APPLICATION OF THE CALIFORNIA DEPARTMENT OF EDUCATION,
Applicant.

Docket No. 90-82-R
Recovery of Funds

ACN: 09-00572

DECISION

Appearances: Joseph R. Symkowick, Esq., General Counsel, Carolyn Pirillo, Esq., Deputy General Counsel, for the California Department of Education.

Jeffrey C. Morhardt, Esq., Office of the General Counsel, for the Chief, Financial Audit Resolution and Cost Determination Branch, United States Department of Education.

Before: John F. Cook, Chief Administrative Law Judge

I. **PROCEDURAL BACKGROUND**.

A Notice of Preliminary Departmental Decision (PDD) was issued by the Chief, Financial Audit Resolution and Cost Determination Branch, Office of Management, United States Department of Education, (Departmental official), which required the California State Department of Education (California) to refund $965,624 to the U.S. Department of Education (Education). The PDD was based on an audit report prepared by the Auditor General of the State of California for the period July 1, 1986, through June 30, 1987. The disallowed costs were charged to the Federal Vocational Education funds provided to California pursuant to the Carl D. Perkins Vocational Education Act (20 U.S.C.§ 2301 et seq.) during FY 1983-84. The funds were part of a subgrant from California to the Chancellor's Office of the California Community Colleges.

California submitted an Application for Review (AFR) to the Office of Administrative Law Judges (OALJ). The OALJ accepted jurisdiction of the case and issued its Notice of Hearing. In its AFR, California agreed to remit $526,682 to Education since no claims existed to support the drawdown of those funds for the 1983-84 award year while California disputed the further claim for $438,942 attributed to 1983-84 charges. The parties later stipulated that the remaining $438,942 was appropriately charged to federal funds and no payment was due. (Stip. 1, para. 3). California paid the admitted liability of $526,682, to Education on November 6, 1990. Since California admitted the debt but did not repay it within 30 days as instructed by the PDD, that led to Education's demand for payment of interest in the amount of $3,950.12.

Since the debt was admitted, the misspent funds described in the PDD are not an issue before the OALJ. California, however, continues to challenge Education's attempt to collect interest. A joint stipulation of undisputed facts and a joint memorandum of issues of law was filed.

Thereafter, briefs were filed by the parties as well as a "Motion to Dismiss or in the Alternative, For Summary Judgment, which was filed by the Departmental official." An oral argument was subsequently held in Washington, D.C.

II. **ISSUES.**

A. Does the OALJ have jurisdiction to determine whether interest may be assessed by Education as to an amount of funds due from a State pursuant to a preliminary departmental decision under 20 U.S.C. § 1234a?

B. If the OALJ does have jurisdiction to determine the interest issue, does the Debt Collection Act (31 USC § 3701 et seq.) (D.C. Act) abrogates Education's common law right or any other statutory or regulatory right to collect interest on debts owed by States?

III. **FINDINGS OF FACT.**See footnote 1

1. On June 16, 1986, the Chancellor's Office for the California Community Colleges (COCCC) requested $965,624 from the Vocational Education program grant for the fiscal year ended September 30, 1984. The California Department of Education (CDE) drew the funds under its letter of credit with the U.S. Department of Education (Education). These funds were not recorded into COCCC accounts until after June 30, 1986. COCCC posted no expenditures against the funds at the time. The State accounting records for the State fiscal year 1983-84 were closed and the $965,624 reverted to the State General Fund. (Preliminary Departmental Determination, dated September 28, 1990, Enclosure No. 1, page 1, Finding #1).

2. Claims supporting the receipt of $438,942 of fiscal year 1984 monies were paid in 1987 by COCCC. (Preliminary Departmental Determination, dated September 28, 1990, Enclosure No. 1, page 4, Finding #2, paragraph 1).

3. On January 31, 1991, the California Office of the Auditor General certified that the State General Fund paid these claims and the State did not receive a duplicate reimbursement for these expenditures from post-1984 federal funds. Both Education and CDE accept this certification and agree that the $438,942 is not due Education. (Exhibit A: Auditor General Certification, letter dated January 31, 1991 to Richard T. Mueller from Kurt R. Sjoberg, page 1).

4. No expenditures were incurred to support receipt of $526,682 of these funds. (Appeal of California Department of Education, at page 2, paragraph 2.)

5. CDE sent a payment of $526,682 to Education and it was received at the National Finance Center on November 6, 1990.

6. Education accrued interest in the amount of $3,950.12 (at the rate of 9.00 percent per annum) on the principal amount of $526,682 because the payment was not received by Education by the due date of October 28,1990. Education posted CDE's payment first against this interest, then against principal, leaving a balance of $3,950.12 which Education now characterizes as outstanding principal.

7. The Debt Collection Act (D.C. Act) (31 USC § 3701 et seq.) applies to grants made on or after its effective date of October 25, 1982. Funds from the 1983-84 Vocational Education grant were the subject of this audit. The D.C. Act was in force at the time these funds were granted. (Preliminary Departmental Decision, dated September 28, 1990, Enclosure No. 1, page 1, Finding #1).

IV. DISCUSSION.

A. Positions of the Parties.

California argues that Education has never cited specific authority for its contention that interest is due on debts owed the United States by States. California states that the PDD does not reference any authority under which it pursues recovery of interest and that lack of notice of the specific authority violates Education's duty regarding notice of a prima facie case for recovery. Next, California discusses Education's program authority and argues that program-specific statutes, statutes of general applicability and implementing statutes like the General Education Provisions Act, as amended, (GEPA) 20 U.S.C. § 1221 et seq., exist yet contain no authority for collection of interest on debts owed the United States by States.

California goes on to state that the D.C. Act (Public Law 97-365), which took effect on October 25, 1982, provides for mandatory collection of interest and penalties on debts owed the U.S. Government and exemption from that mandate for agencies of Federal, State, and local governments. In January 1983, P.L. 97-452 made technical amendments and recodified the Act so that mandated interest and penalty collection is now at 31 U.S.C. § 3717(a)(1) which provides, in part:

The head of an executive or legislative agency shall charge a minimum annual rate of interest on an outstanding debt on a United States Government claim owed by a person . . . .

and the exemption is at 31 U.S.C. § 3701(c), which provides:

In sections 3716 and 3717 of this title, 'person' does not include an agency of the United States Government, of a State government, or of a unit of general local government.

California argues that section 3701(c) controls unless another statute explicitly authorizes interest. California then states that neither the Vocational Education Act nor GEPA provides express authority for the assessment and collection of interest on debts owed by States.

Next, California asserts there is no valid regulatory authority for Education to collect interest on debts owed by States. California cites the D.C. Act as underlying authority for the Federal Claims Collection Standards at 4 CFR Part 101 et seq.

California argues extensively that federal common law as to interest collection on debts owed the Federal government by States was abrogated when Congress enacted the D.C. Act.

California reviews four circuit court opinions on the question of whether the D.C. Act abrogates the federal common law. Three said it did; one said it did not. In all four cases, petitioners were State agencies resisting interest collection on debts owed the U.S. government. None of the cases involved specific statutes authorizing interest collection on State debts. All petitioners argued the D.C. Act abrogated federal common law as to interest recovery from States. All of the cases involved claims arising under contracts after October 25, 1982. The three cases in which the courts agreed that the plain meaning of the Act abrogated any common law right to collect interest from States were: Arkansas v. Block, 825 F.2d 1254, 1258 (8th Cir. 1987), Commonwealth of Pennsylvania Dept. of Public Welfare v. United States, 781 F.2d 334 (3rd Cir. 1986), and Perales v. United States, 751 F.2d 95 (2nd Cir. 1984), affirming 598 F. Supp. 19 (S.D.N.Y.).

California argues that the case which reached the opposite conclusion-- no abrogation of common law right to interest from States-- can nevertheless be distinguished for several reasons. The case, known as Gallegos v. Lyng, 891 F.2d 788 (10th Cir. 1989), according to California, involved faulty analysis of three factors: (a) misapplication of the U.S. Supreme Court's holding in a case that post dated the other three circuits' rulings, but concerned a claim on a contract not subject to the act, (b) the legislative history, and (c) the overall purpose of the act.

The Departmental official raises three issues-- first, that the OALJ lacks jurisdiction over this case in that the OALJ's jurisdiction is limited by statute and regulation to proceedings such as recovery of funds, rather than debt collection. Second, that both the Federal Claims Collection Standards at 4 C.F.R. Parts 101-105 (FCCS), which is government wide, and Education's own debt collection procedures in 34 C.F.R. Part 30 grant Education the right to assess interest at common law against States for debts owed the Federal Government. Third, the Departmental official argues that GEPA authorizes Education to assess interest against a State.

The first issue will be discussed infra.

As relates to the second issue, the Departmental official referred to several regulations as follows:

4 C.F.R. § 102.13(h)(2) provides, in part:

[A]gencies are authorized to assess interest and related charges on debts which are not subject to 31 U.S.C. 3717 to the extent authorized under the common law or other applicable statutory authority.

34 C.F.R. § 30.1(a) provides:

The Secretary may take one or more of the following actions to collect a debt owed to the United States:

. . .

(4) Take any other action authorized by law.

The Departmental official then states that "other action authorized by law" includes without limitation, "[c]harg[ing] interest on the debt as provided in the FCCS." Id. at (c) (3).

In addition, the pertinent departmental regulations at 34 C.F.R. § 30.2(a)(1) provide:

(a)(1) The Secretary takes an action referred to under § 30.1(a). In accordance with--

. . .

(iii) the common law.

Education argues that these regulations are binding on the administrative law judge inasmuch as the judge is bound by all applicable statutes and regulations under 34 C.F.R. § 81.5(b).

California takes issue with the Departmental official's interpretation of the regulations and maintains that the Federal Claims Collection Standards, 4 C.F.R. § 102 et seq., and Education's debt collection procedures, 34 C.F.R. § 30 et seq., were both adopted pursuant to the authority of the D.C. Act, which mandates interest assessments on debts owed to the Federal Government (at 31 U.S.C. § 3717) but exempts agencies of the Federal Government, States, and general local governments from that mandate under 31 U.S.C. § 3701(c). California then argues that from the plain language of the regulations they do not purport to create or grant any rights inconsistent with the statute upon which they are founded, because otherwise they would render the D.C. Act meaningless.

The Departmental official maintains that California's reliance on the state's exclusion from the procedures of the D.C. Act under 31 U.S.C. § 3717 is misplaced in light of the clear and unambiguous language in the applicable regulations which authorize debt collection remedies based on common law.

That official further maintains that the general exclusion of states from coverage of the D.C. Act does not help California's cause. It takes this position since Sections 1234(a)(i) and 1234a(1) were added to the GEPA enforcement provisions by the August F. Hawkins- Robert T. Stafford Elementary and Secondary School Improvement Amendments of 1988, (Pub.L. 100-297) (Hawkins-Stafford), which postdated the D.C. Act of 1982. On this point, the official claims that the two statutes-- the D.C. Act and the Hawkins-Stafford Amendments-- and their relevant sections must be read and interpreted in pari materia. By reading them in that manner and by recognizing that when Congress passed the Hawkins-Stafford Amendments it did so despite the D.C. Act's exclusion of states from coverage of § 3717 (interest collection), the Departmental official argues that the only possible conclusion is that the Secretary has full authority to assess interest against states in cases like the present one where an admitted debt under an applicable program is involved.

California responds that the Departmental official's pari materia reading of the D.C. Act and the Hawkins-Stafford Amendments of 1988 results in an unreasonable conclusion, given the plain language of the two statutes. California challenges as unreasonable the Departmental official's interpretation that a prohibition in GEPA on predecisional interest somehow verifies the

existence of a right to collect post-decisional interest. It argues that that kind of conclusion requires the interpolation of new provisions to the existing statute, which is not permissible. California argues that the fact that GEPA establishes predecisional interest immunity is not dispositive of the total exemption issue under the D.C. Act.

California again argues that 20 U.S.C. § 1234a(i) directs the Secretary to collect debts from recipients "in accordance with the Debt Collection Act," and that Education conveniently leaves the exemption at 31 U.S.C. § 3701(c) as to interest from States out of its discussion. California argues that to overrule the exemption, a statute has to state the intent of Congress unambiguously to that effect, and that Education has not shown through legislative history or otherwise the intent of Congress to overrule the exemption. Contrary to Education's claims, California says that reading selected sections of GEPA and the D.C. Act together does not result in the unavoidable conclusion presented by Education that interest can be levied on States' debts.

The Departmental official argues that a prohibition as to interest assessment on States' debts would lead to the absurd result that the Department may litigate a claim and then not be able to collect the judgment.

California disputes such an absurd result and points out that it is only collection of interest on the principal, and not collection of the principal itself, that is barred by 31 U.S.C. § 3701(c). Additionally, to illustrate further that the exemption from interest under 31 U.S.C. § 3701(c) is not a general exemption nor one which can be stretched to cover a judgment or a debt, California comments that States are subject to procedures prescribed in the D.C. Act, such as for settlement of claims by the Comptroller General (31 U.S.C. § 3720), and for collection and compromise of claims by heads of agencies(31 U.S.C. § 3711).

B. Interest Issue.

Aside from the question as to whether the OALJ has jurisdiction to determine whether interest may be assessed by Education in this case, the fundamental issue is whether or not the D.C. Act abrogates the Federal Government's common law right or any other statutory or regulatory right to collect prejudgment interest on debts owed by States.

Prior to the passage of the D.C. Act it was held that the Federal Government had a right under the federal common law to assess prejudgment interest against persons owing debts to the Federal Government where the underlying claim was a contractual obligation to pay money. Royal Indemnity Co. v. U.S., 313 U.S. 289 (1941). In Bell v. New Jersey, 461 U.S. 773 (1983), the Court held that the provisions of the Elementary and Secondary Education Act, as amended, (ESEA), 20 U.S.C. § 2701 et seq., and GEPA, gave the Federal Government the right to recover funds from federal grants misapplied by States.

West Virginia v. U.S., 479 U.S. 305 (1987), involved a debt owed by the State of West Virginia arising from a contractual obligation to reimburse the United States for services rendered by the Army Corps of Engineers. This occurred in the 1970's prior to the enactment of the D.C. Act. The Court held that West Virginia was liable for prejudgment interest under the federal common law.

In Riles v. Bennett, 831 F.2d 875 (9th Cir. 1987), it was held that the U.S. Department of Education was entitled to prejudgment interest on an award of Elementary and Secondary Education Act grants which were misspent by the State of California. The facts in this case arose prior to the applicability of the D.C. Act.

Thus we see that in circumstances existing prior to the effective date of the D.C. Act. the courts have held that the U.S. Department of Education was entitled to assess prejudgment interest under the federal common law as relates to grants of funds which were misspent by a State.

In 1982, the D.C. Act was enacted to facilitate substantially improved collection procedures in the Federal Government. The D.C. Act provides, at 31 U.S.C. § 3717, for the assessment of interest against persons owing debts to the Federal Government.See footnote 2 Further, 31 U.S.C. § 3701 (c) provides that: "In sections 3716 and 3717 of this title, 'person' does not include an agency of the United States government, of a State government, or of a unit of general local government." Thus the D.C. Act does not provide for the assessment of interest by the Federal Government on debts owed by States.

The question arises as to whether the D.C. Act went further and actually abrogated the Federal Government's common law right to collect interest on debts owed by States.

Certain circuit courts of appeal have held that the D.C. Act has abrogated that common law right. Other federal courts have held the opposite.

In Perales v. United States, 751 F.2d 95 (2nd Cir. 1984), the court of appeals held that the United States Department of Agriculture was not authorized to charge interest on debts arising out of the Food Stamp Program due it from the New York Department of Social Services. In doing this the court affirmed the district court's decision in 598 F.Supp. 19 (S.D. N.Y. 1984). In that decision the district court stated at pages 23-24:

Defendants recognize that the recently amended Federal Claims Collection Act expressly excludes state agencies from the definition of "persons" against whom late payment interest can be assessed. See 31 U.S.C. §§ 3701(c), 3717. Nevertheless, they argue that the United States has a common law right to interest that is not abrogated by this statute. They also maintain that the assessment of interest against DSS is authorized by regulation. There is no legal basis for either of these contentions.

As part of the foundation for the decision the district court cited Pennhurst State School and Hospital v. Halderman, 451 U.S. 1, 17, 101 S.Ct. 1531, 1539, 67 L.Ed. 2d 694 (1981) in connection with the following statements:

In the administration of cooperative federal-state programs, state governments assume only those obligations that are explicitly imposed by statute. . . . In the absence of an unambiguous authorization by Congress, FNS' policy of assessing late payment interest against state agencies must be deemed invalid.

Id. at 24.

However, in Bell v. New Jersey, 461 U.S. 773 (1983), the Supreme Court distinguished the circumstances of the Pennhurst case from cases where a remedy is sought against a noncomplying State. At page 791 of the Bell case the Court stated, in footnote 17:

The States have also argued that Pennhurst State School and Hospital v. Halderman, 451 U.S. 1, 101 S.Ct. 1531, 67 L.Ed.2d 694 (1981), requires a different view of the effect of the pre-1978 version of the statute. Pennhurst required that Congress act "unambiguously" when it intends to impose a condition on the grant of federal money. Id., at 17, 101 S.Ct., at 1539. The States argue that Congress did not speak unambiguously before 1978 in imposing liability and it therefore was not effective in imposing liability. We disagree. As our discussion shows, we think that the plain language of the statute is sufficiently clear, and ESEA meets Pennhurst's requirement of legislative clarity. Moreover, Pennhurst arose in the context of imposing an unexpected condition of compliance--a new obligation for participating States--while here our concern is with the remedies available against a noncomplying State.

Id. at 791 (emphasis added).

In Com. of Pa., Dept. of Public Welfare v. U.S., 781 F.2d 334 (3rd Cir. 1986) the court stated at page 342:

Thus, the plain meaning of the Debt Collection Act now controls the question of state liability for interest to federal agencies, and disallows such assessments in the absence of clear statutory authority. Because the Act's language is clear, we will not defer to the administrators who construe it differently. This situation contrasts with that discussed earlier concerning the liability of states for "financial loss" in disbursement errors. Congress left unstated the method of proof of such loss, and therefore delegated its determination to the agency. The Debt Collection Act, on the other hand, is comprehensive, and the administrators perceive ambiguity where it does not exist. Therefore, as the Food Stamp Act itself contains no interest provision, the Debt Collection Act bars its assessment.

Id. at 342 (footnote omitted).

In State of Arkansas By Scott v. Block, 825 F.2d 1254 (8th Cir. 1987), the court stated, at page 1258, that:

the Secretary argues that in passing the Debt Collection Act, Congress did not intend to abrogate the federal government's pre-existing common law right to collect interest on a state debt in certain discretionary circumstances. We cannot refer to the legislative history of the Debt Collection Act to ascertain congressional intent in passing the statute. The provision exempting states was added to the bill on the Senate floor; no legislative history on this provision is thus available.

Absent legislative history to the contrary, we must assume that the congressional purpose is expressed by the plain meaning of the statutory language and the language must be considered

conclusive. . . . By enacting a statute that explicitly denies the federal government authority to charge interest on debts owed it by the states, Congress abrogated any pre-existing common law right.

Id. at 1258 (footnote, citation and headnote numbers omitted).

In the case of Riles v. Bennett, 831 F.2d 875 (9th Cir. 1987), the court distinguished the Perales and Arkansas cases. The timing of the circumstances of the Riles case was such that the D.C. Act did not apply and the court, in holding that the Department of Education was entitled to prejudgment interest as to funds misspent by the State of California, held that the Pennhurst case was not a bar to such interest. Pennhurst, as mentioned previously, held that "if Congress intends to impose a condition on the grant of federal moneys, it must do so unambiguously." 451 U.S. at 17, 101 S.Ct. at 1540 (footnote omitted). The State in the Riles case argued that Pennhurst barred the recovery of prejudgment interest because Congress had not provided "unambiguously" or indeed at all, for the collection of interest on Title I grants misapplied by a State. The court stated that it was clear from the Supreme Court's subsequent decision in Bell that Pennhurst is not applicable to the State's liability for prejudgment interest.

In Bell the Supreme Court held that States could be required to repay the Secretary of Education for misspent Title I funds. The State in that case had argued that Pennhurst required that Congress state "unambiguously" that a State was obligated to repay misspent funds, and that the statute contained no such statement.

As mentioned above, the Bell court held Pennhurst inapplicable and stated: "Pennhurst arose in the context of imposing an unexpected condition for compliance-a new obligation for participating States-while here our concern is with the remedies available against a noncomplying State." 461 U.S. at 790 n.17, 103 S.Ct. at 2197 n.17.

Therefore, in the Riles case prejudgment interest was a part of "the remedies available against a noncomplying State," rather than an additional condition to the grant.

After stating that the Perales and Arkansas cases, relied upon by the State, appeared to be distinguishable, the court noted:

The Supreme Court has emphasized that decisions to award or deny interest on statutory obligations rest on "an appraisal of the congressional purpose in imposing them . . ." Rodgers v. United States, 332 U.S. 371, 373, 68 S.Ct. 5, 7, 92 L.Ed. 3 (1947). Perales relies heavily on the provisions of the Food Stamp Act, especially those limiting the federal agency's right to collect losses before appeals are exhausted. See 598 F.Supp. at 24-26. In Perales and Arkansas the federal agency sought to impose interest only 30 days after the state had been notified that funds had been misspent, and before administrative appeals had been exhausted. Here, no effort was made to collect interest for the period during which the administrative process was being pursued. Indeed, the Secretary did not seek interest for two-and-one-half years after notice of the final determination. The results in Perales and Arkansas are better understood as applications of the common law balancing test where federal interests were out-weighed by those of the state.

831 F.2d at 878 n.4.

In contrast to the Perales, Pennsylvania, and Arkansas decisions, we find other decisions which come to the opposite conclusion.

In Gallegos v. Lyng, 891 F.2d 788 (10th Cir. 1989), which is the most recent court of appeals decision on the subject, the court held that the D.C. Act did not abrogate the Federal Government's common law right to assess interest on outstanding debts of States incurred pursuant to the Food Stamp Act.

The court recognized that three other circuit courts had reached the opposite conclusion, citing the three cases mentioned above. Id. at 795-796.

The court also referred to a Sixth Circuit Court decision which also rejected the claim that the D.C. Act precludes the Federal Government from charging the States interest on their unpaid debts. County of St. Clair v. United States Dep't of Labor, 754 F.2d 375 (6th Cir. 1984). The Gallegos court at page 796 pointed out that the State involved in Gallegos contended that the D.C. Act clearly was not intended to be applied to the States and that because the statute is not silent or ambiguous there is no need for interpretation by either the agency, the Food and Nutrition Service (FNS), or the court. Then the court went on to say that the FNS countered:

that the Act is completely silent as to the rights and liabilities of state and local governments with respect to overdue debts owed to the United States. FNS reasons that §§ 3701 and 3717 do not prohibit the federal government from charging states interest, but rather impose certain requirements concerning interest rates to be charged, methods for computing those rates, and other penalties applicable to persons other than state and local government entities. The Act does not abrogate the federal common-law right to charge state and local governments interest, it merely maintains the status quo between the federal government and those entities. In other words, FNS argues, the Act leaves intact the federal common-law right to obtain compensation to make the federal government whole when the United States is injured by the failure of a state to pay its debt. The Act simply excepts state and local governments from the mandatory provisions of § 3717.

Id. at 796.

The Gallegos court went on at pages 796-797 to discuss the effect of the West Virginia case on the basic issue as follows:

In West Virginia v. United States, 479 U.S. 305, 107 S.Ct. 702, 93 L.Ed.2d 639 (1987), the United States Supreme Court held:

"[t]he rule governing the interest recovered as damages for delayed payment of a contractual obligation to the United States is not controlled by state statute or local common law. In the absence of an applicable federal statute, it is for the federal courts to determine, according to their own criteria, the appropriate measure of damage, expressed in terms of interest, for nonpayment of the amount found to be due."

Id. at 308-09, 107 S.Ct. at 705 (quoting Royal Indem. Co. v. United States, 313 U.S. 289, 296,

61 S.Ct. 995, 997, 85 L.Ed. 1361 (1941)). The Court observed that it was a "longstanding rule that parties owing debts to the Federal Government must pay prejudgment interest where the underlying claim is a contractual obligation to pay money." 479 U.S. at 310, 107 S.Ct. at 706. "Prejudgment interest," the Court held, "is an element of complete compensation." Id. The West Virginia court noted that the Debt Collection Act of 1982 was inapplicable to the case at bar because the claim at issue arose under a contract entered into before October 25, 1982, and thus under the terms of § 3717(g)(2) the Act did not apply. The court went on to state:

We can draw no inference about Congress' comprehension of the federal common law of interest from its enactment, without any discernible legislative history, of a definitional section excluding state agencies from those "persons" statutorily required to pay interest on debts owed to the Federal Government. Moreover, we venture no opinion regarding the question whether this enactment was intended to abrogate or leave intact the federal common law governing when a State must pay interest to the Federal Government.
479 U.S. at 312 n. 6, 107 S.Ct. at 707 n. 6.

Id. at 796-797 (emphasis added).

After other comments the Gallegos court then stated:

We note also that, while the Supreme Court expressly reserved the issue, its reference (quoted above) to the relationship between the Debt Collection Act and the federal common law right to collect interest at least suggests that the statute is not as unambiguous as appellant would have us find.

Id. at 797.

The Gallegos court went on at page 799 to discuss an argument relied upon by the State in that case which had been raised by the court in the Perales case. The State argued that assessing interest on claims owed by States under the mail loss regulation (of the FNS) improperly extends the terms and conditions under which those States have agreed to participate in the food stamp program, in contravention of the principle established in the Pennhurst case. In Perales the court held that, under Pennhurst and absent an unambiguous authorization by Congress in the Food Stamp Act, "FNS" policy of assessing late payment interest against State agencies must be deemed invalid. The Gallegos court then went on, at pages 799-810, to state that:

The limits of the Pennhurst doctrine were described in Bell v. New Jersey, 461 U.S. 773, 103 S.Ct. 2187, 76 L.Ed.2d 312 (1983). The Bell Court distinguished Pennhurst, explaining: "Pennhurst arose in the context of imposing an unexpected condition for compliance--a new obligation for participating States--while here our concern is with the remedies available against a noncomplying State." 461 U.S. at 790 n. 17, 103 S.Ct. at 2197 n. 17. The same distinction applies here. FNS is not seeking to force New Mexico to comply with an obligation not set out in the Food Stamp Act or program regulations, but rather is seeking interest as a remedy for the state's breach of a known and voluntarily undertaken obligation-the duty to pay for excess losses of food stamps distributed through the mail. The state has failed to reimburse FNS promptly for those losses and thus is in default of its statutory obligation.

The lack of an express provision in the Food Stamp Act authorizing the assessment of interest against a state in default does not preclude the federal agency from assessing interest, nor does it make interest an unknown or unexpected condition of the state's contract with the federal agency.

The five circuit court cases referred to above related to the effect upon federal common law rights caused by the D.C. Act definition of the term "person" contained in 31 U.S.C. § 3701(c) and in doing so those five cases related specifically to the provisions of "section 3717" entitled "Interest and penalty on claims." Those cases did not get into the issue as to whether the definition of "person" in 31 U.S.C. § 3701(c) affected federal common law rights as to the subject matter of "section 3716" entitled "Administrative offset."

Of course the definition of the term "person" contained in 31 U.S.C. § 3701(c) is such that both as to "sections 3716 and 3717 of this title, 'person' does not include an agency of . . . a State government, or a unit of general local government."

Section 3716 provides a basis for federal agencies to collect claims against persons by means of administrative offset. Therefore, similar to the circumstances relating to the assessing of interest on debts of States, the D.C. Act, because of the definition of the term "person", does not provide for the use of administrative offset by the Federal Government to collect claims owed by States or units of general local government.

The question then arises as to whether the D.C. Act went further and actually abrogated the Federal Government's common law right to collect debts owed by States or local governments by means of recoupment or administrative offset.

Therefore, the treatment by the courts concerning the effect of the D.C. Act upon the federal common law rights relating to the subject of "Administrative offset" is relevant to this case.

In Housing Authority of the County of King v. Pierce, 701 F.Supp. 844 (D.D.C. 1988) the court held that the provisions of 31 U.S.C. § 3701 relating to the term "person" as used in § 3716 have not modified or displaced the Department of Housing and Urban Development's (HUD) common law right to recoup funds erroneously advanced to a local housing authority.

The facts of the case indicate that the "recapture" of excess subsidies involved in that case by HUD were first described as the collection of a debt by administrative offset. Id. at 846.

The court found that the D.C. Act and HUD's administrative offset regulation, by their express terms did not apply in view of the definition of the term "person." The court then stated that:

Having departed from the statutory and regulatory scheme, however, matters become less clear. HACK argues that, absent the express authorization to undertake administrative offset contained in the Act and HUD's regulation, HUD has no authority to undertake its recoupment scheme. In essence, HACK argues that a general common law right of government agencies to undertake specific, extra-statutory recoupment mechanisms such as that proposed by HUD does not exist, and that express statutory authorization is a precondition to the implementation of any

such scheme. As HACK notes, the Supreme Court "pretermitted" this issue in Bell v. New Jersey, 461 U.S. 773, 782 n. 7, 103 S.Ct 2187, 2193 n. 7, 76 L.Ed.2d 312 (1983), by finding that the statute at issue in that case did authorize non-litigation recoupment.

Absent a definitive statement from the Supreme Court, this Court finds substantial support for the proposition that HUD enjoys the common law right to recoup, in the manner proposed, the funds erroneously advanced to HACK, and rejects HACK's assertion that the Act or HUD's regulations have somehow displaced or modified that right. The federal government's common law right to recoup erroneously disbursed funds is firmly established and has been consistently recognized. . . . The variation in the above cases as to the manner of recoupment, which HACK cites as somehow limiting HUD's recoupment options, instead appears to this Court to underscore the breadth of the common law remedy . . . .

In this Court's view, Congress has not specifically abrogated HUD's common law right to undertake the recoupment scheme . . . .

Id. at 848-849 (footnotes omitted) (citations omitted).

Thus we have a situation where three circuit courts of appeal have ruled that the D.C. Act has abrogated the Federal Government's common law right to collect prejudgment interest on debts owed by States. And contrary to this we have three other federal courts that have ruled that the effect of the D.C. Act has not abrogated federal common law rights in collecting prejudgment interest or in collecting debts by administrative offset from States or units of general local government. Two of these were circuit courts of appeal dealing with the interest issue while one was a U.S. district court dealing with administrative offset.

Consequently, the solution to the question as to whether the D.C. Act has abrogated the Federal Government's common law right to collect prejudgment interest on debts owed by States is not clear cut. The fact that the resolution of this issue is not clear cut has been made more evident by the comments of the U.S. Supreme Court in the West Virginia case. As stated previously, in that case the Court noted that the D.C. Act was inapplicable to that particular case because the claim at issue there arose under a contract entered into before October 25, 1982 and thus under 31 U.S.C. § 3717(g)(2) that Act did not apply. However, the court stated:

We can draw no inference about Congress' comprehension of the federal common law of interest from its enactment, without any discernible legislative history, of a definitional section excluding state agencies from those "persons" statutorily required to pay interest on debts owed to the Federal Government. Moreover, we venture no opinion regarding the question whether this enactment was intended to abrogate or leave intact the federal common law governing when a State must pay interest to the Federal Government.

479 U.S. at 312 n. 6, 107 S.Ct. at 707 n. 6 (emphasis added).

As is apparent in the discussion earlier in this decision, the court in the Gallegos case took particular note of these comments of the Court in West Virginia. In Gallegos the State involved, in taking the position that the D.C. Act had abrogated the Federal Government's common law

right to charge interest on unpaid debts owed by States, had argued that the D.C. Act was unambiguous and the Gallegos court noted that: "while the Supreme Court expressly reserved the issue, its reference (quoted above) to the relationship between the Debt Collection Act and the federal common law right to collect interest at least suggests that the statute is not as unambiguous as appellant would have us find."

As noted previously, the court in Gallegos went on to hold that the D.C. Act did not abrogate the federal common law right to assess interest on outstanding debts of States owed to the Federal Government.

In the instant case the statute relating to the recovery of Department of Education funds owed by recipients of grants [20 U.S.C. § 1234a(i)] provides that "[t]he amount . . . may be collected by the Secretary in accordance with Chapter 37 of Title 31." (emphasis added). Since the operative statute is not mandatory, the Secretary has the option to determine what procedures to use for the collection of funds, including those under the common law. This is in keeping with the Department of Education regulations.

34 C.F.R. § 30.1 sets forth administrative actions which the Secretary of Education may take to collect a debt as follows:

§ 30.1 What administrative actions may the Secretary take to collect a debt?

(a) The Secretary may take one or more of the following actions to collect a debt owed to the United States:

(1) Collect the debt under the procedures authorized in the regulations in this part.
(2) Refer the debt to the General Accounting Office for collection.
(3) Refer the debt to the Department of Justice for compromise, collection, or litigation.
(4) Take any other action authorized by law.
(b) In taking any of the actions listed in paragraph (a) of this section, the Secretary complies with the requirements of the Federal Claims Collection Standards (FCCS) at 4 CFR parts 101-105 that are not inconsistent with the requirements of this part.

34 C.F.R. § 30.2 sets forth the authority upon which the Secretary relies to collect debts as follows:

(a)(1) The Secretary takes an action referred to under § 30.1(a) in accordance with--
(i) 31 U.S.C. Chapter 37, Subchapters I and II;
(ii) Other applicable statutory authority; or
(iii) The common law.

In accordance with 34 C.F.R. § 30.1(b) reference is made to the Federal Claims Collection Standards (FCCS). As relates to the question of interest 4 C.F.R. § 102.13 of the FCCS contains a provision as to exemptions as to State or local government as follows:

(i) Exemptions. (1) The provisions of 31 U.S.C. 3717 do not apply: (i) To debts owed by any State or local government. . . .

(2) However, agencies are authorized to assess interest and related charges on debts which are not subject to 31 U.S.C. 3717 to the extent authorized under the common law or other applicable statutory authority.

Assuming that these regulations are valid they do set forth a foundation for the collection of outstanding debts owed to the Federal Government pursuant to the federal common law, including the assessment of interest on State debts.

The net result is that the arguments in favor of the authorized Departmental official's position that the D.C. Act has not abrogated the Federal Government's common law right to assess prejudgment interest on debts owed by States are at least as strong as those arguments which are to the contrary.

The result is that, although the solution to the question as to whether the D.C. Act has abrogated the Federal Government's common law right to collect prejudgment interest on debts owed by States is not clear cut, there is a foundation in the statutes and regulations referred to above for such a procedure.

C. Jurisdictional Issue.

Counsel for the Departmental official filed a Motion to Dismiss or in the Alternative for Summary Judgment. The motion to dismiss is premised upon the position that the OALJ does not have jurisdiction of a proceeding involving the collection of interest upon a debt owed by a recipient of grant funds who either made an unallowed expenditure or failed to properly account for the funds. Counsel refers to the statute relating to the jurisdiction of the OALJ as follows:

The jurisdiction of the OALJ is derived from the Hawkins-Stafford Education Amendments of 1988. Pub. L. 100-297, 20 U.S.C. 1234 et seq. 20 U.S.C. 1234(a) states:

The Secretary shall establish in the Department of Education and [sic] Office of Administrative Law Judges (hereinafter in this subchapter referred to as the "Office") which shall conduct-

(1) recovery of funds hearings pursuant to section 1234a of this title,
(2) withholding hearings pursuant to section 1234d of this title,
(3) cease and desist hearings pursuant to section 1234e of this title, and
(4) other proceedings designated by the Secretary.

Departmental official's Brief at 4-5.

Counsel then refers to 20 U.S.C. § 1234(a)(1) which sets forth the foundation for a recovery of funds proceeding. That provision is as follows:

(1) Whenever the Secretary determines that a recipient of a grant or cooperative agreement under an applicable program must return funds because the recipient has made an expenditure of funds that is not allowable under that grant or cooperative agreement, or has otherwise failed to discharge its obligation to account properly for funds under the grant or cooperative agreement, the Secretary shall give the recipient written notice of a preliminary departmental decision and notify the recipient of its right to have that decision reviewed by the Office and of its right to request mediation.

20 U.S.C. § 1234a(a)(1).

Counsel argues that the OALJ in this case has jurisdiction only to conduct a recovery of funds proceeding as set forth above in the statutes and that the assessment of interest against California constitutes a debt collection action and not a recovery of funds proceeding.

Counsel states that the OALJ jurisdiction is predicated on the recovery of misspent funds received under a grant or cooperative agreement and that the demand "for and collection of interest is not such a recovery of misspent funds but rather a claim separate and apart from grantee misexpenditures." For additional support Counsel refers to the decision of the OALJ's predecessor, the Education Appeal Board (EAB) in the case entitled: Appeal of the State of Michigan, EAB Docket No. 15(215)86 (Final Decision May 6, 1988).

California argues that the OALJ has jurisdiction. It strongly argues against dismissal, claiming that the interest claim is not severable from the debt claim. California refers to page 2 of Enclosure 1 of the PDD of September 28, 1990, which describes the circumstances under which interest could accrue if payment was not made within a certain period of time. California goes on to argue that but for the recovery of funds action, no interest would have been assessed by ED, and that the claim for interest is inseparable from the recovery of funds action.

In Appeal of the State of Michigan, the EAB Panel concluded that it did not have authority to rule upon a question as to the authority of ED to assess interest upon a purported collection. It determined that the obligation to pay interest on any indebtedness will arise, if at all, only as and when a final decision has issued from the Secretary by either his adoption of the initial decision or his independent statement.

The EAB Panel at p. 16 further stated as follows:

Appellant has failed to convince us that the Panel's authority goes beyond inquiry into, and decision as to, the principal sums involved in the demand for repayment. We are limited, we think, to the questions of whether there is a debt and if so, the amount thereof. Appellant cites no law that places this facet of collection within the jurisdictional authorization to EAB involved in 34 C.F.R. Subpart A, secs. 78.1 et seq., without which we must decline to assume authority.

The EAB Panel's decision became the Secretary's final decision and was subsequently appealed to the Sixth Circuit in Michigan v. United States, 875 F.2d 1196 (6th Cir. 1989). There the court concluded that the issue regarding prejudgment interest recovery was not ripe for review because ED had retracted its efforts to collect the interest. Thus the matter was resolved

on a procedural rather than substantive basis. However, the court did comment that the D.C. Act defines "person" to exclude an agency of a State government. The court then stated: "Thus, it would seem that the imposition of interest in this case is not mandatory under the Act." Id. at 1206.

This comment indicates that ED therefore had an option to assess interest against the State agency, but that, in view of the definition of the term "person," which,under the D.C. Act, excluded an agency of a State government, the assessment of interest was not mandatory.

The statutory provisions relating to jurisdiction of the OALJ, the nature of recovery of funds proceedings, and the restrictions on collection action pending final decision, which are significant to the determination of this jurisdictional issue in the instant case are similar to the statutory provisions on these same subjects relating to its predecessor, the EABSee footnote 3 Therefore, it is considered that the Michigan decision has some precedential value in reaching a decision in this case.

The EAB decision in the Michigan case became the final decision of the Department of Education on May 6, 1988.

As argued by Counsel for the Departmental official in this case the jurisdiction of the OALJ in this case is confined to the issues involved in a recovery of funds proceeding under 20 U.S.C. § 1234a. Under that statute the funds to be recovered would be that part of the funds received under a grant or cooperative agreement used for an unallowable expenditure or for which there was not a proper accounting. No question or issue arises in that proceeding as to interest. The interest issue would arise later when collection action was taken. This is a separate matter. In keeping with this 20 U.S.C. § 1234a(f) provides that if a recipient submits an application for review of a PDD, ED shall take no collection action until a decision of OALJ upholding the PDD in whole or in part becomes final agency action. Also 20 U.S.C. § 1234a(l) provides that no interest shall be charged arising from a claim during the administrative review of the PDD.

In this case the amount of funds sought to be recovered was uncontested by the State.See footnote 4 And the assessment of interest was the result of the State's late payment of the debt to ED. The assessment of interest was not part of what is contemplated to be the subject matter of a recovery of funds proceeding under 20 U.S.C. § 1234a(a).

Therefore, as relates to the question of jurisdiction of the OALJ, it appears that there is a foundation to follow the last determination by the Department of Education on the jurisdictional issue in Appeal of the State of Michigan, EAB Docket No. 15(215)86 (Final Decision May 6, 1988). As stated earlier the significant statutory provisions relating to the EAB and the OALJ, as relates to the subject matter in this type of proceeding, are substantially similar. The Michigan case is consequently considered to be a good precedent to be followed under the circumstances of this case. Therefore, an order will be issued granting the Departmental official's motion to dismiss the proceeding.

V. **CONCLUSIONS OF LAW**.

The Office of Administrative Law Judges does not have jurisdiction to determine whether interest may be assessed by the Department of Education as to an amount of funds due from a State pursuant to a preliminary departmental decision under 20 U.S.C. § 1234a.

VI. **DETERMINATIONS AS TO THE PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW**.

Both parties have proposed conclusions of law in their briefs. Such proposed conclusions have been considered fully, and except to the extent that such proposed conclusions have been expressly or impliedly affirmed in this decision, they are rejected on the grounds that they are, in whole or in part, contrary to the law or because they are immaterial to the decision in this case.

VI. **ORDER**.

Based on the foregoing findings of fact and conclusions of law, IT IS ORDERED: That this proceeding be DISMISSED with prejudice.

John F. Cook
Chief Administrative Law Judge

Issued: September 25 , 1992
Washington, D.C.

SERVICE LIST

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Footnote: 1 *Findings of Fact No. 1 thru No. 7 are based upon the stipulations of fact No. 1 thru No. 7 which were filed by the parties.*

Footnote: 2 *Also, 31 U.S.C. § 3717(g) provides that that section does not apply:*

(1) if a statute, regulation required by statute, loan agreement, or contract prohibits charging interest or assessing charges or explicitly fixes the interest or charges; and

(2) to a claim under a contract executed before October 25, 1982, that is in effect on October 25, 1982.

Footnote: 3Compare 20 U.S.C. § 1234, § 1234a(a), and § 1234a(c) (1987) with 20 U.S.C. § 1234(a), § 1234(a)(1), and § 1234a(f) (1992) respectively.

Footnote: 420 U.S.C. 1234a(i) provides, in part, that: "[t]he amount of a preliminary departmental decision under subsection (a) of this section for which review has not been requested in accordance with subsection (b) of this section, . . . may be collected by the Secretary in accordance with chapter 37 of Title 31."