IN THE MATTER OF METROPOLITAN CAREER INSTITUTE,
Respondent.

Docket No. 94-6-SP
Student Financial Assistance Proceeding

DECISION

Appearances: David H. Larry, Esq., and Gregory P. Schaffer, Esq., of Manatt, Phelps & Phillips, for the Respondent.

S. Dawn Robinson, 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

This is an appeal under Subpart H of 34 C.F.R. Part 668 contesting a Final Program Review Determination (FPRD) issued on October 28, 1993, by the Region II Office of Student Financial Assistance Programs (SFAP), U.S. Department of Education (ED or the Department). The FPRDSee footnote 1 1/ ordered the return of $17,423,964 which represented all of the funds disbursed to the Metropolitan Career Institute (MCI or the school) under Title IV of the Higher Education Act of 1965 ("Title IV funds") in the 1989-90 and 1990- 91 award years, and included costs and estimated default losses of $275,019 under the Stafford Loan program. The basis for the demand for reimbursement was the school's failure to perform a required file review and failure to submit a required close-out audit when the school closed. MCI closed on August 30, 1991,See footnote 2 2/ shortly after the issuance of ED's Program Review Report. The

reason given by MCI for failure to have the close-out audit performed was lack of financial resources at the time.

While the Department's regulations require close-out audits covering all Title IV funds received by a school, 34 C.F.R. 668.25(a)(2)(II), the FPRD asserts liabilities only for the last two award years of MCI's operation. SFAP has simplified this proceeding by concentrating on MCI's failure to account for funds received (failure to provide a close-out audit), and only for those last two award years. Therefore, other sources of liability specified in the FPRD are not included in this review. The parties have stipulated and agreed: (a) that MCI has not (to this date) filed the required close-out audit, and (b) that the sole issue here is the impact of MCI's failure to perform the required audit (i.e., whether SFAP can demand return of the full amount of Title IV funds disbursed in those two award years based solely on failure to provide the close-out accounting required by regulation).

DISCUSSION

As a threshold matter, Respondent makes the argument (Opening Brief, at 3, fn.3, & at 5) that the FPRD should be dismissed as moot "in light of the commitment by NATS to perform a full close- out audit for MCI" (sometime) "over the next twelve months." However, I fail to see how a "commitment" is any more compelling than a mandatory regulation not complied with when the school closed some three-and-a-half years ago. Under these circum- stances, a "commitment" appears to be no more than a mere representation that something may be done sometime in the future. I recognize that NATS officials tried informally to negotiate with ED to accept a "truncated" (more abbreviated) audit "as detailed ... as available cash flow would allow," and that this offer was rejected. I also understand that the absence of cash resources was the underlying reason an audit firm was not retained. But from a legal standpoint, the asserted "commitment" in no way renders this proceeding "moot."

Respondent also advances the argument that both the Administra- tive Procedure Act (APA) and the General Education Provisions Act (GEPA) prohibit enforcing any substantive rule or any regulation, guideline, interpretation, order or requirement of general applicability unless it has been subject to public notice and comment. (APA, 5 U.S.C. §551 et seq.; GEPA, 20 U.S.C. §1232.) But these are not "new" regulations that are being utilized by ED in this proceeding. Whatever Notice of Proposed Rulemaking (NPRM) procedural requirements (including notice and comment) were in effect at the time the pertinent regulations were enacted have long ago taken place and been laid to rest.See footnote 3

Respondent next argues that 34 C.F.R. 668.25 provides no authority for imposing liabilities amounting to "pay-it-all-back" refunds in the huge amount involved here ($17,423,964), because that would amount to a "fine," "sanction," or "penalty" that can be heard only as part of a Subpart G proceeding (which arguably yields greater procedural protections than Subpart H), and wherein the maximum civil penalty or "fine" would be $25,000, citing 20 U.S.C. §1094(c)(3)(B)(i) and 34 C.F.R. 668.84. However, this is clearly not a fine or civil penalty case, and it is not being heard under Subpart G.See footnote 4 It is a Subpart H proceeding seeking reimbursement for Federal funds either not properly accounted for or not properly disbursed. Respondent had the choice of either properly accounting for those funds (close- out audit) or, in the alternative, reimbursing the full amount of the Federal funds received for which there is no accounting. Respondent places the shoe on the wrong foot when it argues that since the Department cannot specify precisely which funds were improperly disbursed by the school and has no close-out audit with which to make such review and determination, ergo, the Department is "out of luck," goodbye Federal funds, because ED does not have the evidence it needs to prove its case.

To the contrary, the regulations gave MCI, first through the medium of a close-out audit and later, within the time allowed for an appeal to be brought, the opportunity to submit evidence supporting its position and justifying all Title IV expenditures made. MCI, having full custody of its own records and the means for its own defense, has the burden of proof in this proceeding, 34 C.F.R. 668.116(d).See footnote 5 By providing an accounting (a required duty of any fiduciary) for the Title IV funds MCI administered in award years '89-'90 and '90-'91, MCI could have totally avoided or reduced the liability asserted in the FPRD, but to this date it has declined to do so. It has not supplied an audit or even a "truncated" audit. It cannot, at the same time, be heard to argue that since it has failed to account, the Department lacks the necessary evidence to

"prove" that it misused Federal funds. All of the Title IV funds for the two award years are the expenditures "questioned" by SFAP in the FPRD, and precisely because MCI has declined to account for them. It is MCI's burden to prove that the questioned expenditures were proper and that MCI complied with program requirements in the way it disbursed those Federal funds. Because MCI failed to carry its burden of proof, it is liable to reimburse the Department for the full amount of money identified and questioned in the FPRD. In the Matter of Illinois Medical Training Center, Dkt.No.93-87-SA, U.S. Department of Education (ALJ Decision, May 9, 1994), at page 9); accord City of Oakland v. Donovan, 703 F.2d 1104 (9th Cir. 1983) (a grantee that failed to provide a required audit was held liable for all funds received); Montgomery County v. Department of Labor, 757 F.2d 1510 (4th Cir. 1985) (a grantee that could not supply proper documentation of expenditures made was held liable for the entire sum at issue); see also Wooton Land & Fuel Co. v. Ownbey, 265 F. 91, at 99-100 (8th Cir. 1920) (a fiduciary must prove any allowances or credits he claims to have made on behalf of his principal).

The failure of a fiduciary to provide an accounting cannot be held to insulate that fiduciary from liability for funds supplied by the principal, nor can it be held that the absence of such accounting operates to delay or defer the fiduciary's duty to reimburse such funds.

The recent case of Pan American School, Inc., Dkt.No.92-118-SP, U.S. Department of Education (October 18, 1994), involved circumstances similar to those here. SFAP had asked for documentation to establish the amount of improperly disbursed Title IV funds over a period of years. Rather than perform the review of all the files of all recipients, Pan American pleaded financial hardship and, instead, offered to perform a truncated review (like MCI herein). SFAP declined the offer and issued an FPRD which assessed liability for the full amount of Title IV funds received by the school for the period questioned.
Chief Judge Canellos determined, inter alia, that --

> ...(U)nder the circumstances of this case, Pan American's refusal to provide SFAP with the data requested undercuts the school's position that all Title IV funds should not be recovered.
> . . . .
> ...SFAP has no choice, in the circumstances such as the ones before me, where the institution fails to provide [the Department] with the requisite data needed to determine whether, and, if so, to what extent, Title IV funds were spent contrary to the requirements of Title IV, other than to require the return of all Title IV funds disbursed during the period at issue.

In Re Pan American School, Inc., Dkt.No. 92-118-SP, U.S. Dept. of Education (October 18, 1994), at 5-6, emphasis added.

ED's reviewers notified MCI that they questioned all of the Title IV funds MCI received, based upon MCI's failure to account for those funds. Accordingly, it was reasonable for SFAP to calculate and, in some cases, to estimate MCI's liability for the Federal funds it had been disbursed or the loan programs administered which subjected the Federal Government to expenses and liability exposure. MCI was allowed, on several occasions, the opportunity to rebut the estimates made by SFAP, but it declined to do so, while all the time possessing the very documents that could form the basis for its rebuttal. Instead, MCI has chosen to argue that the Department lacks any ability to assess such liability.

The regulations specify a number of actions a school must take when it closes. Inter alia, the school must supply all reports required by each Title IV HEA program in which the school participated, 34 C.F.R. 668.25(a)(2)(i); it must inform the Secretary of the arrangements made for proper retention and storage of all program records, 34 C.F.R. 668.25(a)(3); it must distribute refunds of unearned institutional charges, 34 C.F.R. 668.25(a)(5), 668.22; it must return to the Secretary and lenders, as appropriate, unexpended grant funds and undelivered Guaranteed Student Loan (FFEL) proceeds, 34 C.F.R. 668.25(b); and it must supply a letter of engagement for an independent audit of all Title IV HEA program funds it received, "the report of which shall be reported to the Secretary within 45 days after the date of the letter of engagement," 34 C.F.R. 668.25(a)(2)(ii). In addition to the regulations, the Department sent a number of reminder letters to MCI reminding it of its close-out obligations. It was not until August 1994 (three years after the school closed) that an audit firm was retained by NATS, the parent corporation, to conduct the required close-out audit for the seven closed schools, including MCI. To this date there has been no close-out audit filed for MCI. Other regulatory close- out items remain unperformed.

Regarding Stafford Loan default costs, MCI disputes ED's figures as to the amount of Stafford Loan funds disbursed by MCI for the award years in issue. The Department's figures were obtained from ED's Accounting & Financial Management Service, Program Finance Branch, ED Ex.1-6 and Ex.1-12. MCI's own data used in this dispute is data compiled for purposes of this litigation and at this point appears to have questionable validity.

MCI does not appear to quarrel with ED's use of the school's FY 1991 cohort default rate of 44.2% (ED Ex.1-6) as being a conservativeSee footnote 6 estimate of default losses from Stafford loans. When applied to the total Stafford and Supplemental Loans for Students (SLS) loan amounts, this results in estimated default losses of $275,019. (ED 1-6 & 1-12.) MCI apparently does not dispute ED's evidence that MCI received and disbursed $16,897,680 in Pell grants and $251,265 in Supplemental Educational Opportunity Grants (SEOG), although MCI clearly disputes what it denominates as the "pay-it-all-back" philosophy of SFAP.

Regarding "interest and special allowance costs," MCI disputes SFAP's estimate. In this case, MCI is in far better position to determine those costs than is SFAP, being in possession of the very records needed to make the computation. The costs to the Department of interest payments made while MCI students were in school during the 1989-90 and 1990-91 award years depends on the duration of those students' attendance. Obviously, MCI has ready access to such records, and the Department does not. But such elements of the loss calculation as the interest rate on Stafford loans are public information, and equally available to MCI. Thus, the importance and critical need of the missing final audit.

FINDINGS AND CONCLUSIONS

After due consideration of all the evidence of record, including the FPRD, exhibits and briefs of the parties, I find and conclude that MCI is liable for the full amount of Title IV HEA funds disbursed in the subject award years for which no accounting has been made ($17,423,964), less, however, those amounts calculated or estimated by ED related to the Government's Stafford Loan default costs and Interest and Special Allowance Costs.

As to those latter items, I have a more flexible remedy. First, liability for those potential charges and expenses will be more generally described (as suggested in SFAP's Opening Brief, at 20- 21) rather than expressing liability as a firm, fixed amount, i.e., the liability of the institution is for whatever amount would compensate the Department for all interest and special allowance payments made for loans disbursed to MCI students during the 1989-90 and 1990-91 award years, as well as default losses.

Secondly, MCI will be allowed until June 14, 1995, to produce a certified audit limited to those particular items (or as part of any full audit completed by then). If more precise figures are arrived at that are documented, credible, reliable and acceptable to SFAP, then those new audit figures will be accepted as MCI's liability for the Stafford loan default costs, special allowance costs, and interest charges. Otherwise, the amounts already reasonably and conservatively calculated and estimated by SFAP for those items will be accepted as MCI's liabilities.

I find that MCI has failed to sustain its burden of proving that it should not be required to return the full amount of Federal funds disbursed under Title IV of the Higher Education Act, in accordance with the findings set forth in the FPRD and the regulations requiring a close-out audit. 34 C.F.R. 668.25(a)(2)(ii)(1992).

I also find that it was proper and appropriate to bring this proceeding, a review of a Final Program Review Determination, under Subpart H of 34 C.F.R. Part 668, rather than under Subpart G as asserted by the Respondent. 34 C.F.R. 668.111 (1992).

_____
Thomas W. Reilly
Administrative Law Judge

Issued: April 12, 1995.
Washington, D.C.

_____

S E R V I C E L I S T

_____

A copy of the attached INITIAL DECISION was mailed by Certified Mail -- Return Receipt Requested on this 12th day of April, 1995, to the following:

David H. Larry, Esq.
Gregory P. Schaffer, Esq.
Manatt, Phelps & Phillips
Suite 700 -- 7th Floor

S. Dawn Robinson, Esq.
Office of the General Counsel
U.S. Department of Education
600 Independence Ave., S.W.

1501 M Street, N.W. FOB-10B, Rm.5215
Washington, D.C. 20005-1702 Washington, D.C. 20202-2110

Footnote: 1 *1/ For FPRD, see ED-1 & Resp. Ex.2. ED's exhibits are appended to its Opening Brief (ED-1 thru ED-7); Respondent's exhibits are attached to MCI's December 20, 1993 Request For Review (Resp. Ex.1 thru Resp. Ex.11).*

Footnote: 2 *2/ The parent corporation of MCI is North American Training Services, Inc. (NATS). MCI was just one of seven schools closed by NATS between August 1991 and June 1992 (Resp. Opening Brief, at 3, 6). Officials of NATS conducted some of the contacts and correspondence with ED officials relating to MCI.*

Footnote: 3 */ SFAP has incorporated by reference its Reply Brief in the related Nassau proceeding (Nassau School of New York, N.Y., Docket No.94-35-SP, U.S. Department of Education, now pending) involving another of the seven NATS schools closed at about the same time as MCI. In the interest of brevity, for further discussion of the inapplicability of MCI's APA and GEPA arguments, see the legal analysis and cases cited in pages 7-10 and 14-17 of that ED Reply Brief, which are hereby incorporated by reference in this Decision.*

Footnote: 4 */ See pages 7-10 of the above-cited and incorporated Nassau ED Reply Brief for the discussion of the misuse of the terms "punitive," "sanction," and "fine" in MCI's argument that this proceeding should more properly be conducted under Subpart G, rather than Subpart H.*

Footnote: 5 */ §668.116(d): An institution requesting review of the final audit determination or final program review determination issued by the designated ED official shall have the burden of proving the following matters, as applicable --*

(1) That expenditures questioned or disallowed were proper;

(2) That the institution complied with program requirements.

Footnote: 6 */ By its very nature, the cohort default rate understates the actual rate of loan defaults, as it measures only defaults that occur by the end of the fiscal year following the cohort year, despite the much longer duration of most loans.*