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

In the Matter of **Docket No. 97-102-ST**

PALM BEACH BEAUTY & BARBER SCHOOL

Student Financial Assistance Proceeding

Respondent.

Appearances:

Stewart A. Smith, President, Palm Beach Beauty & Barber School, for Respondent.

Renée Brooker, 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 June 24, 1997, 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 Palm Beach Beauty & Barber School (Palm Beach) to further participate in the student financial assistance programs authorized under Title IV of the Higher Education Act of 1965, as amended (HEA). 20 U.S.C. § 1070 *et seq.* and 42 U.S.C. § 2751 *et seq*. This termination action is based on evidence that Palm Beach's Federal Family Education Loan (FFEL) program cohort default rate for fiscal year 1994 exceeds 40 percent. Pursuant to 34 C.F.R. § 668.17(a)(2), this authorizes the Department to initiate a proceeding under Subpart G to limit, suspend, or terminate Palm Beach's participation in Title IV, HEA programs. Palm Beach has appealed its proposed termination by requesting a hearing before this tribunal.

In its brief, SFAP explains that the Department has been long concerned about educational institutions which have an excessively high number of their students defaulting on their federal student loans. This unfortunate situation not only results in the creation of a poor credit rating for the student who fails to make payments on the student loan, but also results in the escalation of student loan program costs to the Department. To combat these high default rates, in 1989 the Department implemented the Default Reduction Initiative. This provided sanctions such as termination of the eligibility of an institution's Title IV, HEA programs for institutions for which the percentage of students defaulting on their student loans, called cohort default rates, exceeded specified rates. 34 C.F.R. § 668.15 (1990). Recognizing that institutions should not bear total responsibility for the lack of attention some of their graduates give to the timely

repayment of their student loans, the institutions were provided with a means to counter Departmental initiatives to terminate their Title IV eligibility. Institutions which could demonstrate they were taking diligent measures to reduce excessive default rates under Appendix D of 34 C.F.R. Part 668 were exempted from the extreme sanction of termination of their Title IV, HEA eligibility.See footnote 1[1]

SFAP reports that in the years since 1989 there has been continuing pressure from Congress for the Department to modify its Default Reduction Initiatives to further lower the number of loan defaults. The most recent Departmental response to this pressure began in 1995 with the publication of the Secretary of Education's (Secretary) proposed regulations which demonstrate his desire to streamline his authority to take administrative action against institutions to "prevent an institution from evading the consequences of a high cohort default rate." 60 Fed. Reg. 183, 49178 (September 21, 1995, proposed rule), 60 Fed. Reg. 213, 61760 (December 1, 1995) (codified at 34 C.F.R. § 668.17). As a consequence, the Department eliminated the Appendix D defense for institutions with excessive default rates which were facing termination action by SFAP, and introduced a more severe standard for evaluating an institution's further participation in the Title IV programs. Under the current regulation, the Secretary may initiate a proceeding under Subpart G (Fine, Limitation, Suspension and Termination Proceedings) if the institution has a cohort default rate that exceeds 40 percent for any fiscal year. 34 C.F.R. § 668.17(a)(2). When such a proceeding is initiated, SFAP must show that it has calculated a final cohort default rate for the respondent institution and that the rate exceeded 40 percent. The regulation gives no discretion to the hearing official, who must find that the sanction sought by SFAP is warranted unless the institution can show, by clear and convincing evidence, that the cohort default rate in question is not the final rate determined by the Department and the correct rate is 40 percent or less. 34 C.F.R. § 668.90(a)(3)(iv).

The term "final rate" is not defined by the regulations, but the general practice of the Department in these cases, as of January 1997, was to send a letter to each participant in the FFEL program which contained its cohort default rate for a particular year. Institutions were referred to an enclosed booklet which allegedly informed the institutions they had 10 days within which to appeal the data which was used to compute the default rate and that, in the absence of an appeal, the institutions forfeited their right to challenge the data during any future formal appeal process. The authority for this advice is found in 34 C.F.R. § 668.17(i). At the conclusion of the review of any appeal of the data, or if there were no appeal, the Department announced the institution's final rate.See footnote 2[2] As explained by SFAP, during a Subpart G proceeding the only means by which an institution can challenge a rate as not being final are to allege that: a) the time to appeal the final rate has not expired; b) the final rate has not yet been issued; or c) the institution appealed the calculation of its final rate and the decision has not yet been issued. Furthermore the issue of whether the correct rate has been attributed to the institution is limited to whether: a) the institution has been correctly identified and b) the cohort default rate percentage is correctly listed in the Subpart G proceeding.

The Department notified Palm Beach on January 6, 1997, that its FY 1994 Official Cohort Default Rate was 46.5 percent. The correspondence explained that this rate was based upon figures of 398 borrowers in a repayment status with 185 of them in default. The letter informed Palm Beach it could file an appeal to contest the data used to compute the cohort default rate; Palm Beach, however, did not submit any form of a challenge until the instant proceeding was initiated. Consequently, I find this 46.5 percent default rate to be its final rate. Additionally, Palm Beach does not contest that it has been correctly identified or that its cohort default rate is incorrectly listed.

The January 6, 1997, SFAP letter makes it clear that this is not Palm Beach's first encounter with excessive cohort default rates. The letter noted that because Palm Beach's three most recent cohort default rates were equal to or greater than 25 percent, the school's loss of participation in the FFEL program was extended through September 30, 1998. The enclosures to the letter substantiate this by listing the school's cohort default rates for the two preceding fiscal years as 41.2 percent in FY 1993: 41.2 percent and 49.0 percent in FY 1992. An additional Department exhibit indicates that Palm Beach's cohort default rate for FY 1991 was 49.4 percent and for FY 1990 it was 53.4 percent. Palm Beach submitted a July 1993 letter from the Department which informed Respondent that it lost its eligibility to participate in the FFEL program because its cohort default rates for the last three years (Fiscal Years 1989, 1990, and 1991) were equal to or greater than 30 percent.See footnote 3[3] Because Palm Beach's cohort default rates have not fallen below 30 percent since Fiscal Year 1991, it is assumed its FFEL eligibility has never been reinstated.

Palm Beach does not dispute these rates, but advances several defensive positions which are not particularly relevant to this proceeding. It disagrees with the Secretary's presumption contained in the regulation that a cohort default rate of

25 percent or more for the three most recent fiscal years is suggestive of an institution's inability to administer properly the Title IV, HEA programs.See footnote 4[4] It is quick to point out that neither the Department's review of all of its compliance audits nor the Department's Program Reviews have disclosed any problems with its program administration. Even though the Secretary has eliminated the availability of an Appendix D defense to departmental administrative sanctions based on high cohort default rates, Palm Beach advises that it continues to employ an aggressive default management plan following the suggested guidelines found in Appendix D. This plan includes impressing upon its students that federal loans must be repaid, even if the student withdraws from school before receiving a diploma. Palm Beach says it is frustrated in this effort and it faces a dilemma here because approximately 90 percent of its students are terminated because of attendance failures. Despite previous counseling regarding repayment of all student loans, these students become disgruntled when terminated and then refuse to repay their loans when they become due. Despite this, the plan should not be disregarded because it is beginning to pay dividends. This is evidenced by the Department's May 1997 notification that its draft FY 1995 cohort default rate is only 37.3 percent.See footnote 5[5] Palm Beach attributes this success to a comprehensive letter-writing program it administers which periodically advises its student borrowers of approaching repayment dates and of the consequences of not complying with these responsibilities. Additionally, Palm Beach notes that its cohort default rate will continue to fall because it has not participated in the FFEL program since August 1993, so there will be increasingly fewer students entering repayment in the future.

Palm Beach presented three additional arguments to supplement its appeal of the Department's proposed termination, all of which emphasize that Palm Beach performs an invaluable, irreplaceable service to its community by providing excellent training in an employment field with unlimited potential. It first highlights that 75 percent of its graduates find employment in the hair styling/nail industry, an industry which is forecasted to continue to expand well into the next century. It also advises that the importance of the student training that Palm Beach and all other career schools provide to a community is grossly overlooked and undervalued. Secondly, Palm Beach's owner points out that he has approximately 32 years in the hairstyling industry and during that period has earned an impeccable reputation in the industry and is known as a businessman with utmost integrity and business ethics. Lastly, Palm Beach notes that if it is terminated as a result of this proceeding, this will have a devastating effect on the economics of the local community and its citizens because this is the only school of its type in that geographic area. Palm Beach's prospective students cannot realistically turn to community and four-year colleges as an alternative to obtaining the type of career training this institution offers them. Palm Beach concludes that it has never “misused or misadministered Title IV student financial assistance programs”; and it has remedied any deficiencies discovered in its audits and program reviews, so there are no outstanding findings or liabilities to the Department.

The regulations establish an unforgiving level of acceptable cohort default rates to be used for measuring an institution's administrative capability to continue participating in the Title IV programs. The regulation unequivocally states that if the hearing official finds that a school has a cohort default rate in excess of 40 percent, then the hearing official must find that the sanction sought by the designated Department official is warranted. The sanction sought here is termination of Palm Beach's eligibility. I find that Palm Beach's FY 1994 cohort default rate is 46.5 percent and Palm Beach has not presented any evidence to challenge that this is not the final rate or that the correct rate calculated by the Department for Palm Beach is 40 percent or less. Accordingly, I must find that termination is appropriate.

The regulation does not permit me to take into consideration that Palm Beach's cohort default rates have been on a steady decline, with one aberration, since FY 1990; that its unchallenged cohort default rate for FY 1995 is 37.3 percent; and that it has not been participating in the FFEL program since 1993, which means that within a few years there will be virtually no more of its students entering repayment. Also beyond my consideration are Palm Beach's assertions that it is diligently applying its Default Management Plan and it has little control over the fundamental lack of motivation many of the students exhibit as evidenced by the extraordinarily high drop-out rate.

ORDER

On the basis of the foregoing, it is hereby ORDERED that the eligibility of Palm Beach Beauty & Barber School to participate in the student financial assistance programs authorized under Title IV of the Higher Education Act of 1965 be terminated.

Judge Richard F. O'Hair

Dated: October 23, 1997

SERVICE

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

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Footnote: 1 [1] *Appendix D (Default Reduction Measures) contains a detailed listing and description of a number of measures an institution can implement to impress upon its students their obligation to repay student loans and thus avoid a default of the same.*

Footnote: 2 [2] *Palm Beach received a May 1997 notice from the Department containing its Fiscal Year 1995 cohort default rate, and this letter advised the school it had 30 calendar days from the date of receipt to challenge the data used to compute the cohort default rate.*

Footnote: 3 [3] *The regulation now provides for the same loss of eligibility when an institution's cohort default rate exceeds 25 percent for the last three years. 34 C.F.R. § 668.17(b)(2).*

Footnote: 4 [4] *34 C.F.R. § 668.16(m)(1)(i).*

Footnote: 5 [5] *Palm Beach declined to appeal this preliminary rate within the 30 days allotted by the Department because it found no erroneous data.*
