In the Matter of COMMERCIAL COLLEGE,
Respondent.

Docket No. 94-158-ST
Student Financial Assistance Proceeding

Appearances:

Peter S. Leyton, Esq., Ritzert & Leyton, P.C., Fairfax, Virginia, for Respondent.

Paul G. Freeborne, Esq., Office of the General Counsel, U.S. Department of Education, Washington, D.C., for Student Financial Assistance Programs.

Before: Judge Ernest C. Canellos

DECISION

Commercial College (Commercial), is a private, for-profit, post-secondary institution offering a variety of training programs at two schools: Commercial College of Baton Rouge and Commercial College of Shreveport, Louisiana. The schools participate in the Pell Grant Program, authorized under Title IV of the Higher Education Act of 1965, as amended (HEA), which is administered by the office of Student Financial Assistance Programs (SFAP), United States Department of Education (ED).

In September 1989, Commercial filed a Petition for Reorganization under Chapter 11 of the Bankruptcy Code. A reorganization plan was approved in May 1990. In July 1991, ED's Office of the Inspector General (OIG) issued a final report of an audit which had been conducted at Commercial. The report covered, among other things, Commercial's compliance with ED's financial responsibility requirements through January 1990. The OIG found that Commercial failed to meet ED's financial responsibility standards because it was in bankruptcy and recommended that Commercial be required to secure a surety as a condition of continuing in the Title IV programs.

In November and December 1991, SFAP issued program review reports for Commercial's two schools, finding that the schools were not financially responsible because they were in bankruptcy. In addition, SFAP proposed to debar the owner of the two schools and terminate the schools' eligibility to participate in the Title IV programs. On June 4, 1992, SFAP and Commercial entered into a settlement agreement resolving the actions against Commercial and its owner. Paragraph 16 of the Settlement Agreement provides:

> Nothing in this agreement shall be construed to limit ED's authority to initiate, or Commercial College's right to respond, to an emergency action, limitation, suspension, or termination action against Commercial College . . . if ED receives information unrelated to this Agreement that Commercial College is violating the rules and regulations governing Title IV student financial assistance programs. However, ED agrees not to initiate such action based on the findings and determinations of the program reviews dated October 31, 1991, and November 15, 1991, . . . , and OIG Audit No. 06-90510, which formed the bases for the proposed debarment, proposed terminations, alleged audit liabi- lities, and loss of eligibility to participate . . . .

On September 12, 1994, SFAP issued a Notice advising Commercial of its intent to terminate Commercial's eligibility to participate in federal student financial programs under Title IV of the HEA. No fine was proposed. The basis for such action was Commercial's failure to meet the regulatory standards of financial responsibility. Commercial timely requested a hearing. An evidentiary hearing was scheduled to convene on April 18, 1995. The parties, however, jointly requested, and I granted, a substitution of briefs and evidentiary matters in lieu of such an evidentiary hearing. SFAP filed an initial brief on April 26, 1995. Commercial filed a brief on June 7, 1995. A reply brief was file by SFAP on June 21, 1995.

To continue to participate in the Title IV federal student financial assistance programs, an institution must demonstrate it is financially responsible. 34 C.F.R. § 668.15(a). Such an institution must satisfy all the general standards of financial responsibility enumerated in 34 C.F.R. § 668.15(b). Within the category of general criteria, as pertinent to this proceeding, are included: (1) the institution must meet at least a 1:1 acid test ratio, 34 C.F.R. § 668.15(b)(7)(i)(A) and, (2) the institution must maintain a positive tangible net worth for its latest fiscal year, 34 C.F.R. § 668.15(b)(7)(i)(C).

The termination notice recited that SFAP had reviewed the audited financial statements of Commercial for Fiscal Years 1993 and 1994 and determined that Commercial failed both the acid test ratio and the positive tangible net worth test for each such year. Specifically, in 1993, Commercial's acid test ratio was 1:4.4 at the Baton Rouge Campus and 1:2.4 at Shreveport. In addition, Commercial had a negative tangible net worth of $490,820 at Baton Rouge and $523,110 at Shreveport. For 1994, the figures were: acid test ratio of 1:3.4 at Baton Rouge and 1:1.78 at Shreveport; and, negative net worth of $383,160 at Baton Rouge and $356,760 at Shreveport. Commercial does not dispute these figures. I, therefore, find that Commercial did not satisfy the acid test ratio and positive net worth standards of financial responsibility for the years and in the amounts detailed herein.

Although not included in the September 12, 1994, Notice as a basis for termination of eligibility, SFAP argues in its brief that Commercial also fails to meet another general standard of financial responsibility because the audit report for Commercial's most recent fiscal year contains a statement by the accountant expressing substantial doubt about its ability to continue as a going concern. 34 C.F.R. § 668.15(b)(6)(i). I find that SFAP's evidence supports such an allegation.

Similarly, argued in SFAP's brief yet not included in the Notice, is an allegation that Commercial fails to satisfy the general standard by its inability to satisfy its financial obligations to the Secretary. 34 C.F.R. § 668.15(b)(3)(ii). SFAP claims that this violation is established by

Commercial's default in payment of $58,795.58, which was due the Secretary pursuant to the terms of the settlement agreement enumerated above. Commercial claims that, although it had received notices of default, these have all been cured. As to this allegation, I find that SFAP has failed to meet its burden of proof and, therefore, I find for Commercial on this issue.

Commercial also asserts that SFAP's termination action is barred by paragraph 16 of that settlement agreement. Specifically, it concedes that the agreement provides that SFAP is authorized to take adverse action against Commercial if it receives information of violations independent of the reports which ultimately resulted in the settlement agreement. However, Commercial argues that SFAP was knowledgeable of these financial conditions, initiated previous actions on the same lack of financial responsibility grounds and, therefore, this action is barred. SFAP, in response, argues that this action does not reopen any issues which were resolved by the settlement agreement, and hence this proceeding is authorized.

Upon my review of the facts of this case, I find that whether Commercial is currently financially responsible was not at issue in the previous proceedings and, therefore, the reservation in the settlement agreement authorizes SFAP to initiate this action. To accept Commercial's hypothesis would result in an indefinite immunity from action against it for similar generic violations.

This clearly would not be a reasonable reading of such language. Rather, I find that the settlement agreement was meant to, and did, settle the case and controversy then in existence. The current dispute, the financial condition of Commercial at the current time, was not in issue then.

An institution which fails to satisfy the general standards of financial responsibility may still be considered financially responsible if it submits an irrevocable letter of credit equal to one-half the Title IV funds that it received during the last award year. 34 C.F.R. § 668.15(d)(2)(i). No such letter of credit was submitted. Commercial, referring to In the Matter of San Juan City College, Docket No. 93-88-ST, U.S. Dep't of Educ. (September 9, 1994), argues that the regulatory implementation regarding the letter of credit exception conflicts with 20 U.S.C. § 1099c(c)(3)(A), and I should, therefore, disregard it. Specifically, the regulation requires a letter of credit in the above listed amount while the statute authorizes the submission of a performance bond or surety in lieu of a letter of credit and provides that the amount shall be no less that one-half of the potential liability of the institution to the Secretary. It calculates such liability as $48,000 and the surety requirement as $24,000. Further, since Commercial is on the Pell reimbursement system, SFAP retains at any one time approximately $130,000 which the school has earned. This de facto letter of credit should vitiate against the need for any further surety.

SFAP argues that the regulation is in accord with the statute and Commercial has the burden of showing that the amount of the letter of credit is unreasonable, 34 C.F.R. § 668.90(a)(3)(iii). Further, it argues that I must give full force and effect to regulations promulgated by the Secretary, 34 C.F.R. § 668.89(d). I find that the regulation, 34 C.F.R. § 668.15(d)(2)(1), is clear and unambiguous and I must apply it in this case. Doing so, I find that Commercial has not provided the requisite letter of credit, and, therefore, may not claim to be financially responsible on that basis.See footnote 1

Another affirmative defense available to schools who are not financially responsible is to establish to the satisfaction of the Secretary that the it has sufficient resources to insure against precipitous closure. 34 C.F.R. § 668.15(d)(2)(ii). To assert this defense, however, an institution must establish that it had demonstrated financial responsibility in its previous audited financial statement. Commercial argues that, similar to the letter of credit provision previously discussed, the regulatory implementation conflicts with the statute, 20 U.S.C. § 1099c.(c)(3)(C). For the same reason, I find that the regulation is clear and I must apply it. Doing so, I find that Commercial does not satisfy the threshold requirement of previous financial responsibility and, therefore, may not assert this affirmative defense. 34 C.F.R. § 668.15(d)(2)(ii)(A).

Finally, if an institution fails to satisfy the general standard of maintaining minimum cash reserves to pay tuition refunds, it may still be considered financially responsible if it participates in a state sponsored tuition recovery plan acceptable to the Secretary. 34 C.F.R. § 668.15(d)(1). Commercial claims it is a participant in the Louisiana State Tuition Recovery Plan, and that it would be eligible for this exception but for ED's arbitrary and unreasonable delay in approving Louisiana's plan. SFAP rejoins that this defense applies only to satisfy the factor of inadequate cash to pay refunds, and that factor is not in issue in this case. 34 C.F.R. § 668.15(d)(1) specifically provides that this affirmative defense applies only to a situation where an institution does not comply with the standard in 34 C.F.R. § 668.15(b)(5). My review of the facts reveals that this section is not implicated in this proceeding; therefore, I find that Commercial's argument on this issue is without merit.

In summary, I find that Commercial fails to satisfy the standards of financial responsibility for the following reasons: an unacceptable acid test ratio, a negative net worth, and the accountant's doubt as to its ability to continue as a going concern. Failure as to any one of these factors renders the institution not financially responsible. Further, I find that Commercial has not established that it may avail itself of the following affirmative defenses: it has furnished an appropriate letter of credit, it is not in danger of precipitous closure, or that it participates in a state-sponsored tuition recovery fund.

The procedures for terminating the eligibility of an institution to participate in the Title IV, HEA student financial assistance programs are enumerated in 34 C.F.R. § 668, Subpart G. Section 668.86(a) provides that the Secretary may terminate or limit the eligibility of an institution to participate in any or all Title IV, HEA programs, if the institution violates any provision of Title IV of the HEA or any regulation or agreement implementing that Title. SFAP seeks termination for Commercial's failure to meet the requirements of financial responsibility. The record clearly supports such a finding.

Commercial points out that its financial condition is improving, its enrollment is climbing, and this action is severe and unwarranted. Such factors cannot act as defenses to the proposed action and they can only be considered by one who possesses plenary authority -- the Secretary.

ORDER

On the basis of the foregoing, it is hereby ORDERED, that the eligibility of Commercial College of Baton Rouge and Commercial College of Shreveport, Louisiana, to participate in the student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended, is terminated.

Judge Ernest C. Canellos

Dated: August 3, 1995

Footnote: 1 Whether and to what extent the implementing regulation is in conflict with the statute, is a question that is not properly before me. I note that in In the Matter of San Juan City College, supra, Judge Cross discussed the potential conflict. However, his decision was predicated upon a finding that the school had established that they had complied with the statutory provision, and on the fact that the regulation had not yet been implemented. I do not, hereby, indicate any opinion as to whether there is any such conflict.