller. The parties acknowledged to the Puerto Rico Department of Education a change of ownership. While it is true PR Tech continued to double check to see if all federal funds were being managed properly, the day to day operation seems to have transferred to Lamec. The testimony is clear; the parties believed the employees of Mayaguez to be the employees of Lamec.

... Even though the appearances would leave one to believe that the ownership of the school transferred, the law of the Puerto Rico Department of Education does not permit a previous owner of a school to be released from the effects of their regulations....

... The law required the former owner, PR Tech, to indemnify the new owner until the parties met all of the Commonwealth requirements. The new and the previous owner hold "jointly the commitments made as if no transfer of ownership had taken place."

Since the Mayaguez [s]chool was not free standing, Lamec could not immediately meet the requirements of the local law. By implication of the Puerto Rico law, it is found that a total and complete change of ownership could not immediately transfer to Lamec. During the period of the transfer, PR Tech and Lamec jointly guaranteed the commitments of the school. They jointly held ownership of the Mayaguez [s]chool when the 18 transfers of funds were made. Therefore, it is found that PR Tech continued in the eyes of the Commonwealth of Puerto Rico to remain the co-owner of record during the pendency of the ownership transfer. There is no violation of 34 C.F.R. § 668.18 (1987) - the change of ownership regulation.

Decision at 17-19.

Based upon the ALJ's findings of fact, I disagree with the ALJ's holding that no "change of ownership" occurred as a result of the contractual transaction of June 30, 1987 under 34 C.F.R. § 668.18 (1987). For purposes of this decision, it is irrelevant whether a complete transfer of responsibility occurred or whether a de facto "joint venture" was created. Either result constitutes a "change in ownership that results in a change of control." The relevant regulation, 34 C.F.R. § 668.18 (1987) states:

(c) For purposes of this subpart, "change in ownership that results in a change in control" means any action by which a person or corporation obtains authority to control the actions of an institution. These actions may include, but are not limited to--  
...

While a "joint venture" is not expressly included in the regulation's examples of "change in ownership that results in a change in control," the ALJ found that following the June 30, 1987 transaction, Lamec assumed the day to day operations of the Mayaguez facility and PR Tech assumed a very limited oversight role. The ALJ also found that both parties believed and acted as

if a transfer of ownership had occurred. PR Tech's continuing involvement with the Mayaguez facility was defined solely by the contract of sale, and not by any ownership interest. Clearly, Lamec obtained authority to control the actions of the Mayaguez school.

I hold that a "change of ownership" did occur as a direct and immediate result of the June 30, 1987 transaction. The 18 transfers of program funds were in violation of Title IV, HEA. OSFA was correct in levying the fines and terminating PR Tech and Lamec's participation in Title IV, HEA programs.

After deciding that PR Tech and Lamec were appropriately terminated, it is unnecessary to consider the issue of their fiduciary obligations. However, I disagree with the ALJ's holding on this issue, and wish to provide guidance for future proceedings.

**2. Is a finding that an institution did not use federal funds for the intended purpose required to prove a breach of fiduciary duty?**

Institutions that participate in Title IV, HEA programs are required by 34 C.F.R. § 668.82 to act as a fiduciary in regard to the federal funds they administer.

**§ 668.82 Standards of conduct**

(a) A participating institution acts in the nature of a fiduciary in its administration of the Title IV, HEA programs.

(b) In the capacity of a fiduciary, the institution is subject to the highest standard of care and diligence in administering the programs and in accounting to the Secretary for the funds received under those programs.

(c) An institution's failure to administer the Title IV, HEA programs, or to account for the funds it receives under those programs, in accordance with the highest standard of care and diligence required of a fiduciary, constitutes grounds for a fine, or the suspension, limitation or termination of the eligibility of the institution to participate in those programs.

....

34 C.F.R. § 668.82 (1987)

In his Decision, the ALJ found that PR Tech and Lamec did not violate their fiduciary duties. The ALJ appeared to base his

finding on the end result of the institutions' actions. The ALJ found--

... There is no evidence that the funds transferred on the 18 occasions in question were misappropriated, misused, or otherwise misapplied. No evidence is available to refute statements from both PR Tech and Lamec which show the funds being used for the intended purpose - the education of the students at the Mayaguez school.... PR Tech continued to verify all information that Lamec forwarded concerning the draw down and disbursement of funds. Furthermore, the evidence shows that PR Tech met its responsibility to its former students and to the federal government by continuing to refund money to Education. There has been no violation of the fiduciary responsibility under 34 C.F.R. § 668.82 (1987).

Decision at 19 and 20.

In reaching his conclusion the ALJ appears to focus only on the end result of actions taken by PR Tech and Lamec. At the same time, the ALJ ignores other evidence relevant to the fiduciary obligation. The fiduciary duty created by 34 C.F.R. § 668.82 covers not only the final disposition, but all aspects of the administration of federal program funds.

The fiduciary or confidential relationship has been described as--

"... One founded on trust or confidence reposed by one person in the integrity and fidelity of another. ...Out of such a relation, the law raises the rule that neither party may take selfish advantage of his trust, or deal with the subject-matter of the trust in such a way as to benefit himself or prejudice the other except in the exercise of the utmost good faith and with the full knowledge and consent of that other..."

Black's Law Dictionary, 5th Ed., p. 564.

During the course of the hearing the ALJ found that Zenon Torres, President of PR Tech, "...revealed that he did not consult with anyone on the requirements necessary to sell the Mayaguez facility to Lamec..." Decision at 10. The ALJ further found that--

... [Torres] went to the closing on June 30, 1987, signed the document, and received his money - all while engaging in no conversation with any one at the closing. He later stated that had he read the provision "... he would never sign it." He was asked

if he ever read other contracts that he signed. He stated that prior to this contract he had not read contracts that he entered.

Id. at 11.

While PR Tech did not appear to know or care about the consequences of the documents being signed, Lamec attempted to place the blame on the bank for "forcing " them into the troublesome contract.

... Mr. Cruz, testifying for Lamec, stated that the troublesome clause 3-C was put into the sales contract by the bank... According to Cruz, clause 3-C remained in the contract over Lamec's objection. "It was a guarantee for the bank to be able ...[to] collect the money." ... "... it was not eliminated because the bank would not allow us."

Id. at 11 and 12.

The fiduciary obligation of an institution participating in a Title IV, HEA program may not be ignored or overlooked when it becomes inconvenient. This evidence of neglect bears directly on the issue of the institutions' trustworthiness, and the level of confidence Education should repose in their integrity and fidelity.

Further, the fiduciary relationship created by 34 C.F.R. § 668.82, may be compared with the principal-agent relationship--

The duty of an agent to make full disclosure to his principal of all material facts relevant to the agency is fundamental to the fiduciary relationship of principal and agent...Along with the basic duty of full disclosure, moreover, an agent is under the further duty not to misrepresent any matter in connection with the agency."

3 Am. Jur. 2d, Agency § 211.

In this regard, the ALJ did not fully consider relevant Stipulation of Facts filed by the parties in this proceeding--

14. Lamec paid PR Tech the balance of the purchase price, \$135,000, on June 30, 1987.

15. The sales contract under which the purported sale of the Mayaguez campus took place was dated April 29, 1987.

....

79. In its March 20, 1990 response to the January 22, 1990 draft audit report, PR Tech stated that it did not receive \$135,000 of the \$180,000 purchase price in June 1987.

....

81. When OIG requested a copy of the sales contract from Lamec, Mr. Cruz provided to OIG a copy of the sales contract that was dated January 29, 1988.

82. When OIG asked PR Tech whether the January 29, 1988 sales contract that was provided to it by Mr. Cruz was the sales contract governing the sale of the Mayaguez campus, Mr. Contes indicated that it was.

....

These stipulations indicate that both PR Tech and Lamec misrepresented facts to Education's Office of Inspector General. Clearly, PR Tech and Lamec violated their fiduciary obligations created under 34 C.F.R. § 668.82 (1987). These acts and omissions, considered alone would be sufficient to justify the termination of PR Tech and Lamec.

#### CONCLUSION

Based upon the findings of fact by the ALJ and my holdings in this decision, I hereby reverse the decision of the ALJ. PR Tech and Lamec are terminated from participation in Title IV, HEA programs. The fines of \$450,000 against each institution are reinstated.

This decision is signed this 7 day of October, 1991.



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Lamar Alexander, Secretary  
United States Department of Education  
Washington, DC

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**SERVICE LIST**

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