IN THE MATTER OF HARTFORD MODERN SCHOOL OF WELDING,
Respondent.

Docket No. 90-42-ST
Student Financial Assistance Proceeding

DECISION

Appearances: Dan Hagearty, Esq. of Hartford, Connecticut, for the Respondent

Stephen Kraut, Esq. of Washington, D.C., Office of the General Counsel, United States Department of Education for the Office of Student Financial Assistance

Before: Judge Allan C. Lewis

This is an action initiated by the United States Department of Education (ED) to terminate the eligibility of the Hartford Modern School of Welding (Hartford) to participate in the student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended, and to impose a fine of $300,000.See footnote 1 1/ This action was proposed following an inspection by ED and various program reviews by the Higher Education Assistance Foundation (HEAF). These reports allege that Hartford failed to administer the guaranteed student loan programs in accordance with the statute and the regulations thereunder. Based upon the foregoing findings of fact and conclusions of law, Hartford's eligibility to participate in Title IV programs is terminated and a civil fine is imposed in the amount of $105,000.

I. FINDINGS OF FACT

Hartford is a postsecondary vocational institution located in Hartford, Connecticut and accredited by the National Association of Trade and Technical Schools.See footnote 2 2/ It offers a program of "Combination Arc Welding" which consists of 300 clock hours of instruction and training that is offered in 11-week and 14- week periods. Ex. G-5, at 5.

Hartford participates in the Guaranteed Student Loan Programs (GSL) authorized under Title IV of the Higher Education Act of 1965, as amended. Jt. Ex. 1, Stip. 1. Under these programs, a student may borrow money to finance his postsecondary education. In Hartford's case, these loans are guaranteed by one of two organizations, either HEAF or the Connecticut Student Loan Foundation. Jt. Ex. 1, Stip. par. 5; Ex. G-111. For the fiscal years 1988 through 1990, Hartford's students received loans under the GSL Programs in the total amounts as follows:

Fiscal Year	No. of Students	Amount
1988	150	$ .6 million
1989	225	1.3 million
1990	200	1.1 million

Exs. G-110, 111.

Under these programs as relevant to this proceeding, ED reinsures the guarantor of the loans from any losses.

In late November 1989, ED performed an inspection of Hartford's administration of the GSL Programs. Jt. Ex. 1, Stip. par. 23; Ex. G-1. ED conducted, inter alia, an examination of 30 GSL student loan recipients who withdrew from Hartford between February 1989 and October 1989 before completing one-half of the program to determine whether Hartford's refund calculations and the amount of the refunds paid were correct. ED reviewed 28 files of students which Hartford reported as withdrawn in its October 1989 student confirmation report submitted to the Connecticut Student Loan Foundation. It also compared the student confirmation reports submitted by Hartford to the Connecticut Student Loan Foundation, one of the guarantee agencies, with its internal records in order to verify the accuracy of Hartford's reporting. Ex. G-2; Jt. Ex. 1, Stip. par. 24.

ED examined 30 GSL student loan recipients who withdrew from Hartford between February 1989 and October 1989 before completing one-half (150 hours) of the program to determine whether Hartford's refund calculations and the amount of the refunds paid were correct. Of the 30 files examined, ED and Hartford differ as to the proper amount of refund due to the lenders of eight students whose actual clock hours of attendance were less than 50 percent of the total clock hours of the course. Exs. G-1, at 2, G-2, at 27-28. The refund amounts and the refund calculations by Hartford and ED are as follows:

Student's Initials	Loan Amt. Not Paid To Student See footnote 3 3/	Clock Hrs. To Completed	Hartford's Ref. Calculation	ED's Ref. & Disbursement See footnote 4 4/ See footnote 5 5/ Calculation
L.A.	$ 4,355.53	88.5	$ 380	$ 1,355
J.C.	4,900.00	107	-0-	1,753
D.H.	3,975.20	108	-0-	1,478
S.H.	2,415.00	114	-0-	1,207
T.P.	4,900.00	88.5	-0-	2,429
G.T.	4,900.00	129	-0-	1,753
N.W.	5,420.00	105	-0-	2,272
P.R.	3,480.00	60	1,304	See footnote 6 6/ 1,540

Exs. G-64 through G-72; Tr. 83-93; Jt. Ex. 1, Stip. pars. 91-95.

Regarding the 28 files of students who were reported as withdrawn from Hartford in its October 1989 student confirmation report submitted to the Connecticut Student Loan Foundation, ED's initial investigation of Hartford's records revealed that Hartford had (1) incorrectly calculated the refunds for two students; (2) not paid refunds for 14 students; and (3) paid refunds untimely for nine students. However, further investigation into Hartford's records revealed that the June 30, 1989 entries in the check register and the concurrent entries in the student account balance cards for six of the nine students were, in fact, false in that these checks were not sent to the banks on that date and therefore these payments were not made by Hartford. Tr. 69- 70, 75, 138-139; Exs.

G-31 through G-58. The circumstances surrounding the June 30, 1989 check entries are more fully discussed below.

With respect to the unpaid refunds due to the lenders of the 14 student- borrowers as of the November 1989 review, the total amount of unpaid refunds was $37,700. Hartford's overdue payments were, at a minimum, several weeks late and, at a maximum, at least five months late at this point in the investigation. These overdue payments to the lenders were still unpaid one year later as of the November 1990 hearing. Jt. Ex. 1, Stip. pars. 26-42; Tr. 69-70.

The discovery of the six student loans which, according to Hartford's records, had been paid but were, in fact, not paid expanded ED's inquiry. It examined 42 checks prepared, dated, and signed by Hartford's president on June 30, 1989, to pay refunds due to lenders on behalf of approximately 29 students. These 42 checks totalled approximately $80,000 of which $62,244 was purportedly drawn on Hartford's corporate account and $17,514.10 was purportedly drawn on Hartford's SLS account. According to Hartford's ledger sheets, the lenders for the 29 students were paid as of June 30, 1989. Jt. Ex. 1, Stip. pars. 68-213; Exs. G-3, 25. However, Hartford did not forward these 42 checks to the lender-banks on June 30, 1989.

Hartford retained possession of the 42 checks.See footnote 7 7/ In early October 1989, Hartford released $21,037.21 in checks drawn on its corporate account. Thereafter, Hartford released the majority of the remaining checks in November 1989, and others as late as the latter part of December 1989. Jt. Ex. 1, Stip. pars. 68-213; Ex. G-27A. The record reveals the disposition of the checks as to 27 of the 29 students.See footnote 8 8/ Hartford was between four to 10 months late in refunding over $52,000 on behalf of 21 students. The 27 students had a last day of attendance during the following months and their lenders were paid refunds by Hartford as follows:

Month	No. of Students	Full Refund	Partial Refund	Other
10/88	1	1 - 10/89		
12/88	1	1 - ck not cleared, sent to wrong bank		
2/89	4	2 - 11/89	1 - 11/89 1 - 1/90	
3/89	7	5 - 11/89	1 - ck not cleared, sent 1 - 10/89 to wrong bank	
4/89	9	3 - 11/89	2 - 11/89 2 - 12/89 1 - 1/90	1 - unpaid
5/89	4	2 - 11/89	1 - 12/89	1 - unpaid
6/89	1	1 - 11/89		

Jt. Ex. 1, Stip. pars. 68-213; Ex. G-27A.

In addition to the false entries in the general ledger sheet regarding the 42 checks, Hartford also omitted this $80,000 liability in its financial statement for the fiscal year ended June 30, 1989. Moreover, it also omitted in this statement at least $126,000 in outstanding liabilities for unpaid refunds due to lenders whose loans were guaranteed by HEAF which arose from student withdrawals between 1985 and June 30, 1989. Jt. Ex. 1, Stip. pars. 9, 10, 12, 192, 193; Exs. G-25, 102. Thus, Hartford omitted in its current liabilities portion of its balance sheet approximately $206,000.

The financial statement for the fiscal year ended June 30, 1989, which was prepared by Hartford's C.P.A. as of October 13, 1989, reported assets of $672,066, liabilities of $593,585, and equity of $78,000. Ex. G-73. The current liabilities section of the balance sheet reported liabilities of $258,217. Thus, Hartford's balance sheet, as corrected for the omissions in the current liabilities of $206,000, reflected a ratio of current assets to current liabilities of less than 1:1, i.e. a ratio of 1:1.13 ($258,217 + 206,000/$410,188). As corrected, its net worth was a negative $128,000, i.e. $78,000 - ($206,000).

As part of ED's inspection, it also examined whether Hartford was submitting accurate information in its student confirmation reports filed with the guarantee agencies. This report indicates the names of students participating in the student loan programs, their start dates and their end dates. The school completes the report by indicating as to each student enrolled whether the student is a full, half or less than half time student and, as to each student not enrolled, whether the student was never enrolled, withdrew or graduated and the status date thereof. In this regard, ED sought to verify as to 30 students selected from the May and October 1989 reports submitted to the Connecticut Student Loan Foundation whether their reported student status was consistent with their status as reflected in Hartford's records. Tr. 104; Exs. G-6, G-7, G-74. Hartford's student confirmation reports and Hartford's records reflected the following discrepancies in the May 1989 report and the October 1989 report, respectively--

Student's Initials Confirm. Rep. Status Hartford's Rec. Status
W.B. w/drew 3/30/89 never enrolled
J. Cardona completed 2/3/89 completed 4/6/89
M.F. graduated 4/14/89 w/drew after 222 hrs
R.T. graduated 3/28/89 w/drew 3/28/89,
completed 145 hrs

Student's Initials Confirm. Rep. Status Hartford's Rec. Status

J. Cary full time student last day 6/16/89
D. Garner graduated 7/15/89 completed 275 hrs
D. Gonzalez w/drew 5/24/89 last day 6/30/89
R.G. full time student last day 10/20/89
S.H. full time student last day 8/4/89
M.L. full time student last day 10/6/89
G.P. full time student graduated 10/13/89

G.T. full time student last day 10/29/89
N.W. full time student last day 9/29/89
L.S. graduated 10/18/89 graduated 9/27/89

Exs. G-6, G-74 through G-82, G-84 through G-87.

ED questioned Hartford's use of a lapse time concept rather than an actual time concept in determining the amount of a student's refund where the student did not complete the course. Under Hartford's refund policy, the school was entitled to retain an increasing portion of the student's total tuition over the course of the program. In general, the school retained 10% of the contract price plus $150 but not more than $350 in the event a student withdrew within the first week of class. Where a student withdrew after the first week but within the first 25% of the course, the school retained 25% of the contract price plus $150. In the event a student withdrew after the first 25% of the course but within the first 50% of the course, the school retained tuition charges not to exceed 50% of the contract price plus $150. Where a student withdrew after the first 50% of the course, the school retained the full contract price. Ex. G-5, at 10.

Hartford compiled its student attendance records under the following procedure. The instructor indicated each day on a weekly roster the number of hours of attendance by each student. The total number of hours in attendance for each week was then posted to each student's attendance card. The posting did not reflect the days of the week the student was in attendance or the number of hours attended on each day of the week. Thereafter, the weekly roster was disposed. Tr. 98-99, 148-149; Ex. G-88;

In calculating the amount of refund due a student, Hartford utilized a lapsed time concept rather than the actual period of time in which the student attended the course. Thus, for example, a student was considered to have completed three weeks of the course after the third week of the course even though his actual clock hours of attendance including excused absences was substantially less, such as two weeks. Tr. 152-53. In addition, Hartford calculated the refund due a student or his lender on the basis that the student attended the entire week of the student's last week in attendance even though the student dropped out or withdrew before completing the week's program. Jt. Ex. 1, Stip. par. 191. Thus, some students were charged for classes they never attended and paid for a percentage of the program they never received. The record does not reflect the extent to which Hartford, assuming this method was incorrect, benefited thereby to the detriment of some of its students. Tr. 98-101.

During the period in issue, the cancellation and settlement policy of Hartford's accrediting organization, the National Association of Trade and Technical School, was--

1. Termination Date. The termination date for refund computation purposes is the last date of actual attendance by the student.

. . . .

3. Application of Policy.

. . . .

(c) Percentage of course completion is calculated using a ratio the numerator of which is the number of clock, credit, quarter, or semester hours (or other academic periods as set forth in the

catalog) actually completed by the student, and the denominator of which is the number of clock, credit, quarter, or semester hours (or other academic periods as set forth in the catalog) required to complete the course.

Ex. G-114, at 1.

There were six instances in which students were granted a leave of absence without a written request to the school and one instance in which a leave of absence exceeded 60 days. Ex. G-2 at 19; Tr. 101.

Hartford did not submit to ED a financial and compliance audit of its GSL Programs for the fiscal year ending June 30, 1984. Ex. G-63. For the fiscal years ending June 30, 1985 through 1988, Hartford submitted to ED its financial and compliance audits on November 14, 1989. Exs. G-112, 113. However, these audits were unacceptable and inadequate in the view of ED because (1) they failed to include an auditor's opinion on compliance of the institution regarding its system of internal control for documents and records; (2) they failed to include a statement of positive and negative assurances; and (3) the CPA's working papers were deficient or contained several areas of erroneous conclusions. Hartford stipulated that these audits were not acceptable as they were not performed in accordance with general accepted standards of the Department of Education and the standards for financial and compliance audits of the General Accounting Office. Jt. Ex. 1, Stip. pars. 16-20; Ex. G-63; Tr. 42-46.

On January 17, 1989, Hartford and HEAF executed a limitation agreement that governed Hartford's further participation in the GSL programs overseen by HEAF. Under the agreement, Hartford estimated $20,000 as the amount of loan proceeds which it had not repaid or refunded to lenders on behalf of students and was required to pay HEAF immediately $10,000. Thereafter, Hartford was required to pay an additional $10,000 within 30 days and following that payment, $4,000 per month until the balance of the unpaid loans and other charges were paid in full. In addition, Hartford agreed to calculate the amount of refunds it had not paid and, further, agreed to repay those outstanding refunds to HEAF. HEAF, in turn, agreed to repay those refunds to the relevant lenders. Jt. Ex. 1, Stip. pars. 7, 8; Ex. G-96.

Pursuant to the limitation agreement, Hartford reported to HEAF in March 1989 that it had failed to pay approximately $126,000 in refunds to lenders over the last four years. Jt. Ex. 1, Stip. par. 9; Ex. G-97. By January 1990, the outstanding balance rose to $175,000 which represented refunds due lenders on behalf of 105 students over the four-year period of 1985 through 1989. Jt. Ex. 1, Stip. pars. 10-12; Ex. G-102. Hartford continued to make the $4,000 per month payments until June 1990 when it failed to make its monthly payment. On June 29, 1990, HEAF notified Hartford that it was terminated, effective June 16, 1990, from participating in its guaranteed loan programs. Tr. 183- 184; Jt. Ex. 1, Stip. par. 14; Ex. G-107.

Hartford's financial statement for the fiscal year ended June 30, 1988 reflected a deficit net worth and a ratio of current assets to current liabilities of less than 1:1, i.e. 1:4.1. Ex. G-1 at 4-5. By March 1989, Hartford submitted, as requested by ED, a one year letter of credit in the amount of $100,000 which expired March 15, 1990. Ex. G-73 at 11. On January 24, 1990, ED requested Hartford to continue the letter of credit until March 30, 1991, since its financial condition had not

changed markedly. It was to submit this new letter of credit within 30 days. Jt. Ex. 1, Stip. par. 2; Ex. G-108. The purpose of a letter of credit is to provide funds to pay refunds to lenders or for a "teachout" of the current students attending an institution in the event an institution ceases doing business. Tr. 26-27. This demand for the letter of credit was repeated again on February 19, 1990. Hartford has not submitted the letter of credit as requested by ED. Jt. Ex. 1, Stip. pars. 3, 4.See footnote 9 9/

II. OPINION

In this action, ED seeks to terminate the eligibility of Hartford to participate in the student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended, and to impose a fine of $300,000. With respect to jurisdiction, ED notified Hartford on May 22, 1990, of its intent to terminate the institution from participation in the Title IV programs and to fine the institution in the amount of $300,000. Ex. G-1. On August 2, 1990, the United States District Court for the District of Connecticut enjoined ED from terminating Hartford's participation in Title IV programs and from imposing fines against Hartford pending a hearing on the merits before an Administrative Law Judge. The District Court also concluded that Hartford's request for a hearing on the record was filed within the period prescribed by law. Hartford Modern School of Welding, Inc. v. United States Dep't of Education, Civil No. H 90-518 (TEC) at 8-9.

A. Termination Issue. ED is authorized under Section 487(c)(1)(D) of the Higher Education Act of 1965, as amended by Section 451.(a) of the Education Amendments of 1980, Pub. L. 96-374, 94 Stat. 1367 (to be codified at 20 U.S.C. § 1094(c)(1)(D)), to prescribe regulations for--

(D) the limitation, suspension, or termination of the eligibility for any program under this subchapter . . . of any otherwise eligible institution, or the imposition of a civil penalty under paragraph (2)(B) whenever the Secretary has determined, after reasonable notice and opportunity for hearing on the record, that such institution has violated or failed to carry out any provision of this subchapter . . . or any regulation prescribed under this subchapter . . . .

Pursuant to this authority, the ED promulgated 34 C.F.R. § 668.86(a) (1990)See footnote 10 10/ which provides that--

the eligibility of an institution to participate in any or all Title IV, HEA programs [may be limited or terminated] if the institution violates any provision of Title IV of the HEA or any regulation or agreement implementing that Title.

ED proposes to terminate Hartford's eligibility to participate in the student loan programs due to its lack of financial responsibility under 34 C.F.R. § 668.13 and its failure to administer these programs in a manner consistent with its responsibility as a fiduciary.

In order to begin and to continue to participate in the student loan programs, an institution must demonstrate to ED that it is financially responsible under the standards established in 34 C.F.R. § 668.13. 34 C.F.R. § 668.13(a). In general, ED considers an institution financially responsible if, inter alia, it is able to "meet all of its financial obligations." 34 C.F.R. § 668.13(b)(3). However,

an institution is not considered financially responsible if, for its latest fiscal year, it "[h]ad . . . a deficit net worth" (34 C.F.R. § 668.13(c)(1)(ii)) or under its "accrual basis of accounting, it had . . . a ratio of current assets to current liabilities of less than 1:1." 34 C.F.R. § 668.13(c)(2). Even if an institution is considered not financially responsible under the above, the "Secretary may determine an institution to be financially responsible . . . if the institution submits . . . a letter of credit . . . in an amount established by the Secretary." 34 C.F.R. § 668.13(d)(1).

In the instant case, Hartford's financial statement for the fiscal year ended June 30, 1988 reflected a deficit net worth and a ratio of current assets to current liabilities of less than 1:1, i.e. 1:4.1. Thus, under the above regulation, Hartford was not considered financially responsible. However, by March 1989, Hartford submitted a one-year letter of credit in the amount of $100,000 as requested by ED and, as a result thereof, was considered financially responsible. Subsequently, Hartford submitted its financial statement for the next fiscal year, i.e. 1989, which reflected a nominal positive net worth and a slightly positive current ratio. Under these circumstances and in light of the significant amount of unpaid refunds due to HEAF on behalf of its former students, it was reasonable and consistent with the regulations for ED to request an additional one-year extension of the letter of credit which was due to expire on March 15, 1990. The 1989 financial statement misrepresented substantially Hartford's net worth and current ratio. As corrected for the intentional omission of current liabilities in the approximate amount of $206,000, Hartford's net worth was a negative $128,000. Its current ratio, as corrected, was less than 1:1, i.e. 1:1.13. Accordingly, under 34 C.F.R. §§ 668.13(c)(1)(ii) and (c)(2), Hartford is not considered financially responsible to continue in the student loan programs.

Next, ED asserts various grounds in support of its position that Hartford is not administering the student loan programs in a proper manner. In general, an institution continues to have administrative capability if, inter alia, it "maintains student and financial records required under § 668.23 and the individual Title IV, HEA program regulations." 34 C.F.R. § 668.14. In administering the programs and in accounting to ED for the funds received under these programs, an institution "acts in the nature of a fiduciary" and, as such, is "subject to the highest standard of care and diligence." 34 C.F.R. §§ 668.82(a) and (b). An institution's failure to act in accordance therewith "constitutes grounds for a fine, or the suspension, limitation or termination of the eligibility of the institution to participate in those programs." 34 C.F.R. § 668.82(c).

Initially, ED contends that Hartford failed to submit a financial and compliance audit for the fiscal year ending June 30, 1984. Regulations in effect during the applicable program period rather than current regulations govern the disposition of issues concerning matters of compliance with a program. Bennett v. New Jersey, 470 U.S. 632 (1985); In re Temple University, Dkt. No. 89-26-S, U.S. Dep't of Education (Jan. 29, 1990). Under 34 C.F.R. § 668.12(a) (1984), an institution which participates in the GSL and PLUS programs is required to comply with the specific program regulations concerning the biennial audits of the institution's transactions. Under the

GSL and PLUS programs, a school is required to have an audit performed at least once every two years in accordance with ED's audit guides. 34 C.F.R. §§ 682.612(e) and 683.91(f). The audit provides an external means of evaluating the accuracy of an institution's determination of students' eligibility, its awarding and disbursing of aid, and its refunds of students' unearned

tuition and other costs. Pursuant to 34 C.F.R. §§ 682.612(e)(4) and 683.91(f)(4), "[t]he school shall submit the audit report to the appropriate regional office of . . . [ED] for review." In the present case, Hartford did not submit its audit for 1984 and therefore has not complied with the regulations.

ED also asserts that Hartford failed to submit acceptable biennial financial and compliance audits for the fiscal years 1985 and 1986 and the fiscal years 1987 and 1988 within the period prescribed by 34 C.F.R. § 668.23(c)(4)(ii) (1990), i.e. by January 31 of the year following the end of the award year being audited. These two biennial audits were submitted on November 14, 1989. Relying on this regulation, ED maintains that Hartford submitted its biennial audit for 1985 and 1986 approximately 33 months late and its biennial audit for 1987 and 1988 approximately nine months late. ED relies upon the wrong regulations. As noted in the preceding paragraph, the regulation in effect during the applicable program period govern. While the school is required under 34 C.F.R. §§ 682.612(e) and 683.91(f) (1986) to submit an audit, these regulations do not establish a specific date for the submission. In this circumstance, it is consistent with the regulation to require the submission of the biennial audit within a reasonable period of time following the end of the last fiscal year. A seven to eight month period of time for a submission is reasonable. Hence, Hartford was approximately 33 months late in filing its biennial audit for 1985 and 1986.

With respect to the fiscal years 1987 and 1988, the regulations in effect required the submission of a biennial audit by January 31 of the year following the last award fiscal year. 34 C.F.R. § 668.23(c)(4)(ii) (1988). Hence, this biennial audit was due by January 31, 1989. The biennial audit was submitted in November 1989 which was nine months late. Accordingly, Hartford violated the regulations in failing to submit two biennial audits in a timely fashion.See footnote 11 11/

ED asserts that Hartford's nonpayment and late payment of refunds to lenders on behalf of withdrawn students constitutes a serious failure on its part to administer properly the GSL and PLUS programs. Prior to July 20, 1989, a school was required, according to 34 C.F.R. § 682.607(c) (1988), to "pay each refund that is due--(1) [w]ithin 30 days after the date of the student's withdrawal from the school . . . ." For the period after July 20, 1989, the school was required to make the refund within 60 days after the student's withdrawal. 34 C.F.R. § 682.607(c)(1) (1989).

As of November 1989, Hartford failed to pay refunds to lenders in the total amount of $37,700 on behalf of 14 students. These refunds were, at a minimum, several weeks beyond the period within which the refunds were to be made and, at a maximum, at least five months late under the regulations. These refunds were still unpaid as of the November 1990 hearing. More importantly, and as a separate matter, Hartford had also, as of March 1989, failed to pay approximately $126,000 in refunds due to lenders on behalf of its former student which extended over a four-year period from 1985 through 1989. By

January 1990, the balance due to these lenders rose to $175,000 which represented refunds due on behalf of 105 students. Thus, Hartford failed to make refunds to lenders on behalf of its students in significant amounts over a four-year period in violation of 34 C.F.R. § 682.607(c)

(1988) and 34 C.F.R. § 682.607(c)(1) (1989).

In addition, ED's study of 42 checks purportedly issued on June 30, 1989, indicated that Hartford was between four to 10 months late in refunding over $52,000 on behalf of 21 students. These untimely payments by Hartford violated 34 C.F.R. § 682.607(c) (1988) and 34 C.F.R. § 682.607(c)(1) (1989).

ED submits that Hartford failed to maintain complete and accurate books and records in administering the loan programs. In general, an institution is required to--

(1) Establish and maintain proper administrative and fiscal procedures and all necessary records as set forth in the regulations in this part and in 34 CFR Part 668 in order to--
(i) Protect the rights of students and parent borrowers;
(ii) Protect the United States from unreasonable risk of loss; and
(iii) Comply with any specific requirements in those regulations; and
(2) Submit all reports required by this part and 34 CFR Part 668 to the Secretary.

34 C.F.R. § 682.610(a)(1).

Regarding refunds of unearned tuition or other costs, 34 C.F.R. § 668.23(f)(1)(iv) provides that an institution shall "maintain, on a current basis, records regarding . . . [a]ny refunds due or paid to the student, the Title IV, HEA program account(s) and the student's lender under the GSL, PLUS, and SLS programs."

ED asserts that Hartford intentionally maintained misleading records regarding the purported payment on June 30, 1989, of 42 refunds in the total amount of $80,000 to lenders on behalf of 29 students. On June 30, 1989, Hartford's president signed 42 checks reflecting refunds to lenders; however, Hartford retained possession of these checks. Despite the retention of the checks, Hartford made entries in the 29 ledger sheets of the students reflecting that the refunds due were, in fact, paid as of June 30, 1989. Even though partial or full refunds were made in most of the cases, Hartford maintained, intentionally, misleading records in contravention of 34 C.F.R. §§ 682.610(a)(1) and 668.23(f)(1)(iv).

ED asserts that Hartford obtained GSL and PLUS loan proceeds prematurely for the second payment period in violation of the two payment period concept. Where an institution, such as Hartford, does not use a semester, trimester or quarter academic period, the award of loans for its students is made in two payments. The payment for the first period reflects the payment for the period from the beginning of the academic year to the midpoint and the second payment represents the payment for the period between the midpoint and the end of the academic year. 34 C.F.R. § 668.22(c). Thus, Hartford was entitled to draw upon a student's loan proceeds in two installments.

Of the 58 student files examined, ED asserts that Hartford received and subsequently failed to refund amounts owing to eight students for the last half of the course since these students withdrew before completing the first period. In each instance, the student attended the school over a period longer than half of the length of the course although his actual total hourly

attendance in the course was less than half of the clock hours of the course, i.e. each student had between 60 and 129 hours of actual attendance in the 300 clock hour course over a period in excess of seven weeks. The apparent explanation for Hartford's treatment is that it utilized the lapsed time concept rather than an actual time or attendance concept in ascertaining the amount of time a student attended the institution for purposes of determining that portion of the tuition in its possession which represented earned and unearned tuition. Thus, in these cases, Hartford argues that each student attended the institution for more than one-half of the course under the lapsed time concept and, therefore, the institution was entitled to retain all of the student's tuition.

ED argues that Hartford's use of the lapse time concept was in derogation of the cancellation and settlement policy of Hartford's accrediting organization and, therefore, Hartford's failure to make appropriate refunds in conformance with the policy of its accrediting organization in these eight instances violated 34 C.F.R. § 682.606(b). Under this regulation, Hartford must have a fair and equitable refund policy which provides--

> for a refund of at least the larger of the amount allowed under State law or the refund standards established by the school's nationally recognized accrediting agency and approved by the Secretary.

Regarding the lapsed versus actual time concept, the standard adopted by the National Association of Trade and Technical School, Hartford's accrediting organization, was the actual time concept in determining a refund due a withdrawn student--

> 3. Application of Policy.
> . . . .
> (c) Percentage of course completion is calculated using a ratio the numerator of which is the number of clock, credit, quarter, or semester hours (or other academic periods as set forth in the catalog) actually completed by the student, and the denominator of which is the number of clock, credit, quarter, or semester hours (or other academic periods as set forth in the catalog) required to complete the course.

(Emphasis added.)

Thus, Hartford's policy was inconsistent with the policy of its accrediting organization and therefore its policy as reflected in these eight instances violated 34 C.F.R. § 682.606(b). As a result thereof, Hartford improperly retained approximately $12,000 of refunds which should be paid to these students.

In addition, ED's charge that Hartford failed to keep accurate attendance records represents, in essence, a reiteration of the lapsed time versus actual time argument. Hartford maintained attendance records for each student which indicated only the total number of hours a student attended class during a week. This is consistent with the lapsed time concept. ED asserts that the attendance records should reflect the number of hours attended each day of the week by the students. This is consistent with the actual time concept and the basis for ED's contention that Hartford's records were inaccurate. Therefore, Hartford's records were accurate under its method;

however, its policy which led to the manner in which they were kept violated 34 C.F.R. § 682.606(b) as noted in the preceding paragraph. As such, the "inaccuracy" matter to the extent it exists is subsumed within the policy violation. The significance of the lapsed time concept over the actual time concept is that, in certain limited situations where a student withdrew before completing one-half of the course, the institution will retain a larger percentage of the tuition under the lapsed time concept than it would be entitled under the actual time concept. Other than the eight instances referred to above, the record does not reflect the extent to which Hartford benefited from its erroneous policy.

Under 34 C.F.R. § 682.610, an institution is required to "complete and return, within 30 days of receipt . . . [a student confirmation] report to the Secretary or the guarantee agency, as appropriate." This report indicates the names of students participating in the student loan programs, their start dates and their end dates. The school completes the report by indicating as to each student enrolled whether the student is a full, half or less than half time student and, as to each student not enrolled, whether the student was never enrolled, withdrew or graduated and the status date thereof. The purpose of the student confirmation report is to provide the guarantee agency with up-to-date information so that the party responsible for the interest payments on a student loan may be ascertained, i.e. the student or the United States which is responsible for the interest payments while the student is attending school.

ED maintains that Hartford submitted two student confirmation reports to the Connecticut Student Loan Foundation in a manner inconsistent with its fiduciary duty. In its view, a fiduciary must "exercise reasonable care, or common skill, common prudence, and common caution, and that he refrain from negligent acts of commission or omission, or willful defaults." 90 C.J.S. Trusts § 247.d (1955). The tribunal agrees with ED regarding the standard of care to be exercised by a fidicuary. ED alleges that Hartford misreported 14 of 30 students selected from the reports submitted in May and October, 1989. Given the number of students for whom information was sought in each report, a reasonable period over which each report was prepared, and that the critical information regarding a non-attending student was when he left the institution and not whether he graduated or withdrew (Tr. 108), the tribunal finds only seven instances of the 14 alleged misstatements in which the information was arguably materially misrepresented. In light of the number of students for which information was submitted, i.e. over 200 students in each report, it cannot be found that two instances in one report and five instances in the other report represent a sufficient quantity of errors to constitute a negligent preparation of each report.

An institution is required to pay a refund within 30 days after the last day of an approved leave of absence. 34 C.F.R. § 682.607(c)(2). An approved leave of absence requires a student to submit "a written request to be granted a leave of absence" and that it not exceed generally "60 days" in any twelve month period. 34 C.F.R. §§ 682.605(c)(1) and (c)(3). There were six instances in which students were granted a leave of absence without a written request to the school and one instance in which a leave of absence exceeded 60 days. Accordingly, Hartford did not comply with 34 C.F.R. §§ 682.605(c).

Lastly, ED asserts that Hartford breached its fiduciary duty to administer the student loan programs when its owner, Mr. Annecharico, purportedly failed to abide by his debarment which precludes him from participating "in any covered transaction under the non-procurement

programs and activities of any Federal agency." ED's proposed findings of fact on this matter as well as its legal argument are not relevant in the present proceeding. Under 34 C.F.R. § 668.86(b)(1)(i), ED must identify in its notice of termination "the violations which constitute the basis for the action." Such notice is a fundamental aspect of due process and, as a rule which governs the proceedings, it must be scrupulously observed by the agency. See Service v. Dulles, 354 U.S. 363 (1957).

In the instant case, the notice of termination alleges seven detailed areas of purported violations, one of which was Hartford's failure to administer the loan programs properly. This latter alleged impropriety did not include, as a ground for termination, Hartford's breach of its fiduciary duty to administer the loan programs by virtue of any actions by Mr. Annecharico. Inasmuch as this ground for termination was not included within the notice of termination and therefore Hartford did not have notice of this ground as required by the 34 C.F.R. § 668.86(b)(1)(i), it is not properly a matter for consideration in this proceeding.See footnote 12 12/

Where, as here, there are violations of the regulations by the institution in a termination proceeding, it is incumbent upon the tribunal to determine the nature of the appropriate sanctions. In this regard, the Administrative Law Judge may--

> issue a decision to fine the institution or impose one or more limitations on the institution rather than terminating its eligibility to participate.

34 C.F.R. § 668.90(a)(2).

While the tribunal may impose sanctions other than termination, it is not appropriate in this case. The violations are numerous and the combined nature and extent of the violations are significant, particularly Hartford's submission of a false financial statement and the correlative matters related thereto, its failure to make refunds, its failure to submit its biennial audit for the fiscal year 1984, and its lack of financial responsibility. Accordingly, Hartford's eligibility to participate in the student loan programs is terminated.

B. Fine Issue. In addition to the termination of the eligibility of Hartford to participate in the student loan programs, ED also proposes a total civil fine in the amount of $300,000. Under Section 487(c)(2)(B)(i) of the Higher Education Act of 1965, as amended by Section 451.(a) of the Education Amendments of 1980, Pub. L. 96-374, 94 Stat. 1367 (to be codified at 20 U.S.C. § 1094(c)(2)(B)(i)), the Secretary "may impose a civil penalty upon an institution of not to exceed $25,000 for each violation or misrepresentation" of any provision of this subchapter or any regulation thereunder.

In determining the amount of the fine, 34 C.F.R. § 668.92(a) provides that the Administrative Law Judge and the Secretary "shall take into account . . . [t]he gravity of the violation . . . and [t]he size of the institution." The gravity of the violation reflects the relative degree of the seriousness of the violation vis-a-vis other violations as well as the relative nature and extent of the violation itself. In addition, an imposition of a fine functions as a "punishment of the offender as well as [a] warning to others." In re Caguas College of Technology and Science, U.S. Dep't of Education (Oct. 25, 1988) at 10.

In determining the amount of the fines, Hartford is a small-to-medium size institution. Hartford had approximately 200 students each year who received student loans in the total amount of approximately $1.2 million for the fiscal years 1989 and 1990. There are proprietary institutions substantially larger and smaller than Hartford in terms of the total amount of loans received annually by their students, e.g. students received approximately $12 million in student loans in In re Trend Colleges, Inc., Dkt. No. 90-56-ST, U.S. Dep't of Education (case pending before the tribunal), $7 million in student loans in In re Deloux Schools of Cosmetology, Dkt. No. 89-59-S, U.S. Dep't of Education (Oct. 30, 1990) at 52, and $100,000 in student loans in In re Katie's School of Beauty Culture & Barbering, Dkt. No. 90-68-ST, U.S. Dep't of Education (case pending before the tribunal).

ED proposes a fine in the amount of $25,000 based on Hartford's failure to pay $212,700 in GSL refunds due lenders on behalf of 119 of its students. In its view, the amount of this fine is more than fair in light of the $500 per each unpaid refund levied in In re Eastern Technical School, U.S. Dep't of Education (June 24, 1989) and the $1,000 per each unpaid refund levied in In re Deloux Schools of Cosmetology. ED argues that unpaid refunds increase the amount of reimbursements and interest and special allowances incurred by ED on the theory that students who recognize that Hartford has knowingly and erroneously retained their refunds will be less likely to pay off their loans and therefore the Department, as the reinsurer of their student loans, will have to pay these losses. In addition, the students will suffer from poor credit ratings as a result of their defaults and become ineligible to obtain additional Title IV funds to pursue other education.

A fundamental aspect of the student loan system requires that the student loans be repaid. To the extent that loans are not repaid by the borrowers this factor weighs heavily upon the ability of the system to continue. Where an institution fails to pay refunds to a lender on behalf of students, this action is tantamount to the conversion of funds by the institution and, most definitely, reflects the preference by the institution of other creditors or parties over the lenders and the students. This is a severe violation. In the instant case, the average unpaid loan is approximately $1,700 and a fine of $500 or $1,000 per unpaid refund would appear excessive. While some of these loans are outstanding for five years at this point, ED bears the burden of proof and has not proposed any findings of fact which reflect the amount of outstanding loans in relation to the period over which the loans are unpaid. However, even assuming that these unpaid loans were outstanding for a short period of time, a fine in the amount of $25,000 is warranted by virtue of the significant number of unpaid refunds and the nature of the violation.

ED seeks a fine of $25,000 for the late payment of refunds caused by Hartford's retention of 42 checks on June 30, 1989, and four other instances uncovered by ED in its inspection. While the failure to pay refunds constitutes a severe violation, its gravity may be lessened by the payment thereof prior to the issuance of a termination notice. As a result of the retention of the 42 checks on June 30, 1989, Hartford was between four to 10 months late in making full or partial refunds payments in the total amount of approximately $52,000 for 21 students. This represents a moderate violation. The record does not reflect the period over which the three untimely refund payments discovered in the sample of 28 students were outstanding or the total amount of the late paid refunds. In light of these facts, a fine in the amount of $5,000 is appropriate.

ED requests a fine in the amount of $25,000 based upon Hartford's failure to submit one audit for the fiscal year 1984. Failure to submit audits is extremely serious as it hampers ED and increases its costs in determining whether and to what extent institutions may be indebted to ED and to lending institutions for improperly disbursed funds and awarded loans. In re D'or School of Cosmetology and D'or Beauty College, Inc., U.S. Dep't of Education (Aug. 18, 1988) at 9-10. Thus, only the size of the institution is a factor which warrants a reduction in the amount of the fine from the maximum permissible amount where Hartford did not file its financial and compliance audit for the fiscal year 1984. Accordingly, a fine in the amount of $20,000 is imposed for this violation.

In addition, ED proposes two fines of $20,000 each for the late submission of two biennial audits. Ex. G-1 at 4, 6. ED correctly recognizes that there is only one violation, not two separate violations, for the late submission of a biennial audit under 20 U.S.C. § 1094(c)(2)(B)(i)). Moreover, ED also recognizes that the submission of an unacceptable audit is not the violation for which these fines were sought in the notice of termination and fine. Thus, this factor is not a consideration in establishing the amount of the fine. Therefore, the pertinent facts are that Hartford submitted the biennial audit for the fiscal years 1985 and 1986 approximately 33 months late and submitted the biennial audit for the fiscal years 1987 and 1988 approximately nine months late. The audit process is obviously a significant aspect of the student loan system and it is hindered by the failure of an institution to undergo in a timely fashion this evaluation process and submit its results to ED. A biennial audit which is submitted nine months late constitutes a minimal-to-moderate violation. A biennial audit which is submitted 33 months late reflects a severe violation. In these circumstances, it is appropriate to fine Hartford $10,000 for the biennial audit submitted nine months late and $18,000 for the biennial audit submitted 33 months late.

ED demands a fine of $25,000 based upon Hartford's misrepresentation of its financial condition in its financial statement for the fiscal year ended June 30, 1989 and a fine of $20,000 as a result of Hartford's failure to submit the $100,000 letter of credit requested by ED. Under 20 U.S.C. § 1094(c)(2)(B)(i)), a fine may be assessed for a violation or misrepresentation of a regulation or statutory provision. Neither the statute governing the student loan programs nor the regulations require an institution to submit a letter of credit where such a request by ED is made. The voluntary submission of a letter of credit simply allows an institution to establish that it is financially responsible under 34 C.F.R. § 668.13 even though it fails to qualify under subsection (c) thereof due to a negative net worth, poor current ratio, or successive losses. Thus, the proposed fine based on Hartford's failure to furnish the letter of credit lacks a legal basis and must be denied. As indicated earlier however, Hartford was not financially responsible under 34 C.F.R. § 668.13 due to its negative net worth and its current ratio. Moreover, Hartford intentionally misrepresented its financial condition to ED. At the hearing, it did not offer any evidence which indicated that its financial condition would improve. In these circumstances, this represents a severe violation. In determining the amount of the fine, only the size of the institution warrants a reduction in the amount. Accordingly, a fine in the amount of $20,000 is imposed.

ED proposes, in effect, two fines for Hartford's use of a lapsed time concept as opposed to the actual time concept in determining the amount of a refund due to a student where the student

withdrew from the institution sometime prior to completing one-half of the course. This method of determining student attendance violated 34 C.F.R. § 668.22(c). In some instances, the effect of this approach diminishes the amount of a refund due to a student and, correspondingly, benefits the institution. This constitutes a serious violation. ED seeks one fine in the amount of $15,000 due to eight instances between February, 1989 and October, 1989 in which Hartford retained the tuition attributable to the last of the two award periods. This resulted in Hartford retaining $12,000 in refunds erroneously. The second fine in the amount of $25,000 is proposed as a result of Hartford's use of the lapsed time concept in its attendance records which possibly affected some students who withdrew before completing 25 percent of the course. Like the situation addressed in the first proposed fine, Hartford retained a portion of the student's tuition to which it was otherwise not entitled. Unlike the first situation, however, ED has not established the extent to which Hartford benefited from this erroneous policy. In light of these circumstances, it is appropriate to fine Hartford $5,000 for these two infractions.

ED requests a fine in the amount of $25,000 based on the false entries of June 30, 1989, in the books and records which indicated the payment of refunds in the amount of $80,000 involving 29 students.See footnote 13 13/ These entries were false because Hartford retained the 42 checks representing the refunds created as a result of the retention of 42 checks dated and signed on June 30, 1989, involving 29 students. On balance, this is a minimal-to-moderate type violation at best, especially in view of the fact that the majority of the checks cleared the banks within the next five months. Accordingly, a fine of $2,000 is warranted.

ED proposes a fine of $25,000 for Hartford's failure to meet the regulatory requirement for administrative capability. The alleged violations upon which this fine is proposed are the numerous alleged violations discussed above for which separate fines were sought and levied. Thus, there is no basis for this fine. It is, therefore, rejected. Lastly, ED's request for a fine of $25,000 based upon Hartford's submission of alleged inaccurate student confirmation reports to the Connecticut Student Loan Foundation is rejected since there was a previous determination that a violation had not occurred.

In summary, it is determined that fines in the total amount of $105,000 are appropriate in light of the size of Hartford and the gravity of the violations.

III. ORDER

On the basis of the foregoing findings of fact and conclusions of law, and the proceedings herein, it is hereby--

ORDERED, that the eligibility of Hartford to participate in the student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended, is terminated; and it is further

ORDERED, that Hartford immediately and in the manner provided by law pay fines in the total amount of $105,000 to the United States Department of Education.

.....
Allan C. Lewis
Administrative Law Judge

Issued: January 31, 1991
Washington, D.C.

Footnote: 1 *1/ More specifically, ED seeks to terminate Hartford from participating in the Pell Grant, Supplemental Educational Opportunity Grant, Perkins Loan, and College Work-Study programs, and the Guaranteed Student Loan programs which includes the Stafford Loan, PLUS, and Supplemental Loans for Students programs.*

Footnote: 2 *2/ At the conclusion of the hearing, the parties were ordered to submit requested findings of fact and a brief. Hartford failed to comply with the order. These findings address all the requested findings of fact submitted by ED.*

Footnote: 3 *3/ In many instances, the student received a Stafford loan and an SLS loan. This is total amount of the initial loans which was not disbursed to*

the student and retained by Hartford.

Footnote: 4 *4/ This figure does not include excused and unexcused absences of the student. Tr. 89-90.*

Footnote: 5 *5/ This is the amount of the refund determined by Hartford after the student withdrew and was subsequently paid by Hartford on behalf of the student to the student's lender.*

Footnote: 6 *6/ Hartford has not paid the refund to the P.R.'s lender. Hartford did prepare a check made payable to Citibank, which was not P.R.'s lender, in the above amount and dated it June 30, 1989. Even as to the Citibank check, there is no evidence that this check was cleared by Citibank. Jt. Ex. 1, Stip. pars. 91-95.*

Footnote: 7 *7/ Hartford was well aware that the 42 checks were not sent to the banks since they were not reflected as outstanding in the bank statement reconciliations prepared by it for the months of June, July, August and September, 1989, Jt. Ex. 1, Stip. pars. 47, 52, 57, 62, 67, 72, 77, 82, 89, 96, 101, 105, 113, 118, 123, 128, 134, 141, 147, 153, 158, 163, 169, 175, 180, 185, 190.*

Footnote: 8 *8/ The proposed findings of ED do not address the fate of two students whose refunds were drawn on the corporate account by checks numbered 3785 and 3799.*

Footnote: 9 *9/ ED proposes several findings of fact concerning the purported debarment of Robert Annecharico, Hartford's owner and chief executive officer. These proposed findings are not relevant to the present proceedings as more fully explained in the opinion since this*

allegation was not "identif[ied] as alleged violations which constitute[d] the basis for the action" in the termination and fine notice sent by ED to the institution as required by 34 C.F.R. § 668.86(b)(1)(i).

Footnote: 10 *10/ All regulations are cited in their current form unless otherwise noted.*

Footnote: 11 *11/ In addition, these biennial audits were not performed in accordance with generally accepted standards of the Department of Education and the standards for financial and compliance audits of the General Accounting Office. They failed to include an auditor's opinion on compliance of the institution regarding its system of internal control for documents and records and a statement of positive and negative assurances. Also, the CPA's working papers were deficient or contained several areas of erroneous conclusions.*

Footnote: 12 *12/ ED is not without means to include within a proceeding matters discovered subsequent to the issuance of a notice of termination. It may issue a second notice of termination which includes the newly discovered ground for termination.*

Footnote: 13 *13/ ED does not pursue in its brief a fine of $25,000 for inaccurate GSL records which was initially proposed on page 4 of EX. G-1, its termination notice. The tribunal considers ED's silence as a concession of this matter. This result is consistent with the facts in any event since both fines are based on the same facts, i.e. false records by Hartford relative to the checks written but retained by Hartford on June 30, 1989. Therefore, it is not necessary for the tribunal to address the fine originally proposed for inaccurate GSL records.*