IN THE MATTER OF Docket No. 94-151-ST
ART OF BEAUTY COLLEGE,

Student Financial Assistance Proceeding
Respondent.

DECISION

Appearances: Jack L. Simms, Jr., Esq.,of Leesville, Louisiana, for the Respondent.

Denise Morelli, Esq., Office of the General Counsel, U.S. Department of Education, for the Office of Student Financial Assistance Programs.

Before: Thomas W. Reilly, Administrative Law Judge

BACKGROUND

The Respondent, Art of Beauty College (ABC), filed a timely notice of appeal and request for hearing contesting a notice of intent to terminate the school's eligibility to participate in and receive further funds under several programs authorized in Title IV of the Higher Education Act of 1965, as amended (Title IV), 20 U.S.C. §1070 et seq. The termination action is based upon the school's failure to submit its most recent compliance audit, on its repeated violations of Title IV program requirements, and also upon the fact that the school filed for bankruptcy. Respondent also contests a notice of intent to fine the school $36,900 for certain Title IV violations.

On September 23, 1994, ABC appealed the Department's proposed termination and fine, and requested a hearing. This proceeding is governed by 34 C.F.R. Part 668, Subpart G, and the Department has the "burden of persuasion" (34 C.F.R. 668.88(c)(2)).

The hearing on the record was conducted in Shreveport, Louisiana, on March 1, 1995. Both sides were represented by counsel. Counsel stipulated that all exhibits identified by both sides could be received into evidence without objection to admissibility, including some identified for the first time at the hearing.See footnote 1 1/ However, some of ABC's exhibits were never discussed by either witnesses in testimony or by counsel in argument at the hearing and, accordingly, will not be discussed in detail here as they appear to have limited materiality to the legal issues in this

proceeding. (These include, for example, personal medical statements relating to the condition of Patricia Diane Ford, the owner of the subject school, who was the only witness on behalf of ABC to testify at the hearing.)

Counsel for ABC argued that Respondent does not dispute or contest the facts set forth in the exhibits and basic documents of the Student Financial Assistance Programs (SFAP or ED), nor does he seriously contest that ED can take the action it proposes so far as the law and the regulations are concerned. However, the basic thrust of his position is that there are "mitigating circumstances" that should be considered by the Judge, and that the Judge has the discretion to set aside ED's proposed actions in view of the attendant circumstances and the hardship ABC's owner has already undergone and will undergo in the future if she does not have access to additional Federal education funds that would allow the school to continue in operation, as well as to pay off the fines or assessments now demanded by ED, and to make student loan refunds still outstanding and unpaid.

CHRONOLOGY

ABC is a proprietary school owned and operated by Ms. Patricia Diane Ford, offering courses in cosmetology. The college operated a main campus in Leesville, Louisiana, with branch campuses in DeRidder, Louisiana, and Jasper, Texas. However, there was testimony from Ms. Ford that only the Leesville campus would remain open. The college has been participating in Title IV programs since 1985, and its most recent program participation agreement was signed July 22, 1991. On March 31, 1994, the school was required to file a compliance audit for the period July 1, 1991-June 30, 1993, with the Department's Office of the

Inspector General (OIG). The audit was not filed on the due date. As of the present time, the required audit has not been filed with the Department. (See testimony of John Kucholtz, ED Audit Coordinator in the Inspector General's office, Dallas, Texas.) All participants in Title IV are required to have periodic audits performed which review the school's compliance with Title IV program requirements. 20 U.S.C. §1094(c); 34 C.F.R. 668.23(c).

On April 21, 1994, the school filed a petition for bankruptcy with the U.S. Bankruptcy Court for the Western District of Louisiana. The bankruptcy petition lists the debtor as "Patricia Diane Ford, d/b/a Art of Beauty College." Originally filed under Chapter 13 of the Bankruptcy Laws, it was later changed to a petition under Chapter 11. (ED Ex.4)

The Department of Education conducted a program review in January 1994, and ED issued a Final Program Review Determination (FPRD) on June 23, 1994, citing several violations of Title IV. The violations included failure to make timely Federal Family Education Loan (FFEL) and Federal Pell Grant (Pell) refunds. The FPRD noted that similar violations were found in the school's compliance audit for award years 1989-1991. (ED Ex.6) The Department assessed $14,171 in liabilities for those violations. The school did not appeal the findings in the FPRD. To the present time, the school has not paid those outstanding liabilities.

On September 2, 1994, the Department issued a Notice of Intent to Terminate the Eligibility of the school to participate in Title IV programs, based upon the school's failure to submit the

required compliance audits for award years 1991-1992 and 1992- 1993, and its repeated violations of Title IV program requirements specified in the June 1994 FPRD. (ED Ex.10) Also, the Department assessed fines totalling $36,900 for the Title IV violations. On November 4, 1994, the Department amended its termination notice to include the bankruptcy filing as a separate grounds for termination. (ED Ex.11)See footnote 2 2/

DISCUSSION

Two witnesses testified for the Department of Education -- John Kucholtz, from ED Region VI, Office of the Inspector General,

Dallas, Texas; and Michael Wade, an Institutional Review Specialist from the Institutional Review Branch, Office of Student Financial Assistance, ED Region VI, Dallas, Texas. The ED witnesses discussed and were further questioned about the missing compliance audits and the program review documents relating to the ABC school review. Mr. Wade conducted the program review and issued the FPRD on June 23, 1994.

Ms. Patricia Diane Ford, sole proprietor and owner of the Art of Beauty College, was the only witness for the respondent school. She tesified to the problems she has been having lately and her intention to do the right thing, but that lack of funds prevented her from doing all that was required by ED. She testified that her ex-husband took care of the administrative and financial aid matters before their divorce. She also testified that she had paid a CPA to do the required audits, but that he never sent them in. She thinks he requested an extension of time but cannot be sure that he did so. She does not now have the funds to pay the overdue student aid refunds.

Counsel for the school argues (brief, Dec. 21, 1994) that "in neither of (the bankruptcy) proceedings has the debtor attempted to include or seek relief against the U.S. Department of Education, or any other state or Federal agency," and that "the institution has not filed for bankruptcy, but that the owner, individually, has filed" the subject petitions. However, I find this to be a distinction without a difference. The sole owner of the subject school is Ms. Patricia Diane Ford; judging by her testimony this is her only business and has been for some 13 years. The title of the original petition in bankruptcy was "Patricia Diane Ford, d/b/a Art of Beauty College," and it clearly deals with debts incurred by Ms. Ford through and in connection with her operations of the school. So, in essence, it is the institution that is in bankruptcy and clearly its operations are directly affected by the bankruptcy filing. Ms. Ford owns, manages and directs the policies and day-to-day activities of the institution. (Cf., 20 U.S.C. §1088(4)(A).)

The argument is also made that terminating the institution's eligibility (to continue in business and receive more Federal funds) "is in direct conflict with the provisions of the U.S. Bankruptcy Code which prohibit...discrimination against persons who have filed bankruptcy proceedings by effectively preventing them from engaging in business." However, the "automatic stay" provisions of the bankruptcy laws (11 U.S.C. §362(b)(16)) specifically exempt from the stay "any action by a guaranty agency, as defined in §435(j) of the Higher Education Act of 1965 (20 U.S.C. 1001 et seq.) or the Secretary of Education regarding the eligibility of the debtor to participate in programs authorized under such Act."

To be eligible to participate in Title IV programs, a school must

meet the definition of an "institution of higher education." See 20 U.S.C. §1094(a). The definition of an "institution of higher education" includes proprietary schools such as the Art of Beauty College. 20 U.S.C. §1088(a). However, the same statute specifically excludes from that definition institutions which file for bankruptcy. 20 U.S.C. §1088(a)(4):

> (4)An institution shall not be considered to meet the definition of an institution of higher education in paragraph (1) if --
>
> (A)the institution, or an affiliate of the institution that has the power, by contract or ownership interest, to direct or cause the direction of the management or policies of the institution, has filed for bankruptcy.

It follows that by filing for bankruptcy on April 21, 1994, this school effectively removed itself from the Title IV definition of an "institution of higher education", and it is thereby ineligible to participate in Title IV programs. 20 U.S.C. §1094(a). There is no discretion available here for the Judge to substitute his judgement for the clear mandate of the statute.

Respondent's counsel also makes the argument that the term "file for bankruptcy" is "vague and non-specific," and thus any attempt to make those provisions the basis of an action against any entity is "an unconstitutional deprivation of the entity's right to due process of law" (citing the U.S. Constitution). I simply find that argument to be without merit. See footnote 3 3/

There are other separate and independent grounds for terminating the eligibility of this school from participation in Title IV programs. To participate in these programs, the school signs a program participation agreement with the Education Department which specifies various requirements that must be complied with

by the school. 20 U.S.C. §1094. The Secretary has the authority to terminate a school's eligibility based on the school's violation of any Title IV regulation. See 34 C.F.R. 668.86.
In this case, the school failed to file its required compliance audits for award years 1991-1992 and 1992-1993. Compliance audits are essential to the Department's ability to ensure that institutions properly account for Title IV funds, and they are required by both law and regulations. 20 U.S.C. §1094(c); 34 C.F.R. 668.23(c), 668.90(a)(3)(iv). Title IV regulations require the termination of a school's eligibility for failing to meet auditing requirements prescribed in 34 C.F.R. 668.23(c). As expressed in 34 C.F.R. 668.90(a)(3)(iv):

> In a termination action against an institution based on the grounds that an institution has failed to comply with the requirements of §668.23(c)(4), the hearing official must find that termination is warranted.

(Emphasis added.)

For cases wherein the above point has already been ruled upon by the Secretary, see In re San Francisco College of Mortuary Science, Dkt.No.92-8-ST, U.S. Dept. of Education (December 31, 1992), affirmed by the Secretary (March 26, 1994), and In re Institute of Multiple Technology, Dkt.No.92-26-ST, U.S. Dept. of Education (Nov.26, 1993), affirmed by the Secretary (April 18, 1994).

In addition to the termination action, the school has been assessed a series of fines totalling $36,900 as punishment for violation of the Title IV auditing requirements ($18,500 fine), and for repeated violations of refund requirements under the Pell grant and FFEL funds regulations ($18,400 fine). If a student withdraws from an institution prior to the completion of its educational program, the institution is required to refund unearned tuition to the appropriate lender or Title IV program account. 34 C.F.R. 668.22, 682.606, 682.607. Refunds of unearned Pell funds must be made within 30 days from the date the student officially withdraws, and refunds of unearned FFEL funds must be made within 60 days after the student's withdrawal. The documentary evidence (Findings 1 & 2 of the FPRD and Finding 6 of the 1989-1991 compliance audit) clearly establishes that this school repeatedly failed to comply with the refund requirements.

The maximum possible fine is $25,000 per violation, 34 CFR 668.84(a), and the amount of the fine is to reflect "(t)he gravity of the violation ... and (t)he size of the institution." 34 C.F.R. 668.92(a). Although respondent's counsel argues that the $36,900 total fine appears to be "some arbitrary figure

somebody pulled out of the air," See footnote 4 4/ the testimony of the ED witnesses, the ED documentary exhibits and the nature of the violations (some repetitive) indicate that the fines have been fairly and reasonably calculated.

It is not that the Judge has no sympathy for the problems the school owner has had to deal with -- domestic problems, medical problems, and IRS problems -- but the Judge simply has no discretion to disregard a mandatory statute and regulation that removes eligibility from a proprietary school whose sole owner has filed for bankruptcy. Nor does the Judge have the option to eliminate fines for clear violations of Title IV requirements.

Just as the school has a fiduciary relationship toward the Federal funds and loan funds it receives, so a Federal agency has a fiduciary relationship toward the Federal funds (tax dollars) it is authorized to grant or lend. For the past couple of years this school has had its financial books and records not carefully monitored with regard to the Federal HEA funds it has been charged with dispensing and tracking, particularly with regard to required refunds, when and to whom they must be paid. And the failure to have timely required audits conducted is an ominous portent for a school requesting to be kept in the Title IV program, and requesting additional Federal education funds. I recognize that Ms. Ford's ex-husband took care of all these financial and administrative matters before he departed, with Ms. Ford simply handling the teaching aspect of the business. I also recognize her disappointment in the non-performance of the CPA upon whom she relied. However, the ultimate responsibility for ensuring timely audits is hers, as owner/manager of the school. Furthermore, sympathy and understanding cannot substitute for good business management, and a Federal agency that would continue to dispense Federal funds

to a school in such a state of record-keeping disarray would be ignoring its own fiduciary duty to those Federal funds.

FINDINGS AND CONCLUSIONS

After due consideration of all the testimony and evidence of record, and for the reasons discussed above, I find that the Department has met its burden of persuasion in establishing that its proposed termination of eligibility of the respondent school is clearly warranted on the dual grounds (each independently sufficient to support termination) of: (1) the filing for bankruptcy of the school's sole owner, and (2) the school's

failure to submit its most recent compliance audit, and repeated violations of Title IV program requirements relating to failure to make timely required refunds.

I further find and conclude that the fines assessed against respondent are warranted for the violations involved, and have been reasonably and fairly calculated in accordance with the standards and criteria set forth in the applicable regulations.

ORDER

It is hereby ORDERED that the eligibility of the Respondent school to participate in Title IV HEA programs be TERMINATED in accordance with the earlier directions from the U.S. Department of Education to the Respondent Art of Beauty College.

IT IS FURTHER ORDERED that the Respondent school, Art of Beauty College, pay the total fine of $36,900 for the cumulative violations of Title IV program requirements, the fine to be paid in accordance with the directions earlier transmitted to the school by the U.S. Department of Education and the Administrative Billing & Collections Section, USDA, OFM, NFC (see Respondent's Exhibit 3).

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Thomas W. Reilly
Administrative Law Judge

Issued: March 28, 1995.
Washington, D.C.

S E R V I C E L I S T

A copy of the attached INITIAL DECISION was sent to the following by Certified Mail, Return Receipt Requested, on the 28th day of March 1995:

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Footnote: 1 *1/ ED exhibits are numbered 1 thru 19, and are briefly described either in an accompanying list (1 thru 10) or by counsel orally on the record of hearing (11 thru 19).*

Respondent's exhibits were not numbered, but each of the four is briefly described below:

(1)Medical report of Dr.Taghi Shafie, M.D., dated 2/7/95, five pages.(1st page mistake in date:"'94".)

(2)Medical report of Dr. Cyrus Sajad, M.D., dated 2/28/95, two pages.

(3)Notice to Debtor letter from USDA/OFM/NFC, with payment instructions, one page.

(4)Ltr. from attorney Simms to Vernetta Stevenson, ED, dated 10/4/94, one page.

Footnote: 2 *2/ On Nov.4, 1994, the Department also imposed an emergency termination action based upon the bankruptcy filing of April 21, 1994. (See ED Ex.12.) That action was contested but affirmed by Judge Canellos in a decision issued February 10, 1995, Dkt.#94-205-EA, Emergency Action Show Cause Proceeding.*

Footnote: 3 *3/ The arguments of Respondent's counsel are summarized in his post-hearing brief with four main points:*

(1) that the termination on the grounds of filing for bankruptcy is premature;

(2) that termination for failure to file audits should be changed to an order of suspension;

(3) that termination for failure to pay refunds should be dismissed on the grounds that it violates the Bankruptcy Code, and in the alternative the eligibility should merely be suspended until the refunds have been paid; and

(4) that the action to impose fines should be dismissed because they are excessive, out of proportion to the offense, out of proportion to the size of the institution, and in violation of the Bankruptcy Code. Alternatively, any fine should be in a lesser amount.

Footnote: 4 *4/ Hearing transcript, at 110. Also, in his Original Brief for Respondent, counsel asserts that "the fines proposed by the Department are arbitrary and are out of touch with reality. They have absolutely no basis, and constitute excessive punishment."*