IN THE MATTER OF TECHNICAL CAREER INSTITUTE,
Respondent.

Docket No. 92-91-ST
Student Financial Assistance Proceeding

INITIAL DECISION

By letter-notice dated April 23, 1991, an administrative component of the U.S. Department of Education, the Office of Student Financial Assistance (now the Student Financial Assistance Programs) (ED), seeks to terminate the eligibility of Technical Career Institutes (TCI) to participate in the student financial assistance programs authorized under Title IV of the Higher Education Act of 1965, as amended (SFA programs). It is alleged that TCI is not financially responsible. ED also seeks to fine Respondent TCI $20,000 as punishment for its failure to post a $1,500,000 surety and its late filing of 1990 audited financial statements.

Because it was the expectation of the parties that no oral hearing upon the ED charges against TCI would be necessary, ED filed its Opening Brief on December 30, 1992, supported by numerous exhibits and one affidavit. On March 1, 1993, TCI filed a Reply Brief and its exhibits, which included two affidavits. Then, on July 19, 1993, ED filed its Rebuttal Brief, to which it attached additional exhibits and one additional affidavit. In this last brief ED introduced a new matter as to which TCI had no prior opportunity to dispute. When, following ED's second submission, TCI requested an opportunity to supplement its submission with further affidavits for the stated purpose of replying to new assertions made by ED in its Rebuttal Brief, it was decided that case processing entirely by written submissions had failed and that an oral hearing would be necessary in the interest of due process. Oral hearing was held at New York, NY, on September 2, 1993. At that time, in accordance with agreed procedure, the two affidavits previously submitted by ED were treated as the direct testimony of the affiants and counsel for TCI was permitted to cross-examine ED's witness.See footnote 1 [1] Relative to the new ED evidence, TCI presented the testimony of four witnesses. ED presented one rebuttal witness and was allowed to close the case. Copious arguments previously were presented in writing and as well, oral arguments were presented throughout the New York hearing. Because of the abundant prior briefing and convincing evidence and arguments presented at the hearing, I requested, without objection from either party as to the particular procedure, that counsel for TCI prepare a draft of a decision for my review upholding the position of TCI. Such was done, although I have made changes in the draft. ED, of course, disagrees with my bench decision.

Findings of Fact

Based upon the testimony at the oral hearing and the written evidentiary record, I make the following findings of fact:

Technical Career Institutes, Inc., is a proprietary institution of higher education providing training for men and women who are pursuing careers in the fields of electronics, air conditioning and office technology. Its campus is located in Manhattan in New York City. (R-2).See footnote 2 [2]

TCI is authorized by the New York State Board of Regents to confer associate degrees in the fields of electronics engineering technology, industrial electronics, air conditioning, heating and refrigeration technology, and office technology. Its associate degree programs are two years in length. TCI also offers certificate programs of varying length in air conditioning and refrigeration technology, basic electronics, and office technology. (Id.).

TCI's electronics engineering technology program is nationally accredited by the Technology Accreditation Commission of the Accreditation Board for Engineering and Technology. Students in TCI's electronics engineering technology program can transfer their academic credits at full value to four-year institutions that offer electronics programs. The academic credits in TCI's other programs are routinely accepted for transfer, based on a case-by-case evaluation, at other institutions. Among the institutions which have accepted TCI's credits on transfer are New York Institute of Technology, New Jersey Institute of Technology, Pratt Institute, Fairleigh Dickinson University, and City College of New York. (Id.).

TCI is the only for-profit technical college in New York State that offers associate degrees in the technical fields described in the preceding finding and is the largest career college in the State of New York (Tr. 40). TCI currently employs approximately 375 people, including 213 full-time and part-time faculty. (R-2).

TCI's current enrollment is approximately 4,500 students, of whom approximately 1,400 are enrolled in the industrial electronic technology programs, 1,200 in the air conditioning, heating and refrigeration technology programs, 1,000 in the secretarial and office technology programs, and 900 in the electronics engineering technology programs. (Id.).

TCI serves a diverse student body with distinct educational and social needs. Approximately 20 percent of TCI's students are studying English as a second language, 20 percent are Russian, Polish, Chinese and other immigrants with strong technical backgrounds who need additional training to break into the United States job market, 40 percent are receiving some form of public assistance, and 50 percent have had some previous postsecondary education. (Id.).

TCI's cohort default rate, i.e., the rate at which its former students default on their loans under the Federal Family Education Loan programs (FFEL) (formerly the Guaranteed Student Loan programs), is trending downward. According to ED's official published figures, TCI's default rate dropped from 22.2 percent for the 1988 award year to 18.9 percent for 1989, and 16.8 percent for 1990. These rates are low for a for-profit, proprietary institution. (Id.).

TCI's placement rate has been in the 75 to 85 percent range in recent years. That means that 75 percent to 85 percent of TCI's graduates are placed in permanent jobs within six months after graduation. (Id.).

The Secretary of Education authorized TCI to participate in the SFA programs. The Secretary issued TCI's current Program Participation Agreement in September 1991 (R-2 at 8-13). TCI participates in the FFEL programs, the Federal Supplemental Educational Opportunity Grant program (SEOG), and the Federal Pell Grant program (Pell Grant). (Id.).

TCI is a stand alone, independent corporation organized and existing under the laws of New York. TCI is a wholly owned subsidiary of East Coast Training Services of Delaware, Inc. (ECTS), which also owns and operates other proprietary career schools. ECTS is a wholly owned subsidiary of East Coast Capital Corporation (ECCC), which itself is a wholly owned subsidiary of North American Training Services, Inc. (NATS). (R-3; Tr. 38). TCI's parent corporations are all organized and exist under the

laws of Delaware. None of TCI's parent corporations directly operates any postsecondary schools or meets the definition of an institution of higher education as defined in Section 481(a) of the Higher Education Act of 1965, as amended, 20 U.S.C. § 1088(a). (R-3).

TCI transacts no business with any of the other subsidiaries of ECTS, and its transactions with ECTS are immaterial as to the operations and finances of TCI. (Id.).

From 1988 through 1992 and up to the present day, TCI has provided its educational services without any interruption and met all of its financial obligations in a timely manner. (R-3).

TCI was acquired by ECCC/ECTS in July 1988. (Tr. 38). On April 25, 1989, based on ED's review of TCI's financial statements for the year ending September 30, 1988, ED demanded that TCI submit a letter of credit in the amount of $850,000. (E-12). The financial structure of ECCC/ECTS is convoluted. TCI, as a stand-alone school is financially healthy. Its parent companies are not.

On June 14, 1989, TCI posted the $850,000 letter of credit, as required. (E-17). Since that date, TCI has renewed the $850,000 letter of credit (E-24, E-40, and E-43), and the current letter of credit will expire on June 30, 1994 (Tr. 199).

On April 23, 1991, ED issued a notice (Termination Notice) informing TCI that it intended to terminate TCI from participation in the Title IV programs for lack of financial responsibility and to fine TCI $20,000 for failing to post a $1,500,000 surety and for not timely submitting its 1990 audited financial statements. (E-38).

It is the policy of the ED's Financial Analysis Branch (headed by Mr. Selepak) to look to the most recent audited financial statements of an institution to determine whether that institution meets the regulatory standards of financial responsibility. (Tr. 15).

The most current audited financial statements for TCI are for the 12-month period ending September 30, 1992 (R-1), and, based upon those audited financial statements, TCI meets the standards of financial responsibility established in 34 C.F.R. § 668.13 (c)(1)-(3).

The essence of ED's view that TCI is not financially responsible was stated in the following terms by Mr. Selepak in his affidavit (E-51 at 7):

The financial health of TCI cannot be determined without reference to ECCC/ECTS [East Coast Capital Corporation/East Coast Training Services of Delaware, Inc.]. When we look at ECCC/ECTS, we see that it seems to be only a question of time before TCI needs to make good the ECCC/ECTS debt, either formally through the creditors' exercise of loan guarantees, or informally as ECCC/ECTS takes TCI's money and assets.

The creditors of East Coast Capital Corporation are AEA Investors, Inc. (AEA), and Chrysler Capital Corporation. (Tr. 40). The amount of debt owed by ECCC is approximately $90,000,000, of which $55,000,000 is owed to Chrysler Capital Corporation and $35,000,000 is owed to AEA. (Tr. 41.) Both Chrysler Capital and AEA offered detailed testimony in this proceeding at the September hearing. As will be seen, this testimony is based upon an expert financial analysis.

The mortgage on the building and land occupied by TCI is an obligation of TCI, and that obligation of TCI, like all obligations of TCI, is current. (Tr. 66-67).

Chrysler Capital Corporation is a $3.5 billion diversified financial lending institution, which is a wholly-owned subsidiary of Chrysler Financial Corporation, which, in turn, is a wholly owned subsidiary of Chrysler Corporation. (Tr. 128). AEA is a principal investment firm. (Tr. 33).

Chrysler Capital Corporation first became a lender to East Coast Capital Corporation in 1989 and since then has made various concessions with respect to the debt of East Coast Capital Corporation in order to enhance the value and viability of TCI. (Tr. 132).

There has been a material, positive turnaround in TCI's financial condition as of September 30, 1992, and since then as well. TCI was restored to profitability by AEA putting in place a new senior management team as well as significantly strengthening the middle management of TCI.

This was not without cost. AEA indirectly abandoned, through bankruptcy proceedings, five or so other schools. However, AEA sustained the best schools, financially speaking, as has Chrysler. TCI is one of the schools that has survived and has been substantially strengthened.

TCI's admission standards were heightened and its curriculum was improved both by upgrading it and by tying it to the demands of the marketplace in terms of necessary skills. In addition, the services provided students were expanded, including, among other things, significantly more counseling for students. (Tr. 86).

As a result of these efforts, TCI has been able to expand its enrollment, thereby increasing tuition and fee revenue by almost $12 million, from $17,203,373 in 1991 to $28,925,661 in 1992. (R-1). This, in turn, provides the basis for the increases in current assets (rising, in round numbers, from $7.5 million in 1991 to $13.2 million in 1992), in total assets (rising from $20.4 million to $25.2 million) and in earnings from operations (rising from $1.9 million to $6.6 million). Thus, TCI's financial figures are based on solid improvements in its basic operations and educational services that have enabled it to attract and retain more students and thereby greatly increase its revenue. (See R-2).

The testimony at the hearing was that TCI would generate approximately $5,800,000 in operating cash flow for the 12-month period ending September 30, 1993, that TCI is overall doing well financially, and that TCI has a strong financial base. (Tr. 87).

The testimony of the witnesses representing the creditors of ECCC was uniform in stating that the continued operation of TCI as a going concern was the only approach that made economic sense because the continued profitability of TCI was essential to generate cash flow to sustain operations, to pay its obligations, and, ultimately, to create an asset which could be sold to a third party as a going concern, the net proceeds of which would be used to reduce the substantial debts of ECCC See, e.g., Tr. 43. These witnesses are in fact the highest level decision makers for the creditors. Their testimony is convincing. According to Chrysler Capital Corporation, there is no economic reason to "pull the plug" on East Coast Capital Corporation or TCI because:

the value in East Coast [Capital corporation] is really in the assets it[ ] hold[s] and not on a liquidation base of mortar and brick or paper and computers, but really on an ongoing concern value of the schools that they own and operate. And on a market valuation basis, those entities could be traded at a multiple of cash flow at some point. And that's how we would look to get our principal repaid.

(Tr. 134).

Chrysler Capital Corporation also testified that TCI at the present time is an appreciating business and that based on a multiple of approximately four, TCI, as a going concern, would have a value of approximately $20,000,000. (Tr. 135). However, the value of TCI on a liquidation basis would be less than $1 million. (Tr. 201). I find that Chrysler Capital Corporation has no intent, no desire, nor any rational reason to call any portion of a TCI guarantee of the debt of East Coast Capital Corporation to Chrysler Capital Corporation. I further find that the situation will continue for the foreseeable future. Such will continue at least until the eventual contemplated sale of TCI as a going concern. (Tr. 135-136).

The commitment of TCI's creditors to its continuing operation is affirmatively demonstrated by their actual conduct; that is, whenever the needs of TCI required an adjustment in the debt service requirements of ECCC, Chrysler Capital Corporation and AEA always accommodated that through delaying interest, deferring interest, or otherwise altering the debt structure of ECCC. (Tr. 43).

TCI is entirely self-sustaining. Its revenues exceed its cost of operations so that it is generating a profit. Its funds are not co-mingled with that of its parent or affiliated companies. Consequently, neither Chrysler Capital Corporation nor AEA has any expectation that additional funds will be needed to be contributed by them to TCI. In addition, TCI is continuing to use its available resources to improve its facilities and operations, which has the benefit of increased enrollments and an overall increase in its value as an asset in a sale to a third party. In short, the creditors of TCI have every incentive to maintain TCI as a going concern and no incentive whatsoever to take any action which would adversely effect TCI's financial condition. (Tr. 43-44).

The witnesses for Chrysler Capital Corporation and AEA testified, and I find, that the existence of the very large debt owed by ECCC does not pose any threat to TCI or effect its viability as a going concern. ("The only value of TCI to the creditors is as a going concern and to...do anything to jeopardize that just simply would be contrary to our own economic self-interest.") (Tr. 47).

The opportunity to take cash from TCI and "upstream" it to pay off obligations of ECCC has always existed but Chrysler Capital Corporation and AEA have collectively agreed not to do that but rather have every incentive to allow TCI to continue its profitable activity. (Tr. 200).

I find that the fact that both Chrysler Capital Corporation and AEA recognize that a material portion of their investment in East Coast Capital Corporation likely will never be repaid does not adversely effect the financial responsibility of TCI. To the contrary, that fact militates that Chrysler Corporation and AEA will continue to do whatever they can to maximize the value of TCI as a going concern in order to minimize the financial losses already incurred. The facts that TCI's operations have continued to improve and expand and that its value has continued to appreciate mean that for Chrysler Capital Corporation or AEA to reach down and strip TCI of any of its assets or any of its cash would be, in the words of one of the creditors of ECCC, "one of the dumbest things I could possibly think of doing in the circumstances." (Tr. 182). I agree. I further find that ED's concern that Chrysler Capital Corporation or AEA would take such adverse action with regard to TCI's assets or cash, which was Mr. Selepak's stated reason for ED questioning the financial responsibility of TCI, is wholly unjustified.See footnote 3 [3]

There is no incentive for ECCC's creditors to close down TCI. The opposite is ture.See footnote 4 [4] Plainly, the creditors intend to sell TCI to an independent third party at a fair market price based on going concern value. Stripping TCI would net the creditors less than $1,000,000, whereas sale would net up to $20,000,000. Furthermore, TCI's performance has improved dramatically and it has turned itself around relative to its prior situation. Moreover, assuming as I do for purposes of this Decision that ED can go behind the financials of TCI in this case and look at the financials of its parent companies, I find that even after having done so, TCI is nonetheless financially responsible. TCI is profitable and its value is that of a going concern, not that of a turkey to be plucked by creditors.

I find that TCI has affirmatively shown that it is a going concern.

The Witnesses At the hearing, the following individuals testified:

1. Ronald G. Selepak. Mr. Selepak is the Acting Chief, Financial Analysis Branch of the Institutional Participation Division of the Institutional Participation and Oversight Service within the U.S. Department of Education.

2. Michael Peterson. Mr. Peterson is Chief Financial Officer and Chief Credit Officer of Chrysler Capital Corporation.

3. MacDonell Roehm, Jr. Mr. Roehm is a Managing Director of AEA Investors, Inc. and President and Chief Executive Officer of North American Training Services, Inc. (NATS).

4. David S. Gellman. Mr. Gellman is a Managing Director of AEA Investors, Inc. and a Vice President of NATS and each of its subsidiaries, including TCI. (Tr. 173-174).

5. Eric M. Biederman. Mr. Biederman is Vice President for Administration for TCI.

6. Keith Kistler.See footnote 5 [5] Mr. Kistler is a Senior Financial Analyst within ED's Financial Analysis Branch and is a Certified Public Accountant. Conclusions of Law The HEA

ED's policy of looking to an institution's most current audited financial statement to determine whether it meets the regulatory requirements for financial responsibility (Tr. 15) is wholly consistent with the statutory requirements of the Higher Education Act of 1965, as amended (the HEA), with the Higher Education Amendments of 1992, amending the HEA regarding financial responsibility, and with the relevant regulations implementing the HEA (Title IV regulations).See footnote 6 [6] This is so because both the HEA and the Title IV regulations provide distinctly forward-looking standards. After all, an institution's financial responsibility must be measured by its most current financial statements in order to ensure that the institution can and will be able to meet its financial obligations to students and to the Secretary.

Indeed, since their inception some 18 years ago,See footnote 7 [7] the Title IV regulations relating to financial responsibility have required that the Secretary measure an institution's compliance by that institution's current financial condition. Moreover, when the Secretary questions an institution's financial status, the Title IV regulations have consistently provided an opportunity for the institution to submit its most recent financial statements to demonstrate that, regardless of what its prior condition may have been, it meets the tests of financial responsibility based on its most recent audited statements.

The financial responsibility regulations currently provide:

To begin and to continue participation in any Title IV, HEA program, an institution must demonstrate to the Secretary that it is financially responsible under the standards established in this section. 34 C.F.R. § 668.13(a) (1992)(emphasis added). In addition, when Congress enacted express statutory language on financial responsibility in the Higher Education Amendments of 1992, Pub. L. 102-325 (1992 Amendments), it largely adopted and expanded upon the existing Title IV regulations. The HEA, as amended by the 1992 Amendments, also uses the present tense and directs the Secretary to evaluate the institution's existing condition, not its past record. The overriding question under the new statute, effective July 23, 1992, is whether an institution "is able" to demonstrate financial responsibility.

(c) FINANCIAL RESPONSIBILITY STANDARDS. -

(1) The Secretary shall determine whether an institution has the financial responsibility required by this title on the basis of whether the institution is able -

(A) to provide the services described in its official publications and statements;

(B) to provide the administrative resources necessary to comply with the requirements of this title; and

(C) to meet all of its financial obligations, including (but not limited to) refunds of institutional charges and repayments to the Secretary for liabilities and debts incurred in programs administered by the Secretary.

(2) Notwithstanding paragraph (1), if an institution fails to meet criteria prescribed by the Secretary with respect to operating losses, net worth, asset-toliabilities ratios, or operating fund deficits then the institution shall provide the Secretary with satisfactory evidence of its financial responsibility in accordance with paragraph (3).

(3) The Secretary may determine an institution to be financially responsible, notwithstanding the institution's failure to meet the criteria under paragraphs (1) and (2), if -

(A) such institution submits to the Secretary third-party financial guarantees, such as performance bonds or letters of credit payable to the Secretary, which third-party financial guarantees shall equal not less than one-half of the annual potential liabilities of such institution to the Secretary for funds under this title, including loan obligations discharged pursuant to Section 437, and to students for refunds of institutional charges, including funds under this title;

(B) such institution has its liabilities backed by the full faith and credit of a State, or its equivalent;

(C) such institution establishes to the satisfaction of the Secretary, with the support of a report of an independent certified public accountant prepared under generally accepted accounting principles, that the institution is a going concern capable of meeting all of its financial obligations, including (but not limited to) refunds of institutional charges and repayments to the Secretary for liabilities and debts incurred in programs administered by the Secretary; or

(D) such institution has met standards of financial responsibility, prescribed by the Secretary by regulation, that indicate a level of financial strength not less than those required in paragraph (2).

Pub. L. 102-325, § 498(c), reprinted in 1992 U.S.C.C.A.N. (106 Stat.) 448, 647-648 (enacted on July 23, 1992) (emphasis added).

After all, under the "general" requirements for financial responsibility, the Secretary must determine whether an institution "is able" (1) to actually provide the services it promises to provide to students; (2) to actually provide the administrative resources necessary to comply with Title IV requirements; and (3) to actually meet all of its financial obligations, including refunds to students and required repayments to the Secretary. 34 C.F.R. § 668.13(b).

Furthermore, for an institution to meet these "general" requirements is not sufficient in and of itself. The institution also must be able to meet the so-called "numeric tests" of financial responsibility in 34 C.F.R. § 668.13(c):

[T]he Secretary considers an institution not to be financially responsible if:

(1) under its basis of accounting, it --

(i) Has had operating losses over at least its two most recent fiscal years; or

(ii) Had, for its latest fiscal year, a deficit net worth. A deficit net worth occurs when the institution's liabilities exceed its assets;

(2) Under an accrual basis of accounting, it had, at the end of the latest fiscal year, a ratio of current assets to current liabilities of less than 1:1. 34 C.F.R. § 668.13(c)(1), (2) (emphasis added). These tests are based exclusively on the institution's audited financial statements for its "latest" or "most recent" fiscal year or years. TCI's audited financial statements for its "latest fiscal year," i.e., the 12-month period ending September 30, 1992, demonstrate that it meets each and every one of these numeric tests. See R-1.

Moreover, the corresponding subsection to the above-quoted regulations that directs an institution to submit financial information goes even further because it also directs an institution to submit financial statements "for its latest complete fiscal year and its current fiscal year. "

To enable the Secretary to make this determination [of financial responsibility], an institution shall, to the extent requested by the Secretary, submit for its latest complete fiscal year and its current fiscal year

(1) A profit and loss statement and a balance sheet ... ; or

(2) A financial audit report of the institution.

34 C.F.R. § 668.13(e) (emphasis added).

The forward-looking character of the financial responsibility requirements is even clearer in light of the 1992 Amendments' provision of alternate methods for an institution to show its financial responsibility if it cannot meet the numeric tests. Congress expanded upon the methods provided in the existing Title IV regulations by adding new alternatives, including allowing the institution to establish that it "is a going concern." Id. at § 498(c)(3)(C) (emphasis added). This provision, on its face, measures the institution's existing ability to meet its financial obligations on a current and continuing basis, not its past financial condition.

Going Concern

One of the principal contentions of ED was that notwithstanding the fact that TCI met the so-called numeric tests of financial responsibility under the regulations based on its most current audited financial statements (R-1).See footnote 8 [8] ED had the right to "go behind" TCI's audited financial statements and examine the audited financial statements of TCI's parent corporations, ECCC/ECTS, to determine whether TCI was financially responsible. For purposes of this case I will assume without deciding that ED has this right; however, upon examination of the financial information regarding TCI's parent corporations, it, nonetheless, still is found that TCI is financially responsible. I disagree with ED's attempt to establish that merely because ECCC is in poor financial condition, TCI therefore is not a going concern.

Furthermore, my finding that TCI has affirmatively established that it is a going concern has additional significance because the 1992 Amendments provide four alternatives for an institution to demonstrate its financial responsibility. Pub. L. 102-325, § 498(c)(3). The third alternative is:

The Secretary may determine an institution to be financially responsible, notwithstanding the institution's failure to meet the criteria under paragraphs (1) and (2), if -

(C) such institution establishes to the satisfaction of the Secretary, with the support of a report of an independent certified public accountant prepared under generally accepted accounting principles, that the institution is a going concern capable of meeting all of its financial obligations, including (but not limited to) refunds of institutional charges and repayments to the Secretary for liabilities and debts incurred in programs administered by the Secretary. Pub. L. 102-325, § 498(c)(3)(C). This "going concern" alternative for establishing financial responsibility was first created by Congress, effective July 23, 1992, and must now be given effect.

Under established case law, the 1992 Amendments to the HEA, including the new "going concern" provision, are binding because I must consider the law as it exists at the time of decision, particularly with regard to issues of financial responsibility.

We anchor our holding in this case on the principle that a court is to apply the law in effect at the time it renders its decision, unless doing so would result in manifest injustice or there is statutory direction or legislative history to the contrary. Bradley v. School Board of City of Richmond, 416 U.S. 696, 711 (1974) (applying new statute and new regulations enacted during appeals process). See, e.g., Tully v. Mobil Oil Corp., 455 U.S. 245, 247 (1982) ("The normal rule in a civil case is that we judge it in accordance with the law as it exists at the time of our decision."); Cort v. Ash, 422 U.S. 66, 76 (1975) (Court must apply new statutory remedy, enacted after case was filed, because "our duty is to decide this case according to the law existing at the time of our decision."); City of Harrisburg v. Franklin, 806 F. Supp. 1181 (M.D. Pa. 1992) (upon motion for reconsideration by the parties, the Court reviewed its decision of September 1992 and applied the new controlling statute enacted in October 1992). In this regard, no ED rights are vested in the old law and there is no prejudice to ED. Instead the public interest is advanced. TCI meets a public need and its continuation serves the public interest.

In applying a similar legal framework that provided an institution with alternate methods of compliance with other, unrelated requirements of Title IV regulations, this Tribunal has held that ED could not require an institution to do more than comply with one of the alternatives.

[T]he regulations permit ATC to choose its method of measuring its programs, so long as it satisfies one of the alternative regulatory minimums. While OSFA may wish that ED's regulations were different, they are not and cannot be enforced as if they were.

In re Associated Technical College, Docket No. 91-112-SP, at 19 (Initial Decision Feb. 3, 1993), aff'd by the Secretary, July 23, 1993. The same reasoning applies here. The going concern provision is a statutory standard, and I find that TCI satisfies that statutory standard, even while it also satisfies the provisions of Section 498(c)(1) and (2).

This conclusion is not affected by the language of Section 498(c)(3) of the 1992 Amendments which states that the Secretary "may" find an institution is financially responsible under the four alternative tests and requires the institution to establish that it is a going concern "to the satisfaction of the Secretary." This is so because it is not the fiat of the Financial Analysis Branch that the statute requires to be satisfied, and also because the term "may" and the reference to the Secretary's "satisfaction" do not vest unbridled discretion in the Secretary to arbitrarily reject the plain evidence that TCI is a going concern.See footnote 9 [9]

In this regard, I note that ED argues here that its construction of the financial responsibility provisions of the HEA and the relevant Title IV regulations addressing financial responsibility must be accepted by this Tribunal, citing Chevron U.S.A.. Inc. v. Natural Resources Defense Council Inc. 467 U.S. 837 (1984) (Chevron). ED is wrong in its contention. This Tribunal owes no deference to unsupported interpretations, positions, or characterizations of the HEA or its implementing regulations, the source of which is an administrative component within the Department of Education. Chevron deference is owed to the Secretary. In this proceeding ED is an advocate for its position and does not speak for or stand in the shoes of the Secretary and therefore is not entitled to clothe itself in the mantle of Chevron deference. For the purposes of this case, the Tribunal also is an administrative component of the Department of Education. Interpretations should be based upon statute, legislative history and decisions of the Secretary. Expert opinions offered by an ED witness also must be given deference, but only in the area of expertise of the witness.

Concerning termination, 34 C.F.R. 668.13(a) provides: "To begin and to continue participation in any Title IV, HEA program, an institution must demonstrate to the Secretary that it is financially responsible under the standards established in this section." Although termination for cause, such as repeated flagrant violation of HEA or Title IV requirements is sometimes undertaken by ED, here the termination issue is related to eligibility or lack thereof. The wording of this provision requires that it is the institution's responsibility to demonstrate that it is financially responsible. At the same time, in this proceeding, ED has the overall burden of persuasion.

Finally, in another recent proceeding, Docket No. 93-15-ST, In the Matter of Bliss College. decided September 7, 1993, I ordered termination of Bliss. That case is similar but differs from the one at hand in at least eight particulars. Bliss is bankrupt, TCI is not. Bliss does not have a CPA opinion, TCI does. Bliss does not offer evidence from its creditors or stockholders, TCI does. Bliss intermingles its assets with other affiliated corporations, TCI does not. Bliss offers no affirmative expert evidence of its going concern status, TCI does. Bliss is not a fully successful stand-alone school because its liabilities exceed its assets, TCI is. TCI is timely in paying refunds, Bliss is not. The holding company of TCI is not in bankruptcy, that of Bliss is bankrupt.

I find that TCI is eligible to participate in SFA programs and should not be terminated.

The Fine Proceeding

According to 34 C.F.R. § 668.92(a), a fine, which is punishment, must be based on the gravity of the violation and the size of the institution.

The Termination Notice states that ED "intends to fine TCI $20,000 based on the violations set forth in Part I of this letter." (E-38). The ambiguity of the foregoing (i.e., referring to "violations" but proposing a single fine) is not clarified in ED's opening Brief because ED seeks a single $20,000 fine for two alleged violations by TCI; namely, failing to post surety in the amount of $1,500,000 and submitting its 1990 Financial Statements to OSFA 19 days late. Consequently, the Termination Notice is inherently defective. I cannot assess the reasonableness of the proposed fine without knowing how much ED proposes to fine TCI for each of the two separate and unrelated violations alleged. TCI raised this issue in its written submission, but ED has provided nothing clarifying this issue either in the form of an affidavit with its Reply Brief or through a witness at the evidentiary hearing.

However, even if ED had an evidentiary predicate for its counsel's assertion in ED's Reply Brief that the fine proposed for each violation was $10,000, the fine proceeding would still be dismissed.

With regard to the issue of surety, even if TCI had not demonstrated that it is financially responsible, thereby rendering moot the issue of the amount of surety it could be asked to post, TCI still could not be fined for not posting surety it was not legally obligated to post. This is so because 34 C.F.R. § 668.13(d)(1) is entirely discretionary, not mandatory. In other words, within certain parameters, the Secretary has discretion as to the amount of surety he requests of TCI to establish its financial responsibility, and, at that point, TCI could establish its financial responsibility under (d)(l) "if the institution" submits to the Secretary what he wants. However, TCI cannot be fined for a violation of (d)(l) since, while (d)(l) may not be complied with, (d)(l) does not state a regulatory requirement or obligation that can be violated.

An additional reason why TCI cannot be fined for not posting a $1,500,000 surety is the fact that TCI posted the surety it agreed with OSFA to post (E-17), and that letter of credit remains in effect today. (Tr. 199). TCI never agreed to post a $1,500,000 letter of credit, and thus never breached an agreement with OSFA.

With respect to the so-called late filing by TCI of one set of financial statements, the facts are as follows: ED asked TCI to submit by March 31, 1991, the audited financial statements for TCI for the year ending September 30, 1990. That deadline was later advanced to February 28, 1991, but then extended back to the original due date of March 31, 1991, as explained in the Termination Notice. (E-38).

While the Termination Notice states that TCI had not submitted the financial statements as of the date of the Termination Notice, April 23, 1991, TCI in fact submitted its financial statements on April 19, 1993 (E-36), i.e., shortly before the Termination Notice. Apparently, the financial statements were misplaced within ED's offices, and counsel for TCI submitted them again on April 29, 1991. (E-39).

ED does not contest these facts, and, in any event, a fine is to punish a school for its conduct and this minor delay does not merit a fine.

Dismissal of the fine proceeding is wholly consistent with the fact that in a fine proceeding "it is incumbent upon the tribunal to determine the nature of the appropriate sanctions." In Matter of Southern Institute of Business and Technology, Docket No. 90-62-ST, issued May 3, 1991, reprinted at 75 West's Educ. L. Rep. 1263, 1269 (Decision of Administrative Law Judge Lewis) (Southern Institute). The Tribunal has this authority under 34 C.F.R. § 668.90(a)(2), which provides:

If the designated department official brought a termination action against the institution, the administrative law judge may, if appropriate, issue a decision to fine the institution or impose one or more limitations on the institution rather than terminating its eligibility to participate.

Any fine for submitting a financial statement 19 days late is grossly disproportionate. Southern Institute considered the appropriate fine for an institution that had entirely failed to submit a required SFA biennial audit regarding that school's participation in all SFA programs. A fine of $15,000 was imposed, but provision was made for the fine to be totally annulled if the institution cured the violation by submitting the audit within 45 days of the decision. 75 West's Educ. L. Rep. at 1272. Under this standard, TCI should not be fined since the financial statements were submitted even before the Termination Notice was issued. In terms of 34 C.F.R. § 668.92, the "gravity" of the offense in my opinion does not warrant a fine. After all, fines should be used to punish willful, volitional behavior. That clearly does not obtain here.

For these reasons, no fine will be assessed against TCI.

The Bond

Since TCI has established that it is financially responsible, the $850,000 surety posted by TCI must be released. This is so as a matter of law because 34 C.F.R. § 668.13(d)(1) provides an alternative to an institution that does not meet the numeric tests under (c)(l) or (2). That institution can submit surety to the Secretary in the form of "a letter of credit payable to the Secretary in an amount established by the Secretary ...." Here, ED admits the obvious: namely, TCI meets those numeric tests. (Tr. 16-17). Therefore, the Secretary cannot demand surety of an institution that meets the numeric tests under (c)(l) or (2). Consequently, TCI is no longer obligated to maintain its $850,000 letter of credit and that surety must be released immediately, notwithstanding its current expiration date of June 30, 1994.

Findings and Order

I find:

(1) that TCI is financially responsible;

(2) that TCI is a going concern; and

(3) that TCI should not be fined $20,000 because TCI is financially responsible, because it had no obligation to post a $1,500,000 surety, because the Termination Notice is flawed and ED did not cure that flaw, because TCI submitted the financial statements prior to the Termination Notice being served, and because the 19-day delay does not warrant any punishment;

I order:

(1) that ED must take all steps necessary to have the $850,000 surety released; and

(2) that these proceedings are dismissed, with prejudice.

In the absence of a timely appeal or stay, this decision will become effective as the decision of the United States Department of Education.

Dated this 8th day of October, 1993.

Paul S. Cross
Administrative Law Judge
Office of Higher Education Appeals
U.S. Department of Education
400 Maryland Avenue, S.W.
Washington, DC 20202-3644

Footnote: 1 [1] *1/ ED witness Ronald G. Selepak, without objection from TCI, adopted the previously-submitted Affidavit of Jeffrey Raffensberger (E-1) as his own testimony and was cross-examined as to the Raffenaberger affidavit as well as his own (E-51).*

Footnote: 2 [2] *2/ R-2 is the Affidavit of Eric M. Biederman, TCI's Vice President for Administration. Mr. Biederman testified at the hearing and was available to ED to be cross-examined as to R-2. ED elected not to cross-examine Mr. Biederman. (Tr. 203).*

Footnote: 3 [3] *3/ Mr. Selepak testified that the view of the Financial Analysis Branch that TCI was not financially responsible was predicated on the very large amount of debt owed by ECCC/ECTS, TCI's parent corporation. (Tr. 22). He also testified that the Financial Analysis Branch would view TCI as financially responsible if suitable assurances could be obtained that would insulate TCI from the debt of its parent entity. (Tr. 22-23).*

Footnote: 4 [4] *4/ Even if East Coast Capital Corporation should go into bankruptcy, it is probable that the bankruptcy court would make the same judgment regarding the preservation of TCI, given the testimony presented to this Tribunal. Whatever, TCI is not bankrupt and is not in danger of bankruptcy. Moreover, bankruptcy of ECCC would automatically result in bankruptcy of TCI. Such probably would stop all Federal student assistance to TCI and would serve no purpose to anyone.*

Footnote: 5 [5] *5/ Mr. Kistler was ED's rebuttal witness.*

Footnote: 6 [6] *6/ The Title IV regulations relating to financial responsibility have not as yet been amended to reflect the Higher Education Amendments of 1992.*

Footnote: 7 [7] *7/ The financial responsibility regulations were first promulgated in 1975 under Pub. L. 92-318, § 132E, 86 Stat. 235, 264 (1972), and authorized the then Commissioner of Education to prescribe regulations providing "reasonable standards of financial responsibility" for institutions participating in the Guaranteed Student Loan programs. In 1976, in Pub. L. 94-482, § 133(a), go Stat. 2081, 2150 (1976), Congress expanded the Commissioner's authority to promulgate regulations providing "reasonable standards of financial responsibility" for institutions participating in any of the SFA programs.*

Footnote: 8 [8] *8/ ED witness Selepak admitted that TCI does meet the numeric tests (Tr. 16), and based on R-1, I so find.*

Footnote: 9 [9] *9/ ED presented the testimony of expert witness Keith Kistler who I find is a qualified Certified Public Accountant; however, I also find that he is not an expert in bankruptcy and the opinions he expressed with regard to bankruptcy and what a bankruptcy court might do if East Coast Capital Corporation were placed into bankruptcy are found to be testimony of a lay person. In Mr. Kistler's expert opinion, East Coast Capital Corporation is not a going concern, which opinion this Tribunal must respect; however, the 1992 audited financial statements for ECCC (E-52), which were prepared by Deloitte & Touche, a well-known accounting firm known as one of the Big Six (Tr. 217), did not contain a going concern qualification. Mr. Kistler conceded that Deloitte & Touche had much more information than was available to him and also that it was more likely that Deloitte & Touche did not have a substantial doubt about ECCC being a going concern based on that additional information than that Deloitte & Touche simply had erred in not including a going concern qualification in E-52 (Tr. 219-220). Ultimately, these collateral issues as to ECCC are not germane because TCI itself is financially responsible and has affirmatively proven that it is a going concern. Moreover, at the hearing, ED, through its counsel, conceded that the regulations do not require that the financial health of either a parent corporation or an affiliated corporation be considered for purposes of determining the financial responsibility of a subsidiary corporation. (Tr. 227).*