UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF HEARINGS AND APPEALS

IN THE MATTER OF

Phillips Colleges, Inc.,

Respondent.

Docket No. 92-64-SA

Student Financial
Assistance Proceeding

DECISION

Appearances:
Leslie H. Wiesenfelder, Esq., and Jonathon C. Glass, Esq., Dow, Lohnes & Albertson of Washington, D.C., for Phillips Colleges, Inc.

Carol S. Bengle, Esq., Office of the General Counsel, for the Office of Student Financial Assistance Programs, United States Department of Education.

Before:
Judge Richard I. Slippen.

BACKGROUND

On March 31, 1992, the Office of Student Financial Assistance Programs (SFAP) 1 of the United States Department of Education (Department) issued a final audit detemiination finding that Phillips Colleges, Inc. (PCI), improperly drew-down Federal funds in excess of its immediate cash need for student financial assistance funds. The underlying audit was conducted by the Department's Office of Inspector General (OIG) and ostensibly covered the period July 1, 1997, through March 31, 1990. During the OIG's investigation, OIG auditors interviewed PCI corporate officials, reviewed PCI corporate policies and procedures, and evaluated bank records and financial reports concerning all of the institutions operated by PCI during the audit period. ED Ex. 1. Over the course of the audit period, PCI disbursed approximately $97 million in Pell Grant and campus-based program funds. 2

The fmal audit determination requires PCI to: [1] repay the Department $586,700 for interest imputed on excess Federal filnds maintained by PCI during the audit period, [2] calculate and refund to the Department imputed interest on excess cash balances after March 31, 1990, through the date refund balances are reduced to an amount not to exceed three to five days need, and [3] reduce cash on hand to amounts needed for a maximum of three to five working days and implement procedures to monitor Federal fund balances and cash requests to ensure that cash on

hand at each school does not exceed the immediate cash needs of the institution. PCI Ex. R-1 at 4.

PCI is a privately held corporation which operated from 27 to 90 institutions during the audit period. PCI's corporate office, located in Gulfport, Mississippi, maintained all accounting and bank records, and controlled the bank accounts for which the Federal funds at issue were deposited. The Department provided Federal funds to PCI through an electronic funds transfer system triggered by telephone requests by PCI for pre-approved Title IV program funds.

This case comes before the tribunal as a result of an appeal by PCI of finding 1 of the final audit determination. 3 For the reasons stated below, finding I of the final audit determination is **affirmed**. 4

DISCUSSION

I

According to SFAP, throughout the audit period, PCI had a duty to comply with the Department's Payment Management System Recipient's Guide (Payment Management Guide) which governs the timely draw-down and use of Federal student financial assistance funds. ED Ex. 6 at 2. SFAP argues that this Department manual along with a Department policy statement set out in Appendix 6 to a Departmental Directive entitled "Departmental Policy on Recovery of Interest in the Audit Resolution Process" require institutions that disburse student financial assistance program funds to disburse those funds within three working days of the draw-down. If any of these funds are held more than three working days, the Department has a legal right to recover interest actually earned on the excess funds or interest though not earned that is deemed to have accrued a benefit to the institution or could have been earned by the Federal Government. Stated another way, SFAP contends that it may collect earned interest or imputed interest on Federal funds held by an institution in excess of its immediate cash needs. Under both Appendix 6 and the Payment Management Guide, the "immediate cash needs" of an institution is narrowly defined to include the institution's ability to permissibly disburse the drawn-down Federal funds within three working days.

SFAP also relies on the Program Participation Agreements (PPAs) signed by PCI's institutions to support its position that despite the lack of a governing regulation or statutory provision defining what the "immediate cash need" of an institution is, PCI bound itself to the Department's definition of immediate cash need by being a signatory to the PPAs, which provide in relevant part:

[t]he institution agrees to use the funds provided to it in advance or by way of reimbursement under any Title IV, HEA Program, plus any interest or other income earned on those funds, only in accordance with the statutes, regulations, and the Department's Recipient's Guide-Payment Management Systems pertaining to that program.

PCI Ex. R-9 at 2 (Art. II, para. 2 of the PPA). According to SFAP, because the PPA requires PCI to use Federal funds in accordance with, inter alia, the Payment Management Guide, PCI was required to disburse the drawn-down Federal funds within three working days of the draw-down.

PCI argues that it has not violated any Title IV, HEA statutory provision or related regulation because neither the HEA nor the statute's duly promulgated regulations defines "excess cash" or "immediate cash need." In addition, PCI contends that neither the Payment Management Guide nor the Department's Directive set forth in Appendix 6 has the force and effect of law because these policy statements do not constitute duly promulgated regulations. 5 PCI also argues that SFAP cannot seek recovery of funds on the basis of the PPA because the PPA also does not directly define "immediate cash need." PCI's view is that the PPA is not governed by traditional principles of contract law because the PPA is not a contract; rather, the provisions of the PPA, itself, are governed only by Title IV regulations and their statutory precursor, the HEA. I find each of PCI's arguments unpersuasive.

As a condition precedent to participation in student financial assistance programs, section 487(a)(3) of the HEA, 20 U.S.C. § 1094(a)(3), requires all eligible institutions to enter into a participation agreement with the Department. The PPA conditions the initial and continuing eligibility of institutions to participate in student financial assistance programs upon compliance with the agreement and with program regulations. See 34 C.F.R. § 668. 12(b)(1). As SFAP notes, PCI's PPAs specifically require PCI to use Tide IV, HEA program funds in accordance with, inter alia, the Payment Management Guide. 6 The Payment Management Guide requires PCI to disburse its Federal funds within three working days of a draw-down. Although the Payment Management Guide, itself, is not a duly promulgated regulation, PCI bound itself to the terms of the Payment Management Guide by becoming a signatory to the PPAs and participating in Tide IV programs. 7 Consequently, it is the provisions of the PPA, rather than Title IV regulations that provides SFAP the legal basis to impose a liability on PCI in this proceeding.

It is impertant to note that PCI concedes that it maintained Federal funds in its accounts in excess of its three-day cash needs. 8 PCI Ex. R-6 In fact, the record is replete with unrebutted evidence that the cash balances at some PCI institutions significantly exceeded the amount needed for three working days. 9 According to the OIG auditors, one of PCI's institutions in Pennsylvania maintained enough Federal funds in PCI's accounts to meet the school's needs for 143 days of the audit period; another PCI institution in Connecticut maintained enough Federal funds to meet its needs for 113 days of the audit period; an institution in Utah, 94 days; and, an institution in California, 46 days. 10 PCI Ex. R-2 at 12. Accordingly, I fmd that PCI violated its obligation to comply with the provisions of its PPAs, which prohibited PCI from maintaining Federal funds in excess of its immediate cash needs. 11

II

As a separate matter, PCI urges this tribunal to find that the final audit determination is arbitrary and capricious and, as a consequence, "ultra vires." According to PCI, despite the merits of whether PCI maintained Federal funds in excess of its immediate needs, SFAP cannot impose a liability against the institution because SPAP lacks the statutory and regulatory authority to recover imputed interest.

PCI's position, however, is at odds with governing authority. The resolution of the same legal question in several Department cases upheld SFAP's legal authority to recover imputed interest from an institution that improperly uses Title IV funds. See In the Matter of International Career Institute, Dkt. No. 92-144-SP, U.S. Dep't of Education (July 7, 1994) (holding that SFAP may recover imputed interest on excess cash maintained by an institution), In the Matter of New York Business School, Dkt. No. 93-81-SP, U.S. Dep't of Education (July 22, 1994), and In the Matter of Puerto Rico Technology and Beauty Co1lege, Dkt. No. 92-73-SA, U.S. Dep't of Education (October 9, 1992). In each of these cases, the tribunal determined that SPAP may recover imputed or prejudgment interest as an essential element of damages to compensate for the loss of the use of money from the time SPAP's claim accrues until judgment is entered.12 This is so because in a Subpart H proceeding, upon a finding of liability against an institution, SFAP may recover, as part of its damages, improperly disbursed Title IV funds and any interest or other earnings thereon and any funds calculated as harm caused to an identifiable Federal interest. 13 See In the Matter of Macomb Community Co1lege, Dkt. No. 91-80-SP, U.S. Dep't of Education (June 28, 1993).

The basic concern in awarding damages is to compensate the Federal Government in cases where the Federal interest has been harmed and to promote compliance with the requirements of the applicable Federal program. Macomb at 7-8. Consequently, a demand for damages is more in the nature of an effort to collect upon a debt, which is appropriate in a Subpart H proceeding, rather than the imposition of a penal sanction, which is only appropriate in a Subpart G proceeding. Id. (also citing Bennett v. Kentucky Dep't of Educ., 470 U.S. 656,105 S. Ct. 1544, 1549 (1985)). Accordingly, I find that the issuance of the final audit determination was neither beyond the scope of SFAP's authority nor "ultra vires" and that the weight of prevailing legal authority decisively supports SFAP's position that it may recover $586,700 in imputed interest on the Federal funds maintained by PCI in excess of its immediate cash needs.

III

Finally, PCI challenges SFAP's calculation of the imputed interest it seeks to collect. I am persuaded that SFAP has sufficiently established the basis for the imposition of its $586,700 liability. 14

According to SFAP, to determine PCI's liability, SFAP computed PCI's average excess cash balance for the audit period by deducting PCI's average cash needs for three working days ftom its average monthly cash balances. Under this computation, PCI had an average excess cash balance of $5.1 million during the audit period. PCI Ex. R-1 at 3. SFAP then applied the Treasury Department's "current value of funds" rate to the average excess cash balance to determine the imputed interest, which was calculated to be approximately $679,000.

The OIG auditors noted, in their audit report, that PCI challenged the auditors' method used to determine excess cash balances by arguing that reconciled cash bank balances, which do not include checks written that have not cleared, should be used to compute excess cash instead of actual monthly cash bank balances. See PCI Initial Br. at 14; PCI Ex. R-1 at 3 (Page 5 of OIG audit report). In its final audit determination, SFAP concurred, in part, with PCI's position that some checks that have not been cleared should he deducted from the actual cash balances when

calculating excess cash. Consequently, to compute the amount of excess cash maintained by PCI, SFAP modified the OIG auditors' computation by considering only cash held more than 7 days as excessive, instead of the auditors' benchmark of three working days. Following SFAP's modification, the imputed interest was reduced from $679,000 to $586,700.

In its opening brief, PCI argues that the 7-day period, which was "plainly plucked out of air[,] . . . must be rejected as a matter of law." PCI Initial Br. at 68. According to PCI, SFAP's modification only purports to reduce SFAP's claim in a fair and reasoned manner, but does not do so. PCI proposes to reduce its imputed interest liability to $320,000 through the use of reconciled bank balances. PCI Ex. R-6. According to PCI, throughout the audit period, it was required to maintain Federal funds in its bank account to cover outstanding checks written against the account, but which had not cleared the account, and therefore, were not reflected in the bank statements relied upon by the OIG auditors. Consequently, according to PCI, for purposes of calculating excess cash balances, the bank statements actually reflect inflated cash balances.

As the final audit determination and the OIG audit report make clear, however, SFAP bases its excess cash determinations on the amount of Federal funds remaining in an account after three working days have passed since the initial draw-down of funds by an institution. To this extent, reconciled bank balances are only relevant where SFAP, in its discretion, chooses to include in its computation of excess cash, a reasonable time to account for checks written, but not cashed or cleared within three-days of the draw-down. Consequently, I find no reason to bind the OIG auditors or SFAP to only computing excess cash through the use of reconciled bank balances when neither the Payment Management Guide nor the PPA, which together define SFAP's excess cash requirement, explicitly require such a result. In addition, I am persuaded by SFAP's position that its reasonable enforcement of the immediate cash need requirement is reflected in the fact that it nearly doubled the amount of time that PCI could hold on to Federal funds before the institution became liable for imputed interest on the excess Federal funds. Accordingly, PCI must pay the Department the $586,700 in imputed interest sought in the final audit determination.[15]

ORDER

Based on the foregoing findings of fact and conclusions of law, it is hereby ORDERED, that Phillips Colleges, Inc. pay the United States Department of Education $586,700 in imputed interest on excess funds.

Richard I. Slippen
Administrative Judge

Issued: August 24, 1994
Washington, D.C.

CERTIFICATE OF SERVICE

UNITED STATES DEPARTMENT OF EDUCATION
THE SECRETARY

In the Matter of

PHILLIPS COLLEGES, INC.,

Respondent

Docket Number 92-64-SA

Student Financial
Assistance Proceeding

ORDER

This matter comes before the Secretary on the Respondent's June 9, 1995, Motion for Reconsideration of the Certification of Decision issued on May 25, 1995. The Department's Office of Student Financial Assistance Programs filed an opposition to the Respondent's motion on June 27, 1995.

I hereby deny the Respondent's motion.

So ordered this 13th day of July 1995.

Richard W. Riley

Washington, D.C.

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1 At the time of the issuance of the final audit determination, SFAP was named the Office of Student Financial Assistance (OSFA).

2 The disbursal of Pell Grant and campus-based funds is authorized by Tide W of the Higher Education Act of 1965, as amended, Pub. L. No.89-329, 79 Stat. 1219 Critle IV, HEA) (to be codified as amended at 20 U.S.C. § 1070 et seq.).

3 Although the final audit determination imposes a liability for $2,195,420, the patties have stipulated that the only issue involved in this appeal is finding 1, which seeks to impose a liability of $586,700. The other issues in the final audit determination presumably have been resolved.

4 Both parties present arguments challenging the admissibility of the other party's exhibits. Recognizing that the admission of evidence does not carry along with it any indicia of how much probative weight the tribunal should give to the evidence, the exhibits of both patties are admitted into evidence. In accordance with the Secretary's decision in In the Matter of Baytown Technical School. Inc., Dkt. No. 91-40-SP, U.S. Dep't of Education (April 12, 1994), and consistent with my obligation to provide the parties with a fair hearing, I find no grounds for finding that the submissions of the parties should not be duly considered in my fact finding in this case.

5 But see 31 C.F.R. § 205.4(a) (1988) (requiring that cash advances be timed in accordance with the immediate cash requirements of the recipient organization).

6 The parties did not submit into evidence the individual institution PPAs because, according to SFAP, "there are in excess of 50 [PPAs]" and, according to PCI, the blank PPA submitted as PCI's exhibit R-9 is a copy of the "standard program participation agreement" used by the parties. SFAP Reply Br. at 2 n.2; PCI Br. at 57. In addition, PCI does not challenge SFAP's assertion that exhibit R-9 is a representative copy of the PPAs signed by the parties. Accordingly, I find that the submission of exhibit R-9 into evidence and the reliance by both parties on the exhibit as a representative PPA signed by the parties, taken together, are sufficient evidence diat exhibit R-9 represents the standard PPA applicable to the issues in this proceeding.

7 See also Elizabeth Brant School of Business. Inc. v. Bennett, No.5-85-00131 (Bankr. W.D. Va. August 15, 1986) holding that a PPA is a legally binding contract between the Department and the institution signing the agreement and In the Matter of New York Business School, Dkt. No. 93-81-SP, U.S. Dep't of Education (July 22, 1994) recognizing that the PPA may provide sufficient legal basis to uphold a finding against an institution that maintained Title IV funds in excess of its immediate cash needs. (citing In the Matter of Draughon Co1lege, Dkt. No. 93-4-ST, U.S. Dep't of Education (November S, 1993)).

8 According to PCI, its reconciled bank records show that over the course of the audit period PCI maintained over $37 million in Federal funds in excess of its three-day cash needs. PCI Ex. R-6 at l.

9 SFAP maintains that for the Pell Grant and campus-based programs, the average monthly balance of Federal funds maintained by PCI exceeded the immediate cash needs of its institutions by approximately $5.1 million.

10 The OIG auditors also determined that for all of PCI's institutions, the balance of Federal funds maintained, on average, was sufficient to meet the needs of PCI institutions for 39 days. PCI Ex. R-2 at 15.

11 The fact that the final audit determination only holds PCI responsible for maintaining Federal funds in excess of seven days instead of three working days does not alter my finding on this issue. Undoubtedly, SPAP's willingness to negotiate or compromise the amount of PCI's liability does not diminish its legal authority to impose liability. See Bennett v. Kentucky Dep't of Educ., 105 S. Ct. 1544, 1550 (1985).

12 Moreover, as a general matter, SPAP has often sought damages or the recovery of funds as a remedy in Subpart H proceedings. See, e.g., In the Matter of Berk Trade and Business School, Dkt. No. 91-5-SP, U.S. Dep't of Education (December 10, 1992 Judge Cook)(school ordered to repay $42,040.89 in Title IV funds); In the Matter of Garces Commercial College, Dkt. No. 92-23-SP, U.S. Dep't of Education (November 25, 1992 Judge Shell)(school ordered to repay $702,704 in Title IV funds); In the Matter of French Fashion Academy, Dkt. No. 89-12-S, U.S. Dep't of Education (March 30, 1990)(Decision of the Secretary)(school ordered to repay $366,702 in Title IV funds); In the Matter of Temple University, Dkt. No. 89-26-S, U.S. Dep't of

Education (March 13, 1990 Judge Lewis)(school ordered to repay $169,208 in Title IV funds). See also Bell v. New Jersey, 461 U.S. 773, 783 (1983)(collecting Title I cases wherein the Department sought the recovery of funds under an analogous administrative proceeding).

13 The decisions of the Secretary have often recognized that pure speculation as to damages is insufficient to prove harm or justify the award of damages based upon a theory of breach of the PPA. See e.g., Macomb, infra, at 6. In this case, SFAP is seeking to recover interest, not earned on the excess funds by PCI, but interest that could have been earned on these funds by the Federal Government Consequently, SFAP's basis for recovery identifies a discrete Federal interest that has been harmed as a result of PCI's draw-down of excess Federal funds.

14 In determining the amount of liability, mathematical accuracy of proof is not required. See In the Matter of Macomb Community College, Dkt. No. 91-80-SP, U.S. Dep't of Education (June 28, 1993) (citing National Merchandising Corp. v. Leyden, 348 N.E.2d 771, 774 (Mass 1976).

15 To the extent that the final audit determination seeks to impose a liability on PCI to pay the Department imputed interest on excess funds maintained after March 31, 1990, that part of the final audit determination is denied. Any dispute regarding excess funds outside the scope of the OIG's audit and the record in this case is clearly beyond SFAP's means to impose a liability in this proceeding. Of course, PCI should take steps to ensure that it does not draw-down Title IV funds in excess of its immediate cash needs in the future.