In the Matter of MR. ARNOLD'S EXCELLENCE BEAUTY SCHOOL,
Respondent.

Docket No. 92-121-ST
Student Financial Assistance Proceeding

Appearances: Leigh M. Manasevit, Esq., and Peter D. Horkitz, Esq., of Washington, D.C., for the Respondent

Steven Z. Finley, Esq., of the Office of the General Counsel, U.S. Department of Education, for the Office of Student Financial Assistance

Before: Judge Ernest C. Canellos

DECISION

PROCEDURAL HISTORY

Mr. Arnold's Excellence Beauty School (Mr. Arnold's), of Miami Beach, Florida, is an eligible proprietary institution of higher education offering a program in cosmetology. It participates in the Pell Grant Program, authorized under Title IV of the Higher Education Act of 1965, as amended (HEA), which is administered by the Office of Student Financial Assistance Programs (SFAP), United States Department of Education (ED). Mr. Arnold's previously participated in the federal Guaranteed Student Loan Program (GSL), but withdrew in order to avoid being terminated from that program because of its high cohort default rate.

A program review was conducted at Mr. Arnold's by two reviewers from ED's Regional Office in Atlanta, Georgia, between November 12-15, 1991. Based upon their review of student files and other pertinent information, program reviewers concluded that Mr. Arnold's had committed the following violations: 1) failure to fully implement default reduction measures outlined in 34 C.F.R. § 668, Appendix D; 2) falsification of Ability-to-Benefit test answers; 3) failure to refund tuition and fees of students who withdrew; and 4) failure to meet the standards of administrative capability and fiduciary standard of conduct.

On October 26, 1992, on the basis of the findings in the program review, SFAP issued a notice advising Mr. Arnold's of its intent to terminate its eligibility to participate in federal student financial programs under Title IV of the HEA, and to impose a fine of $45,000. Mr. Arnold's timely requested a hearing. By SFAP letter of April 30, 1993, an additional violation was added and the proposed fine was increased to $70,900.

I held a hearing on this matter between October 28-29, 1993, in Miami, Florida. Evidence was submitted in the form of sworn testimony and documentary evidence. The hearing was transcribed verbatim by a court reporter and a record was made and provided to both sides. The

parties were authorized to submit a post-hearing brief, which each side accomplished in a timely manner.

DISCUSSION OF JURISDICTIONAL BASIS

The April 30, 1993 notice added to the list of reasons for terminating Mr. Arnold's eligibility to participate in the Title IV programs an allegation that Mr. Arnold's had not timely filed its required bi-annual audit. SFAP increased the requested fine by $25,900 for that added charge. This allegation was not raised in the original Notice, although it was apparently known to SFAP at the time of that Notice.

Before proceeding to discuss the merits of the allegations before me, I must address a threshold jurisdictional issue. That is, is the additional charge of failing to file the required bi-annual audit before me for adjudication? Put another way, do I have jurisdiction to consider that allegation in deciding whether or not to terminate and/or fine Mr. Arnold's?

The facts pertinent to this issue are not in dispute. Ronald D. Lipton was, during the time of the issuance of both the Notice and the amended Notice, dated October 26, 1992, and April 30, 1993, respectively, the Acting Director, then Director of the Compliance and Enforcement Division of OSFA. As such, he was the Designated ED Official as envisioned in 34 C.F.R. § 668.81(f), the one who initiates either a termination or fine procedure by sending a Notice to the Respondent to that effect. 34 C.F.R. § 668.86 and 668.84. Mr. Lipton did, in fact, execute the original letter of notification to Mr. Arnold's. The amended letter, however, was executed by Mark A. Gilbert, "for Mr. Lipton." At the hearing, Mr. Lipton testified, "When I was absent from the office . . . from April 22 through May 4, I signed an absence from the office memorandum stating that Mr. Gilbert would be acting in my position while I was absent from the office." In a colloquy with me he stated, in essence, that: he believed he could appoint someone to be the acting Director; he did not utilize a Standard Form (SF) 50, Notification of Personnel Action; he did not believe it was significant that Mr. Gilbert signed for him rather than for himself; and he believed that Mr. Gilbert was doing both what he would do if he were there and what Mr. Gilbert would do himself.

After taking evidence, I inquired if the Respondent had any issue to raise; the respondent had none. In its post-hearing submission, however, Mr. Arnold's claims, for the first time, that the amended Notice of Intent to Terminate was not issued by the Designated Departmental Official and should be dismissed.

The issue of whether someone may act for the Designated ED Official during periods of short absences has been litigated before me recently. See In the Matter of Pan American School, Docket No. 92-118-SP, U.S. Dep't of Education (Order of Dismissal)(December 27, 1993), and the cases enumerated therein. In each instance, I have dismissed the letters of notification finding that: the Secretary had barred redelegation when he delegated the authority to act as the Designated ED Official; any attempt to avoid that limitation by redefinition or otherwise would fail; administrative inconvenience could not constitute a reason to avoid the clear prohibition set out by the Secretary; and this error was jurisdictional, could be raised at any time during the proceedings, and could not be waived.

Consistent with the above, I find that the April 30, 1993 Letter of Notification, signed by Mark A. Gilbert, was not executed by the Designated ED Official, and therefore is jurisdictionally void. It is returned to SFAP for whatever further action it deems to be appropriate. I will not consider it as part of this proceeding.

DISCUSSION ON MERITS

SFAP claimed that Mr. Arnold's fraudulently changed answers from incorrect to correct on certain students' Ability-to Benefit tests. The result of these "corrections" was to give some students passing grades, thereby enabling them to gain federal student financial assistance. These intentional falsifications call into question its exercise of due care and diligence as a fiduciary. As proof of this violation, one of the program reviewers testified that when he reviewed some of the student files, he noticed that some of the answers on the Ability-to-Benefit tests had been covered over with "white out" correction fluid, and a different answer entered. In almost all instances, the new answers were correct and the changed answers resulted in a passing score. The reviewer went on to testify that he did not ask officials of the school about these findings nor did he attempt to ask the students in question about these "corrections," because he believed that the only explanation was that the school officials had fraudulently made them.

At the hearing, however, six of the students in question testified under oath. They stated, in essence, that they recognized their answer sheet from their Ability-to-Benefit test; the use of "white out" was common in their locale and they used it on their exams; they were authorized to do so by the proctor of the exam; they did it because it was neater that erasing; and, they did not receive any help with their answers. Counsel for SFAP cross-examined these witness, however, they persisted in their testimony.

These witnesses appeared to be credible. It is inexplicable why no verification was attempted by program reviewers when they first discovered the suspicious alterations. Their lack of diligence in questioning witnesses before they had an opportunity to consult has made it difficult to determine if there was fabrication.

TERMINATION ISSUE

The procedures for initiating the termination of eligibility of an institution to participate in the Title IV, HEA programs are set forth at 34 C.F.R. § 668.86. Section 668.86(a) provides that the Secretary may terminate or limit the eligibility of an institution to participate in any or all Title IV, HEA programs, if the institution violates any provision of Title IV of the HEA or any regulation or agreement implementing that Title.

ED seeks termination for fraud, which SFAP asserts is the most serious violation which can be committed. I agree with the categorization of fraud. However, as discussed above, the record clearly fails to support such a violation. In further support of its proposed termination, ED points to the violation of failure to timely make refunds to students who have either graduated or dropped out, as required by 34 C.F.R. §668.21. Mr. Arnold's does not dispute the violation, but

does point out that the liability is relatively small and is being liquidated automatically through administrative offset.

I find that Mr. Arnold's did, in fact, violate the rules regarding the timely repayment of refunds due. I find further that, although failure to properly pay refunds is serious, the facts of this case are such that the imposition of the most serious form of sanction, that of termination, is not appropriate.

I find that SFAP has failed to meet its burden of establishing that Mr. Arnold's did not meet the standards of administrative capability and fiduciary standards of conduct, or did not implement the Default Reduction Measures outlined in 34 C.F.R. § 668, App.D.

FINE CONSIDERATIONS

In addition to the proposed termination of eligibility, ED seeks a fine of $45,000 pursuant to §487(c)(3)(B) of the HEA, and 34 C.F.R. 668.84. ED describes Mr. Arnold's as a medium sized institution because its students received approximately $640,000 in student aid in the 1990-91 award year, the latest year in which complete data is available. However, in light of its withdrawal from the guaranteed student loan program with its corresponding reduced access to federal student aid, I believe Mr. Arnold's should more appropriately be described as a small institution.

ED treats the violation for fraudulent alterations of test answers as serious and seeks a fine of $30,000. Because of my finding above, no fine will be assessed for this claim. ED also treats the failure to timely pay refunds as serious and seeks a fine of $15,000. ($2500 for each of the 6 violations). It seeks no fines for the other alleged violations.

In Puerto Rico Technology and Beauty College, and Lamec, Inc., U.S. Dept. of Ed., Docket Nos. 90-34-ST & 90-38-ST (June 11, 1993), the Secretary iterates the statutory and regulatory requirement that in setting an appropriate fine, one must take into account the gravity of the violations as mitigated by the size of the institution.

No doubt, Mr. Arnold's erred in not meeting its timely refund requirements. However, I find no evidence of fraud. Therefore, I believe a fine of $6,000 ($1,000 for each violation) is warranted. Because Mr. Arnold's is a small school and there is no evidence of bad faith, such a mitigated fine is adequate and reasonable.

Evidence was introduced as to the positive impact the school had in the neighborhood for helping the disadvantaged. Also, because of their financial condition, the school would have to close if it were terminated or an excessive fine was imposed. Finally, current school management attributes its problems to a dispute between the current partners, which they are trying to rectify through a purchase of the interest of the absentee owner.

FINDINGS

(1) ED has failed to meet its burden of proving that Mr. Arnold's committed fraud by altering Ability-to-Benefit test answers.

(2) ED has failed to meet its burden of proving that Mr. Arnold's did not meet the standard of administrative capability and the fiduciary standard of conduct.

(3) Mr. Arnold's did not make timely refunds as required by 34 C.F.R. § 668.21.

(4) ED has failed to meet its burden of proving that Mr. Arnold's did not implement the default reduction measures of 34 C.F.R. § 668 Appendix D.

(5) Mr. Arnold's participation in federal student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended, should not be terminated.

(6) Mr. Arnold's should be fined $6,000.

ORDER

On the basis of the foregoing it is hereby ORDERED, that the eligibility of Mr. Arnold's Excellence Beauty School to participate in the student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended, not be terminated.

It is further ORDERED, that Mr. Arnold's Excellence Beauty School immediately and in the manner provided by law pay a fine in the amount of $6,000 to the United States Department of Education.

Judge Ernest C. Canellos

Issued: January 3, 1994
Washington, D.C.