

IN THE MATTER OF SAN JUAN CITY COLLEGE
Respondent.

Docket No. 93-88-ST
Student Financial Assistance Proceeding

DECISION

This proceeding arises under Title IV of the Higher Education Act (HEA) of 1965, as amended (HEA Programs). The Office of Student Financial Assistance Programs (SFAP) of the Department of Education (ED) seeks to terminate San Juan City College of Santurce, PR, (SJCC) from further participation in Title IV HEA Programs. SJCC does not meet certain financial requirements for such participation, but attempts to show that it meets certain Other criteria which would permit continued participation in HEA programs. Essentially, the question herein is whether SJCC is financially responsible under ED regulations. SFAP also seeks to terminate and fine SJCC \$38,600 because SJCC submitted an overdue annual compliance audit.

Between March 1-3, 1994, at San Juan, Puerto Rico, and on March 24, 1994, at Washington, D.C., this tribunal held an oral hearing to consider whether SJCC's eligibility to participate in the HEA Programs should be terminated and whether SJCC should be fined. Prior to the oral hearing a considerable volume of written evidentiary statements were filed. Post hearing opening and reply briefs also were filed, as were supplemental closing briefs on July 15, 1994. Further comments were received thereafter, with the last dated July 25, 1994.

Statement of Facts

SJCC is a post-secondary vocational and technical school. The main campus is at Santurce with branch locations at Juana Diaz and Arecibo, PR. As of March 1, 1994, its student enrollment was 1,340. Few of its students default. Also, it has an excellent graduate placement rate.

SJCC fails to meet certain regulatory requirements for financial responsibility codified at 34 C.F.R. § 668.13. [See footnote 1](#)¹

Subsection 13(a) thereof provides that: "To begin and to continue participation in any Title IV, HEA program, an institution must demonstrate to the Secretary that it is financially responsible under the standards established in this section." That provision requires an institution to demonstrate that it is financially responsible. Nonetheless, SFAP has a responsibility under 34 C.F.R. § 668.88(c)(2) initially to show that SJCC fails to meet certain basic financial requirements.

SFAP submits financial statements of SJCC for fiscal years ending June 30, 1991, and June 30, 1992. SFAP shows that SJCC's ratios of current assets to current liabilities for each of these fiscal years fail to meet certain numeric standards prescribed at 34 C.F.R. § 668.13 for participation in HEA Programs. An audited balance sheet as of September 30, 1993, reflects a continuing imbalance of current assets to current liabilities. SJCC, therefore, fails a financial

responsibility test under ED regulations. 34 C.F.R. § 668.13 (c). SFAP also demonstrates that SJCC had operating losses during fiscal year 1992. However, the school does show a profit for a three month period ending September 30, 1993, and also shows a positive net worth as of that date. This, nonetheless, is not shown to have persisted for an entire year. SJCC Ex V.

In order to meet standard ED financial responsibility requirements, an institution must be able to demonstrate to the Secretary of Education that it meets certain numeric tests set forth in 34 C.F.R. § 668.13 (c). That paragraph states, in pertinent part:

(c) Notwithstanding paragraph (b) of this section, the Secretary considers an institution not to be financially responsible if-

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

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

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

(2) Under an accrual basis of accounting, it had, at the end of its latest fiscal year, a ratio of current assets to current liabilities of less than 1:1;

34 C.F.R. §668.13 (c).

In verified statements, a spokesman for ED's Financial Analysis Branch (FAB), Ronald Selepak, explains that SJCC's 1992 and 1993 fiscal year financial statements fail regulatory requirements for demonstrating financial responsibility:

Q. What is financial responsibility?

A. Financial responsibility, in the definition of the regulations, is that an institution is able to meet all of its obligations including refunds and also meet the standards, the numerical standards that are in the outline at 34 C.F.R. § 668.13.

Q. If I could redirect your attention to the Department's Exhibit 3 and ask you to take a look at that and identify it for me?

A. This is a financial statement of San Juan City College for the year ending June 30, 1992.

Q. Did the Financial Analysis Branch perform an analysis of this financial statement for

- purposes of determining whether San Juan City College met the standards of financial responsibility?

A. Yes.

Q. And what was its conclusion?

A. The conclusion was that San Juan City College did not meet the factors of financial responsibility.

Q. And was that based on Exhibit 3?

A. Yes. Based on Exhibit 3, FAB reviewed the information therein, and concluded that the institution did not meet the current ratio standard. And the determination was, therefore, that SJCC did not meet the standards of financial responsibility based on this balance sheet.

Q. What is the current ratio standard?

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A. The current ratio standard is the institution's ratio of current assets to current liabilities. Current assets are those assets that an institution can reasonably expect to convert to cash within the next business cycle, and current liabilities are those liabilities that the institution is expected to pay within the next business cycle.

Q. And what is a business cycle?

A. In this case, it would be a year. Q. Twelve months?

A. Yes. Q. These are standard accounting criteria?

A. That's right. And the determination was that based on the June 30, 1992 balance sheet, San Juan City College did not have current assets equal to or greater than its current liabilities?

Q. And why did you make that determination?

A. In this particular balance sheet, the current assets total \$3,586,439 and the current liabilities total \$7,844,213.

Q. If an institution's current liabilities exceed its current assets, is it financially responsible?

A. No.

Opening Verified Statement of Ronald G. Selepak. ED Ex 8. This information is not contradicted.

Additional information submitted at the hearing shows that SJCC failed from time to time all of the three required tests. CFR provision §668.13(c)(1)(i) requires that an institution should not have "a deficit net worth" nor "operating losses over at least its two most recent fiscal years." Such did occur, except that recent audited statements show some improvement. A September 30,

1993, three month income statement shows SJCC converted an operating loss of (\$232,322) for a period ending June 30, 1993, to the plus side. SJCC Ex V.

Based upon this information, SFAP concludes that SJCC is not financially responsible under at least one of the three numeric tests under ED regulation §668.13. Mr. Selepak, after reviewing the evidence, testifies,

Q. Mr. Selepak, is San Juan City College financially responsible?

A. No. Tr 139.

I agree.

II

- Under section 498(c)(3) (A) of the HEA, SJCC has the option of providing a letter of credit or performance bond to demonstrate that it is financially responsible. 20 U.S.C. §1099(c)(3) (A) . The amount established for the surety is approximately one-half of the amount of HEA Program funds at risk during the award year for which data is available. This requirement is consistent with 20 U.S.C. §1099c(c)(3) (A) .

Evidence was received concerning two performance bonds purchased by SJCC. The two bonds in question, set forth in Respondent's Exhibit M, have expired or otherwise been cancelled by the bonding companies.[See footnote 2](#) SFAP sets one-half of SJCC's HEA Program participation at \$3,170,000, an amount SJCC is unwilling to provide. In this regard, an interim final ED regulation published April 29, 1994, at §668.15(d)(2)(i) establishes the amount of surety at "not less than one-half of Title IV, program funds received by the institution. ..." As well, surety would mean a letter of credit and not a performance bond. The interim regulation became "effective" July 7, 1994, but is the subject of a court challenge.

As noted, Section 498(c)(3) of HEA provides alternatives by which an institution that fails the numeric standards of financial responsibility can otherwise demonstrate financial responsibility. This includes the submission of a performance bond payable to the Secretary. The HEA provides that the amount of the bond must be equal to at least one-half of the institution's "annual potential liabilities" to the Secretary for Title IV funds. The statute, as amended by the Higher Education Technical Amendments of 1993, provides:

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

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

HEA, § 498(c) (codified as 20 U.S.C. § 1099c(c)) (emphasis added). In this litigation, SFAP takes the position that the "annual potential liabilities" of SJCC are equal to the total amount of Title IV funding the school received on behalf of its students during a combination of 1990-91 and 91-92 award years. Tr 32 (Phillips), 74 (Selepak), and 858 (Kelly). Again, as noted, SFAP seeks a surety in the amount of \$3.17 million. SFAP says that such amount is 50 percent of SJCC's "latest" total Title IV participation which is in excess of \$6.3 million. ED Ex 1. SFAP's \$6.3 million figure is based on Pell, SEOG, and CWS program funds received in the 1991-92 award year plus FFEL (then GSL) program funds received in the 1990-91 award year. Thus, SFAP asserts that all of the indicated antiquated Title IV funds paid to students are part of the current annual potential liabilities of SJCC.

SFAP also takes the position that a previously requested amount of surety, \$1.67 million, based on 1992-93 Pell Grant figures no longer is acceptable because the lower amount was based only on SJCC's participation in the Pell Grant program. Tr 857-58. Instead, SFAP wants to go back in time to a combination of 1990-91 and 1991-92 award years for all ED funding.

The school establishes that, as a factual matter, it cannot in any circumstances be liable for the entire amount of Title IV funding it receives in a one-year period. SFAP, of course, provides evidence of how much Title IV aid students received during various periods, all of which have long passed. However, none of SFAP's testimony or documentary evidence explains how the school would be liable for all of the Title IV funding its students received during fiscal year 1994 or 1995, well past the SFAP selected 1991-92 combination year. [See footnote 3](#)³ Indeed, the school's enrollment dramatically dropped after the 1990-91 and 1991-92 award years upon which SFAP bases its estimate of the school's annual potential liabilities. SJCC Ex A. This exhibit shows reduced enrollment in October 1993 of 2500 for award year 93-94 which was further reduced during the same award year to 1340 in March 1994 Tr 159. Also see ED Exs 1 and 6. The latter is a printout of funds received in 1990-91 and 1991-92 which together with Tr 32 (Phillips), 74 (Selepak), and 858 (Kelly) support the \$6.3 million figure. However, SJCC received Federal funds during 93-94 far lower than the \$6.3 million that SFAP shows were received during a combination of 90-91 and 91-92 award years.

It is, as well, impossible for SJCC to have a potential liability for 100 percent of Title IV aid for award year 93-94 or 94-95.

Title IV disbursement procedures applicable to all institutions do not allow a school to receive an entire year of aid where the school provides no educational services to the student recipients of the aid. Further, because SJCC is on a reimbursement system of payment, and not on an advance payment system, ED provides program funds to the school only after the school documents that it is legally entitled to receive the funds. [See footnote 4](#)⁴

SJCC Ex Z; Tr 800-1. Procedures enabling SFAP to pass upon the school's entitlement to Title IV funds before it receives them materially reduces the amount of Title IV program funds at risk. SJCC offers the additional safeguard of subjecting all of its reimbursement requests and underlying documentation to review by an independent certified public accountant with Title IV expertise. This reduces potential liabilities even further. Much more importantly, the evidence establishes that at an earlier time not more than 85 percent of Title IV 90-91 funds are Pell Grant

monies and that presently, 98 percent is Pell Grant money. If a student receives six months of qualifying education at SJCC, there would be no SJCC liability for a Pell Grant which already has been earned. There is an earned Pell Grant requiring no repayment by anyone. At least, such is the case with SJCC where Pell Grants currently are 98 percent of Federal aid. Incidentally, there is no challenge to the quality of SJCC's educational program which, as noted, has an extremely low student loan default rate and an extremely high student placement rate.

SFAP's analysis of SJCC's annual potential liability considers none of these factors. Instead, SFAP deems a combination of the Title IV aid SJCC students received much earlier in 1991-92 and 1990-91 to be a potential liability. This is incorrect for several reasons. As stated, SFAP's estimate of annual Title IV disbursements to SJCC is based on a combination of Title IV funding received in one year and other Title IV funding received in a prior year, both long gone. Tr 32 (Philips), 74 (Selepak) and 858 (Kelly). Given the fact that SJCC's present participation in Title IV funds during the 93-94 award years is much reduced, SFAP's analysis is incorrect for that reason alone. The school also is not at risk for bankruptcy. As well, Pell Grants are earned before there is a second payment. Thus, there is little potential of SJCC liability for Pell Grant refunds, except during the current term. As noted, audited Pell Grants are the present source of SJCC's Federal funding, minus about two percent for loans.

The school's chief financial officer, Mr. Aquiles, testifies that SJCC offers two academic terms during a school year and a third term during the summer. Tr 158. Federal Pell Grants are credited to students' accounts twice a year, once each of two academic terms. Half of the Pell Grant is given out at the beginning of the academic term; the other half is given out at the midpoint of the academic term. Therefore, before the school receives the second half of the Pell Grant, the student recipient completes the first half of the term. A situation in which SJCC faces a refund liability for the total annual amount of Title IV funds is impossible. SFAP does not consider this regulatory safeguard in determining the school's annual potential liabilities. Tr 32 (Philips), 74 (Selepak), and 858 (Kelly).

On March 13, 1992, SFAP placed the school on a reimbursement form of payment because of a pending Office of Inspector General audit. This form of payment is "designed to prevent the misuse of Federal funds to avoid the necessity of pursuing later liability claims against the institution." SJCC Ex Z. The reimbursement instructions state: "The purpose of the reimbursement system of payment is to ensure to the extent possible, that Federal funds under the Pell Grant and campus-based programs are spent properly."

To accomplish this purpose, the instructions provide guidance on how an institution must prepare its requests for reimbursement. The first step is that "[t]he institution must hire a certified public accountant or expert in the administration of the Title IV programs." SJCC engaged the CPA firm of Pannell, Kerr, Forster for this purpose. Additionally, there must be a reimbursement agent approved by ED.

The reimbursement instructions provide that the agent, here a CPA, is to provide an initial tier of expert review to ensure that Title IV funds are properly released to the school. The CPA must "certify, after reviewing the institution's records and documents, that those records and

documents fully support the amount of the institution's request for reimbursement." SJCC Ex Z. The instructions further require the CPA to ensure that the documents:

demonstrate that the institution calculated the student awards properly, that the students were eligible to receive their awards, taking into account such factors as whether they were enrolled in and attending an eligible course at an eligible campus, whether they met ability-to-benefit and satisfactory academic progress standards, and whether they were owed refunds.

Thus, before the school can request reimbursement for funds, it must obtain an expert third-party's certification that it complies with all requirements. Humberto Roche Leon, a certified public accountant with the firm Pannell, Kerr, Forster, serves as SJCC's reimbursement agent. He testifies that in his review of SJCC's reimbursement requests, tolerable errors, which are errors that will not trigger further reviews, are limited to differences of less than five percent. Tr. 598. These procedures reduce the potential liabilities of SJCC. The certification process significantly reduces SJCC's liability for mistakes and adheres to an ED requirement that Federal funds be ". . . spent properly." SJCC Ex Z.

In addition to the CPA reimbursement agent, ED officials review the accuracy of the supporting documentation before reimbursements are made. The regional office of SFAP, in this case Region II, New York, NY, approves the reimbursement request. Tr 35. Examples of the documentation submitted to the regional office include student enrollment, student eligibility, eligible courses, and student progress. Tr 33. SFAP has the authority to deny reimbursement requests. SFAP may affirm a region's request for payment to an institution and, under some circumstances, not pay a request. Tr 37.

The reimbursement process also requires that SJCC deduct Title IV Program funds that it owes from every reimbursement amount requested. SJCC Ex Z. "Where refunds are due when students drop and you have previously requested more than the earned amount, you must net out these amounts when your request for funds is made." Tr 825-26, and Tr 570-71. Thus, a reimbursement request must ensure that SJCC is current on any refunds of Title IV Program funds it may owe.

The reimbursement system of payment thereby reduces the accrual of significant Title IV liability and guarantees that the school cannot incur liability reaching the total annual Title IV disbursements to the school.

The school, in fact, demonstrates that one-half of its actual annual potential liability to the Secretary for Title IV funds is far below the 92-93 award year. Pell Grant to SJCC, even taking a "worst-case-scenario," do not begin to approach prior amounts of student aid by ED to SJCC students. For example, loans to students are now almost non-existent. The school placed performance bonds for more than 50 percent of its potential liabilities. In fact, the school placed bonds for twice the 93-94 potential liability. Indeed, the school thus shows that it is financially responsible, as required by section 498(c)(3) (A) of the HEA. Under 20 U.S.C.A. § 1099c(c)(3) (A) "The Secretary shall determine an institution to be financially responsible" if its performance bond equals at least one-half its annual potential Title IV liabilities to the Secretary.

SJCC is a term institution with two terms per academic year. Thus, with respect to the Pell Grant Program, the school receives \$1,200 to \$1,300 (\$1,150) per student per term. The school's current enrollment is 1340 students. [See footnote 5](#)⁵ Tr 159. In a "worst-case" scenario, all SJCC students would receive a Pell Grant. However, this is not even remotely possible for SJCC students. There is no reason to believe that the entire enrollment of the College would be eligible for a full Pell Grant award.

Typically, student documentation for financial aid is provided by students at a gradual pace. The student population does not supply all of the necessary documentation at the very beginning of the semester. However, a "worst-case" scenario also assumes that every SJCC student provides their student award report, tax returns, and all other required documentation at the same time and before the term begins. Only if this impossible set of conditions occurs does the entire student population begin the term prepared to receive a Pell Grant.

Thus, only in an extreme hypothetical sense does SJCC commence a term with every single student eligible to receive a full Pell Grant and with all of their documentation in order. This impossible situation would result in the College being eligible to request reimbursement in the amount of \$1,541,000, which is equal to the total enrollment, 1340 students x \$1,150 per student. Moreover, a "worst-case" scenario would also assume that the College closes before the end of a term following the receipt of the \$1,541,000 and before earning any of the disbursement. Therefore, a "worst-case" scenario would assume that on the first day of the term, SJCC: (1) posts credits to all 1340 student accounts; (2) compiles all of the documentation for each student; and (3) submits the package to the CPA. The CPA reviews the documentation presented and certifies the accuracy of the College's reimbursement request on the same day. Finally, Region II of the Department reviews the documentation; determines that it is acceptable; passes it on to the Division of Compliance and Enforcement, which itself reviews and accepts the documentation; and approves the release of the funds. Unquestionably, the "worstcase" scenario is an unlikely series of events and yet the school's maximum Pell liability would be \$1,541,000, one-half of which is subject to surety requirements. [See footnote 6](#)⁶ Until recently, the school had two performance bonds in effect for about \$835,000 a piece, totaling over \$1.6 million.

There is no question but that the school's current annual potential liabilities are less than \$1,541,000 and that the school posted bonds in an amount exceeding not just half, but all of its currently much reduced potential liabilities. As stated, the school cut its enrollment of students drastically and is not much involved in Federal aid programs other than Pell Grants.

SFAP asserts that the language of SJCC's performance bonds is unacceptable. Tr 49-50 (Lipton) and 98 (Selepak). SFAP says that SJCC's performance bonds must contain language that is identical to the language of SFAP's form bond. ED Ex 1. "The Department ... will only accept a performance bond that conforms in sum and substance to the existing language contained in the model performance bond." Tr 50 (Lipton) and 98 (Selepak). However, it is not clear what is unacceptable about the language of the bonds submitted by the school. [See footnote 7](#)⁷ Mr. Aquiles testifies that Department officials would not explain to him what changes were required to the bond. Tr 181. Despite SFAP's insistence upon the language of SFAP's form bond, and despite claims that SJCC's bond language is deficient, no official or representative of ED identifies a substantive difference between the SFAP form and SJCC's bond.

Throughout prolonged discussions leading to this action and throughout this litigation, ED officials continue to provide an inconsistent explanation of the merits of the various forms of the bond. Diane M. Sedicum, then-Acting Director of the Department's Institutional Participation Division, thanked the College's counsel for "pointing out . . . inconsistencies in the Performance Bond document," but she was referring to inconsistencies in SFAP's form bond. SJCC Ex E. Mr. Lipton concedes on cross-examination that "[his] understanding is that eventually the school did submit bonds that were acceptable [in form] but not an acceptable amount." Tr 52. After taking counsel for SFAP's direction on redirect examination, Mr. Lipton qualified his answer, saying that he would look to Mr. Selepak or Gene Kelly, a financial analyst at the Department, for advice on this issue. Tr 61-62.

Mr. Selepak testifies that the language of SFAP's form bond, upon which SFAP insists, is not the subject of "notice and comment" regulation promulgation procedure. Tr 140. Question: "The language of the performance bond, the ax-performance bond, has it ever gone through -- [notice and comment]?" Selepak: "No." Even counsel for SFAP concedes that the language of the form bond is not mandated by any "rule, regulation, or a 'dear colleague,' letter or any other general statement to all participants in the Title IV program." Tr 423.

Finally, Mr. Selepak testifies that he is the ED official who makes the determination as to whether or not a performance bond is acceptable. Tr. 98. He testifies that the deficiencies in the SJCC bond are that SJCC had a provision that provided for a 12month renewable effective date of July 1 and that it covered only liabilities on contracts made subsequent to the effective date of the bond. Tr 111. SJCC Ex M. However, upon review of ED's form bond language, SJCC Exhibit L, Mr. Selepak concedes that SJCC's bond actually provides more coverage than SFAP's form bond. To the question: "Isn't it true . . . that the bond that was issued by the College actually provides more coverage" than SFAP's form bond?" Mr. Selepak responded: "I think you're right." Tr 113-15.

SFAP's form bond would only cover a violation if the act or omission took place before the expiration date of the bond. SJCC Ex L. The bond would require repayment of "any and all liabilities owing to the Secretary that arise from acts or omissions by the institution, on or before the expiration date of this bond." The school's bond covers a violation if the act or omission occurred after the bond had expired, provided the liability arose from contracts made during the bond period. SJCC Ex M. There must be repayment of "any and all liability owing to the Secretary that arise from acts or omissions by the institution, respecting contracts made during the bond period." Mr. Selepak admits that, in this respect, SJCC's bond provides more coverage to ED than does SFAP's form bond. Tr 111-15. This is because SJCC almost entirely benefits only from Pell Grants and is on a reimbursement Title IV basis. The possibility of significant SJCC retroactive liability for Pell Grants prior to issuance of a bond is remote. The difference is of major importance because, except for Pell Grants, SJCC presently is scantily involved in Federal Title IV funds.

Asked to identify any other deficiencies with SJCC's bond, Mr. Selepak suggests that SJCC posted an insufficient amount. Tr 115. However, Mr. Selepak makes it clear that he also is not satisfied with the language of the ED model bond. Tr 140. He says: "Perhaps the bond could be

written better and more clear " I conclude that in the circumstances presented, SJCC's proposed bonds are materially superior to SFAP's form bond.

None of SJCC's surety is still in effect. However, SJCC should be given a brief time to resubmit. This must include half of SJCC's annual potential Title IV liabilities to the Secretary. Clear and convincing evidence submitted by SJCC establishes that a bond of \$885,000 is ample for this purpose. As shown, one-half of maximum Title IV liability for award year 1993-94 is \$885,000. This represents one semester of Pell Grants at \$1,541,000 plus 15 percent for other forms of Federal aid formerly received by SJCC, amounting to \$231,000 which, divided by two, equals \$885,000. This one-half amount convincingly is established by SJCC, and likely is much less because SJCC's participation in Title IV non-Pell Grant funds is much reduced from 15 percent of the total to about two percent. SJCC appears willing to provide surety of around \$800,000 or \$900,000. I find that \$885,000 is an amount which is at least one-half of SJCC's potential annual liabilities to ED and SJCC students. (The \$885,000 amount, as noted, may be significantly overstated because at SJCC, Ex A, there is evidence that currently, 96 to 98 percent of SJCC's Title IV funds are derived from Pell Grants; not 85 percent as was true during 1990-91.) Because SJCC has vocational programs of one and two years, there would be few 1990-91, 1991-92, and 1992-93 award year students remaining at SJCC.

There still is a question as to duration of the bonds. SJCC bonds extend for 12 months unless renewed. However, ED's bond can be cancelled. I see a difference without a distinction. Also, ED's bond applies only to Pell Grants made subsequent to the bond, as does SJCC's. I do believe, however, that SJCC's bond should coincide with the exact dates of the school semester extant time of placement.

III

SJCC also places importance on section 2(i)(9)(C) of P.L. 103208 (107 STAT. 2479), the Higher Education Technical Amendments ("HETA") of 1993, [See footnote 8](#)⁸. The school argues ED must find that it is financially responsible under an alternate standard set out in the HETA. [See footnote 9](#)⁹ 20 U.S.C. § 1099c(c)(3)(C). Only technical changes are made by HETA to former section 498(c)(3)(C) of the HEA which provided an alternative means of establishing financial fitness and which spoke in terms of "going concern," a phrase that is precise under CPA accounting standards. A new phrase "precipitous closure" is now in place under the most recent 1993 amendments. Interim final regulations incorporating the Higher Education Amendments of 1992 and the HETA of 1993 are at issue in this case. The interim regulations interpret the HETA changes so as to greatly diminish the alternative methods of establishing financial responsibility. In so doing, the interim regulations purport to conform to Congressional intent. [See footnote 10](#)¹⁰

The interim regulations seek to narrowly construe the recent HETA changes to the financial responsibility standards. [See footnote 11](#)¹¹

SJCC's accountant takes a stab at the meaning of the precipitous closure provisions of section 498(c)(3)(C):

Q. What is your understanding of the phrase "precipitous closure"?

A. That they will not file Chapter 11 or 7 and that the[y] have no intentions to do [so], on their own free will, to go to the bankruptcy court. Q. It's a bankruptcy issue? A. Yes. Tr 732.

However, SFAP, even in the absence of the interim regulations, would permit an institution to avail itself of section 2(i)(9)(C) of HETA, only in situations where an analysis by SFAP of the institution's financial information shows that the institution has taken comprehensive steps to ensure against precipitous closure. 20 U.S.C. §1099c(c)(3)(C). SFAP asserts that SJCC has not made such a showing and that the school fails to establish that it "has sufficient resources to ensure against [its] precipitous closure, including the ability to meet all of its financial obligations."

- 20 U.S.C. §1099c(c)(3)(C). Indeed, SFAP asserts that SJCC's most recent financial statement (SJCC Ex V), viewed in combination with the other information introduced and discussed at the hearing, compels a contrary conclusion. Further, SFAP urges immediate enforcement of the interim final proposed ED regulations next described: A new CFR section 668.15(d) would provide:

(d) Exceptions to the general standards of financial responsibility. (1) An institution is not required to meet the standard in paragraph (b)(5) of this section if the Secretary determines that the institution-

(i) Is located in, and is legally authorized to operate within, a State that has a tuition recovery fund that is acceptable to the Secretary and ensures that the institution is able to pay all required refunds; and

(ii) Contributes to that tuition recovery fund.

(2) The Secretary considers an institution to be financially responsible, even if the institution is not otherwise financially responsible under paragraphs (b)(1) through (4) and (b)(6) through (9) of this section, if the institution-

(i) Submits to the Secretary an irrevocable letter of credit that is acceptable and payable to the Secretary equal to not less than one-half of the Title IV, HEA program funds received by the institution during the last complete award year for which figures are available; or

(ii) Establishes to the satisfaction of the Secretary, with the support of a financial statement submitted in accordance with paragraph (e) of this section, that the institution has sufficient resources to ensure against its precipitous closure, including the ability to meet all of its financial obligations (including refunds of institutional charges and repayments to the Secretary for liabilities and debts incurred in programs administered by the Secretary). The Secretary considers the institution to have sufficient resources to ensure against precipitous closure only if-

(A) The institution formerly demonstrated financial responsibility under the standards of financial responsibility in its preceding audited financial statement (or, if no prior audited financial statement was requested by the Secretary, demonstrates in conjunction with its current

audit that it would have satisfied this requirement), and that its most recent audited financial statement indicates that-

(1) All taxes owed by the institution are current;

(2) The institution's net income, or a change in total net assets, before extraordinary items and discontinued operations, has not decreased by more than 10 percent from the prior fiscal year, unless the institution demonstrates that the decreased net income shown on the current financial statement is a result of downsizing pursuant to a management approved business plan;

(3) Loans and other advances to related parties have not increased from the prior fiscal year unless such increases were secured and collateralized, and do not exceed 10 percent of the prior fiscal year's working capital of the institution;

(4) The equity of a for-profit institution, or the total net assets of a non-profit institution, have not decreased by more than 10 percent of the prior year's total equity;

(5) Compensation for owners or other related parties (including bonuses, fringe benefits, employee stock option allowances, 401k contributions, deferred compensation allowances) has not increased from the prior year at a rate higher than for all other employees;

(6) The institution has not materially leveraged its assets or income by becoming a guarantor on any new loan or obligation on behalf of any related party;

(7) All obligations owed to the institution by related parties are current, and that the institution has demanded and is receiving payment of all funds owed from related parties that are payable upon demand. For purposes of this section, a person does not become a related party by attending an institution as a student. . . .

59 Fed. Reg. 22429-30 (April 29, 1994) .

Application of three of the seven proposed provisions of the precipitous closure requirements might well require the following conclusions. 1. SJCC Is Current on All Taxes It Owes.

Note 6 to SJCC's September 30, 1993, three month financial statements (Resp. Ex. V) shows that SJCC owes \$575,763 in back taxes. Of this, \$24,388 is owed as part of a state unemployment payment plan, \$213,277 is owed as part of a social security payment plan, and \$338,098 plus additional interest is owed as part of a corporate income tax payment plan. Strictly speaking, SJCC meets the requirements proposed to be set forth at 34 C.F.R. §668.15(d)(2)(ii)(A)(1), because it has tax payment plans in effect and is current in its payments under those plans.

2. SJCC's Net Income, or a Change in Total Net Assets, Before Extraordinary Items and Discontinued Operations, Has Decreased by More Than 10 Percent From the Prior Fiscal Year, but May Be Explained by Downsizing Pursuant To a Management Business Plan. .

ED Ex. 3-6, shows net income for the 12 months ending June 30, 1991, to be \$485,419 and shows a net loss for the twelve month period ending June 30, 1992, of (\$824,556). The loss may be attributable to "downsizing pursuant to a management-approved business plan" as allowed in the new regulation. The result of the 1992 loss was explained by SJCC. Many management changes were made by SJCC. The large net loss in 1992, which clearly was a "bad year," does not prohibit SJCC from relying on the limited exception which is outlined in the precipitous closure provision of the proposed regulation. SJCC may well meet the requirement to be set forth at 34 C.F.R. §668.15(d)(2)(ii)(A)(2).

3. SJCC's Equity May Have Increased by More Than 10 Percent of the Prior Year's Total Equity.

Equity, or total net worth, may be increasing. In 1991 it was \$1,246,706. In 1992 it was \$422,150. ED Ex 3. As of June 30, 1993, it had declined even further to a deficit (\$232,322). Tr 26 859-860. However, as of September 30, 1993, net worth was \$433,174. SJCC may well meet the requirement to be set forth at 34 C.F.R. §66i3.15(d)(2)(ii)(A)(4).

Thus, SFAP inaptly argues that the foregoing three financial items deny SJCC an opportunity to rely on the HETA precipitous closure provisions as a safe harbor. SFAP also says that under the interim final regulations, SJCC in no event can meet the precipitous closure exception because SJCC fails the numeric tests during two current and consecutive audit years.

SJCC, of course, disagrees with all of the arguments presented by SFAP. Before the Higher Education Technical Amendments of 1993 were signed into law on December 20, 1993, the provision read: "The Secretary may determine an institution to be financially responsible, notwithstanding the institution's failure to meet the criteria under paragraphs (1) and (2), if" (Emphasis added). However, Congress' substituted the word "shall" for "may." SJCC, therefore says that the Secretary must find an institution to be financially responsible if the institution can show that it has sufficient resources to prevent precipitous closure. The school argues that it has met the requirements of this provision by presenting documentary and testimonial evidence that it is sufficiently financially stable and that it will not precipitously close. [See footnote 12](#)¹²

Specifically, the school presents the testimony of Pannell, Kerr, Forster's certified public accountant, Mr. Humberto Roche, who testifies that in his opinion the College will not close or enter into bankruptcy in the next year. Tr 556. That opinion is supported by an unqualified audited financial statement for the three-month period ending September 30, 1993, which contains a note stating that it is management's opinion that the school has sufficient resources to prevent precipitous closure, including the ability to meet all of its financial obligations. SJCC Ex V. As explained by SFAP's expert witness, Mr. Kistler, CPA:

Notes to the Financial Statements are an integral part of the Financial Statements and, as such, are provided to clearly bring to the attention of the reader items that they might not necessarily be aware of from reading the numerical numbers printed on the forms.

Tr 808. Mr. Roche, at Tr 555, explains that the notes also reflect the opinion of Mr. Roche in that if he had disagreed with the conclusions reached in the notes, he would have been obliged to

provide notice in his Auditor's Report that he disagreed with the conclusion. Indeed, Mr. Kistler testifies similarly:

If he [Mr. Roche] had a disagreement with management, he would be required to address the topic with management to see if management would withdraw their statement, or modify it and if, after consulting with management, they determined that the statement was to management's ability true and correct and it was not misleading to the Financial Statements, then, in fact, it should be included in the notes.

Tr 827. Mr. Kistler explains that if an auditor were not able to resolve a disagreement with management, he would be required to offer a less than unqualified opinion stating his disagreement. Tr 828. Finally, he attributes no significance to the qualifying phrase, "In management's opinion," in Note 11. Tr 845.

SJCC presents two financial statements designed to show that it has sufficient resources to prevent precipitous closure. One of these, a profit and loss statement, covers a three-month, rather than a twelve-month, period. The other, a balance sheet, presents a single snap-shot in time. The applicable statute requires only that a financial statement be audited by an independent, certified public accountant in accordance with generally accepted auditing standards. The statute does not require a twelve-month period. Section 498(3)(C) of the HEA. There is no dispute that the three month P&L statement for the period ending September 30, 1993, or the balance sheet were audited by a certified public accountant under generally accepted auditing standards. In fact, SFAP's Mr. Kistler testifies that the statements were audited in accordance with generally accepted accounting principles. Tr 813, 814. Mr. Kistler testifies that audited financial statements would be reliable and would contain reliable information. Tr 797.

Mr. Kistler also points out that Mr. Roche, in providing an opinion that the College has sufficient resources to prevent precipitous closure, takes on "additional liabilities" other than that which normally would result from an audit. Tr 827. The credibility of Mr. Roche's testimony is bolstered by the fact that he places his reputation and resources, and that of his firm, as surety to ED by stating that the school has sufficient resources to prevent precipitous closure and the ability to meet its financial obligations. Of course, he refers only to his opinion that SJCC will not declare bankruptcy during the fiscal year ending June 30, 1994, a meaningless statement now that the fiscal year has expired. It also is clear that while a balance sheet is a snap-shot of current conditions, a profit and loss statement for only three months is not as probative as one for an entire year. As well, even the balance sheet loses some meaning when identical past periods cannot be compared.

There are demand notes payable by SJCC to the Royal Bank of Canada for \$750,000 and to Scotia Bank de Puerto Rico for \$2,362,093 referenced in note 6 of the twelve and three-month financial statements of SJCC, ED Exhibit 14 and SJCC Exhibit V, respectively. Tr 840-41.

As to these, Mr. Kistler says:

To get a clear picture, one should read the individual notes, but the fact that these are audited statements and they have been prepared [as] such, I would believe the auditor has presented them correctly. Tr. 841.

SFAP asserts that a \$750,000 demand note to the Royal Bank of Canada is a current liability of the school. Such is true. In fact, both SJCC's financial statements include the \$750,000 as a current liability. This is shown on the balance sheet for the audited financial statement for the three-month period ending September 30, 1993. The same amount appears as a current liability on the balance sheet for the unaudited, compiled financial statement for the twelve-month period ending September 30, 1993, as well. ED Ex 14 and SJCC Ex V, respectively. [See footnote 13](#)¹³

Mr. Kistler makes it clear that the fact that the Royal Bank of Canada has filed a collection suit for the \$750,000 does not necessarily mean that the school is subject to precipitous closure. Indeed, the fact that Pannell, Kerr, Forster did not qualify its opinion in the auditor's report establishes that the auditors believe that the likelihood of foreclosure in this case is not a probable outcome, only a possibility. Tr 828-9. Mr. Kistler believes that the notes to the financial statements indicate that the parties are in the process of negotiating a resolution to allow the school additional time to make payment. Tr 850; SJCC Ex V, and ED Ex 14.

Thus, San Juan City College argues that it meets the statutory requirement of Section 498(c)(3)(C) by establishing, with the support of an audited financial statement and the testimony of Mr. Roche and Mr. Aquiles, that the school has sufficient resources to prevent precipitous closure and the ability to meet all of its financial obligations. SJCC believes that SFAP not only fails to refute the school's evidence, but that, as well, SFAP supports the school's position relative to the financial statements. That, of course, is incorrect. In fact, in its July 15, 1994 brief, SFAP includes a copy of a complaint filed against SJCC by a bank for collection of loan extended to SJCC by the bank. The latter seeks to foreclose upon the valuable Arecibo property of SJCC. There is no showing that other SJCC property is involved in the suit. The Internal Revenue Service, which has a tax lien on the property, also is a party to the suit. I am unable on the record presented to make definitive findings concerning Arecibo upon the precipitous closure exception. However, during the hearing, the possibility of sale or foreclosure upon the valuable Arecibo property was discussed. The school takes the position that it can find an alternative rental property at Arecibo.

IV

SFAP shows that SJCC's biennial, non-federal, audit of student financial aid programs for award years 1988-89 and 1989-90 was submitted to ED on April 7, 1992. However, on July 1, 1992, after SJCC submitted its audit, Molly Hockman, the Director of the Division of Audit and Program Review, declared a general extension of audit deadlines for fifteen days for any audit that was outstanding as of July 1, 1992, as part of an "Overdue Audit Project." Mr. Lipton of ED acknowledges that there was in fact an amnesty for otherwise late submission of audits. Tr 45-46.

SJCC Exhibit P is an example of a letter that was sent to institutions that had not submitted its 1988-90 audit as of July 1, 1992. It permitted those institutions 15 days from the date of the letter

to submit audits. Thus, if SJCC had not already submitted its audit, Mr. Lipton testifies that it would have received a letter like SJCC Exhibit P and would have been permitted an additional 15 days to submit its audit. Tr 42. The letter states "to avoid possible termination of your institution's eligibility to participate in the student financial assistance programs, you must immediately resolve this situation." SJCC Ex P. The letter also clearly states, "If we do not receive your written response within fifteen days from the date of this letter, we will proceed with the termination action."

SFAP fails to explain why SJCC is not entitled to the same extension that all other institutions received. In fact, Mr. Lipton acknowledges that SJCC would have received an Exhibit P letter had not the school, just a few months earlier, submitted its audit. Tr 42. Because all other institutions were permitted to submit audits for the same time period as late as July 15, 1992, SJCC cannot be terminated for submitting this same audit on April 7, 1992. As to a fine, it appears likely that schools taking advantage of the amnesty were not fined, although this is not clear.

Mr. Lipton also testifies that the school should not be subject to the maximum fine of \$25,000 for failure to submit the audit on time. Tr 20. Nonetheless, SFAP attempts to multiply a single violation into four violations by counting each program audited as a separate violation.

In *Hartford Modern School of Welding*, Docket No. 90-42-ST, U.S. Dept. of Educ. (February 25, 1991), this Tribunal found that submission of a late biennial audit is a single violation. The law must be applied consistently. SJCC's 1988-90 audit, except for the amnesty, was submitted late on April 7, 1992. SFAP shows that the audit was initially due on June 30, 1991. Thus, SJCC's audit cannot be deemed to be more than 10 months late. The Termination Notice states that audits more than six months, but less than one year, late are subject to one-half of the scheduled fine amount. ED Ex 1. For institutions that received over \$1 million in Title IV Program Funds, the scheduled fine amount is \$25,000. ED Ex 1. Thus, under *Hartford Modern School of Welding*, SJCC's 1988-90 audit amounts to one violation. The Termination Notice provides that the fine for that one alleged violation should not exceed one-half of the maximum fine, \$12,500. However, in light of ED's aforementioned amnesty, there is no violation warranting a fine of any amount.

Discussion and Conclusions

In summary, SJCC's posits three arguments for this Tribunal to consider why the school should not be fined and why the school's eligibility to participate in the Title IV Programs should not be terminated. SJCC argues that, although it fails to meet certain regulatory financial responsibility standards, SFAP seeks to withhold a surety alternative (a bond) that would allow continued eligibility. SJCC asserts that SFAP seeks to impose irrational requirements. Secondly, SJCC argues that its continued eligibility must be allowed because it will not file for bankruptcy protection and, as well, it has a well conceived plan for restoration to financial health. Finally, SJCC argues that it should be neither terminated nor fined because a required audit, while overdue, was submitted along with other audits which were given exculpatory "grandfather" protection by ED.

SJCC's arguments, as previously indicated, mostly are meritorious.

This termination action is based on SJCC's failure to meet the regulatory requirements for financial responsibility formerly found in 34 C.F.R. §668.13. [See footnote 14](#)¹⁴ It is clear that SJCC fails the "numeric tests" described in §668.13. Based on this failure, SJCC's eligibility must be terminated unless it otherwise demonstrates that it complies with the financial responsibility requirements. ED regulation at 34 C.F.R. §668.13 (a) provides, "To begin and to continue participation in any Title IV, HEA program, an institution must demonstrate to the Secretary that it is financially responsible under the standards established in this section." Failure to make such a demonstration of financial responsibility requires that the institution's Title IV Program eligibility be terminated.

Much of the hearing involved the propriety of a surety that SJCC had attempted to provide to ED in lieu of its failure to meet the numeric tests. At page 16 of its initial posthearing brief, SJCC asserts "The College [SJCC] still has a performance bond in effect for \$835,000, Perf. Bond 9314685, Exhibit M . . ." SJCC Posthearing Brief at 16. However, SJCC received a copy of a letter dated April 8, 1994 (8 de abril de 1994), from United Surety & Indemnity Company notifying ED that the bond was cancelled on May 8, 1994. Thus, there currently is no bond provided by SJCC to ED as a demonstration of the institution's financial responsibility. [See footnote 15](#)¹⁵

If a SJCC performance bond, such as No. 9314685, were still in effect, performance bonds no longer will be an acceptable form of surety for an institution to demonstrate financial responsibility according to SFAP's understanding of the interim final ED regulations. On April 29, 1994, as noted, ED published proposed regulations addressing the standards of financial responsibility. These were to be effective on July 1, 1994. 59 Fed. Reg. 22348, 22428-29 (April 29, 1994). SFAP now says that the rules were effective on July 7, 1994. The rules are silent concerning an institution's ability to demonstrate financial responsibility through a bond. Under the proposed new rules, only letters of credit are mentioned. 34 C.F.R. 668.15(d)(2)(i) (59 Fed. Reg. 22429, April 29, 1994).

[See footnote 16](#)¹⁶ However, the rules, which are under Federal court challenge, may never be enforced because they vary materially from the applicable law which specifically refers, for example, to "performance bonds" and one-half of annual potential "liabilities." SFAP would ignore the statutory language referring to "bonds" and "liabilities."

Under applicable law, ED is unable to reject sureties which are shown to be sufficient. As established at the hearing, the amount of even one of the sureties originally provided by SJCC and the form of such surety are sufficient. SFAP seeks to impose arbitrary requirements never adopted by Congress.

SJCC rightfully refuses to provide a surety in the amount established by SFAP at \$3.17 million. The statute in question explicitly states that the surety must be in an amount predicated upon one-half of potential SJCC liability according to the most recent data. Even one of SJCC's sureties would now be adequate for this reason. [See footnote 17](#)¹⁷

SJCC's next argument appears to be a claim that because an accountant testifies that in his opinion SJCC will not file for bankruptcy protection during the next term, this Tribunal must find that SJCC is financially responsible. In making this argument, SJCC, and its accountant, equate the "precipitous closure" provision with a filing for bankruptcy. This simplistic argument is without merit.

In enacting the Higher Education Amendments of 1992, Congress dealt summarily with institutions that file for bankruptcy protection by using such a filing to trigger the loss of an institution's eligibility to participate in most Title IV Programs.

Section 481(a)(4) of the HEA states that an institution fails to meet the definition of an institution of higher education if such institution has filed for bankruptcy. 20 U.S.C. 1088(a)(4). If an institution files for bankruptcy, therefore, it essentially loses its eligibility to participate in Title IV Programs by statutory definition. It might be permissible to interpret the "precipitous closure" provision of §498(c)(3) (20 U.S.C. 1099c(c)(3)) as anticipatory to the conduct (bankruptcy) that Congress addresses in §481(a)(4) (20 U.S.C. 1088(a)(4)). At the same time, SFAP incorrectly asserts that this Tribunal already has accepted the view that legislative history of the precipitous closure provision requires more stringent financial responsibility standards than ever before. SFAP cites my decision, *In the Matter of Mile Hi College*, Docket No. 93-105-ST, U.S. Dept. of Educ. (March 15, 1994), but the decision speaks for itself. I understand the legislative change to be neutral in terms of added leniency or stringency.

Of course, if the interim final regulations "effective" July 7, 1994, endure, SJCC might not be able to avail itself of the "precipitous closure" exception. Possibly SJCC is not current on its taxes; possibly SJCC's net income has decreased by more than 10 percent; and possibly SJCC's net worth has similarly decreased by more than 10 percent. SFAP's Posthearing Brief at 11-14. As well, possibly SJCC will not pass muster for other financial reasons. Naturally, SJCC should be permitted to test such conclusions of SFAP and should be permitted to introduce current information under new standards. I conclude that the new standards cannot be applied, except as SJCC has an opportunity to show compliance therewith.

In my opinion, the legal and factual issues in this case are whether SJCC is financially responsible under Sections 498(c)(3)(A) and 498 (c)(3)(C) of the Higher Education Act of 1965, as amended (HEA). [See footnote 18](#)¹⁸ Under these statutory sections, the HEA provides SJCC at least two alternative means to demonstrate its financial responsibility and, thereby, maintain its eligibility to participate in the Title IV programs. SJCC may be deemed financially responsible if it posts a performance bond covering one-half of the school's potential Title IV liabilities, HEA § 498(c)(3)(A), or if the school has sufficient resources to ensure against precipitous closure, as supported by the report of an independent certified public accountant. These are affirmative defenses as to which SJCC carries the burden of persuading this Tribunal that the bonds provided by SJCC are legally sufficient or that SJCC has sufficient resources to ensure against precipitous closure in the manner provided by statute. As discussed, SJCC has met its burden on one of these issues. Consequently, SJCC cannot be terminated for failure to comply with Title IV financial responsibility requirements.

SFAP offers little on the issue of the adequacy of SJCC's performance bonds. SFAP essentially contends that SJCC's performance bonds have expired, and that, in any event, bonds no longer are acceptable to ED. SFAP does cite to Mr. Selepak's testimony concerning differences in the language of the SFAP form bond and the SJCC bonds. However, Mr. Selepak also testifies that the substantive effect of the differences in language is that in this instance, SJCC's bonds provide more coverage to ED than SFAP's form bond provide. Tr 115. SJCC's bonds do not cover pre-bond liability, but, considering that presently 96 or 98 percent of SJCC Title IV funds are Pell Grants given out under strict controls and also considering that SJCC is under a reimbursement formula for Title IV funds, the one deficiency cited by Mr. Selepak disappears. (Even during award year 90-91, the Pell Grants represented 85 percent of the Title IV funds.) A conclusion is required that in the circumstances presented, SJCC's bonds provide more coverage to ED than SFAP's form bond.

Unaccepted bonds serve no purpose other than to needlessly tie up the SJCC resources used to secure bonds. [See footnote 19](#)¹⁹

Because SFAP fails to provide a rational justification for rejecting SJCC's bonds, SFAP must accept, with modest changes, SJCC's bond form. SJCC was provided by SFAP with the opportunity to post a performance bond in the amount of \$1.67 million as an alternative means of demonstrating financial responsibility. SJCC did exactly that; in fact, SJCC did so before SFAP followed its offer with written confirmation. Given SFAP's failure throughout the negotiations and throughout this entire litigation to provide a material difference between the SFAP form bond and the bonds submitted by SJCC, I conclude that the bonds submitted by SJCC essentially are in an adequate form. As well, because of a greatly reduced Title IV participation by SJCC, the amount of the required bond no longer is \$1.67 million.

As noted, the school's bonds were more than large enough to cover one-half of the school's annual potential liability. Section 498(c)(3)(A) of the HEA requires that such bonds equal one-half of the institution's annual potential Title IV liabilities. SFAP adds to its claims concerning the amount of SJCC's annual potential Title IV liabilities, a citation to 34 C.F.R. § 668.15 as presented in the April 29, 1994 Federal Register Notice. However, amendments made by that notice to 34 C.F.R. § 668.15 are being challenged and appear defective because they do not mention surety bonds and fix a factually unsupported extra amount of potential liability. Consequently, the regulations are problematical as applied to this case. In my opinion, SFAP fails to overcome overwhelming proof by SJCC that SJCC's annual potential Title IV liabilities do not come even close to \$6.34 million. In contrast, SJCC affirmatively shows that one-half of its annual potential liabilities amount to not more than \$885,000, even in a "worst-case" scenario.

As to whether the school has sufficient resources to ensure against its precipitous closure, SJCC demonstrates a commitment to recover from its financial difficulties. These difficulties result in part from the acquisition of an institution in Arecibo and a delay in receiving Title IV eligibility for that location. Tr 16061. SJCC presently has a Financial Development Plan of considerable depth. SJCC Ex U. SJCC shows through the testimony of its Chief Executive Officer, Mr. Luis Aquiles, and confirmed by the school's accountant, Mr. Roche, that it is complying with the Financial Development Plan. Tr. 216-52 (Aquiles); Tr 564 (Roche). The school's implementation of this Plan provides a basis for its certified public accountant to agree

that the school has sufficient resources to ensure against the closure of the school, whether precipitous or otherwise. Tr 554 (Roche).

SJCC also demonstrates that it has valuable real estate assets that might ensure that it will not precipitously close and that it can meet its financial obligations. Indeed, SJCC offers considerable testimony concerning highly valued real estate, but at least one of these properties is subject to a foreclosure suit. The school's balance sheet lists the value of real estate holdings in accordance with generally accepted accounting principles and only historical costs are shown. Tr 559. These are much less than the actual value.

Nonetheless, I am unable to conclude that, as to precipitous closure, SJCC meets the statutory requirements of HEA § 498(c)(3)(C). The SJCC showing that it has sufficient resources to ensure against bankruptcy is not enough. SJCC's owner can withdraw assets from the school. There are no promises by him, and, in fact, he did not testify in this matter. The owner once received a large sum (\$300,000) from the school as salary. No doubt I can invent conditions designed to restrict the owner's freedom to convert SJCC assets but such should come from SJCC, not me.

It is true that SJCC has not had a full opportunity to present evidence on the issues raised by the interim final regulations. Thus, the application of new regulations to this proceeding might require a new round of evidence. Of course, it still is incumbent upon SJCC to present affirmative defenses. The onus is not on SFAP to prove or even to give notice of affirmative defenses that may be available to SJCC. It also is true that SFAP is limited to those specific allegations set forth in the Termination Notice. However, SJCC is not so limited. SJCC can and has invoked alternative means of establishing its financial responsibility. In so doing, SJCC cannot thereby place additional notice requirements upon SFAP. Nonetheless, if ED, through rulemaking, eliminates an affirmative defense, SJCC still should have a nominal opportunity to meet new standards.

Stated differently, SJCC has the burden of raising affirmative defenses; and if new regulations affecting those defenses are effective, SJCC should have an opportunity to satisfy the new regulations. However, because SJCC fails to show that it meets the old standards, I am extremely doubtful that new ED standards for testing the precipitous closure provisions can be satisfied by SJCC.

SFAP's claim that the College submitted its 1988-90 audit of Title IV programs late is insufficient. The circumstances surrounding the submission of the audit do not merit a penalty for SJCC. SFAP renews its contention that SJCC's audit for the 1988-90 award years was more than one year late. SFAP Post-hearing Brief, at 14. SFAP's own witness testifies that the due date for late audits initially was extended until June 30, 1991. SJCC's audit was submitted on April 7, 1992. However, SFAP's witness, Mr. Lipton, also testifies that there was a further general amnesty of audit deadlines. Tr 45-46. SJCC shows that under such a general amnesty the due date for SJCC's audit was July 16, 1992. Thus, the audit was submitted three months earlier than required.

The school also should not be fined or terminated because there were exculpatory circumstances that delayed the completion of the audit. The accountant who prepared the audit testifies that the delay in the finalization of the audit was not attributable to any fault of the school. Instead, it was caused by an unwarranted refusal of the school's previous auditors to provide necessary workpapers for review. Tr 635-39. SJCC Ex N.

As a final matter, I conclude that any bond submitted by SJCC must be for a current 12 month period covering entire semesters. This could require some back dating if a semester already has commenced at the time of the bond's placement. The bond also must be renewed if so specified by SFAP.

FINDINGS AND ORDER

I find that a performance bond as described above in the amount of \$885,000 must be posted by SJCC within 45 days from the date of this decision, except as modified here, in the previous form presented by SJCC. I find that such is a proper demonstration of SJCC's financial responsibility. In addition, SJCC may present a letter of credit of \$885,000 in the event that upon review of this decision, the Secretary of Education finds that new regulations of ED eliminate all utilization of bonds. Failure of SJCC to meet these requirements will result in its termination from Title IV programs. The same 45-day requirement would apply to the filing of a letter of credit, subject to due process requirements that might exist if SFAP imposes requirements not contained in ED rules.

In all other respects, I find that this termination and fine proceeding should be dismissed.

Dated this 9th day of Sept. , 1994 ,

Paul S. Cross
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[Footnote: 1](#) ¹ 1 As discussed herein, on April 29, 1994, the Secretary published new financial responsibility standards to be codified at 4 C.F.R. §668.15.

[Footnote: 2](#) ² 2 The bonds were rejected by SFAP. New bonds are not out of the question should there be ED acceptance of SJCC arguments about form and amount.

[Footnote: 3](#) ³ 3 As will be repeatedly referenced, the Secretary published proposed rules on February 28, 1994, at 59 Fed. Reg. 9526. The Secretary also has published interim final rules changing the financial responsibility regulations at 34 C.F.R. § 668.15. However, these rules are interim final rules, pending further study. The rules also are under court challenge. Moreover, the Secretary of Education has indicated that the rules do not reflect his final position. He has requested public comment on the interim regulations.

[Footnote: 4](#) ⁴ 4 The College has been on a reimbursement form of payment since March 13, 1992.

[Footnote: 5](#) ⁵ 5 SJCC's enrollment level is drastically reduced. As of October of 1993, enrollment was approximately 2500 students. SJCC Ex A. As of early March 1994, during award year 93 - 94, the enrollment dropped to 1340 students. Tr 159. This decrease results in a major reduction of Title IV funds received by the school. SFAP calculations do not reflect this nearly 50 percent reduction, and as a result SFAP figures are incorrect.

[Footnote: 6](#) ⁶ 6 SJCC also participates in the FSEOG, CWS and Stafford Loan Programs. CWS funds are disbursed to students as all wages are disbursed: on an as-earned basis. Thus the likelihood of extensive resultant liabilities is slim. According to SFAP's figures, CWS FSEOG, and Stafford Loan program funds accounted for only 15.7 percent of the total of Title IV funds for 1990-91. ED Ex 6-. The reduction in SJCC's enrollment has not been factored into this analysis. The major reduction reduces overall funding and insures that much fewer FSEOG, CWS, and Stafford Loan program funds are scarcely at risk.

[Footnote: 7](#) ⁷ 7 SJCC Exhibits B through K consists of the correspondence between the College's representatives and Department officials. The requests of the College's representatives for specific concerns of the Department regarding the language of the bond are included in SJCC Exhibits C-3, F, H-2, and J-4.

[Footnote: 8](#) ⁸ 8 The Higher Education Technical Amendments of 1993 became effective as if such amendments were included in the Higher Education Amendments of 1992 (P.L. 102-325), pursuant to §5 of P.L. 103-208 (107 STAT. 2488).

[Footnote: 9](#) ⁹ 9 Under § 2(i)(9)(C) of HETA, the Secretary shall determine an institution to be financially responsible, notwithstanding the institution's failure to meet the criteria under paragraphs (1) and

(C) such institution establishes to the satisfaction of the Secretary, with the support of a financial statement audited by an independent certified public accountant in accordance with

generally accepted auditing standards, that the institution has sufficient resources to ensure against the precipitous closure of the institution, including the ability to meet all of its financial obligations (including refunds of institutional charges and repayments to the Secretary for liabilities and debts incurred in pro-trams administered by the Secretary). 20 U.S.C. §1099c(c)(3)(C)

[Footnote: 10](#) ¹⁰ 10 During Senate hearings on the Higher Education Technical Amendments Senator Pell commented, "We also clarify the financial responsibility provisions enacted as part of the 1992 Higher Education Amendments. This will protect institutions that are not financially at risk, but it does so without weakening the current law. It has been difficult to strike the necessary balance in this area, but the provisions in the amendment will, we believe, make sure that financially at-risk institutions will be subject to careful scrutiny and even exclusion from participation in Federal student aid pro-trams. Our goal in this regard has been a constant one: to insure that students have access to a quality education at schools that are strong and viable institutions of postsecondary education." 139 Cong. Rec. 162-2, S16593 (daily ed. November 19, 1993) (statement of Senator Pell).

[Footnote: 11](#) ¹¹ 11 Under the interim regulations which became "effective" on July 7, 1994, a performance bond, notwithstanding explicit reference thereto in the underlying statute, is not mentioned as a permissible surety for institutions to demonstrate financial responsibility. Only letters of credit are mentioned as being acceptable. 34 C.F.R. §663.15(d)(2), 59 Fed. Reg. 22429 (April 29, 1994). As well, as will be shown, the "precipitous closure" provisions of section 498(c)(3)(C) are constricted to the point of virtual extinction under the regulations. Of course, the regulations are under court challenge.

[Footnote: 12](#) ¹² 12 Mr. Selepak's testimony during direct examination equates the precipitous closure provision in the Higher Education Technical Amendments of 1993 with a standard that requires that an institution be a going concern. Tr 77. He says: " The amendments state that a school that demonstrates to the satisfaction of the Secretary with the support of an audited statement that a school is a going concern." San Juan City College's most recent financial statements do not include a going concern opinion from the auditor, which under precise CPA indicates the absence of a problem in this regard. SJCC Ex v. Also see ED Exs 3, 4 and 14.

[Footnote: 13](#) ¹³ 13 Specifically, the amount is included in the \$1, 630,516 designated as current obligations. The \$1, 630,516 represents the current portion of the long term debt listed in Note 6 of SJCC Exhibit V and ED Exhibit 14. The \$1,630,516 breaks down as follows:

Long Term Debt

<u>Listed in Note 6</u>	<u>Current Portion</u>
\$2,362,093	\$137,502
254,320	2,527
222,650	222,650
516,910	66,697
750,000	750,000
1,652,232	105,981

166,667	74,996
24,388	8,130
213,277	180,000
<u>338,098</u>	<u>82,033</u>
6,500,635	1,630,516

The \$750,000 was properly listed as a current liability in both the audited financial statement for the three-month period ending September 30, 1993. ED Exhibit 14.

[Footnote: 14](#) ¹⁴ 14 As discussed herein, on April 29, 1994, the Secretary seeks to impose interim final financial responsibility standards to be codified at 34 C.F.R. §668.15. Such are under challenge in a Federal court.

[Footnote: 15](#) ¹⁵ 15 As noted in its Posthearing brief and as discussed at the hearing, SFAP would not accept the performance bond SJCC provided because of non-substantive procedural differences from a SFAP favored bond format. The bonds are cancelled. However, SJCC represents that it will resurrect the bonds if given a rational SFAP requirement. I find that a bond of \$885,000 as proposed by SJCC is appropriate, subject to minor structural changes as will be explained.

[Footnote: 16](#) ¹⁶ 16 That section provides, in pertinent part:

(2) The Secretary considers an institution to be financially responsible, even if the institution is not otherwise financially responsible under paragraphs (b)(1) through (4) and (b)(6) through (9) of this section, if the institution-

(i) Submits to the Secretary an irrevocable letter of credit that is acceptable and payable to the Secretary equal to not less than one-half of the Title IV, HEA program funds received by the institution during the last complete award year for which figures are available. . .

34 C.F.R. §668.15(d)(2)(i) (April 29, 1994).

The section, of course, establishes another alternative demonstration, i.e., that the institution can demonstrate to the satisfaction of the Secretary that it has sufficient resources to ensure against its "precipitous closure." 34 C.F.R. §668.15(d)(2)(ii). The "precipitous closure" provision is discussed below.

[Footnote: 17](#) ¹⁷ 17 The interim final regulation clearly is problematical. It defines the institution's surety obligation as the submission of "an irrevocable letter of credit that is acceptable and payable to the Secretary equal to not less than one-half of the Title IV, HEA program funds received by the institution during the last complete award year for which figures are available." 34 C.F.R. §668.15(d)(2)(i). However, the amount of surety SFAP requests from SJCC is far in excess of the potential liability of SJCC. Also, the statute refers to the use of bonds

in addition to letters of credit. Of course, I do not here declare invalid a lawfully established regulation of ED, but, as noted, there is no final ED regulation, only an interim final regulation which is subject to a Federal court challenge. Moreover, even if the interim regulation is applied, such must be done in a manner consistent with the underlying statute. I see the regulation's reference to one-half of Title IV funds, at most, as imposing a rebuttable presumption, one which SJCC rebuts.

[Footnote: 18](#) ¹⁸ 18 Compliance with either of the cited subparagraphs substitutes for failure to meet numeric financial tests.

[Footnote: 19](#) ¹⁹ 19 SJCC confirms the accuracy of a representation of SFAP in its post hearing brief--namely, that Performance Bond No. 9314685 issued by the United Surety & Indemnity Company has been cancelled. SJCC chose to terminate the bond in order to eliminate the restrictions upon the assets used to secure the bond. Inasmuch as SFAP rejected the bonds, SJCC represents on brief that it would be a waste of resources to have the bonds posted until the College is notified that the bonds will be accepted. SJCC, on brief, says that it stands willing to have bonds re-posted after the guidelines are determined by this Tribunal.