

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

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In the Matter of

**Docket No. 96-15-EA**

**Cannella Schools of Hair Design**

**and**

**Kankakee Academy of Hair Design,**

Respondents.

Emergency Action

Show Cause Proceeding

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Appearances: Stanley A. Freeman, Esq., and Joel M. Rudnick, Esq., Powers, Pyles, Sutter & Verville, P.C.,  
Washington, D.C., for Respondents.

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

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

### **DECISION**

By letter dated February 14, 1996, from David L. Morgan, Acting Director, Compliance and Enforcement Division, the Student Financial Assistance Programs (SFAP), U.S. Department of Education (ED), notified Respondents that ED had imposed an emergency action withdrawing the authority of the Respondents to obligate funds under Title IV of the Higher Education Act of 1965, as amended. By letter dated February 29, 1996, Respondents, through counsel, requested the opportunity to show cause that the emergency action is unwarranted. Accordingly, a hearing was held on March 12, 1996, in Washington, D.C., in which evidence and oral argument was presented by both parties in support of their respective positions.

On March 14, 1996, I issued an order as the show cause official, pursuant to 34 C.F.R.  
§ 668.83(e)(5), revoking the emergency action. This decision is issued in support of that order.

### **Discussion**

Under 34 C.F.R. § 668.83(c)(1), an initiating official, in this case David L. Morgan, may impose an emergency action if that official determines that immediate action is necessary to prevent misuse of Title IV funds and that the likelihood of loss from that misuse outweighs the importance of awaiting completion of any proceeding that may be initiated to limit, suspend, or terminate an institution's participation in the Title IV programs. The emergency action in this case was taken because SFAP determined that two of the ten Respondent schools were operating at ineligible locations. Although the Respondent schools, all located in the Chicago metropolitan area, are separate corporate entities and have individual program participation agreements, they are owned and operated by two people out of one central office. Based on this central control, and SFAP's allegation that the central office was submitting false information to SFAP in seeking reimbursements under the Pell grant program, the emergency action was imposed on all ten schools. The Respondents do not participate in the Federal Family Education Loan program.

In 1986 the Cannella School located at 3646 North Broadway (hereinafter referred to as the "Broadway School") was declared by ED to be eligible for participation in the Title IV program. On May 11, 1994, the Broadway School moved

to 1152 North Milwaukee Avenue. In 1991, a Cannella School located at 3442 South Halsted Street (hereinafter referred to as the "Bridgeport School"[See footnote 1<sup>1</sup>](#)) was declared by ED to be eligible for participation in the Title IV program. On May 11, 1994, the Bridgeport School moved its main campus to 5912 West Roosevelt Road. Another Cannella school, which was not participating in the Title IV programs, simultaneously moved into the location vacated by the Bridgeport School. On May 21, 1994, Respondents notified the accrediting agency for these schools, the National Accrediting Commission of Cosmetology Arts & Sciences, of these moves. The applications for approval of these moves were not submitted to the accrediting agency until June 23, 1994, since Respondents were not provided with applications from the accrediting agency until June 21, 1994. Testimony of David R. Adams, tr. at 113, 139. The reasons provided to the accrediting agency for the move of the Broadway School had to do with the size of the location and the placement of the school's clinic. Respondents Exhibit 15. The reasons given to the accrediting agency for the Bridgeport School move had to do with the size of the two student bodies involved in the moves, and the convenience of the locations to the students. Respondents Exhibit 7. On September 17, 1994, the Broadway School moved back to its original location on North Broadway. The reason given for this additional move to the accrediting agency was that the school was unable to find another tenant for the North Broadway location for which it held a four year lease. Respondents Exhibit 17. Approval was secured from both the accrediting agency and the state for all of the moves in question. *See* Respondents Exhibits 8, 9, 11, 12, 13, 14, 16, 18, and 20.

On August 13, 1994, Respondents submitted an Application for Institutional Eligibility and Certification to SFAP seeking approval of the new locations.[See footnote 2<sup>2</sup>](#) *See* Respondents Exhibit 2. On December 22, 1994, these applications were returned to the Respondents with an unsigned handwritten "post-it" note attached explaining that the forms had been revised and that Respondent should resubmit the applications on the revised forms. *See* Respondents Exhibit 12; testimony of David R. Adams, tr. at 122-123. The revised applications were promptly resubmitted to SFAP. *See* testimony of David R. Adams, tr. at 123-134; Respondents Exhibits 13 and 14.

In the meantime, on June 22, 1994, Respondents were placed on reimbursement. Beginning in September 1994, and continuing for the next eighteen months, Respondents submitted reimbursement requests for students receiving Pell grants and attending the Broadway and Bridgeport Schools. The reimbursement packages submitted by the Respondents for the Broadway and Bridgeport Schools included a manifest form on the front which listed all ten of the Respondent schools, along with the address for each school and other summary information of data included in the reimbursement request package. Underneath the manifest form appeared packages for each of the ten Cannella schools. The first form on each of the individual packages was an SFAP form called Standard Form (SF) 270, entitled "Request for Advance or Reimbursement." SF 270 contains a number of blocks to be completed for each institution, including the address of the institution and a Payee ID (PIN) number which is assigned by ED to each participating institution. Behind the SF 270 was a list of each student for whom reimbursement was sought, along with the PIN number and address of the institution at which the student was enrolled. On the cover manifest and the SF 270s submitted for the Broadway and Bridgeport Schools, the original addresses are given. However, the correct PIN number appears on both the manifest and SF 270, and the correct address is provided on the back-up documentation for each student. In addition, the institutional file was submitted for each student, along with each student's registration contract, in which the proper addresses for the schools are provided. Each packet for each school contained a form signed by Joe Cannella, one of the Respondents' owners, certifying to the accuracy of the information submitted. *See* Respondents Exhibits 21 and 22; Ed Exhibits 31-46; *see also* testimony of Donald Grybas, tr. at 60-62; testimony of David R. Adams, tr. at 150-179; testimony of Steve Berry, tr. at 256-273..

SFAP alleges that, although the state and the accrediting agency approved all of the changed locations in question, since ED was not properly notified, the new locations became automatically ineligible as of the date of the original moves, *i.e.*, May 11, 1994. Moreover, SFAP alleges, since the original locations were vacated without proper notification to ED, the original location likewise became ineligible; thus, the North Broadway location remained ineligible even when the Broadway School returned to that location on September 17, 1994. Since none of the locations for the Broadway and Bridgeport Schools were eligible, and since Respondents submitted reimbursement requests to ED using SF 270s which provided the wrong locations for those schools, SFAP questions the veracity of Respondents in submitting these forms. Thus, although only two of the ten Cannella schools are operating on sites alleged to be ineligible, SFAP contends that the submission of the allegedly false information concerning the Broadway and Bridgeport Schools must lead it to question the submissions for all of the schools.

I find no merit in SFAP's determination that it was justified in imposing the emergency action in order to prevent a misuse of Title IV funds. Even assuming that SFAP's interpretations of the applicable regulations are correct, there was strong evidence presented at the show cause hearing that the Respondents were not attempting to mislead ED and had made an honest, good faith effort to notify SFAP of the new locations. Since the Respondents are on a reimbursement method of payment, and since SFAP is now clearly aware of the location changes in question, there is little likelihood of funds being misused. SFAP would argue that the funds are being misused because reimbursement requests are being submitted for institutions which are not eligible because the locations of those institutions became automatically ineligible as of May 11, 1994. However, the regulations relied on by SFAP are sufficiently ambiguous for one to question SFAP's use of its discretion in imposing the emergency action and its determination that the risk of misuse of Title IV funds outweighs the importance of awaiting the outcome of a termination action wherein eligibility is not summarily withdrawn pending a resolution of those arguments before an independent hearing official and where SFAP bears the burden of proof. Given the evidence, I doubt the wisdom of even bringing a termination action based solely on the allegations put forth in the emergency action letter; an audit proceeding to recover alleged unauthorized Pell funds may be more appropriate.

Under 34 C.F.R. § 600.10(b)(3), the eligibility of an institution to participate in the Title IV programs does not extend to any location that an institution establishes after it receives its eligibility notification unless the institution has notified ED of the new location in accordance with 34 C.F.R. § 600.30(a)(3). Under 34 C.F.R. § 600.30(a)(3), an eligible institution must notify ED no later than ten days after it changes its location. Under 34 C.F.R. § 600.30(d), the failure of an institution to provide this notice "may result in adverse action against it, including the loss of eligibility." Section 600.30(d) clearly undermines SFAP's argument that once an institution fails to notify ED of a change in location, both the old and new locations become automatically ineligible. When questioned on this point at oral argument, counsel for SFAP responded that another section, not cited in the emergency action notice, 34 C.F.R. § 600.40, read in its entirety, would lead to the conclusion that such loss of eligibility is automatic. See also SFAP's Response to Respondent's [sic] Legal and Regulatory Contentions at 2. I have closely examined section 600.40; a very sophistic reading of that section standing alone may support SFAP's position, but that section, read along with section 600.30 would lead one to conclude that the regulations concerning a change of location are very confusing and is the type of matter which should be argued in a termination or audit proceeding. Section 600.40, when read along with Section 600.30, appears to deal with where an institution ceases operations at its main campus, not where the main campus physically moves to a new location.

For the first several months after the Respondents were put on a reimbursement system of payment, the reimbursement packages were submitted to SFAP by Gemcor, Inc., a firm specializing in student financial aid, and functioning as the reimbursement file review agent for the Respondents. Respondents' account was handled by Steve Berry. Mr. Berry testified that, when he first started doing the file reviews, he had just recently joined Gemcor and had no first-hand knowledge of the locations of the various Cannella schools. Mr. Berry testified that he took the addresses for the schools off of Standard Form 272, which is issued to participating schools by SFAP, and put the addresses on a SF 270 for each school. He also inserted additional information on the forms, including the PIN number for each school, which was not likely to change on a monthly basis. He then Xeroxed the forms and used them each month for the reimbursement submissions, simply filling in the information which changed on a monthly basis, such as the period covered by the reimbursement request. After several months, Respondents decided to do the reimbursement submissions themselves. Mr. Berry then trained Mr. David Adams, Respondents Financial Aid Director, to do the submissions and gave Mr. Adams copies of the SF 270s with the addresses and the other constant information written in by Mr. Berry. Mr. Adams then proceeded to submit the very same forms to SFAP. After the reimbursement packets were prepared each month, Mr. Cannella signed the certification forms relying on the representation by Mr. Adams that the information submitted was correct. *See* testimony of Steve Berry, tr. at 261-273; testimony of David R. Adams, tr. at 161-179, 190-193, 248-250. . Based on this evidence, I find that there was no effort or intent by Respondents to mislead ED. In addition, Mr. Adams testified that he dealt with the SFAP regional office in Chicago on a regular basis and that SFAP employees in that office were fully aware of the new locations in question. Testimony of David R. Adams, tr. at 181, 250-252. This testimony is corroborated by two letters from the SFAP regional office in Chicago sent in December 1995, stating that it had recommended approval of reimbursement requests submitted for the Cannella school "located at 5912 W. Roosevelt Road, Chicago, Illinois," -- the new location for the Bridgeport School. Respondents Exhibits 24 and 25. .

SFAP cites *In re Emergency Action Against Dayton Academy of Hair Design*, U.S. Dept. of Educ. (August 31, 1993), in support of its argument that the Respondents violated their fiduciary duties to ED by submitting reimbursement requests for the Broadway and Bridgeport Schools. The *Dayton Academy* case is inapposite to the case at hand. In *Dayton* the institution was operating an unauthorized branch campus created after the main institution's original eligibility determination and appears not to have notified ED of its existence. The school was also cited for a number of other egregious violations. Under those circumstances, the show cause official declined to alter the emergency action. In the case at hand, by contrast, ED was notified of the changes in locations although, arguably, the notice was late. *But see* footnote 2, *supra*. The regulations are clear that eligibility does not extend to branch campuses, unless those campuses are also determined as eligible by ED. As noted above, the regulations concerning the change of location of a main campus are ambiguous as to whether the main campus becomes ineligible if a move is made without providing ED with notice of the new location within ten days. In the present case, the evidence indicates a good faith effort by the Respondents to keep SFAP informed of the changes in locations, although they may have not complied with the technical requirements of the very complex regulations in this area. Absent a showing of bad faith and intentional deception, failure to comply with the regulations is not a *per se* violation of a fiduciary duty.

### **Conclusion**

Based on the evidence presented at the show cause hearing, there is no basis for SFAP's conclusion under 34 C.F.R. § 668.83(c)(1) that an emergency action is necessary. The evidence demonstrates little or no threat to an immediate misuse of Title IV funds, and any threat that may exist does not outweigh the importance of awaiting the completion of any proceeding initiated by SFAP to limit, suspend, or terminate Respondents participation in the Title IV programs.

March 19, 1996

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Frank K. Krueger, Jr.  
Administrative Judge

### **SERVICE**

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

Stanley A. Freeman, Esq.  
Joel M. Rudnick, Esq.  
Powers Pyles Sutter & Verville, PC  
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 Ave., S.W.  
Washington, D.C. 20202-2110

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**Footnote: 1** <sup>1</sup>The Respondents refer to this school as the Bridgeport School because that was apparently the name of the neighborhood where the school was located when it was at the South Halsted location. It is not clear to me whether

*the new location was also in the Bridgeport neighborhood. But, since there were two Cannella schools located on Halsted Street, I refer to this school as Bridgeport rather than South Halsted. See testimony of David R. Adams, tr. at 99-100, 154.*

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*Footnote: 2 <sup>2</sup> Respondents claim that SFAP was notified of the new locations by letters dated May 18, 1994, signed by David Adams, the Financial Aid Director for the Respondent schools. Respondents did not submit the applications for the changed locations until August 13, 1994, since it took most of that time to secure the necessary state and accreditation agency approval. Respondents did not introduce original copies of the letters into evidence, but instead introduced unsigned copies which Mr. Adams stated were taken off the hard drive of his computer. Testimony of David R. Adams, tr. at 101-112, 243-245; see Respondents Exhibit 6. There was no evidence that SFAP ever received the letters, although there was no evidence of whether anyone in SFAP or the Office of the Inspector General (OIG) ever attempted to find these letters in SFAP files. SFAP questioned the authenticity of the letters because they are not original copies and that, during a presently ongoing OIG audit, Mr. Adams produced signed copies of these letters on Cannella School letterhead. See Ed Exhibits 17 and 18. Shortly after the signed letters were produced to the OIG auditor, Mr. Adams told the auditor that he had only recently signed the letters which were run off of the storage in his computer. Mr. Adams testified that it was not his intent to deceive the auditor, but only to produce a copy exactly like the one he claims he sent to SFAP in May of 1994. SFAP also questions the 600 Independence Avenue address on the letters which it alleges was not in use by ED. However, both the 400 Maryland Avenue address and the 600 Independence Avenue address appears to have been used by the Department during this period. See Respondents Exhibit 5. At any rate, given the ambiguity of the regulations and the other evidence in the case, it was not necessary for me to reach any conclusions concerning the evidentiary value of these letters.*

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