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

In the Matter of

CANNELLA SCHOOLS OF HAIR DESIGN,

Respondent.

Docket No. 99-22-SA

Student Financial Assistance Proceeding
ACN: 05-1997-84349
05-1996-84362
05-1997-84401
05-1997-84324
05-1997-84410
05-1997-84390
05-1996-84391
05-1997-84359

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.

Lee S. Harris, 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

The Respondent in this proceeding, Cannella Schools of Hair Design, operates a number of beauty schools in and around Chicago, Illinois, which are separately eligible to participate in various 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 proceeding involves eight final audit determinations (FAD) of six of Respondent=s institutions and addresses the issue of whether Respondent violated federal regulations by failing to make appropriate *pro rata* refunds on behalf of student recipients of federal student financial aid who either withdrew from, or failed to ever attend, the institutions in question. The office of Student Financial Assistance Programs (SFAP), U.S. Department of Education, has made a demand of Respondent for $127,202, representing underpaid refunds and the costs of those funds to the Department. Pursuant to 34 C.F.R. ' 668, Subpart H, Respondent requested a hearing to contest this liability.

On January 8, 1999, SFAP sent Respondent eight final audit determination letters which collectively covered audits for six of its institutions for an 18 month period between July 1, 1996, and December 31, 1997. The only finding addressed in this proceeding alleges that Respondent=s *pro rata* refund calculations improperly provided for the exclusion of charges for student equipment kits from the refund calculations because the Respondent treated the retail price of the equipment kits as a non-institutional charge. SFAP asserts that the charge for the equipment must be considered an institutional charge which would permit Respondent to exclude only the documented cost to the institution of the beauty kits it sold to the students.

During the enrollment process, Respondent=s students were required to sign a Books, Equipment and Chemicals Acknowledgment form which informed them that they were required to have specific books, equipment, and chemicals in their possession when they started classes. Furthermore, they were advised in this same document that they had the option either to purchase the equipment directly from Respondent or they could purchase these items from any outside vendor and the names of two were listed.* The form explained that the fees associated with the purchase of these required books, equipment, and chemicals were not automatically being charged directly to the student account by Respondent, but were optional because they would be incurred only if the student elected to purchase these items from the school rather than exercising the option of purchasing them from an outside source or vendor. The only mandatory provision was that the student must have the beauty kit items available prior to the beginning of class. In further support of Respondent=s claim that the retail price of this equipment it collected from its students is a non-institutional charge, it submitted a declaration from its Director of Financial Aid who explained that Respondent=s staff provided supplemental information to its applicants advising them that if a student elected to purchase the materials elsewhere, Respondent would reimburse the student with a check drawn upon the student=s Pell grant. According to this declaration, and one from Respondent=s School Manager, most of its students took advantage of Respondent=s offer to sell them the required equipment, even though there were retail outlets in the vicinity of each institution which sold these same items. One of the possible reasons for the decision by students to purchase from Respondent may have been the price savings they realized. The School Manager visited one of the beauty supplies stores and found that purchasing items at that store, identical to what was included in Respondent=s box of books and equipment, would cost the students approximately $40 more than Respondent=s price.

Respondent treated this equipment charge as a non-institutional charge and, if the student withdrew or failed to attend, it believed itself entitled to exclude the retail price of this required equipment prior to computing the *pro rata* refund. SFAP alleges that by virtue of this practice, Respondent understated the refunds due the Pell Grant account, and that Respondent was entitled only to deduct the documented cost of the equipment to the institution in the refund calculation. Accordingly, SFAP makes a demand of $127,202, which includes not only the unmade portions of the refunds to the Pell Grant account, but also an amount determined to be the cost of those unmade refunds.

DISCUSSION

Institutions participating in student financial assistance programs under the Higher Education Act of 1965 are required to have in effect a fair and equitable refund policy under which the institution refunds unearned tuition, fees, room and board, and other charges assessed the student by the institution equal to the portion of the period of enrollment for which the student has been charged that remains on the withdrawal date, rounded downward to the nearest 10 percent of that period. 34 C.F.R. ' 668.22(c)(1) (1995-1998). The phrase Aother charges assessed the student by the institution@ is the center of the debate between SFAP and Respondent in this proceeding. SFAP insists that actions of the Respondent require the charges of this equipment be categorized as an institutional charge and Respondent strongly disagrees. The regulation provides that these Aother charges assessed the student by an institution,@

> include, but are not limited to, charges for any equipment (including books and supplies) issued by an institution to the student if the institution specifies in the enrollment agreement a separate charge for equipment that the student actually obtains or if the institution refers the student to a vendor operated by the institution or an entity affiliated or related to the institution.

34 C.F.R. ' 668.22(c)(5)(i).

A reasonable interpretation of this language would be that the words Ainclude, but are not limited to@ apply only to equipment, i.e. books and supplies, and this means this category of equipment can be expanded to include other unmentioned types of equipment. The chemicals, combs and brushes Respondent=s students were required to have for their classes, could also easily be included in the category of equipment envisioned by the regulation. Reading further in that explanatory sentence, the regulation identifies the charges as being institutional only if either of two conditions are met. One, the charge must be included in the enrollment agreement the student and institution sign, or two, the student must be referred to a particular vendor who has such a close business relationship with the institution that the latter might benefit financially from the sale of the equipment to the institution=s students.

SFAP insists that the Respondent=s charge for the beauty kits is an institutional charge even though Respondent does not include a separate charge for the beauty kit in its enrollment agreement with each student, and even though Respondent does not refer the students to any vendor it operates or is affiliated with it, but rather offers students the option to purchase the kit from a number of sources, including Respondent. SFAP=s position on this issue is that the language Ainclude, but are not limited to@ refers to the two stated conditions of whether the charges are included in the enrollment agreement and whether the students are referred to specific vendors. In other words, SFAP wants the opportunity to add additional conditions or circumstances which it should be able to consider to determine whether the charge for the beauty kit is an institutional charge. This argument lacks any external support and is not persuasive.

This is not the first time this issue has been raised by SFAP with respect to Respondent. The audit finding in controversy here is identical to one contained in a final audit determination addressing Respondent=s Kankakee, Illinois, institution during the 1996 award year. On August 20, 1997, after the Seattle regional office of SFAP evaluated Kankakee=s explanation of its handling of the beauty kit sales to students, SFAP reversed its earlier position and concluded that the charge for beauty kits Kankakee=s student=s purchased from the institution was non-institutional in nature and, therefore, there was no underpayment of *pro rata* refunds. Meanwhile, the Chicago regional office of SFAP which prepared these eight final audit determination letters obviously disagreed with that interpretation. Additionally, this issue was recently addressed in a case involving the assessment of liability following audits of another two of Respondent=s institutions whose administrative handling of the beauty kits was identical to the facts before me. In that case Judge Krueger agreed with Respondent that the charges were non-institutional and that Respondent had no refund liability to SFAP. *In re Cannella Schools of Hair Design*, Dkt. No. 98-72 SA & 98-73-SA, U.S. Dept. of Educ. (Feb. 22, 1999) (*Cannella)*. Judge Krueger highlighted language found in the preamble to the provision of the regulation cited above which provides some insight into the Secretary of Education=s intent in publishing this section of the regulation. Specifically, the Secretary noted:

> If an institution does not have a separate charge for equipment and the student has the option of purchasing the equipment from more than one source, the institution would not have to include the equipment charge in the *pro rata* refund calculation.

59 *Fed. Reg.* 61163 (November 29, 1994).

I agree with Judge Krueger=s conclusion in *Cannella* that the Anot limited to@ language in Section 668.22(c)(5)(i) of the regulation means there may be charges for items other than equipment for which an institution is responsible for inclusion in the computation of a *pro rata* refund. The language does not stand for the proposition that there may be more than the two conditions cited in the regulation which SFAP may examine to determine the nature of the charge.

SFAP=s next position is that the beauty kit price is an institutional charge because the students did not have a Areal and reasonable@ opportunity to purchase the items elsewhere. In this discussion it cites guidance provided to institutions in the Department=s 1996-97 and 1997-98 Student Financial Aid Handbooks addressing the issue of what constitutes an institutional charge:

> Usually, if the student purchases the item from the school, it=s an institutional cost. However, ED has determined that if the student has a **real and reasonable** opportunity of obtaining the items (such as books) elsewhere, and only *chooses* to get them at the school as a matter of convenience, the cost is a noninstitutional charge.

Clearly, Respondent=s students were given the option to purchase the beauty kits from a source outside of Respondent=s realm of operation. SFAP may argue that the students were not really given a true alternative, which it believes is proven by the fact that most students purchased the beauty kit from Respondent. However, it is not difficult to comprehend that when these students were presented with the convenience of having all of the required materials assembled together and boxed by Respondent at the institution=s location, plus a documented price savings, they easily elected to take advantage of Respondent=s offer to sell the items. The alternative to the students which involved getting transportation to one or more retail outlets to purchase these same items at the same or greater price would not be appealing. The guidance Respondent gave these students clearly afforded them with a real and reasonable opportunity to purchase the beauty kits from a vendor other than Respondent.

Another facet of SFAP=s argument is that the Books, Equipment and Chemicals Acknowledgment form is signed at the time of enrollment and should be considered as just one more incident of the enrollment process. It insists that even though there were two separate documents, this nearly simultaneous signing transforms a student=s election to buy the kit from Respondent into a separate charge included in a now all-encompassing enrollment agreement. SFAP believes this interpretation brings the entire process in line with that found in a previous decision of this tribunal, *In re Contempo School of Beauty*, Dkt. No. 98-141-SA, U.S. Dept. of Educ. (March 5, 1999). In that case the institution was permitted to exclude only the documented cost of beauty kits issued to students, provided it could establish that each student received all items in the kit. Contempo attempted to prove the student=s property receipt by submitting three documents: its enrollment agreement, a kit list, and a Acheck list@. All documents were signed by the student and the latter two addressed the receipt of the beauty kit. A major factor in *Contempo* which is not present in the case before me is that Contempo conceded the beauty kits represented an institutional charge -- the very issue which Respondent here vigorously contests. Additionally, receipt of property by the students is not a contested issue here. The fact that Respondent=s students executed the enrollment agreement and the acknowledgment forms on the same day is not dispositive. I find the two forms are separate and distinct documents. Respondent provided its students with adequate explanation, both orally and in writing, to sufficiently establish a scenario in which its students knew they had a real and reasonable opportunity to purchase the required equipment and supplies elsewhere. Furthermore, the requirement in the acknowledgment form that the students have this equipment in their possession as a prerequisite to their beginning classes did not transform the charge for this equipment into an institutional charge when the students elected to purchase it from Respondent, a decision which they presumably made on the basis of personal convenience.

One other distinction which supports the separateness of the kit charge from the enrollment charges is that Respondent=s students were specifically told in the acknowledgment form that if they elected to purchase the equipment from Respondent, the fees associated with this purchase would not be directly charged to them by the institution, but the transaction would require their signing a preprinted AVoucher@ which contained the language that it was AGOOD TOWARD PURCHASE OF BOOKS, EQUIPMENT AND CHEMICALS. VALUE $690.00.@ I find this procedure further supports Respondent=s claim that the price of this beauty kit need not be treated as an institutional charge, but rather as a separate charge for books and equipment which the students were required to have in their possession before the education process can begin. In conclusion, I find Respondent properly excluded the retail price of its required beauty kits during the computation of its *pro rata* refunds.

ORDER

On the basis of the foregoing, it is hereby ordered that the assertion of liabilities against Cannella Schools of Hair Design is dismissed.

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Judge Richard F. O'Hair

Dated: October 15, 1999

SERVICE

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

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* Respondent provided a statement that there were over one hundred beauty supply stores in the Chicago metropolitan area which were vendors not associated with Respondent and which were within 10 to 17 blocks distance from the respective beauty schools. The equipment the students were required to purchase was available at any of these stores.