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

In the Matter of **Docket No. 97-122-ST**

HAIR DESIGN INSTITUTE,

Student Financial Assistance Proceeding

Respondent.

Appearances:

Ronald L. Holt, Esq., Bryan Cave, LLP, Kansas City, Missouri, for Respondent.

Paul G. Freeborne, Esq., Office of the General Counsel, United States Department of Education, Washington, D.C., for Student Financial Assistance Programs.

Before:

Frank K. Krueger, Jr., Administrative Judge

DECISION

Respondent participates in the Pell Grant and Federal Family Education Loan (FFEL) programs authorized under Title IV of the Higher Education Act of 1965, as amended. On January 6, 1997, the Student Financial Assistance Programs (SFAP), U.S. Department of Education, notified Respondent that its FFEL cohort default rate for fiscal year (FY)1994 was 41.7 percent. Respondent appealed the SFAP determination under 34 C.F.R. § 668.17(h) (1997), alleging that a number of loans considered by SFAP to be in default should be excluded from the cohort default rate calculation because of improper loan servicing and collection. On May 8, 1997, SFAP denied Respondent's appeal, and on July 21, 1997, notified Respondent of its intent to terminate its participation in both the FFEL and Pell Grant programs based on its FFEL cohort default rate for FY1994.

Respondent filed a timely request for a hearing under 34 C.F.R. § 668, Subpart G to challenge the proposed termination.See footnote 1[1] In its initial brief, Respondent argued that SFAP did not calculate the FFEL cohort default rate in accordance with standards established by several recent U.S. district court decisions, and if the rate were correctly calculated it would be below the threshold rate necessary for termination. Respondent also requested that SFAP reopen its FY 1994 cohort default rate appeal. In response, the parties requested that the Subpart G proceeding be stayed to enable SFAP to reconsider Respondent's FY 1994 cohort default rate appeal. The case was stayed; however, on May 7, 1998, almost one year after its initial determination of Respondent's appeal under 34 C.F.R. § 668.17(h), SFAP affirmed its original determination that Respondent's FY 1994 cohort default rate is 41.7 percent. As a result, the parties filed supplemental briefs in this proceeding.

Notwithstanding various creative arguments raised by the Respondent, under the regulations governing this

proceeding, I have no discretion in this matter and must order that Respondent be terminated from the Pell as well as the FFEL programs.

DISCUSSION

As noted in a large number of recent decisions issued by this tribunal, under 34 C.F.R. § 668.90(a)(3)(iv) (1997), since Respondent's FY 1997 FFEL cohort default rate is above 40 percent, and it is a “final” rate arrived at by SFAP under 34 C.F.R. § 668.17 (1997), I must find that the “remedy” proposed by SFAP _ termination _ is warranted, even though the school's FFEL rate for FY 1995 is below the 40 percent threshold. *See Aladdin Beauty College #26, et al.*, Docket No. 98-109-ST, U.S. Dept. of Educ. (July 1, 1998); *CC's Cosmetology* College, Docket No. 98-15-ST, U.S. Dept. of Educ. (June 4, 1998); *Interactive Learning Systems*, Docket No. 97-169-ST, U.S. Dept. of Educ. (May 21, 1998) *Avanti Hair Tech*, Docket No. 97-179-ST, U.S. Dept. of Educ. (May 21, 1998); *Michigan Barber School*, Docket No. 97-172-ST, U.S. Dept. of Educ. (May 5,1998) (on appeal to Secretary of Education); *Trend Beauty College*, Docket No. 97-173-ST, U.S. Dept. of Educ. (April 28, 1998); *Jon Louis Schools of Beauty*, Docket Nos. 96-108-ST & 97-19-ST, U.S. Dept. of Educ. (April 3, 1998), p. 15-16 (on appeal to Secretary of Education); *Delaware County Institute of Training*, Docket No. 97-175-ST, U.S. Dept. of Educ. (March 13, 1998); *Academy for Career Education*, Docket No. 97-124-ST, U.S. Dept. of Educ. (Feb. 2, 1998); *Aladdin Beauty College # 32*, Docket No. 97-108-ST, U.S. Dept. of Educ. (Dec. 15, 1997) (on appeal to Secretary of Education); *Palm Beach Beauty & Barber* School, Docket No. 97-102-ST, U.S. Dept. of Educ. (Oct. 23, 1997).

Prior to December, 1995, the regulations authorized the Secretary to initiate proceedings under 34 C.F.R. § 668, Subpart G to limit, suspend, or terminate a school from participation in all Title IV programs if its FFEL cohort default rate exceeded 40 percent for any fiscal year since 1989 and had not been reduced by 5 percent from the cohort default rate for the previous fiscal year; or exceeded certain other ranges specified in the regulations. *See* 34 C.F.R. § 668.17(a)(1) (1995). If the Secretary initiated a proceeding under Subpart G for a cohort default rate which exceeded the limits specified in section 668.17(a)(1), the hearing official was required to order the “remedy” sought by SFAP _ i.e., limitation, suspension, or termination _ unless the school was implementing the default reduction measures specified in Appendix D to the regulations. *See* 34 C.F.R. § 668.90(a)(3)(iv) (1995). In September, 1995, the Department published proposed regulations wherein the Secretary was authorized to initiate Subpart G proceedings whenever a school's FFEL cohort default rate exceeded 40 percent. In addition, section 668.90(a)(3)(iv) was modified to eliminate the so-called Appendix D defense, and to provide that the hearing official must order the “remedy” sought by SFAP, except as follows:

> . . . the hearing official finds that no sanction is warranted if the institution presents clear and convincing evidence demonstrating that its FFEL Program cohort default rate . . . is not final or does not accurately reflect the final rate determined by the Department and that the correct rate would result in the institution having an FFEL Program cohort default rate . . . that is beneath the thresholds that make the institution subject to limitation, suspension, or termination action.

60 *Fed. Reg.* 49178, 49191 (Sept. 21, 1995); emphasis added. The preamble to the proposed regulation states as follows:

> The Secretary is proposing that the only means by which an institution may successfully appeal an L, S, and T [limitation, suspension, and termination] action against its participation in the title IV programs is to demonstrate to the hearing officer that its FFEL Program cohort default rate . . . is inaccurate, and that a correct recalculation of the rate would result in the institution having a rate that is beneath the thresholds that make the institution subject to L, S, and T action.

Id. at 49179.

In other words, the proposed regulations, while eliminating the Appendix D defense, would allow a school to challenge the FFEL cohort rate determination by SFAPSee footnote 2[2] in a Subpart G proceeding. Respondent relies on

the quoted language from the preamble to the proposed regulation to argue that the Secretary's interpretation supports its position that it should be allowed to challenge the validity of the SFAP "final" determination that its FY 1994 FFEL cohort default rate exceeds 40 percent. "To suggest otherwise would reduce the hearing official's role to a purely ministerial and virtually meaningless function of determining if the Department has issued a piece of paper setting forth what it characterizes to be a 'final' CDR [cohort default rate] determination." Respondent's initial brief, p. 14. Respondent states that it "is significant that, when the Secretary, on December 1, 1995, published the final L S & T regulations now appearing at 34 C.F.R. §§ 668.17(a) and 668.90, no change was made to the text of the revised regulations which had been proposed on September 21, 1995." Respondent's response to SFAP reply brief, p. 2. However, the final regulations were changed to eliminate the language highlighted above, to which the quoted language from the preamble to the proposed regulation was referring and, indeed, reduced the hearing official's role to a "ministerial" function. When published in final on December 1, 1995, 34 C.F.R. § 668.90(a)(iv) was changed to provide that the hearing official shall order the sanction sought by SFAP, except as follows:

. . . the hearing official finds that no sanction is warranted if the institution presents clear and convincing evidence demonstrating that the FFEL Program cohort default rate . . . on which the proposed action is based is not the final rate determined by the Department and that the correct rate would result in the institution having an FFEL Program cohort default rate . . . that is beneath the thresholds that make the institution subject to limitation, suspension, or termination action.

60 *Fed. Reg.* 61760, 61774 (Dec. 1, 1995); emphasis added to highlight language not included in proposed regulation. By changing the language in the proposed regulation from specifically allowing the hearing official to consider evidence that a school's cohort default rate "does not accurately reflect the final rate determined by the Department" to the language in the final regulation which makes no mention of such a challenge, the regulatory history makes it crystal clear that I have no authority to consider whether SFAP applied the correct legal standards in arriving at Respondent's FY 1994 FFEL cohort default rate.

Respondent next argues that this tribunal has in the past "recognized that it has the authority and responsibility to examine the integrity of the process leading to determinations or findings which are the basis for an LS & T proceeding." Respondent's response to SFAP reply brief, p. 3. Respondent cites the following cases in support of its position: *Pan American School, Inc.*, Docket No. 92-118-SP, U.S. Dept. of Educ. (Oct. 18, 1994); *Stautzenberger College*, Docket No. 90-102-SA , U.S. Dept. of Educ. (March 11, 1991); *Long Beach College of Business*, Docket No. 92-132-SP, U.S. Dept. of Educ. (Nov. 30, 1993); *Southeastern University*, Docket No. 93-61-SA, U.S. Dept. of Educ. (October 22, 1993); *International Career Institute*, Docket No. 92-144-SP, U.S. Dept. of Educ. (Dec. 1, 1993); *Chauffeurs Training School*, Docket No. 92- 113-SP (Dec. 3, 1993); *Cincinnati Metropolitan College*, Docket No. 93-22-ST, U.S. Dept. of Educ. (Aug. 16, 1993); *Belzer Yeshiva*, Docket No. 95-35-ST, U.S. Dept. of Educ. (March 28, 1995); *Centro De Estudios Multidisciplinarios*, Docket No. 96-79-SP, U.S. Dept. of Educ. (Aug. 15, 1996). The *Pan American*, *Stautzenberger*, *Long Beach*, *Southeastern*, *International*, and *Chauffeurs* cases all dealt with challenges made to the authority of the person who signed the final SFAP program review or audit determination which was the subject of the administrative proceeding. Similarly, the *Cincinnati* case dealt with a challenge to the authority of the SFAP official who signed the notice of termination issued in that case. The *Belzer Yeshiva* case dealt with a challenge by SFAP to the timeliness of a request for a hearing to challenge an SFAP notice of termination. The *Centro* case dealt with the issue of whether a school could raise an issue in a Subpart H proceeding not covered in the final program review which was the subject of the proceeding. All of these cases have a common thread; namely, they deal with questions which go to the jurisdictional authority of SFAP or this tribunal. Under this line of cases, I could consider any challenge to the authority of the SFAP official who issued the termination notice, or any challenge concerning whether the FFEL cohort default rate was a "final" rate. Such a challenge goes to the underlying jurisdiction of SFAP to bring this proceeding, but does not deal with the actual calculation of the cohort default rate. Thus, the cases do not support Respondent's position.

Respondent further argues that its FY 1994 FFEL cohort default rate cannot be considered "final" since SFAP failed to apply the correct legal standards in calculating the rate.See footnote 3[3]

Such an interpretation would eviscerate the meaning of 34 C.F.R. § 668.90(a)(3)(iv) and would place the hearing official in the middle of Respondent's challenge to the SFAP computation of its FFEL cohort default rate. As

Respondent knows, the hearing official is bound by all applicable statutes and regulations. 34 C.F.R. § 668.89(d) (1997). Respondent argues that the hearing official is also bound by "applicable . . .judicial decisions interpreting" applicable statutes and regulations. However, the judicial decisions which Respondent would have me apply do not interpret the regulation which limits my authority, but rather the regulation which clearly places the authority to compute the FFEL cohort default rates with SFAP.

Next Respondent argues that the termination proceeding should be dismissed since Respondent's most recent FFEL cohort default rate for FY 1995 (36.1 percent) is below the 40 percent threshold. Respondent cites in support of its position the SFAP "policy" of not terminating a school's eligibility to participate in the FFEL program if, during the pendency of any appeals of a school's cohort default rates, a school's most recent rate is determined to be less than the 25 percent necessary to be ineligible to participate in the FFEL program. Under the regulations and the Title IV statute, if a school's three most recent FFEL cohort default rates are above 25 percent, the school automatically becomes ineligible to continue in the FFEL program. If a school has three consecutive cohort default rates above 25 percent, but is in the process of appealing at least one of these rates, and, during the pendency of the appeal, another fiscal year rate is issued which is below the 25 percent threshold, SFAP apparently allows the school to remain in the program. However, this practice does not help Respondent, since the statute and the regulations dealing with the 25 percent rule clearly state that a school's three "most recent" cohort default rates must exceed 25 percent. If during the pendency of a cohort default rate appeal a school receives its most recent rate below 25 percent, SFAP appears compelled by statute and regulation to allow the school to continue in the FFEL program. SFAP's so-called "policy" is dictated by law. Under the 40 percent rule, the regulations, although not the statute, provide that SFAP may initiate a limitation, suspension, or termination proceeding if a school has an FFEL cohort default rate above 40 percent for "any" fiscal year. Thus, for example, a school could have an FFEL cohort default rate above 40 percent for 1992, and have cohort default rates for 1993 and 1994 below 40 percent; SFAP could still initiate a termination proceeding since the school had a cohort default rate above 40 percent for "any" fiscal year, namely 1992. In such a proceeding I would have no discretion but to order termination.

Finally, Respondent contends that there are a number of mitigating circumstances which indicate that the Secretary should exercise his discretion and not order termination, such as Respondent's contention that it serves a large number of disadvantaged students who are inherent credit risks, that its retention rate is 62 percent, and that its placement rate is 70 percent. Respondent argues that I should make a recommendation to the Secretary that it not be terminated in light of these mitigating factors. Although I agree that the Secretary should consider these factors, I cannot make a recommendation that the Secretary not order termination in light of these factors without conducting a full evidentiary hearing. I am reluctant to conduct such a hearing without any clear direction or authority from the Secretary. However, given the small number of loans (three or four) necessary to bring the Respondent's FY 1994 rate below the 40 percent threshold, the fact that its most recent rate is below the threshold, and the lack of any clear relationship between the quality of the education program being provided by the Respondent and its cohort default rate,See footnote 4[4] the Secretary should consider alternative remedies; e.g., suspension from the FFEL program.

FINDINGS

1. SFAP made a final determination that Respondent's FFEL program cohort default rate for fiscal year 1994 is 41.7 percent.
2. SFAP seeks an order terminating Respondent's eligibility to participate in all programs authorized under Title IV of the Higher Education Act of 1965, as amended.

ORDER

Respondent is terminated from participation in all programs authorized under Title IV of the Higher Education Act of 1965, as amended.

Date:

August 5, 1998

Frank K. Krueger, Jr.
Administrative Judge

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] *Because of my limited authority to consider a challenge to a "final" FFEL cohort default rate determination, as discussed in detail in the text of this decision, an evidentiary hearing was not conducted; the parties were restricted to the submission of briefs and exhibits.*

Footnote: 2 [2] *Under the regulations, as noted, the Secretary computes the FFEL cohort default rate and initiates the Subpart G proceeding. These functions have been delegated to SFAP.*

Footnote: 3 [3] *Respondent contends that SFAP has not complied with Calise Beauty School, Inc., et al. v. Riley, 1997 U.S. Dist. LEXIS 15706 (S.D.N.Y. 1997) and Advanced Career Training v. Riley, 1997 U.S. Dist. LEXIS 12776 (E.D.Pa. 1997). Respondent argues that, under Calise, SFAP was precluded from considering nine loans as being in default because of the absence of original lender and servicing records. SFAP argues that the decision only requires that it take the steps necessary to obtain these documents, that it took the necessary steps, but that the documents are not available. (Respondent is a party to the Calise litigation; if it believes that SFAP is not correctly interpreting the court's orders, it can, of course, bring the matter to the attention of the court.) Under Advanced Career Training, Respondent argues that SFAP should exclude an additional six loans from the cohort default rate calculation since Respondent did not receive notice of the borrowers' delinquencies until shortly before or after the loans had gone into default, thus preventing the school from making direct contact with the borrowers to attempt to avoid the defaults. SFAP disputes Respondent's contention as to the facts alleged as to these six loans and Respondent's interpretation of Advanced Career Training.*

Respondent also challenges two loans as being included in the default rate calculation because it contends that the servicing records for these loans contain no evidence that one of the required servicing activities was performed by the guarantee agency. SFAP disputes the accuracy of this contention.

In addition, Respondent challenges SFAP's method of calculation. When SFAP calculates FFEL cohort default rates it excludes improperly serviced loans from both the numerator (number of defaulted loans) and the denominator (number of loans in repayment). Respondent argues that improperly serviced loans should be excluded from the numerator only. If improperly serviced loans were removed only from the numerator, Respondent's FY 1994 cohort default rate would be reduced below the 40 percent threshold by excluding three loans from the computation. If improperly serviced loans are removed from both the numerator and denominator, then four loans must be removed

from the computation to bring the rate below the 40 percent threshold. Although the regulation seems ambiguous, SFAP notes that the preamble to the final regulation dealing with loan servicing appeals makes clear that the proper interpretation is to exclude improperly serviced loans from both the numerator and the denominator. In addition, SFAP argues that there were no improperly serviced loans in the calculation of Respondent's FY 1994 cohort default rate. In any event, as discussed in the text of this decision, I have no authority to rule on any of the issues outlined in this footnote.

Footnote: 4 [4] *SFAP suggests that schools with high default rates are engaged in some unspecified conduct which causes the high default rates. In support of its position SFAP cites to Association of Accredited Cosmetology Schools v. Alexander, 979 F.2d 859 (D.C. Cir. 1992), which upheld the Student Loan Default Prevention Initiative Act and its implementing regulations and, in so doing, relied on a Congressional finding that schools bear a fair share of the blame for high default rates. See SFAP initial brief, p. 4. However, as noted in my decision in Aladdin Beauty College # 32, supra p. 2, at 2, note 1, while the Court of Appeals did indeed uphold the constitutionality of the 25 percent rule mandated by the Student Loan Default Prevention Initiative Act, the Court did not consider the Department's 40 percent rule which was not mandated by Congress or supported by any Congressional findings. As noted earlier, the 25 percent rule removes a school from participation in the FFEL program. The Court in Association of Accredited Cosmetology Schools, at 866, noted that Congress, much like a private lender, in mandating the 25 percent rule was simply refusing to take unusually high credit risks. In addition to removing schools from the FFEL program, which deals with credit risk, the 40 percent removes schools from the Pell Grant program as well, which, as a grant program, has nothing to do with credit risk.*