THE SECRETARY OF EDUCATION
WASHINGTON, D.C. 20202

In the Matter of

HAIR DESIGN INSTITUTE

Respondent

Docket No. 97-122-ST
Student Financial
Assistance Proceeding

DECISION OF THE SECRETARY

Procedure

The Hair Design Institute (HDI) is a postsecondary vocational school that operates within the State of New York. On January 6, 1997, the Student Financial Assistance Programs (SFAP), U.S. Department of Education, notified HDI that it had a cohort default rate (CDR) for the fiscal year 1994 of 41.7 percent. HDI appealed this determination alleging that a number of the loans used should have been excluded from the total CDR calculations due to improper loan servicing and collection. SFAP denied the pre-deprivation appeal.[1] Pursuant to 34 C.F.R. §668.17(a)(2), SFAP terminated HDI's participation in all student assistance programs authorized under Title IV of the Higher Education Act of 1965, as amended. In accordance with 34 C.F.R. § 668, Subpart G, HDI then requested a hearing to challenge the proposed termination. On August 5, 1998, Judge Frank Krueger Jr. issued an Initial Decision in this case, ordering HDI's termination.

Rule of Law

Regulation 34 C.F.R. § 668.17 (a)(2) provides that the Secretary may initiate a proceeding under Subpart G (Fine, Limitation, Suspension, and Termination proceedings) if an institution has a cohort default rate that exceeds 40 percent for any fiscal year. During such a 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 at this point may exercise its right to request a hearing, but if the Hearing Official finds that SFAP has accurately determined that the institution's CDR is above 40 percent, then the Hearing Official must find that the sanction sought by SFAP is warranted. The institution can prevail on appeal by establishing through clear and convincing evidence

[1] In a pre-deprivation appeal, the institution may challenge, *inter alia*, the accuracy of the data used to compute the CDR - - known as an erroneous data appeal - - or may challenge the propriety of including a given loan in the calculation of the CDR - - known as a loan servicing appeal.

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).

Issue

The issue on appeal is whether Judge Krueger correctly interpreted 34 C.F.R. § 668.90(a)(3)(iv) (1997) when he held that the Hearing Official does not have discretion to review SFAP's final determination of an institution's cohort default rate, by examining the legal standards applied by SFAP when calculating the rate.

Discussion

On appeal, HDI claims that its 1994 cohort default rate should not be considered final and that several of the loans considered to be in default by SFAP should be excluded from the total cohort default rate calculation because of improper loan servicing and collection. Specifically, HDI maintains that SFAP did not provide HDI with the complete original borrower collection and servicing records for several of the loans included in the 1994 CDR calculations.[2] These records would have provided the servicer's "diary account" of telephone calls, correspondence, and any other attempts to communicate to the borrower. HDI contends that these records would identify loan-servicing omissions, which would justify the exclusion of these loans from the calculations. HDI asserts that if these loans were not included in the final rate, then their 1994 CDR would be well below the 40 percent threshold.

In response, SFAP contends that under the applicable regulations it holds exclusive authority to calculate an institution's CDR during the pre-deprivation hearings. In addition, SFAP asserts that its final rate determination may not be reexamined by a Hearing Official. As calculated by SFAP, HDI's final rate was 41.7 percent, which exceeds the regulatory 40 percent threshold. Thus, SFAP maintains that under the applicable regulations, the Hearing Official had no choice but to terminate the school from all Title IV programs. In support of this assertion, SFAP chiefly relies on my decision in *In the Matter of Aladdin Beauty College #32,* Docket No. 97-108-ST (Aug. 20, 1998) where I stated that "once a final determination is made that a school's default rate exceeds 40 percent, the Hearing Official must order the sanction sought by SFAP."

In his Initial Decision, Judge Krueger stated that since the final rate determined by SFAP, according to the standards of 34 C.F.R. § 668.17 (1997), was above 40 percent, he had no choice but to interpret the regulation strictly and terminate HDI from all Title IV programs. Judge Krueger adopted SFAP's reading of *Aladdin.* However, my holding in

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[2] From the record, it is unclear whether HDI was provided with copies of these records or with no records at all. Undoubtedly, it is not fatal to SFAP's position if it cannot obtain all the records at issue. A de minimis number of missing records should be of little or no import in most cases.

Aladdin is more narrow than SFAP's interpretation. *Aladdin* stands for the proposition that the Hearing Official in the post-deprivation hearing does not have the authority to re-consider the mitigating circumstances that were raised in the pre-deprivation appeal. By that determination, however, I did not deprive HDI of its opportunity to present to the tribunal clear and convincing evidence that the CDR is not final and that the correct CDR is less than 40 percent.

Judge Krueger also held that Hearing Officials lack all discretion to consider whether SFAP used the correct legal standards in determining HDI's cohort default rate. As a basis for this finding, Judge Krueger examined the differences between the proposed and final versions of 34 C.F.R. § 668.90(a)(3)(iv) as were promulgated by the Department in 1995. Specifically, he noted that the proposed regulations allowed the Hearing Official to avoid limitation, suspension or termination if:

> the institution presents clear and convincing evidence demonstrating that its FFEL Program cohort default rate . . . is not final *or does not accurately reflect the final rate determined by the Department* and that the correct rate would result in the institution having an FFEL Program cohort default rate . . . that is beneath the thresholds that make the institution subject to limitation, suspension, or termination action.
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> Student Assistance General Provisions, 60 Fed. Reg. 49178, 49191 (1995) (to be codified at 34 C.F.R. pt. 668) (emphasis added).

In contrast, the final version of 34 C.F.R. § 668.90(a)(3)(iv) omitted the phrase "does not accurately reflect the final rate determined by the department," and stated only that the Hearing Official would find a sanction is not warranted if:

> the institution presents clear and convincing evidence demonstrating that the FFEL Program cohort default rate . . . is not the final rate determined by the Department and that the correct rate would result in the institution having an FFEL Program cohort default rate . . . that is beneath the thresholds that make the institution subject to limitation, suspension, or termination action.
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> 34 C.F.R. § 668.90(a)(3)(iv) (1997).

Judge Krueger concluded that the exclusion of this phrase made it "crystal clear that I have no authority to consider whether SFAP applied the correct legal standards in arriving at Respondent's FY 1994 FFEL cohort default rate." *Initial Decision* at 4. The Initial Decision indicates that while the proposed regulations gave the Hearing Official the authority to consider evidence pertaining to the accuracy of the school's cohort default rate, the removal of this phrase in the final regulations reduce the court's role to a

"ministerial function" with tightly constrained actions. *Id.* at 3. Judge Krueger contends that the inclusion or exclusion of this phrase found in the proposed regulation greatly impacts the Hearing Official's authority. I do not agree. The semantic difference between the proposed and final regulations does not completely erase the Hearing Official's authority to hear the matter. Rather, the omission of this phrase makes the regulation more concise, but does not significantly alter its meaning.

The 1995 amended regulations were meant to be tough in order to curb the problem of institutions evading the consequences of high cohort default rates.[3] Excessive cohort default rates have proved to be a consistent "indication that an institution lacks the administrative capacity to continue in the Title IV, HEA programs," and thus need to be censured stringently. *In the Matter of Aladdin Beauty College #32,* Docket No. 97-108-ST (Aug. 20, 1998). Thus, as I held in *Aladdin*, the Hearing Official is not given any discretion to impose alternative remedies once he is convinced that the Department has made an unrebutted final determination that the school in question has a cohort default rate that exceeds 40 percent.

One purpose of the amended regulation was to provide sufficiently strong institutional incentives to keep defaults on student loans low. It was not meant to entirely deprive schools of their procedural rights. 34 C.F.R. § 668, Subpart G provides that institutions have the right to request a hearing when the Department has brought a limitation, suspension or termination proceeding against them. Neither the amended regulation nor the *Aladdin* decision reduces the Hearing Official's role to a ministerial and meaningless function of rubberstamping SFAP's final determination. These, however, have been the effects of the narrow reading of the regulation.

The goal of reaching lower loan default rates must be balanced with the need to provide institutions with a fair and equitable hearing. Thus, 34 C.F.R. § 668.90 does not allow the Hearing Official to engage in a full review of the final rate as determined by SFAP. However, the Hearing Official must determine whether SFAP has shown that the CDR was calculated in a manner consistent with 34 C.F.R. § 668.17.

The recent case *Calise Beauty School, Inc. v. Riley*, No. 96 CIV. 6501(SHS), 1997 WL 630115 (S.D.N.Y.), (*Calise*) is important when considering the accuracy of a CDR calculation. *Calise* dealt with a loan servicing appeal brought before the United States District Court for the Southern District of New York. The case was remanded to the

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[3] The 1995 amendments were partly based on the large success of the Secretary's 1991 regulations which provided that when an institution had a Federal Family Education Loan (FFEL) Program cohort default rate of above 25 percent for three consecutive years, the Department could initiate proceedings to limit, suspend or terminate that school from the program. This default reduction initiative proved that cohort default rates are a useful and objective measure of institutional performance, and also that the potential loss of eligibility to participate in programs provides schools with much incentive to keep their CDRs low.

Department for further consideration. The school claimed that it was not provided with complete loan servicing and collection records as mandated by 20 U.S.C. § 1085(a)(3) and 34 C.F.R. § 668.17(h)(3)(iii). These records provide the schools with data related to the efforts of the lender to service and collect the loans. The school argued that these complete records were necessary to the presentation of a proper loan servicing appeal because they contained information necessary to determine whether the standards of 34 C.F.R. § 668.17(h)(3)(viii) had been met.

The district court acknowledged that "failure of the Secretary to provide complete loan servicing and collection records has compromised plaintiffs' ability to make an effective loan servicing appeal . . .." *Calise,* 1997 WL 630115, at *8. Thus, the court set a standard for the calculation of CDRs saying that the language of 20 U.S.C. § 1085(a)(3) and 34 C.F.R. § 668.17(h)(3)(iii) plainly states that "the institutions must be provided with the complete "collection history" records that guaranty agencies are required to receive and maintain pursuant to 34 C.F.R. §§ 682.406 and 682.414 of the HEA." *Id.* at *7.

In accordance with *Calise*, the Hearing Official in the present case must determine whether SFAP has presented a prima facie case that the CDR is final and that it was determined in accordance with the statutory and regulatory provisions governing the calculation of CDRs. Therefore, I remand this case to the tribunal below to review the evidence and determine whether SFAP complied with the court's decision in *Calise* and whether SFAP made a prima facie showing in accordance with 34 C.F.R. § 668.17, when calculating HDI's 1994 FFEL cohort default rate.

So ordered this 16th day of August.

Richard W. Riley

Washington, DC

Richard W. Riley

Docket 97-122S

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