In the Matter of ROYAL COLLEGE OF BEAUTY,
Respondent.

Docket No. 93-173-ST
Student Financial Assistance Proceeding

Appearances: J. Andrew Usera, Esq., of Vienna, Virginia, for the Respondent.

Denise Morelli, Esq., and Russell B. Wolff, Esq., of the Office of the General Counsel, U.S. Department of Education, Washington, D.C., for the Office of Student Financial Assistance Programs.

Before: Judge Ernest C. Canellos

DECISION

PROCEDURAL HISTORY

Royal College of Beauty (Royal) of Mesa, Arizona, is an eligible proprietary institution of higher education offering a program in cosmetology. It participates in the Pell Grant Program (Pell); Federal Family Education Loan Program (FFEL), formerly the Guaranteed Student Loan Program (GSL); the Supplemental Education Opportunity Grant Program (SEOG); and the Perkins Loan Program (Perkins), authorized under Title IV of the Higher Education Act of 1965, as amended (Title IV). These programs are administered by the Office of Student Financial Assistance Programs (SFAP), United States Department of Education (ED).

A program review to examine the administration of the Title IV programs was conducted at Royal by two reviewers from ED's Regional Office in San Francisco, California, between February 3-7, 1992. Based upon their review of student files and other pertinent information, the reviewers concluded in a program

review report, dated April 19, 1993, that Royal had committed a number of regulatory violations. As a result, on November 26, 1993, SFAP issued a notice of intent to terminate Royal's participation in the Title IV programs. The basis for such action was: Royal's failure to produce records and documents when requested; failure to meet ability-to-benefit testing requirements; failure to timely refund tuition and fees of students who withdrew; failure to provide consumer information; failure to properly apply satisfactory academic progress; failure to maintain valid Student Aid Reports (SAR); failure to properly administer leaves of absence; failure to conduct entrance and exit counselling; and failure to meet the standard of administrative capability and fiduciary standard of conduct. A fine of $75,000 was proposed. Royal filed a timely appeal and requested a hearing. A briefing schedule was established and complied with by the parties.

On September 13, 1994, SFAP amended its termination notice to add the allegation that Royal failed to submit the biennial audits due June 30, 1992, and 1994. 34 C.F.R. § 668.23 (c)(3). The amended notice also listed additional claims of SAR and ability-to-benefit violations and proposed an additional fine of $34,000.

I held a hearing on this matter between October 26-28, 1994, in Phoenix, Arizona. Evidence was submitted in the form of sworn testimony and documentary evidence. The hearing was transcribed verbatim by a court reporter and a record was made and provided to both sides. The parties were authorized to submit post-hearing briefs which each side accomplished in a timely manner.

DISCUSSION OF JURISDICTIONAL BASIS

The September 13, 1994 notice added to the list of reasons for terminating Royal's eligibility allegations which were not included in the original notice, although they were apparently known to SFAP at the time of that notice. At the beginning of the hearing, Royal's counsel moved to dismiss the additional allegations claiming that proceedings, under Subpart G, 34 C.F.R. § 668.81 et seq., do not provide for amending the charges. SFAP objected, pointing out that although there is no provision specifically authorizing amendment, neither is there a specific provision prohibiting it. SFAP argued that, given the flexibility of the administrative process and, further, given that adequate notice was provided, the motion should be denied and I should litigate the entire matter. Royal offered no evidence of surprise or the inability to defend itself because of inadequate time to prepare, nor did they ask for time to present additional evidence. I took the motion under advisement with

leave to the parties to include argument on this issue in its post-hearing brief.

After considering the evidence submitted at the hearing and the arguments of counsel, I find that I have jurisdiction to hear the matters raised by the amended notice. Royal's motion that I not consider the amended notice is, therefore, DENIED.

During the course of the hearing, SFAP withdrew the allegations regarding the failure to properly administer satisfactory academic progress and failure to provide consumer information. This action removed those allegations from consideration as a basis for the termination of Royal and reduced SFAP's requested fine by $20,000. In addition, SFAP withdrew some of the specified violations of ability-to-benefit, unsigned SARs, and failure to pay refunds.

DISCUSSION ON MERITS

A representative of ED's Office of Inspector General (OIG) testified that he reviewed the records for Royal and determined that Royal had not filed the required two-year audits due on June 30, 1992, and June 30, 1994. Further, Royal's last audit was filed in 1989. He stated that ED

apparently does not track late filings of audits and that Royal was not, as far as he knew, informed previously that they were in violation of Title IV by not filing.

One of the program reviewers testified that he reviewed a random sample of 20 student files at Royal. He noticed that in four such files, a copy of the ability-to-benefit test used to determine the student's eligibility to participate in Title IV student financial assistance was not contained in the file, as required. He asked officials of the school for copies of these tests, but none were provided.

Out of the 20 files examined, he found four where a refund was not made, as required. In three of these cases, the student received a disbursement of federal aid after that student had ceased to attend classes. This amount should never have been credited to the student and should have been refunded in its entirety. (At the hearing, OSFA withdrew the allegation involving the fourth student.) Because of these findings, the reviewer demanded that the school do a full file review to determine the extent of the problem. Royal has yet to do so.

In seven of the 20 student files reviewed, the reviewers found that there was no signed SAR in the file, as required. The amended notice added five more students to the list of those

without a valid SAR. Again, although he asked, none were provided by school officials during the program review.

In four of the 20 files, students were listed as being on an approved leave of absence, yet there were no documents in the file to support the granting of such status. The import of such an action is that if the student is not on a proper leave of absence, the student is not currently attending and should either be withdrawn or terminated from school, thus terminating one's entitlement to federal student financial assistance.

Of the 20 files reviewed, seven contained no evidence of FFEL entrance counselling, as required by 34 C.F.R. § 682.604 (f), and five did not contain any evidence of exit counselling, as required by 34 C.F.R. § 682.604 (g).

In addition, a compliance specialist from the United Student Aid Funds guaranty agency testified that she performed a review of the administration of the FFEL program at Royal in November 1992, after receipt of complaints from some of Royal's students. She observed numerous failures to follow the administrative requirements of the Title IV programs and concluded that Royal lacked the administrative capability to administer these programs. She and Royal have exchanged correspondence since then in an attempt to close out the findings in her report.

In defense, the owner of Royal testified regarding the allegations raised by the program review. He stated that at the time of the review he was going through personal tragedies - his son was in the hospital and his wife had an automobile accident. Even though he is the hands-on manager of the school, this necessitated his absence from the school for long periods of time. He stated that the bank records were maintained at the office of his "servicer" and, therefore, were not available. If there was any failure to provide records, he argued, it was as a result of misunderstandings exacerbated by his absences. Moreover, he claimed that Royal has a good

history of graduation, licensing, and placement rates. The school has been on the Pell Grant cash reimbursement system where all claims for Pell payment are reviewed by an independent agency approved by ED.

He complained that it took over a year after the review for the notice of intent to terminate to be issued, when common practice is that it should only take a few months, at most. He pointed out that ED's OIG conducted an audit at Royal shortly after the program review. The OIG report found no evidence of fraud. As to the failure to file audits, he testified that he did not realize that he was required to file the first audit because he believed the program review was a sufficient substitute. He believed that the second audit had been filed; when he realized that it had not been filed, on December 8, 1993, he engaged a

C.P.A. to perform both of the audits with an estimate that they should be completed by November 20, 1994.

As to the failure to properly administer leaves of absence, he testified that some of the cases cited in the review were instances of a request for a short time off, which are treated differently, and not a true leave of absence. He stated that the students in question were still in attendance when they received their Title IV payments.

He testified that the school regularly carries out entrance and exit counselling. The entrance counselling requirement is met by use of a test, the application, and a film. The exit counselling was accomplished by use of a form. He could not explain why evidence of such counselling was not included in the student files.

As to the ability-to-benefit issue, the school utilized the Able Test, which was independently administered and maintained by the examiner. He knew of no requirement that a copy of the test must be in the student files. He understood that a copy of the certification by the test administrator, which was maintained in the files, was sufficient.

As to the allegation that Royal did not maintain signed SARs in the file, he maintained that there was a signed SAR in each case. He added that some files contained numerous unsigned copies of the SAR, but only one copy is required to be signed. He surmised that during the audit, some of the signed SARs were in the office but had not yet filed in the student records.

A consultant hired by Royal testified that he reviewed the files at Royal sometime after the issuance of the program review. He is a retired ED employee who formerly served as an ED program reviewer. He testified that the certificates he saw in the student files attesting to the successful completion of an ability-to-benefit test were sufficient to establish the students' eligibility; he found all the signed SARs in question in the student files; and he determined that copies of entrance and exit counselling were available at the school. He did admit that he could only testify as to what was in the files as of the time he reviewed them. On cross-examination, his credibility was attacked by his admission that he had been de-certified as a test examiner, yet, on one occasion, he administered an ability-to-benefit test. At that time, when questioned by an ED employee, he produced a credential which made it appear that he was still certified.

One current and two former students testified in rebuttal. In summary, they detailed certain problems that they personally had with student financial assistance at Royal. In one, the student

was not credited with a Pell grant, even though she was eligible. In another, the student cancelled a GSL, yet, after graduation, was asked to repay the loan. Royal cashed her student loan check without either her knowledge or indorsement and, as a result, she was relieved of any obligation to pay for the loan. The third testified that she had enrolled, withdrawn, and re-enrolled at a later date. She was asked by Royal's owner to produce and sign a SAR for the period of her first enrollment and backdate it (approximately two years) so as to make it appear to be timely.

TERMINATION ISSUE

The procedures for initiating the termination of eligibility of an institution to participate in the Title IV, HEA programs are set forth in Subpart G, 34 C.F.R. § 668.81 et seq. During any such proceeding, ED has the burden of proof and persuasion. See, 34 C.F.R. § 668.88(c)(2). The Secretary may terminate or limit the eligibility of an institution to participate in any or all Title IV, HEA programs, if the institution violates any provision of Title IV or any regulation or agreement implementing it. 34 C.F.R. § 668.86(a).

In this proceeding, ED seeks termination for Royal's failure to submit biennial audits. I find that Royal failed to file the audits which are required by 34 C.F.R. § 668.23 (c)(3). As a consequence, I must find that termination of Royal's eligibility to participate in the Title IV programs is warranted. 34 C.F.R. § 668.90 (a)(3)(iv).

In further support of its proposed termination, ED points to the violation of failure to make refunds to students who have either graduated or dropped out, as required by 34 C.F.R. §668.21. Royal disputes the violation, but I find that the evidence is sufficient to show there was such a violation. I reach the same conclusion regarding Royal's failure to maintain signed SARs, copies of ability-to-benefit tests, and evidence of entrance and exit counselling in the student files, as well as its failure to properly determine leaves of absence. The evidence attesting to Royal's failure to provide records to program reviewers when properly requested to do so is also convincing. I find that Royal's evidence to the contrary is not completely exculpatory and, in any case, is not persuasive.

Finally, I find that SFAP has met its burden of establishing by the totality of the evidence that Royal failed to comply with the standards of administrative capability and, further, by its various actions and inactions, failed to uphold its required fiduciary standard of conduct.

FINE CONSIDERATIONS

In addition to the proposed termination of eligibility, SFAP seeks a fine of $75,000 (reduced by $20,000 at the hearing) in its original notice. This is broken down as follows: $10,000 for failure

to make refunds, $10,000 for failure to have signed SARs, $10,000 for failure to conduct entrance and exit counselling, $10,000 for failure to correctly administer leaves of absence, and $15,000 for failure to provide accounting and fiscal records. The amended notice adds a requested fine of $25,000 for failure to file audits and $9,000 for additional unsigned SARs and ability-to-benefit violations.

SFAP chose to present no evidence addressing the issue of the fines sought from Royal. In Puerto Rico Technology and Beauty College, and Lamec, Inc., Docket No. 90-34-ST, U.S. Dept. of Educ., (June 11, 1993), the Secretary iterated the statutory and regulatory requirement that in setting an appropriate fine, one must take into account the gravity of the violations as mitigated by the size of the institution.

No doubt Royal erred in not meeting its obligations to properly administer the Title IV programs. I believe that Royal operated in an inefficient manner where administrative requirements were not afforded any attention, and that Royal belatedly attempted to "fill in the holes" in its documentation. However, I find no compelling evidence of fraud. Therefore, I believe a fine of $25,000 is warranted. Because there was no evidence to the contrary, I find that Royal is a small school and, in view of the fact that there is insufficient evidence of bad faith, such a mitigated fine is adequate and reasonable.

FINDINGS

(1) ED has met its burden of proving that:

Royal failed to submit required audits due on June 30, 1992, and June 30, 1994.

Royal failed to provide fiscal and accounting records, failed to demonstrate administrative capability, and failed in its fiduciary standard of conduct.

Royal did not make timely refunds as required.

Royal failed to properly maintain signed SARs.

Royal failed to properly administer leaves of absence.

Royal failed to maintain a copy of ability-to-benefit tests in students' record.

Royal did not maintain evidence of entrance and exit counselling.

(2) Royal's participation in federal student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended, should be terminated.

(3) Royal should be fined $25,000.

ORDER

On the basis of the foregoing it is hereby ORDERED that the eligibility of Royal College of Beauty to participate in the student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended, be terminated.

It is further ORDERED that Royal College of Beauty, immediately and in the manner provided by law, pay a fine in the amount of $25,000 to the United States Department of Education.

Judge Ernest C. Canellos

Issued: November 29, 1994
Washington, D.C.

S E R V I C E

A copy of the attached decision was sent to the following:

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