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

In the Matter of **Docket No. 97-22-ST**

AMBASSADOR BEAUTY COLLEGE,

Student Financial Assistance Proceeding

Respondent.

Appearances:

James H. Zander, Esq., Encino, California, for Ambassador Beauty College.

Steven Z. Finley, 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

Ambassador Beauty College (Ambassador), a proprietary, postsecondary vocational school located in Burbank, California, is the product of a partnership entered between Eugene Milew and Mark Schwind on September 10, 1982. On January 31, 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 Ambassador 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 notification followed an emergency action proceeding which was initiated by the Department against Ambassador on January 3, 1997, and which, following a hearing, was revoked on April 15, 1997.

Ambassador appealed SFAP's termination effort and filed a request for hearing on February 19, 1997. During subsequent discussions with the parties, it was agreed that it was unnecessary to conduct an evidentiary hearing prior to deciding this appeal, but that the presentation of an oral argument would be appropriate. Accordingly, an oral argument was conducted on December 16, 1997.

SFAP recited two grounds for its initiation of an emergency action, and simultaneously this termination proceeding, against Ambassador. It first alleged that Ambassador lost its eligibility to participate in the Title IV, HEA programs upon the occurrence of a voluntary change of ownership of the institution effective July 1, 1991, a change which changed its legal status from a partnership to a sole proprietorship and that Ambassador failed to notify the Department

of this change, as it was obliged to do. 34 C.F.R. §§ 600.30, 600.31 (1991). The second ground is that on June 30, 1994, Ambassador lost its legal authorization to operate within the state of California. 34 C.F.R. § 600.5(a)(4). SFAP concludes that either one of these occurrences was sufficient by itself to result in Ambassador's loss of eligibility.

Ambassador challenged the emergency action and on April 15, 1997, Judge Krueger issued a decision in which he concluded that Ambassador met its burden of proving that the emergency action was not warranted and should be revoked. In support of this decision Judge Krueger found that, although there was a certain amount of ambiguity regarding the status of the partnership, there was no showing of an immediate threat of the misuse of federal funds which would justify the continuation of the emergency action. Similarly, the judge found that Ambassador inadvertently allowed its state license to expire, but that, since the state did not consider its students to have been improperly enrolled during this period, an emergency action was not necessary to prevent a misuse of Title IV funds.

Although the emergency action proceeding and the termination proceeding were initiated simultaneously and for identical reasons, they are governed by two different regulatory provisions (34 C.F.R. § 668.83 and 34 C.F.R. §§ 668.86, 668.88) (1997), each for different purposes and with different burdens of proof. The former, generally, is an expedited proceeding in which SFAP seeks to prevent the immediate misuse of Title IV, HEA program funds by halting the disbursement or obligation of any of these funds; the institution has the burden of showing that the grounds for the proceeding either no longer exist or they will not cause a loss or misuse of federal funds. The latter proceeding is conducted in a less immediate fashion to pursue SFAP's intent to terminate an institution's future participation in any Title IV, HEA programs and SFAP carries the burden of persuasion. Contrary to Respondent's argument in its brief, these two proceedings are dissimilar in their goals and procedures and, therefore, this tribunal is not bound by the findings in the emergency action. Additionally, Judge Krueger went to great lengths in his emergency action decision to explain that he was not making findings as to disputed interpretations of Respondent's various legal activities regarding whether the Respondent's partnership was terminated or whether Respondent operated without a valid state license.

Dissolution of Partnership

The first reason advanced by SFAP for this termination proceeding is that Ambassador's Title IV eligibility “ended” or “lapsed” when it failed to notify the Department that there had been a change of ownership. This occurred when the partnership between Eugene Milew and Mark Schwind was dissolved, with the result that Ambassador became the property of Mark Schwind. Ambassador denies that the partnership was dissolved, arguing that the Dissolution Agreement upon which SFAP relies only commemorated the two partners' intent to dissolve the partnership at some unspecified date in the future, after certain prerequisites were satisfied, but that the partners did not implement such a dissolution on July 1, 1991, as the agreement contemplated. Since there was no dissolution, and consequently no change of control, Ambassador maintains that SFAP is without a basis for this termination proceeding.

SFAP has an obligation to monitor the ownership of institutions which participate in Title IV, HEA programs to guarantee that such institutions are fiscally and administratively sound and have the ability to properly administer these programs. To enforce this responsibility, the regulations provide that “[a]n institution's participation agreement automatically terminates on the date the institution changes ownership that results in a change of control.” 34 C.F.R. § 668.12(e) (1991). The regulation defines the term “a change in ownership of an institution that results in a change of control” as any action by a person or corporation which results in new authority to control the actions of that institution. 34 C.F.R. § 600.31(c) (1991). The rationale for this construction is that an institution which undergoes a change of control is not considered to be the same institution after this change, unless the new owner agrees to specified conditions which address certain financial concerns of the Department and protect student interests. 34 C.F.R. § 600.31(a) (1991). SFAP relies on this authority to aver that coincidental with the implementation of the Dissolution of Partnership Agreement, Ambassador underwent a change of ownership which resulted in a change of control and that this effectuated the automatic termination of Ambassador's eligibility.

The Agreement is a four-page document and the preamble of that document contains the following relevant provisions:

> This agreement is entered into on June 12, 1991 by Eugene L. Milew and Mark S. Schwind, hereinafter referred to as Milew and Schwind, executed within the County of Los Angeles, State of California, and is to take effect at 12:01 AM July 1, 1991.
>
> Whereas, the parties hereto have agreed to a Partnership Agreement entered into on September 10, 1982 and hereto desire to discontinue said partnership and dissolve same in the proportions as follows:
>
> Whereas, the party known as Milew wishes to withdraw from the partnership and dissolve same and give his consent to the party known as Schwind to continue the business known as Ambassador Beauty college.
>
> Therefore, in consideration of the premises, and the mutual promises of the parties hereto, it shall be agreed to as follows:
>
> . . . .

Thereafter, in Articles I through III in the body of the Agreement, Schwind is given authority to continue operating the school at its current location and with the same name. Articles IV and V are financial sections in which Schwind acknowledges a monetary debt to Milew derived from the original capitalization of the school and agrees to the terms of repayment of that debt. Article VI states that Milew retains a fifty percent ownership of the leasehold improvements for which Schwind will pay a monthly rental, with a right to purchase those improvements. According to Article VII, the death or insanity of either party "will be cause for immediate takeover by the remaining party in this agreement," and, without regard to the partnership debt described above, the remaining party must pay the value of his interest in the partnership to the legal representative of the other. In Article VII the parties agree to the use of arbitration to settle disputes, and in Article VIII the parties limit the rights of the other to engage in certain activities. Without the consent of the other, no party may borrow money in the firm's name, assign debts due the business, assign or pledge any assets of the business, lease or encumber any real estate, transfer an interest in the business, make a purchase or sale for the business of more than $100, or lend partnership money. In the last article, the parties agree to maintain a banking account and business records; and checks for over $200 must be signed by two authorized persons. On the same date the Dissolution Agreement was executed, the parties also signed a lease wherein Schwind agreed to lease the school premises from Milew for five years.

Five years after signing the two documents, Milew petitioned a California county court to order Schwind to arbitrate certain disputes which arose regarding the renewal of Schwind's lease of the school property and Schwind's failure to repay any of his partnership debt to Milew. In the petition, Milew acknowledges that he "has at all times done and performed all of the stipulations, agreements and conditions stated in the Dissolution Agreement."

Aside from the Agreement, SFAP presented additional documents to prove that the partnership was dissolved and that Schwind was operating Ambassador as a sole proprietorship. This included a January 8, 1996, reapproval application Ambassador submitted to California's Council for Private Postsecondary and Vocational Education (CPPVE) in which Schwind noted that the school is "individually owned; sole proprietorship" and that he was the owner. Again, in Ambassador's March 1, 1996, Annual Report to its accrediting agency, the National Accrediting Commission of Cosmetology Arts & Sciences, Schwind indicated that the school was a sole proprietorship and he signed the report as the owner. Ambassador's auditor prepared a draft audit of the school's 1994 balance sheet in February 1996 in which he refers to the school as a sole proprietorship and notes a debt due to, and a lease with, the former partner. In later correspondence the auditor attempts to minimize the importance of references in his report to a "sole proprietorship" and "former partner" by explaining that this report was a draft and not a finalized statement because there has been no resolution of the dispute regarding the status of the relationship between Milew and Schwind. SFAP's evidence concludes with copies of eight school checks in amounts greater than $200 which were signed only by Schwind, thus

indicating he was in sole control of Ambassador.

Ambassador initially argued that the partnership dissolution issue before this tribunal was previously addressed by Judge Krueger in the emergency action proceeding, and it relies on a portion of that decision in which Judge Krueger stated “it appears that Ambassador Beauty College continued as a partnership until Mr. Schwind could buy out Mr. Milew. Thus, there was no change of ownership or control.” Judge Krueger later commented that the evidence “suggests that Ambassador remains a partnership.” However, he qualified this remark by adding that it was possible that during a termination proceeding that it might be concluded that the partnership was dissolved. In conclusion, he noted that, for purposes of the emergency action, there was sufficient ambiguity regarding the legal relationship between Milew and Schwind to convince him that there was no immediate threat of the misuse of federal funds so as to justify the continuation of the emergency action.

On December 15, 1997, Ambassador supplemented its response to the dissolution of partnership issue by claiming that the partnership was finally dissolved on December 11, 1997, the date the parties executed a Settlement Agreement and Mutual Release. Pursuant to this agreement, Mr. Schwind and Mr. Milew settle on a lease arrangement and the terms for the purchase for all real and personal property used by Ambassador, as well as resolving a financial disputes between the parties which arose subsequent to their entering the Dissolution of Partnership Agreement in June 1991.

I am convinced SFAP has met its burden of proving that Ambassador changed its ownership by operation of the Dissolution Agreement Milew and Schwind executed on June 12, 1991, and that this resulted in a change of control. First of all, the Agreement said it was to take effect on July 1, 1991, and there is no documentary evidence that amended or withdrew this intent. In furtherance of the implementation of this dissolution, the parties also executed a lease agreement whereby Schwind agreed to lease Ambassador's premises from Milew and to continue the operation of Ambassador. According to the draft 1994 financial statement submitted as an exhibit by SFAP, this apparently has been done. Not only does the statement identify the institution as a sole proprietorship, but there are also references to the payment of rent to the former owner. Additional support is found in Schwind's referral to himself as a sole proprietor in several pieces of correspondence, as well as the allegations contained in Milew's suit against Schwind to settle certain disputes which arose after execution of their Dissolution Agreement. I am not dissuaded from reaching this conclusion because of Schwind's on-going financial obligations to Milew, such as his obligation to repay the monetary debt he owes to Milew and the five year lease of Ambassador's premises. Furthermore, I view the December 1997 Settlement Agreement and Mutual Release as no more than a by-product of the acts or omissions of the two parties following the 1991 dissolution, rather than as the embodiment of the years of negotiations which finally culminate in the termination of the partnership. Accordingly, I am satisfied SFAP has shown that the partners who owned and operated Ambassador effected a change of ownership which resulted in a change of control effective July 1, 1991, and that this change went unreported to the Department.

Lapse of State License

SFAP's second basis for initiating this termination proceeding is that Ambassador lost its eligibility to participate in the Title IV, HEA programs when it allowed its California state license to lapse. SFAP alleges this occurrence violates one of the basic prerequisites for an institution to obtain and thereafter retain Title IV, HEA eligibility, which is, that the institution be “legally authorized to provide an educational program beyond secondary education in the State in which the institution is physically located.” 34 C.F.R. § 600.6(a)(3) (1994-1997). From this premise, one must surmise that if an institution loses its state license to provide educational programs, it becomes ineligible to further participate in the Title IV, HEA programs. Further, there are no provisions for an automatic reinstatement of eligibility once a state license is renewed or reacquired.

SFAP presented evidence that on January 2, 1996, CPPVE notified Ambassador that its state license expired on June 30, 1994, and that Ambassador initiated the renewal process on February 16, 1996. CPPVE initially informed the institution that, if the renewal application were approved, the old license could not be extended and that the new license would be effective the date of the new approval. Later, CPPVE amended this advice and informed the parties that, upon approval, the renewed license would be effective retroactively to the date the renewal application was submitted. Ambassador's renewal application was approved and it was issued a renewed license with an effective date of February16, 1996.

Even though there was a lapse in the effective dates of Ambassador's state license from June 30, 1994, until February 16, 1996, CPPVE treated the situation as if there were none. After Ambassador inquired about the status of its license during its lapse, a January 6, 1997, CPPVE replied that Ambassador's "approval to operate in California was continued with the filing of the reapproval application." (Emphasis added.) Furthermore, CPPVE explained in the same letter that it did "not consider student's [sic] enrolled prior to the issuance of the approval document to have been enrolled improperly," and it considered this particular process to be a renewal of Ambassador's license and not a new approval. In response to further requests for clarification from the Department, CPPVE commented that, even though there was a "brief 'gap' created between the time of the prior expiration and the new approval date", Ambassador is "currently in compliance with state laws." Regardless of how CPPVE views the status of the degrees Ambassador conferred between June 30, 1994, and February 16, 1996, I find that Ambassador lost its ability to participate in the Title IV, HEA programs between those two dates.

Discussion of Termination of Title IV Eligibility

SFAP argues that Ambassador's change of ownership resulting in a change of control, combined with its lapse of its state license, constitute sufficient grounds to warrant the institution's termination from further participation in Title IV, HEA programs. I agree that both of these are technical violations of the regulations; however, based on the facts before me, I decline to afford either of them, separately or combined, sufficient magnitude to require that Ambassador be disqualified from disbursing federal student aid. With respect to the change of control issue, I cannot overlook the fact that one of the two original partners remains in control of Ambassador and it is obvious from the Dissolution Agreement that the departing partner continues to have a significant financial interest in the continued operation of the institution. I suspect that the Department's primary motivation for seeking this termination is the failure of the parties to timely notify SFAP of the pending dissolution. If they had done so, I am confident a replacement program participation agreement would have been executed and Ambassador would not be before me today. I apply the same reasoning to the lapse of the state license. California is not overly concerned about the lapse of Ambassador's license and certainly has not taken any sanctions against the school. In fact, it recognizes all degrees awarded during the period for which Ambassador had no license. It is unknown whether CPPVE sent the institution a notice that its license had expired, or was about to, which would have reminded it of this critical requirement; nor is there any evidence that Ambassador was engaged in any misconduct which prevented it from submitting a timely renewal application. Apparently as soon as Ambassador was made aware of the expired license, it expeditiously submitted its "reapproval" application. During oral argument, counsel for SFAP surmised that if Ambassador had notified SFAP immediately upon discovering its lapse of license, the latter would have attempted to accommodate the institution and all might have been forgiven.

SFAP has cited several reported cases for my consideration in which the Department has been successful in its efforts to recover Title IV, HEA funds from institutions which have disbursed funds to students enrolled in programs that had not received the necessary approval or authorization from either the state in which the courses were given or from the institution's accreditation organization.[See footnote 1]* Although these decisions may support a recovery of federal funds expended by Ambassador at such times that it was unlicensed, none of them were termination proceedings, so they are not controlling in situations such as this where SFAP is attempting to terminate the school's future eligibility for participation in the Title IV programs.

I recognize the importance of ensuring that Ambassador notifies the Department of any change in ownership that results in a change of control and, likewise, that it satisfies its state licensing requirements; however, in the absence of any intentional wrongdoing or lack of good faith, I fail to see that either of these infractions, in this case, are sufficiently serious to warrant the termination of its Title IV eligibility. In the grand scheme of things, these two violations do not clearly demonstrate to me that Ambassador lacks the administrative capability to successfully operate a postsecondary educational institution which would mandate such a harsh remedy. *See Instituto de Educacion Universal*, Dkt. No. 96-28-ST, Dkt. No. 96-93-SP, Dkt. No. 96-103-SA, U.S. Dep't of Education, Decision of the Secretary (Oct. 28, 1997). Alternatively, though, Ambassador should receive some form of punishment for these regulatory violations which will ensure it is more vigilant in the future and will serve as a general deterrent to other Title IV institutions as well. Using authority granted to this tribunal pursuant to 34 C.F.R. § 668.90(a)(2) (1997) to fine an institution rather than terminating its eligibility, I believe a fine of $10,000, based on $5000 per violation, is appropriate in this instance. 34 C.F.R. § 668.84(a).

ORDER

On the basis of the foregoing, it is hereby ORDERED that Ambassador Beauty College be fined $10,000, but that its eligibility to participate in the student financial assistance programs authorized under Title IV of the Higher Education Act of 1965 not be terminated.

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Judge Richard F. O'Hair

Dated: January 15, 1998

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 * *See, In re Simmons School, Dkt. No. 93-6-SP, U.S. Dep't. of Educ. (Aug. 2, 1993) aff'd by Secretary (Nov. 4, 1994); In re Shorter College, Dkt. No. 92-125-SP, U.S. Dep't of Educ. (Feb. 4, 1993); and In re French Fashion Academy, Dkt. No. 89-12-S, Decision of the Secretary , U.S. Dep't of Educ. (Mar. 30, 1990). In all of these decisions, the Department was successful in recovering federal funds which were expended at times when the institutions lacked state authority to provide courses and the institutions' "good intentions" in attempting to obtain the required approval was not an acceptable defense. In French Fashion Academy, the Secretary reversed the finding of the administrative law judge that the institution's liability for federal funds based on an absence of a state license and state approval of its programs for specified periods of time should be waived because they amounted to de minimis defaults. In upholding the assessed liability against the institution, the Secretary found that the amounts owed were not de minimis and he was not persuaded by the fact that the state had chosen to take no sanctions against the institution because it offered unapproved classes.*
