UNITED STATES DEPARTMENT OF EDUCATION
WASHINGTON, D.C. 20202

In the Matter of

NATIONAL SHAKESPEARE CONSERVATORY,

Respondent.

Docket No. 95-133-ST

Student Financial
Assistance Proceeding

Appearances:
Yolanda R. Gallegos, Esq., Dow, Lohnes & Albertson, Washington, D.C., for Respondent.

Sarah L. Wanner, Esq., Office of the General Counsel, U.S. Department of Education, Washington, D.C., for Student Financial Assistance Programs.

Before:
Frank K. Krueger, Jr., Administrative Judge

DECISION

Introduction and Ruling on Contested Exhibits

On August 15, 1995, the Student Financial Assistance Programs (SFAP), U.S. Department of Education (ED), issued a notice of intent to terminate participation by the National Shakespeare Conservatory (Respondent) in the student financial assistance programs authorized under Title IV of the Higher Education Act of 1965, as amended, based on Respondent's alleged failure to meet the regulatory requirements for financial responsibility. By letter dated August 31, 1995, signed by Albert Schoemann, Director, National Shakespeare Conservatory Co., the Respondent requested a hearing under 34 C.F.R. Subpart G. During the pre-trial telephone conference held on October 12, 1995, counsel for both parties agreed that the taking of evidence through live testimony was not necessary, and that the case could be decided on the basis of written submissions by the parties. This agreement was memorialized by the Order Governing Proceeding issued on October 12, 1995. Accordingly, both parties have submitted briefs and exhibits in support of their positions The Order Governing Proceeding called for the submission of simultaneous briefs and reply briefs only. On February 23, 1996, Respondent filed a motion to submit an additional brief in reply to SFAP's reply brief, and attached a copy of the additional brief. Although I find the additional legal argument made by Respondent in this brief to be rather sophistic, I have considered the argument in arriving at this decision; thus, the motion to submit the additional brief is granted.

Under the Order Governing Proceeding, the parties were given the opportunity to object to exhibits. On December 1, 1995, Respondent objected to SFAP's Exhibit 7, the Declaration of Ronald Selepak, Chief of the Financial Analysis Branch within ED's Office of Postsecondary Education, inasmuch as Respondent had not had the opportunity to cross examine the declarant. This objection appears inconsistent with Respondent's original agreement to have the case decided on the basis of the written submissions of the parties. In addition, the objection is inconsistent with Respondent's briefs, which make it clear that Respondent's "defense" against SFAP's termination notice is a legal interpretation of the Title IV statute and the implementing regulations. In fact, Respondent expressly does not dispute the essential factual allegations by SFAP. See Respondent's Reply Brief at 2. Given that Mr. Selepak's Declaration merely provides certain factual information for the record and attests to the authenticity of a number of documents, none of which are contested by the Respondent, Respondent's motion is hereby denied and SFAP's Exhibit 7 is admitted into evidence.

SFAP, in turn, objected to Respondent's Exhibit A, the Declaration of Albert Schoemann, and sought to cross examine Mr. Schoemann if Respondent was given an opportunity to cross examine Mr. Selepak. SFAP also objected to certain factual statements in Mr. Schoemann' s Declaration. Again, given the nature of Respondent's defense, this motion is denied and Exhibit A is admitted into evidence.

Under the Order Governing Proceeding, if a proffered exhibit is not specifically objected to it is deemed admitted. Thus, all other proffered exhibits are in evidence.

Issue

Whether Respondent was required to post a letter of credit equal to one-half of the Title IV funds Respondent disbursed during the last award year ($136,633) as a condition for continued participation in the Title IV programs, or whether the letter of credit could be reduced to one-half the amount of Title IV funds it disbursed during one term ($44,545).

For the reasons provided below, I conclude that Respondent was required to post a letter of credit in the amount equal to one-half of the total Title IV funds it received during the last award year, i.e., $136,633.

Discussion

I.

The notice of intent to terminate Respondent's participation in the Title IV programs is based on SFAP's contention that Respondent does not meet the applicable standards of financial responsibility put forth in the regulations implementing Title IV. Under 34 C.F.R. § 668.15 (b)(8) (1994), an institution participating in the Title IV programs must maintain a 1-to- 1 ratio of current assets to current liabilities (the so-called acid-test ratio) or have a credit rating at or above the second highest rating of credit quality given by a nationally recognized statistical rating organization. Respondent does not qualify as financially responsible under either of these alternatives. See ED Exhibit 5; ED Exhibit 7, ¶¶ 25-28. Respondent's ratio of current assets to

current liabilities is less than 1 to 1-- it is. 186:1. 1 Respondent's current Dunn and Bradstreet rating of credit quality is "3," with a "1" being the highest and a "4" the lowest. ED Exhibit 6; Ed Exhibit 7, ¶¶ 27-28.

An institution in otherwise unsatisfactory financial condition can nonetheless qualify as financially responsible for purposes of Title IV participation if it submits to the Secretary an irrevocable letter of credit that is payable to the Secretary in an amount equal to not less than one-half of the Title IV 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) (1994). The Title IV program funds that Respondent received during the last complete award year for which figures are available totaled $273,266. ED Exhibit 7, ¶ 32; ED Exhibit 16. Thus, according to SFAP, a letter of credit in the amount of $136,633 (1/2 of $273,266) is required for Respondent to remain in the Title IV program.

Respondent does not contest the essential facts as alleged by SFAP. Nor does Respondent deny that it has never complied with SFAP's demand that it post a letter of credit equal to one-half the total Title IV funds disbursed by the Respondent in the previous award year. See Respondent's Initial Brief at 1-2, 5; Respondent's Reply Brief at 1-3. Instead, Respondent defends itself by arguing that SFAP's insistence on a letter of credit in the amount of $136,633 is excessive, and that it is required to submit a letter of credit for only $44,545, which it is ready and able to do. See Respondent's Exhibit A, ¶ 9.

II.

The 1992 amendments to Title IV provide as follows:

The Secretary shall determine an institution to be financially responsible notwithstanding the institution's failure to meet the [numerical] criteria [for determining financial responsibility] under paragraph (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....

20 U.S.C. § 1099c(c)(3)(A).

ED has interpreted this provision to allow an exemption from the numerical requirements of financial responsibility if an institution

(1) Submits to the Secretary an irrevocable letter of credit that is acceptable 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)(1994). 2

Notwithstanding the apparent clarity of the regulation, Respondent argues that the regulation merely creates a rebuttable presumption that an institution's annual potential liabilities are all Title IV funds received during the past award year. In constructing its argument, Respondent relies on In re San Juan City College, Docket No. 93-88-ST, U.S. Dept. of Educ. (Sept. 9, 1994), certified by Secretary (July 11, 1995) and In re Upsala College, Docket No. 93- 148-ST. U.S. Dept. of Educ. (Decision of Secretary, May 15, 1995).

In San Juan Administrative Law Judge Paul S. Cross found a potential conflict between the statute and regulation quoted above. From this Judge Cross construed the regulations as creating a "rebuttable presumption." San Juan City College at 38, n.17. Because Pell Grant funds are issued only in increments consistent with the number of terms in an institution's academic year, Judge Cross reasoned that an institution, receiving only Pell Grant funds, and on a reimbursement system of payment is potentially liable for no more than what is disbursed to the institution during one academic term. Thus, the total amount of the letter of credit should be one-half of the total Title IV funds disbursed by the school for one semester. The academic year for the National Shakespeare Conservatory is divided into three start dates, one each in September, January, and June. Respondent's Exhibit A, ¶ 5. From this Respondent argues that, since it is on a reimbursement method of payment, its total letter of credit should be equal to one-third of the amount it disbursed for the past award year, or $45,545.

Respondent's argument is flawed for several significant reasons, not the least of which is that San Juan is not controlling precedent. In San Juan Judge Cross specifically concluded that the regulations at issue in this case, 34 C.F.R. § 668.l5 (1994), were not controlling on the San Juan case. In San Juan SFAP made a determination that the school in question was not financially responsible based on financial data submitted by the school for the 1990-91 and 1991 - 92 award years. San Juan at 2. Thus, in Judge Cross's view, the controlling regulations were 34 C.F.R. § 668.13 (1993). As noted above, in 1992 Congress amended Title IV. However, the regulations implementing the 1992 amendments did not become effective until July 1, 1994, were published as "Interim Final Regulations." and were immediately subject to challenge in Federal district court. 3 Notwithstanding the fact that Judge Cross did not consider the new financial responsibility regulations found at 34 C.F.R. § 668.15 (1994) controlling, he nevertheless went on to state that he considered them in conflict with the 1992 amendments and thus he interpreted them as creating a rebuttable presumption. However, since the judge did not consider the regulations to be controlling, his conclusions about them are obiter dicta. For purposes of this case, it cannot be disputed that the operative regulations appear at 34 C.F.R. § 668.15 (1994). Those regulations are discussed in In re Commercial College, Docket No. 94-158-ST, U.S. Dept. of Educ. (August 3, 1995), certified by Secretary. (Nov. 22, 1995). Unlike San Juan, this case is controlling precedent. In Commercial College, Administrative Judge Ernest C. Canellos specifically found that the regulation at issue was clear and unambiguous. Id. at 4. San Juan was expressly distinguished on the basis that the decision was predicated on the assumption that the regulations in question had not yet been implemented. Id. at 4, n. 1. I fully agree with the decision in Commercial College. 4 The controlling regulation, at 34 C.F.R. § 668.115(d)(2)(i) is "clear and unambiguous," and requires an irrevocable letter of credit in an amount equal to one-half of the total Title IV funds received by the Respondent during the last award year.

Respondent, in its reply to SFAP's reply brief, argues that the Commercial College holding is limited to the question of whether 34 C.F.R. § 668.l5(d)(2)(i) requires the submission of a letter of credit or other surety of any kind rather than dealing with the amount of the surety. I reject this argument. The Commercial College case deals with the issue of whether, in a Subpart G proceeding, the deciding official must follow the requirements of 34 C.F.R. § 668.15(d)(2)(i), or whether he or she may essentially ignore the "clear and unambiguous" provisions of the regulations and rely instead on the less specific statutory provision in 20 U.S.C. § 1099c(c)(3)(A). Judge Canellos decided, and I agree, that the specific requirements of the regulations are controlling and that the deciding official was not free to deviate from those requirements. Commercial College at 4; see also 34 C.F.R. § § 668.89(d) and 668.90(a)(3)(iii) (1994).

As noted, Respondent also relies on the May 15, 1995, decision of the Secretary issued in Upsala College, supra. In Upsala College, again Judge Cross, in applying the "precipitous closure" defense to the college's failure to meet the numerical standards for financial responsibility, decided that, since Upsala College was on a cash reimbursement basis, only one semester of Federal student assistance was at immediate risk to the Department if the school closed. In re Upsala College, Docket No 93-148-ST, U.S. Dept. of Educ. (May 17, 1994), at 3. Notwithstanding this finding, Judge Cross concluded that the college failed to meet the precipitous closure standards, and ordered the college terminated from the Title IV program. On appeal the Secretary remanded the case for further review to determine if Upsala College had sufficient resources available to ensure against a precipitous closure. There is nothing in the Secretary's remand decision, relied on by the Respondent, which specifically addresses the issue here in contention. On remand the case was reassigned to Administrative Judge Richard F. O'Hair who, in summarizing the arguments made by the parties in the case, repeats the argument made by Upsala College -- since the college is on a cash reimbursement system, less than one semester of Federal student aid is at risk in the event that the school should cease operations. In re Upsala College, Docket No. 93-143-ST, U.S. Dept. of Educ. (August 4, 1995) at 4; certified by Secretary (October 31, 1995). However, Judge O'Hair never discussed the issue again and decided the case on an entirely different basis.

CONCLUSION AND ORDER

Respondent is not financially responsible under 34 C.F.R. § 668.15 and has not submitted a letter of credit in an amount required under that section. Thus, Respondent's eligibility to participate in the Federal student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended, is hereby terminated.

Frank K. Krueger, Jr.
Administrative Judge

Date: February 27, 1996

SERVICE

A copy of the attached decision has been sent by **CERTIFIED MAIL, RETURN RECEIPT REQUESTED**, to the following:

Yolanda R. Gallegos, Esq.
Dow, Lohnes & Albertson
Suite 800
1200 New Hampshire Avenue, N.W.
Washington, D.C. 20036-6802

Sarah L. Wanner Esq.
Office of the General Counsel
U.S. Department of Education
600 Independence Ave.. S.W.
Washington, D.C. 20202-2110

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1 SFAP incorrectly represented this as "(5.36) to 1," apparently dividing current liabilities by current assets, rather than vice versa. See ED Exhibit 7, ¶ 26; SFAP's Initial Brief at 9.

2 Another "defense" available to an institution that does not currently meet the numerical requirements concerning financial responsibility, but can show that it met those requirements for the immediate preceding year is for the institution to establish that it has sufficient resources to ensure against a precipitous closure including the resources to meet all of its outstanding financial obligations including those owed to the Department. This allows a qualified institution to operate without a letter of credit for one year, and thus ensures that an institution which simply has a bad year stays in the Title IV program. See 20 U.S.C. § 1099c(c)(3)(C) and 34 C.F.R. § 116.1 5(d)(2)(ii). This defense is not available to Respondent since it has failed to satisfy the standards of financial responsibility for fiscal years 1994 and 1993. See ED Exhibit 4; ED Exhibit 7, ¶¶ 4-15 34-35; ED Exhibit 8.

3 See Career College Association v. Riley, -- F.3d --, 1996 WL 27992 (D.C. Cir., Jan. 13, 1996), for a description of the history of this court litigation. As noted by the court, the fact that the regulations were initially entitled "Interim" did not mean that they were not final. Id. at 27992*1.

4 In addition to not being controlling precedent, the San Juan City College case is distinguishable on its facts from the present case. San Juan City College was receiving virtually no other Federal student aid except Pell Grant funds. San Juan at 10-11. Because the school was on a reimbursement system of payment and was only receiving Pell Grant funds, Judge Cross found very little risk involved to the Department beyond one semester. Thus the letter of credit could be reduced from one-half of the total funds received during the past year to one-half the total funds received for the previous semester. Although the National Shakespeare Conservatory is on a reimbursement basis for its Pell Grant funds it appears to also be receiving a significant amount of Title IV loans which are not part of the reimbursement system and for which the Department would be liable if the school went out of business before the loans disbursed for its students were paid off. See ED Exhibit 16. In addition, Judge Cross made a specific determination that the

school was in no danger of going bankrupt and that the school had engaged the services of an independent accountant to examine the school's requests for reimbursements before they were submitted to the Department for payment. Id. at 11. There has been no such showing by the National Shakespeare Conservatory.

Contrary to Judge Cross's conclusion in San Juan even if an institution is only receiving Pell Grant funds on a reimbursement basis, subsequent audits program reviews, and investigations may reveal that the institution incorrectly certified students as eligible for Pell Grants who are not eligible. If the institution goes out of business or declares bankruptcy, the Department may not be able to recover Pell Grant funds improperly released to the institution even on a reimbursement basis.