THE SECRETARY OF EDUCATION
WASHINGTON, D.C. 20202

In the Matter of

JON LOUIS SCHOOL OF BEAUTY,

Respondent.

Docket No. 96-108-ST
97-19-ST

DECISION OF THE SECRETARY

PROCEDURE

Jon Louis School of Beauty (Jon Louis) is a New York based vocational institution, comprised of several branches. On August 16, 1996, the U.S. Department of Education (Department), Student Financial Assistance Programs (SFAP), issued a notice to Jon Louis of its intent to fine and terminate the eligibility of Jon Louis-Levittown from participation in the programs authorized under Title IV of the Higher Education Act of 1965, as amended, 20 U.S.C. § 1070 et seq. (Title IV). Jon Louis requested a hearing to contest the proposed sanctions. [1]

On February 5, 1997, the Department also issued a notice of its intent to terminate and fine Jon Louis-North Babylon, Jon Louis-Bronx, Jon Louis-Patchogue, and Jon Louis-Jamaica for serious violations of Title IV program requirements. Jon Louis also appealed this notice and a consolidated hearing was held before Judge Frank Krueger in September, 1997. On April 3, 1998, Judge Krueger issued a decision terminating the eligibility of all Jon Louis locations, except Jon Louis-Jamaica, and fined the school $219,500. Jon Louis appealed.

DISCUSSION

In his Initial Decision, Judge Krueger made several findings. First, Judge Krueger found that Jon Louis routinely failed to pay refunds of unearned tuition and fees to the appropriate Federal Family Education Loan (FFEL) lenders and to the Federal Pell Grant programs. Specifically, Judge Krueger held that during approximately three award years Jon Louis failed to pay 238 refunds in a timely manner. Secondly, Judge Krueger held that Jon Louis failed to pay 180 credit balances to students in a timely fashion.[2] Thirdly, the Initial Decision held that Jon Louis continually maintained excess cash. Lastly, Judge Krueger held that the cohort default rate of Jon Louis-North Babylon, and

[1] On February 5, 1997, an amended termination and fine notice was issued to Jon Louis-Levittown.
[2] SFAP argues on appeal that Judge Krueger decision did not reflect the correct total of late credit balances supported by the evidence. SFAP contends that Jon Louis paid 216 late credit balances, not 180. SFAP, however, does not request an increase in the fine imposed as a result of this discrepancy.

its Bronx branch, exceeded 40 percent. As a result of these findings, Judge Krueger terminated the Jon Louis schools from participation in the Title IV programs and fined the schools $219,500.

Refunds

Under the applicable regulations, institutions are required to return any unearned Pell Grant funds credited to a student's account within 30 days of the date the student withdraws or is expelled, or the institution determines that the student has unofficially withdrawn. 34 C.F.R. § 668.22(g)(2)(iv). In addition, an institution must also return a refund allocated to the FFEL programs to the borrower's lender within 60 days after the date of the student's withdrawal. 34 C.F.R. §§ 682.605(b)(I), 682.607(c)(1).[3]

In the case at hand, Judge Krueger held that Jon Louis-Levittown, North Babylon/Bronx, and Patchogue consistently failed to make refunds within the required time frame. Further, Judge Krueger held that Jon Louis' failure to make timely refunds was either an intentional act on the part of the schools to delay or avoid the return of the Title IV funds or evidence of Jon Louis' wanton disregard for the requirements of the regulations and its fiduciary duty. Initial Decision at 18.

On appeal, Jon Louis admits that it consistently failed to make timely refunds, but strongly disputes the degree of the refunds' lateness. Jon Louis argues that it was not given ample notice regarding the specific number of unpaid refunds and late refunds. Further, Jon Louis asserts on appeal that its evidence and documentation was not recognized or properly evaluated by Judge Krueger. *See* Jon Louis' Appeal Brief at 17-18. In response, SFAP contends that Jon Louis knowingly disregarded its refund responsibilities to the Department by failing to pay approximately 250 refunds in a timely manner. SFAP argues that these numerous violations resulted in a great misallocation of Federal dollars. SFAP also notes that these violations occurred while Jon Louis was generating income between $2 and $4 million dollars annually.

In 1994, SFAP and the Higher Education Services Corporation of New York (HESC), the guarantor of Federal student loans and the administrator of State financial aid in New York, conducted reviews of the Jon Louis schools. HESC found that Jon Louis failed to pay 134 of the refunds in a timely manner. SFAP's subsequent review also revealed numerous untimely refunds. Almost three years after these reviews, at the time of the hearing, 5 of the unpaid refunds discovered during the reviews remained unpaid. SFAP further established that the majority of the late refunds found during the reviews were 200 to 2,000 days late.

In addition to Jon Louis' grave failure to make timely refunds, SFAP asserts that Jon Louis intentionally falsified student file documentation and continually made misrepresentations to HESC and SFAP concerning the payment of refunds. Hearing testimony and exhibits established that Jon Louis routinely entered the date the refund

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[3] **The date of withdrawal is determined by the earliest date of either: 1) the student's notification of withdrawal; 2) the withdrawal date given by the student; or 3) the date of withdrawal as determined by the school.**

checks were written on student ledger cards as proof of payment. Reviewers discovered that in many cases the refund checks were not actually negotiated until a date much later than reflected on the ledger cards. Further, receipt stamps on the front of several checks indicated that these checks were sent months after the ledger entries.

When Jon Louis was directed to provide proof of all refund payments, Jon Louis provided copies of the front of its refund checks. After conferring with lenders, HESC demanded the actual cancelled checks corresponding to the copies previously provided by Jon Louis. Over a year later, Jon Louis provided the canceled checks and HESC discovered that Jon Louis paid the refunds in question in November of 1995, not 1994, as it had represented with the provided check copies. Jon Louis also made similar misrepresentations to Department reviewers. In total, Jon Louis represented 176 refunds as paid earlier than they were actually paid.

Judge Krueger properly weighed all of the evidence presented by both parties and determined that Jon Louis committed serious refund violations that were "consistent and widespread." Initial Decision at 18. Judge Krueger also correctly found that SFAP provided ample notice to Jon Louis concerning all reclassifications of charges from unpaid to late refund violations.

Credit Balances

In accordance with 34 C.F.R. §§ 690.78(a), 682.604(d) (ii) (A), when an institution receives Title IV funds on behalf of a student in excess of the student's cost of attendance, the school must return those funds to the student, unless the student permits the school to retain the funds to cover future costs. The time frame for the payment of timely credit balances varied for the award years involved in the instant case.[4]

The HESC review included 500 files and revealed 175 credit balance violations. Of the 175 credit balances, 157, or 90 percent, were paid late or not at all. The Department review also exposed 23 credit balance violations. A later *joint review* discovered an additional 36 late credit balance payments. (Emphasis added.)

Jon Louis argues on appeal that SFAP unfairly represented the number of credit balance violations at the hearing without proper notice. Specifically, Jon Louis asserts that during the hearing, SFAP represented multiple credit balances for the same student after including only one violation per student in the original termination notice. As with refunds, Jon Louis also contends that SFAP shifted a number of students from the unpaid credit balance category to late credit balance category without notice to Jon Louis.

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[4] For award year 1994-1995, institutions had 30 days to pay a student credit balance. For award 1995-1996 institutions had 21 days to pay a student credit balance, and for award year 1996-1997 institutions had 14 days to pay a student credit balance. *See* 34 C.F.R. § 668.165 (b) (2) (I) (1995) and 34 C.F.R. § 668.165 (b) (2) (ii).

Aside from its notice argument, Jon Louis failed to present an adequate defense to address the credit balance violations alleged by SFAP. Jon Louis simply argues that the degree of the credit balance lateness was overstated by SFAP. Jon Louis points to a cash flow problem as an explanation for the late and unpaid credit balances. Jon Louis also argues that Judge Krueger failed to consider mitigating evidence of student authorizations to retain credit balances.

SFAP admits that it submitted an inaccurate chart during the hearing that did not reflect student authorizations to retain credit balances. However, SFAP later submitted a revised chart that included the student authorizations. The revised chart established that Jon Louis did receive permission to retain some credit balances. Judge Kreuger properly determined that SFAP's error did not prejudice Jon Louis since the corrected evidence resulted in a reduced number of late credit balance payments.

Fiduciary Duty

Institutions participating in Title IV programs act as a fiduciary and are subject to the highest standard of care and diligence during the administration of such programs and the accounting of funds received. 34 C.F.R. § 668.82(a). Further, 34 C.F.R. 668.82(c)(1) provides:

> The failure of a participating institution or any of the institution's third-party servicers to administer a Title IV, HEA program or to account for the funds that the institution or servicer receives under that program in accordance with the highest standard of care and diligence required of a fiduciary, constitutes grounds for—
>
> (1) ...a fine on the institution, or the limitation, suspension, or termination of the institution's participation in that program ...

Excess cash is any amount of Title IV funds that an institution does not disburse to its students 3 business days after the school receives the funds. 34 C.F.R. § 668.166. Continual excess cash maintained by an institution may demonstrate a school's inability to adequately administer Title IV programs and meet its fiduciary duties.

SFAP's review of Jon Louis revealed that it repeatedly maintained excess cash at its North Babylon/Bronx, Patchogue, and Jamaica locations for periods well over three days, in some cases over a year. The excess cash balances ranged from $55 to $74,000. On appeal, Jon Louis argued that the excess cash balances were the result of the errors made by its servicer. The Initial Decision correctly states that: "The fact that Jon Louis was following the instructions of its Title IV servicer in maintaining the excess cash is no excuse for the practice." Initial Decision at 15. Jon Louis failed to present any other evidence to explain the excess cash balances it maintained.

Cohort Default Rate

Regulation 34 C.F.R. § 668.17(a)(2) provides that the Secretary may initiate a proceeding under Subpart G if an institution has a cohort default rate (CDR) that exceeds 40 percent for any fiscal year. During such proceeding, SFAP must show that it has correctly calculated the cohort default rate for the institution and that it does indeed exceed 40 percent. The institution can prevail on appeal by establishing through clear and convincing evidence that the CDR calculated by SFAP is not the correct final rate, and that the correct rate would be less than the 40 percent threshold. 34 C.F.R. § 668.90 (a)(3)(iv).

In accordance with the applicable regulations, the Administrative Judge must first determine whether SFAP has shown that the CDR was correctly calculated. 34 C.F.R. § 668.17(d). Thus, while the Administrative Judge may not reconsider the substance of any pre-deprivation proceeding, the Judge should render a determination that the loans at issue did, in fact, default during the fiscal year in question, and were properly included in the subject cohort default year.

As I recently stated in my decision In the Matter of Westchester School of Beauty Culture, Docket No. 98-97-ST (August 19, 1999), the Administrative Judge should begin its assessment by determining whether SFAP has shown that the CDR was calculated in a manner consistent with the definition of a CDR. *See* 34 C.F.R. § 668.17(d). In addressing this factor, the Administrative Judge should note whether SFAP presented probative evidence that the elements noted in the CDR definition are met, including whether the minimum number of students entered repayment status for the fiscal year at issue, as required by the HEA. The Administrative Judge must also determine whether the institution established, by clear and convincing evidence, that the rate used for the proposed action is not the final rate. 34 C.F.R. § 668.909(a)(3)(iv). Finally, the Administrative Judge must rule on whether the institution established that the final CDR did not meet or exceed the regulatory threshold that would subject the institution to further action, such as termination. 34 C.F.R. § 668.17.

In the instant case, it does not appear that Judge Krueger conducted the review described above. Jon Louis claims on appeal that the cohort default rate SFAP presented should not be considered final by the court. Thus, Jon Louis requests that the case be remanded on this issue for further review.

In its appeal brief, SFAP states that when the Initial Decision was issued, Jon Louis' 1994 CDR was 41.3 percent. Following the Initial Decision, based on the decision Calise Beauty School, d/b/a Hair Design Institute-Livingston, et al. v. Riley, 1997 WL 630115 S.D.N.Y. (Oct. 9, 1997) decision, the Department re-opened its review of Jon Louis' 1994 cohort default rate, considered additional evidence, and determined that Jon Louis' 1994 CDR was 40.7 percent. Consequently, SFAP argues that this supplementary review conducted by the Department renders the CDR final and that the issue should not be remanded for further review. SFAP Brief at 32. I disagree.

The supplementary review conducted by the Department of Jon Louis' CDR was conducted to ensure that the rate calculation did not rely upon incomplete summary loan servicing records as adequate proof of the five loan servicing requirements of 34 C.F.R. § 668.17(h)(3)(viii). Calise at 5. Although vital to the accuracy of the CDR calculation, this review cannot be substituted for the judicial review needed to determine whether the CDR is final. This function rests with the Administrative Judge.[5] Therefore, upon remand, the Administrative Judge should reconsider its finding concerning Jon Louis' CDR in light of the standard of review set forth above.

Findings

1. Jon Louis consistently failed to pay refunds in a timely manner, as required by the applicable regulations.
2. Jon Louis consistently failed to pay credit balances in a timely manner, as required by the applicable regulations.
3. Jon Louis failed to meet its fiduciary duty when it consistently maintained excess cash balances and misallocated Federal funds through refund and credit balance violations.
4. The Administrative Judge did not apply the standard of review required to determine whether the CDR calculation was final and accurate.

ORDER

The Initial Decision issued by Judge Krueger in this matter is affirmed as to findings 1, 2, and 3, and remanded for further proceedings consistent with this decision as to finding 4.

So ordered this 17th day of November, 1999.

Washington, D.C.

Richard W. Riley

[5] **In his Initial Decision, Judge Krueger noted it is not clear from the record whether the CDR includes the Jon Louis' Bronx location. *See* Initial Decision at 15. Without this information, it is impossible for this tribunal to calculate the final CDR.**

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