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

In the Matter of **Docket No. 95-141-ST**

CANNELLA SCHOOLS OF HAIR DESIGN, Student Financial Assistance Proceeding
Respondent.

Appearances: Stanley A. Freeman, Esq., and Joel M. Rudnick, Esq., Powers, Pyles, Sutter & Verville, P.C., Washington, D.C., for Cannella Schools of Hair Design.

Edmund J. Trepacz, II, Esq., and Russell B. Wolff, Esq., Office of the General Counsel, United States Department of Education, Washington, D.C., for Student Financial Assistance Programs.

Before: Judge Richard F. O'Hair

DECISION

On August 29, 1995, the Office of Student Financial Assistance Programs (SFAP) of the U.S. Department of Education (Department) issued a notice of intent to terminate the eligibility of the Cannella Schools of Hair Design (Cannella Schools), an entity which consists of ten branch schools, See footnote 1 *1* to participate in the student financial assistance programs authorized under Title IV of the Higher Education Act of 1965, as amended (Title IV). 20 U.S.C. § 1070 *et seq.* and 42 U.S.C. § 2751 *et seq*. This termination notification was amended on April 12, 1996. In

addition, SFAP proposed the imposition of a fine of $809,500. Cannella filed a request for a hearing before this tribunal on September 14, 1995, and the hearing was held in Chicago, Illinois, on June 18-19, 1996.

Before the hearing, SFAP notified the tribunal and counsel for Cannella Schools by telephone that SFAP was limiting the scope of the termination proceeding to only three violations: 1) failure to submit and to timely submit audit reports; 2) failure to meet financial responsibility requirements; and 3) excessive cohort default rates. In the process of withdrawing the other bases, the amount of the proposed fine was then reduced to $425,000 and was grounded solely on the untimely audit submissions.

Timely Audits

For academic years prior to July 1, 1994, an institution participating in Title IV programs was required to have a financial and compliance audit performed at least once every two years for each Title IV program in which it participated. 20 U.S.C. § 1094(c)(1)(A)(i); 34 C.F.R. §§ 668.23(c), 682.610(a). The primary purpose for requiring submission of these audits is to provide a measure of assurance to the Department that Title IV funds are being expended appropriately. The due date for the audits was either March 31 or June 30 of the year following the last award year covered by the audit, depending on whether the school received campus- based funds. There is a further requirement that the audit be performed by an independent auditor and that it be conducted in accordance with the general standards and the standards for compliance audits in the Government Accounting Office (GAO). 34 C.F.R. § 668.23(c)(1). Up until September 14, 1991, an institution's failure to comply with this audit submission requirement subjected the institution to potential termination action pursuant to the general language of 34 C.F.R. § 668.86(a). (This section addresses violations of any statutory provision of Title IV or any regulatory provision prescribed under the statute.) With the promulgation of 34 C.F.R. § 668.90(a)(3)(v) on September 14, 1991, all discretion as to the appropriateness of termination of eligibility is removed from the tribunal. Pursuant to that section, if the hearing official finds the institution failed to timely submit the appropriate audit report, the hearing official must find that termination is warranted.

The 1994 program review report asserted that each of the ten schools which comprise Cannella Schools failed to submit acceptable audit reports to the Department in a timely manner for award years 1986-87, 1987-88, 1988-89, and 1989-90. Not all of the schools received campus-based funds during the four years in question, so the due dates of the audits varied between either March 31 or June 30 of the years following the last award year covered by the audit. For the bulk of the schools, the due dates for the biennial audits were March or June 1989 and March or June 1991. It appears that in October 1991 Cannella Schools submitted audits for most of its schools for all four award years directly to the Audit Review Branch of the Department in Washington, D.C. Inasmuch as the audits should have been sent to the Department's Regional Inspector General for Audit (RIGA) in Kansas City, the audits were forwarded to that location, where they arrived on November 27, 1991. The RIGA rejected those

reports on December 13, 1991. It was not until September 8, 1994, that Cannella Schools resubmitted audits for these same four years, and those were all rejected in May and June 1995, several months before this termination and fine proceeding was initiated. Cannella Schools then terminated its contract with its auditor and retained a new auditor who prepared audits that were resubmitted during the latter portion of 1995, mostly in November. As of February 27, 1996, all of the late audits were deemed acceptable by the Department.

Cannella Schools concedes that the audits for the four years in question were submitted late, but presents several reasons why it is inappropriate to terminate and fine it for these infractions. First, it argues that such action is barred by prior sanctions instituted by the Department; second, it points out that the audits were rejected because of technical accounting deficiencies and argues that it cannot be punished for audit deficiencies based on acts or omissions of its auditor, as there is no provision for a termination premised on the submission of deficient audits; third, it

maintains that this action is arbitrary and capricious; and, finally it argues there are mitigating circumstances which should preclude a termination and fine in this instance.

Cannella Schools alleges that it and the Department addressed this issue of late audits in late 1991 and concluded the matter by entering into a settlement which bars SFAP from now pursuing this termination and fine. After the submission of its late audits to the Audit Review Branch in October 1991, but before they were received by the RIGA in Kansas City, the Department's Chief, Audit Review Branch, on November 14, 1991, sent correspondence to six of the 10 schools.See footnote 2 *2* These six letters noted the late submission of each school's audits and proposed an "informal fine" for this failure, but cautioned the institution that it was not obligated to pay the fine. The amount of the fines for all six totaled $47,000 and ranged from $5000 to $10,000 for each school. The letters further informed the institutions that if the fines were not paid,

> we will refer the case to the Program Compliance Branch, Division of Audit and Program Review. That Branch may initiate a formal administrative action pursuant to Title 34, Part 668, Subpart G which provides for fine, limitation, suspension, or termination proceedings. Formal administrative action may include one or more of the following: 1) assessment of a larger fine; 2) loss of advance funding privileges; or 3) termination of eligibility.

Faced with these possible ramifications, Cannella Schools employed a student financial aid consultant who was familiar with the subject of informal fines. He negotiated with an employee in the Audit Review Branch who announced that the Department agreed to accept $35,000 in satisfaction of its request for informal fines. As was the practice in this area, apparently, no documentation was prepared to memorialize this settlement agreement, but on

January 24, 1992, Cannella Schools issued, and the Department accepted, a check for $35,000.

Cannella Schools contends the principles of res judicata should be employed against the Department to forestall its attempt to terminate Cannella Schools for late audits after it had previously entered a settlement agreement with the institution regarding those same late audits. There is support for the position that the doctrine of res judicata, also known as claim preclusion, can be applied to the judgments of administrative agencies when acting in an adjudicative capacity. *Greenberg v. Board of Governors of the Federal Reserve System*, 968 F.2d 164, 168 (2nd Cir. 1992); *In re Decker*, 977 F.2d 1449, 1452 (Fed.Cir. 1992). However, one of the necessary prerequisites is that there be a judgment entered by the administrative agency, and that is lacking here, with respect to payment of an informal fine. Not only is there no judgment, but there is also no document memorializing the settlement which describes the intent of the parties or the alleged preclusive effect of the deliverance and acceptance of $35,000.See footnote 3 *3* For these reasons, I will not apply the doctrine of res judicata to preclude the Department from pursuing this termination proceeding.

Even if res judicata did apply in this case, the Department would not be completely impotent. Res judicata would limit the Department only with respect to the six Cannella Schools which paid the informal fines, thus leaving the remaining four schools available for potential termination. Additionally, res judicata might have barred the Department from initiating a

termination proceeding within a reasonable time after accepting Cannella Schools' money. However, the facts disclose that Cannella Schools issued the check to the Department in January 1992 but did not resubmit the late audits until September 1994. The Department demonstrated exceptional tolerance in not initiating termination proceedings by that time. Upon payment of the informal fine there was an implied concession from Cannella Schools that it would engage in a concerted effort to resubmit the late audits in a reasonable time. Two and one-half years between audit rejection and resubmission is beyond reasonable.

Next, Cannella Schools argues that it should not be terminated because of technical deficiencies in the audits which are solely attributable to its auditor, who is not considered to be a third party servicer.See footnote 4 *4* This theory is premised on the regulatory provision that provides for termination only of an institution **or a third party servicer** which violates any Title IV statute or implementing regulation. Cannella Schools maintains that since this section does not provide for the termination of an institution because of the actions of its independent auditor, it cannot be done. 34 C.F.R. § 668.86(a)(1)(i). Cannella Schools' argument is misplaced. SFAP initiated this action because Cannella Schools did not comply with the regulatory requirements of filing an audit, not because the independent auditor selected and hired by Cannella Schools apparently was

not diligent in the preparation of the audits, or because the auditor used an improper procedure guide. It is true that an institution could look at an audit and not know whether it was prepared in technical compliance with the appropriate GAO audit guide; however, the basic timeliness of an audit submission is something any institution is expected to monitor.

Cannella Schools might be forgiven for the existence of technical deficiencies in its audits, but it cannot be forgiven for the lack of timeliness of the submission of those audits. An institution's obligation to submit a financial and compliance audit does not end with its engagement of an independent auditor. The importance of timeliness must be stressed at the time of negotiation of the engagement contract with the auditor and must be monitored until completion and submission. Cannella Schools was remiss in its monitoring of its auditor for the 1986-90 audits and, because of this, they were filed late. Cannella Schools must bear the responsibility of its regulatory violation.

Cannella Schools next challenges the Department's action here as being arbitrary and capricious. Cannella Schools reports it responded appropriately to the requested corrective actions in the 1994 program review report that it immediately submit a letter of engagement for an independent audit for each institution. The audits in question have been prepared properly by its new auditor and have been resubmitted to, and accepted by, the Department. Cannella Schools' position is that it has cured a program deficiency which was not of its making and that SFAP's termination and fine proceeding is arbitrary and capricious. I disagree. The corrective action Cannella Schools pursued following the program review does not preclude SFAP from subsequently initiating a termination and fine proceeding. SFAP had a need to know how Cannella Schools' funds for the 1986-90 award years were being expended and this was accomplished by the review and acceptance of the late audits. This overview function is a distinctly separate concern from that which is before me: whether Cannella Schools' prospective eligibility to participate in the Title IV program should be terminated.

Its final point on the issue of timely audits is that the automatic termination provision contained at Section 668.90(a)(3)(v) in the regulation only applies to a case of a late submission of the compliance audit and not to a timely submission of an audit which is subsequently rejected by the Department's auditors because of other deficiencies. 34 C.F.R. § 668.23(c)(1)-(4)(1991). As discussed above, it believes that it has already been penalized for lateness by virtue of the $35,000 informal fine it paid in January 1992 for submitting late audits. Despite its argument to the contrary, "lateness" continued to be an issue up to and including August 29, 1995, the date SFAP initiated this termination proceeding. Non-compliant audits continue to be the responsibility of one party, the institution, until such time as an audit is finally accepted by the Department's auditors. A timely, but unacceptable, audit is no better than one which has not been submitted. The automatic termination provisions unquestionably can be implemented whenever a school fails to submit an acceptable compliance audit by the date prescribed.

By virtue of the automatic termination provision of Section 668.90(a)(3)(v), I find that termination of Cannella Schools' Title IV eligibility is warranted because of its failure to file

timely compliance audits for the 1986-90 award years. However, this might be an appropriate case in which the Secretary should exercise his plenary authority and mitigate this result. Even though I have found they do not serve as a defense to the charge of filing untimely audits, circumstances or factors in support of mitigating the outcome of this proceeding for Cannella Schools include the following:

1. Audits for the 1986-1990 years were rejected because of technical deficiencies in the preparation of the audits, not program errors committed by Cannella Schools.
2. Cannella Schools paid an informal fine of $35,000 to the Department because of these late audits.
3. Cannella Schools replaced its original auditor with a second one who prepared new audits for all its institutions for the years in question.
4. Audits for the years 1986-90 have been submitted and accepted.
5. Audits for all years after 1990 were timely submitted and accepted by the Department.
7. The most recent compliance audit reports for all of the institutions demonstrate that the institutions are administratively capable.

Financial Responsibility

The regulations are unambiguous when addressing the minimal requirements of the financial soundness of an institution which wishes to begin or continue participating in the Title IV programs. If an institution is considered to be not financially responsible, then it may neither begin nor continue participating in the programs. 34 C.F.R. § 668.15(a). For-profit institutions, such as Cannella Schools, must satisfy the following three separate tests or requirements:

1. Demonstrate at the end of its latest fiscal year, an acid test ratio of at least 1:1.See footnote 5 *5*
2. Have not had operating losses over both of its two latest fiscal years that result in a decrease in tangible net worth in excess of 10 percent of the institution's tangible net worth at the

beginning of the first year of the two year period.

3. Had, for its latest fiscal year, a positive tangible net worth.

34 C.F.R. §§ 668.15(b)(7)(i)(A),(B),(C) (1996).

If a for-profit institution fails any of these numerical standards, it is considered to be not financially responsible; however, the institution may overcome this presumption and thus demonstrate financial responsibility by posting an irrevocable letter of credit that is acceptable to the Secretary and is equal to not less than one-half of the Title IV Program funds it received during the last award year for which figures are available. 34 C.F.R. § 668.15(d)(2)(i).

On April 12, 1996, when SFAP amended its original notification to Cannella Schools of this termination and fine proceeding, it added an allegation that Cannella Schools was not financially responsible, based upon a review of Cannella Schools' latest financial statements, the FY 1994 financial statements. Based on these, SFAP determined that Cannella Schools was not financially responsible because the acid test ratio for the "eight different corporations that own the ten Cannella Schools" was below 1:1. Furthermore, it noted that none of the corporations had posted letters of credit to demonstrate their financial responsibility.

Cannella Schools charges that SFAP is without a basis for proceeding on this issue because subsequent to the amended letter of notification, Cannella Schools submitted financial statements for FY 1995. These statements have been accepted by SFAP and they disclose that at the end of its latest fiscal year all eight corporations satisfy the acid test ratio. SFAP acknowledges that these corporations now satisfy the acid test ratio; however, it does not concede that this should be interpreted as meaning all eight corporations should be considered financially responsible. In fact, SFAP finds that three of the corporations, Archer, Aurora (Broadway), and Westlawn (Cermak), still fail to satisfy other standards of financial responsibility. This is so because Westlawn violates the second financial responsibility test because in FY 1995 it had operating losses which resulted in a decrease in tangible net worth in excess of 10 percent of the institution's tangible net worth at the beginning of the first of the two-year period; and Archer and Aurora fail the third test of financial responsibility, the requirement that at the end of the fiscal year they must have a positive net worth.

Cannella Schools vigorously objects to my consideration of any evidence that any of its schools fail either the second or third tests for financial responsibility because SFAP's amended letter of notification to them addressed only the first test, the satisfaction of the acid test ratio. It insists that SFAP is barred from considering these other two criteria because SFAP did not amend its letter of notification and thus properly place Cannella Schools on notice it must be prepared to defend against these additional financial responsibility standards. I decline to so hold. SFAP's major concern is to ensure that participating institutions be financially responsible. In April 1995 SFAP had a legitimate foundation for its original allegation that none of the Cannella Schools corporations were financially responsible based upon a review of the latest financial statements available to SFAP, the FY 1994 statements, and the finding that they failed the acid test ratio. Shortly thereafter Cannella Schools sought to refute this allegation with its submission of its FY 1995 financial statements indicating a satisfaction of the acid test ratio by all corporations. During the review of those statements, SFAP discovered the further allegations

that three of the corporations now fail one of the other two standards. Since all three standards come under the umbrella paragraph which establishes standards for measuring financial

responsibility for for-profit schools, since this later allegation is based on an analysis of these same financial statements, and since it was Cannella Schools which presented these new statements to SFAP to defend itself against the original charge of lack of financial responsibility, SFAP is not limited to the presentation of evidence addressing solely the first of the three standards.

Cannella Schools relies on *In re Fischer Technical Institute*, Dkt. No. 92-141-ST, U.S. Dept. of Educ. (Mar. 16, 1992) for its argument to preclude consideration of the two additional standards. In *Fischer* SFAP initially claimed the school failed two of the three standards of financial responsibility. When Fischer successfully disproved that allegation, SFAP raised the new issue that Fischer lacked financial responsibility based on the school's nonpayment of refunds. The tribunal refused to consider this "new ground" in the termination proceeding. The facts in *Fischer* are distinguishable from those found before me. Here, SFAP has alleged two additional grounds for termination which have a direct relationship with the original charge. The two additional financial responsibility standards are closely related to the acid test ratio standard, and the analysis performed by SFAP was limited to the same category of documents which was considered for the original proceeding. I do not find that this amounts to the inclusion of an additional, or new, ground which would require that the institution be placed on notice of the additional charge. Three of Cannella Schools' corporations have failed to meet two standards within the same subparagraph of the general standards of financial responsibility as the standard originally alleged to have been violated, the acid test ratio. This occurred as a result of a permissible reassessment by SFAP of the same financial documents which Cannella Schools submitted to refute SFAP's original allegation of lack of financial responsibility.

An institution's alternative means of meeting the general standards of financial responsibility is to post an irrevocable letter of credit. Cannella Schools was originally offered the opportunity to submit letters of credit for all eight corporations, but declined to do so. With the finding that only three of the corporations do not meet those standards, then only those three need be concerned with providing letters of credit. Cannella Schools objects that this is not a reasonable alternative because SFAP set unreasonably high amounts for those letters, making them prohibitively expensive. As explained by Cannella Schools, SFAP based the amounts upon the Title IV program funds received by each participating institution during the last complete award year, which was 1993-94. Since these amounts are almost double the amounts received by the institutions in the 1994-95 award year, Cannella Schools' request that the amounts necessary for the letters of credit for the Archer, Aurora, and Westlawn corporations be recomputed utilizing the more current figures is a reasonable one. In my view, if those corporations elect not to supply letters of credit in the recomputed amounts as a means of demonstrating financial responsibility, they should be terminated.

Excessive Cohort Default Rate

A cohort default rate is the percentage of graduates from a Title IV institution who fail to repay the Federal Stafford (Stafford) loans and Federal Supplemental Loans for Students (SLS)

they received under the Federal Family Education Loan (FFEL) program. Recognizing that an excessive cohort default rate is one indication the institution lacks the administrative capability to continue in the Title IV program, the regulations in effect when this proceeding was initiated authorized the Secretary to initiate a proceeding to terminate the eligibility of any school with a fiscal year cohort default rate which exceeds 40 percent after 1989, provided the rate has not been reduced by an increment of at least 5 percent from its rate for the previous fiscal year. 34 C.F.R. § 668.17(a)(1)(i) (1995). Alternatively, the Secretary may also initiate such a termination proceeding if the institution's cohort default rate exceeds--

1. 60 percent for fiscal year 1989
2. 55 percent for fiscal year 1990
3. 50 percent for fiscal year 1991
4. 45 percent for fiscal year 1992, or
5. 40 percent for any fiscal year after fiscal year 1992.

Id. 17(a)(1)(ii) (1995).

Aside from the above limitations, if at any time an institution has a cohort default rate in excess of 20 percent, it must implement all of the default reduction measures described in 34 C.F.R. Part 668, Appendix D. These consist of a variety of measures designed to help an institution reduce the number of its graduates who fail to repay their student loans upon graduation. In a termination proceeding premised on an institution's excessive cohort default rates, if the institution's rate exceeds the limits set out in 17(a)(1), the hearing official is obligated to find that termination is warranted, unless the institution has demonstrated that it has implemented the default reduction measures described in Appendix D. 34 C.F.R. § 668.90(a)(3)(iv). *See In re Alma's Beauty College*, Dkt. No. 95-152-ST, U.S. Dept. of Educ. (April 22, 1996) aff'd by the Secretary (Decision of the Secretary, July 15, 1996).

None of Cannella Schools' corporations currently participate in the FFEL programs. The eligibility of three of them was terminated in 1989 and the remainder voluntarily withdrew from the program prior to 1993. Even though there are no new loans being disbursed under this program to Cannella Schools students, there are students who previously received loans and are entering repayment status and for whom cohort default rates are computed. SFAP presented evidence that six Cannella Schools institutions had cohort default rates which exceeded 40 percent for every fiscal year from 1987 to 1992 and that none of those rates were reduced by an increment of at least 5 percent from the previous year, as required by 34 C.F.R. § 668.17(a)(1)(i).See footnote 6 *6* Additionally, six had cohort default rates which exceeded the annual thresholds set out in 34 C.F.R. § 668.17(a)(1)(ii).See footnote 7 *7* Since the cohort default rates at Elmhurst and

Roosevelt do not exceed the regulatory limits, this issue affects only eight of the ten institutions under Cannella Schools.See footnote 8 *8*

Cannella Schools' primary defense is that its eligibility should not be terminated because none of its institutions, with one minor exception, have participated in the FFEL or Direct Loan programs since 1992. In fact, two schools have had no borrowers since the 1989-90 award year,

four have had none since the 1990-91 award year, one has had none since the 1991-92 award year, and one has had none since the 1992-93 award year.See footnote 9 *9* Even though there are no new borrowers, SFAP continues to compute cohort default rates for Cannella Schools for its former student borrowers when they enter repayment status; however, the numbers of such borrowers are dwindling significantly and with the lower number of borrowers the default rates are somewhat misleading. When the number of borrowers entering repayment reaches a level below 31, SFAP utilizes a three year average of the number of defaulting borrowers to compute a cohort default rate, rather than using the actual numbers for each year. For example, the FY 1992 default rate for Cermak is 72.3 percent, but this represents a three year average because there were no borrowers going into repayment in 1994, the year during which the FY 1992 rate is computed. Similarly, the FY 1992 default rate for Elgin was 41.9 percent, but since there were only 4 borrowers going into repayment a three year average was used. Elgin's actual default rate for FY 1992 was 19 percent. These observations are only meant to mitigate the seriousness of the excessive default rates assigned to these schools. SFAP maintains that Cannella Schools' eligibility should be terminated because its high cohort default rates compel a conclusion that the schools lack administrative capability. I believe Cannella Schools, in most instances, came to the realization that its students were having repayment difficulties and that this is why it has been out of the FFEL program, with one exception, since 1992. It is natural to expect that past repayment problems will continue to plague Cannella Schools as long as its students have outstanding loans.

Regardless of Cannella Schools' argument that it is out of the student loan business, the fact remains that its FFEL program history reflects that its excessive cohort default rates consistently placed it in jeopardy with the program and signified its impaired ability to manage its Title IV programs. Even though it has had no new borrowers since FY 1993, Cannella Schools has had many more than five borrowers entering repayment during the years following its voluntary and involuntary termination of its participation. Therefore, Cannella Schools cannot take advantage of the Secretary's announced philosophy that he will not seek to terminate the eligibility of an institution with fewer than five borrowers in the FFEL program based on excessive cohort default rates. 60 Fed.Reg. 61764 (Dec. 1, 1995).

Cannella Schools also seeks protection from termination by relying on language in the "Gordon-Roukema Amendment," which is part of the Omnibus Consolidated Rescissions and

Appropriations Act of 1996.See footnote 10 *10* The language of this amendment to the statute denies Pell Grants to institutions which are ineligible to participate in a Title IV loan program as a result of an excessive cohort default rate, but it provides an exception for schools which are no longer participating in the loan program. Contrary to Cannella Schools' interpretation, I find this language does not limit in any way SFAP's ability to terminate the eligibility of a school to participate in any non-FFEL program.

Next, Cannella Schools contends that SFAP should only rely on the most current cohort default rates available for this proceeding, which includes the FY 1993 and FY 1994 rates, whereas it alleges SFAP has included only the FY 1987 to 1992 rates. I find this argument to be without merit. Clearly, the default rates for Cannella Schools will improve as the number of borrowers diminishes, but what is important here is Cannella Schools' long history of excessive default rates. In assessing a school's administrative capability based on excessive cohort default

rates, one must examine a series of years to make an appropriate assessment, not just the rate of the most recent year. Perhaps this proceeding could have been initiated several years earlier; however, it would appear that SFAP wished to give Cannella Schools time to realize the benefits from an expeditious implementation of Appendix D measures, thus permitting Cannella Schools to salvage its poor performance in the FFEL program. SFAP should not be penalized for delaying the initiation of this proceeding by being prohibited from relying on the cohort default rates Cannella Schools established *ab initio*.

The one true means by which an institution may defend itself in a termination proceeding based on excessive cohort default rates is the satisfactory implementation of Appendix D to 34 C.F.R. Part 668. This appendix contains default reduction measures an institution can initiate which are designed to reduce defaults by dropout students, address the borrowers' difficulty in finding employment, and improve the borrowers' understanding and respect for the loan repayment obligation. Cannella Schools became obligated to place these default reduction measures into effect in 1989 when the FY 1987 default rates were published and Cannella Schools discovered it exceeded the limits. Examples of some of the specific measures an institution must implement are:

1. Revise admission policies and screening practices to ensure that students have a reasonable expectation to succeed in their programs of study.
2. Demonstrate it improved the availability and effectiveness of academic counseling and other support services to decrease withdrawal rates.
3. Demonstrate it consulted with its accrediting agency regarding how to reduce its withdrawal rates.
4. Establish a liaison with the local office of the U.S. Employment

Service and the Private Industry Council to assist students in finding employment.
5. Conduct an annual comprehensive self-evaluation of its Title IV administration to identify and implement practices that should be modified to reduce defaults.

34 C.F.R. Part 668, Appendix D.

Cannella Schools' testimonial evidence indicates a less than dedicated and complete implementation of the Appendix D measures. This deficiency, combined with its history of excessive cohort default rates over the course of its participation in the FFEL program, document that the Appendix D defense to a termination proceeding is not available to Cannella Schools.

Based on a finding that Cannella Schools' cohort default rates exceed the standards set by the regulation, and Cannella Schools' inability to demonstrate a full implementation of the Appendix D provisions, I am obligated to conclude that eight of the Cannella Schools institutions warrant termination pursuant to 34 C.F.R. § 668.90(a)(3)(iv) (1995). Once again, however, in light of Cannella Schools' complete withdrawal from the FFEL program in 1993 and with the removal of any further possibility of potential loss of Federal funds based on an excessive number of student borrowers defaulting on their loans, I recommend that the Secretary exercise his plenary authority and mitigate this result.

Fines

SFAP seeks a fine of $425,000 from Cannella Schools, premised on the position that the failure to submit biennial financial and compliance audits is a serious matter, warranting further punishment beyond the termination of its current Title IV eligibility. To arrive at this figure, SFAP treated the failure to file a timely and acceptable audit for each year for each school as one violation. The maximum fine which may be imposed for each violation is $25,000, and SFAP has variably assessed between $15,000 and $25,000 for each school's failure to timely file its audits, with the total being $425,000. Considering the mitigating factors expressed above, including Cannella Schools' payment of a previous informal fine, the fact that all late audits have been submitted and accepted by the Department, and that all audits from 1990 to the present were submitted on time, as well as my finding that termination is warranted for this offense, I find that the imposition of a fine is not appropriate. However, should the Secretary follow my recommendation and mitigate my conclusions by suspending the termination of Cannella Schools' Title IV eligibility, I find that a fine of $10,000 per school, or a total of $100,000, would be an appropriate substitute.

FINDINGS

1. The tribunal must terminate Cannella Schools pursuant to 34 C.F.R. § 668.90(a)(3)(v) (1995) for its failure to submit timely compliance audits for its ten schools for the 1986-90 award years.

2. Three of Cannella Schools' corporations have failed to meet the standards of financial responsibility and should be terminated unless they supply letters of credit based upon the Title IV funds received by these institutions during the 1994-95 award year.

3. The tribunal must terminate eight of the Cannella Schools institutions pursuant to 34 C.F.R. § 668.90(a)(3)(iv) (1995) because of their excessive cohort default rates.

4. The facts of this proceeding indicate that this might be an appropriate case for the Secretary to exercise his plenary authority by suspending the termination of Cannella Schools and fining it $100,000.

ORDER

On the basis of the foregoing, it is hereby ordered that the eligibility of the Cannella Schools of Hair Design to participate in the student financial assistance programs authorized under Title IV of the Higher Education Act of 1965 be terminated and that no fine be imposed. Additionally, the tribunal respectfully requests that the Secretary exercise his authority to suspend the implementation of this termination. If the termination of Cannella Schools' Title IV eligibility is suspended, Cannella Schools is hereby ordered to pay a fine of $100,000.

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Judge Richard F. O'Hair

Dated: March 20, 1997

SERVICE

A copy of the attached initial decision was sent by certified mail, return receipt requested to the following:

Stanley A. Freeman, Esq.
Joel M. Rudnick, Esq.
Powers, Pyles, Sutter & Verville, P.C.
Third Floor
1275 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2404

Edmund J. Trepacz, II, Esq.
Russell B. Wolff, Esq.
Office of the General Counsel
U.S. Department of Education
600 Independence Avenue, S.W.
Washington, D.C. 20202-2110

Footnote: 1 *1 Eight corporations separately own and operate the following 10 branch schools:*

Cannella Schools -- Elmhurst: Elmhurst, North, and Kankakee
Cannella Schools -- Westlawn: Cermak
Cannella Schools -- Marquette: Roosevelt
Cannella Schools -- Aurora: Broadway
Cannella Schools -- Wheaton: Halsted
Cannella Schools -- Elgin: Elgin
Cannella Schools -- Joliet: Joliet
Cannella Schools -- Archer: Archer

Footnote: 2 *2 Joliet, Elgin, North, Archer, Halsted, and Elmhurst.*

Footnote: 3 *3 See also In re Leonard's Hollywood Beauty School, Dkt. No. 95-131-SA, U.S. Dept. of Educ. (Mar. 19, 1996).*

Footnote: 4 *4 SFAP's June 27, 1996, Motion to Take Judicial Notice is denied.*

Footnote: 5 *5 The acid test ratio is calculated by adding cash and cash equivalents to current accounts receivable and dividing the sum by total current liabilities.*

Footnote: 6 *6 Broadway, Halsted, Cermak, Elgin, Archer, and Kankakee.*

Footnote: 7	*7 Joliet, North, Broadway, Halsted, Cermak, and Kankakee.*
Footnote: 8	*8 Broadway, Halsted, Cermak, Elgin, Archer, Kankakee, Joliet, and North.*
Footnote: 9	*9 During the 1992-93 award year Elmhurst disbursed loan funds of $7,875.*
Footnote: 10	*10 Pub.L.No. 104-134, 110 Stat. 1321-244 (1996).*