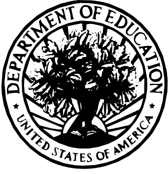

UNITED STATES DEPARTMENT OF EDUCATION
WASHINGTON, D.C. 20202

In the Matter of	**Docket No. 09-22-SA**
STAR TECHNICAL INSTITUTE,	Federal Student Aid Proceeding
Respondent.	

Appearances: Ronald L. Holt, Esq., and David L. Lefevre, Esq., Brown & Dunn, P.C., Kansas City, Missouri, for Star Technical Institute.

Denise Morelli, Esq., Office of the General Counsel, U. S. Department of Education, Washington D.C., for Federal Student Aid.

Before: Judge Ernest C. Canellos

DECISION

Star Technical Institute (Star) is a proprietary institution of higher education that operated at three main campuses (Stratford, New Jersey, Upper Darby, Pennsylvania and Northeast Philadelphia, Pennsylvania) and four additional satellite locations. At these various locations, Star offered training in computers, allied health, business and technology. Star was accredited by the Accrediting Commission of Career Schools and Colleges of Technology and participated in the Federal Student Aid Programs authorized by Title IV of the Higher Education Act of 1965, as amended (Title IV). 20 U.S.C. § 1070 *et seq.* and 42 U.S.C. § 2751 *et seq.* Within the U. S. Department of Education (ED) the office having jurisdiction over the oversight of these programs is the office of Federal Student Aid (FSA).

In July 2006, a team of program review specialists from FSA's Philadelphia Case Management Team performed an on-site program review at Star. At the time of the program review, 34 C.F.R. § 600.5(a) (8) and (d) (1) provided that to be eligible to participate in the Title IV programs, a proprietary institution had to derive no more than 90% of its revenue from Title IV funds -- conversely, it had to receive no less than 10% of its revenue from tuition, fees and other institutional charges for students enrolled in eligible programs. This has become known and has been alluded to as the 90/10 Rule. If an eligible institution exceeded the 90% rate, it had

to notify ED of that fact within 90 days of the end of its fiscal year, and it became ineligible to participate in the Title IV programs for the following year. *See,* 34 C.F.R. §600.5 (f) and (g). As part of the program review, the team examined Star's 90/10 calculations for years 2004 and 2005. Because of concerns raised during the program review relative to some of the elements used by Star in its 90/10 calculations, the issue was referred by FSA to ED's Office of Inspector General (IG) for further inquiry.

In an ensuing audit, IG focused on Star's Upper Darby location for years 2003, 2004, and 2005, and determined that the Upper Darby School did not comply with the 90/10 rule for each of the three fiscal years examined. Although Star's audited financial statements for the Upper Darby location showed the Title IV increment of the 90/10 ratio to be compliant at 89.35% in 2003, 89.48% in 2004, and 89.29% in 2005, the IG recalculated these rates resulting in disqualifying rates of 96.16% in 2003, 94.67% in 2004, and 92.67% in 2005. IG's audit disallowed two types of income that Star claimed were funds generated outside of Title IV. The first category of disallowance was for the value of direct gifts of cash to the institution from the owners thereof. The second was for the proceeds of the sale of student accounts receivable owed to Star, to United Financial Group, a finance company owned by one of the owners of Star.

The IG's recalculation of the 90/10 percentages resulted in Star's Upper Darby School becoming ineligible to participate in the federal student aid programs from January 1, 2004, through December 31, 2006. As a consequence, FSA issued a Final Audit Determination (FAD) demanding that Star return $9,830,436.00 to ED as misspent Title IV funds. Star appealed on April 2, 2009. Once assigned this case for adjudication, on May 12, 2009, I issued an order governing proceedings directing the parties to file their respective briefs on an assigned schedule.

Subsequent to the final submission from the parties, on November 25, 2009, the Secretary of Education issued his decision in *In the Matter of Gibson Barber and Beauty College*, Docket No. 05-49-SA. In *Gibson*, the Secretary determined that the loan or gift of money by an owner to a proprietary school may not be counted as non-Title IV funds for purposes of the 90/10 calculation. However, based on the unique facts of that case, the Secretary exercised his plenary authority and declared his conviction that requiring a school owner to repay the entire years worth of federal student aid for a relatively small violation of the 90/10 standard would not be in accord with the owner's effort to execute corrective measures to bring the institution into compliance with the 90/10 standard. The Secretary emphasized three extraordinary factors that influenced his decision: first, the exceedingly small amount by which the institution exceeded the 90% amount; next, the absence of evidence of fraud or of a pattern of other violations of the 90/10 Rule; and finally, the absence of allegation of any other regulatory violation.

Since that decision contained the Secretary's views on the import and application of the 90/10 Rule that is at issue before me, I ordered the parties to comment as to the applicability of the Secretary's decision to the present proceeding. The parties submitted such comments, as I directed. After submission of the aforementioned comments, I took this case under advisement for the purpose of issuing a decision on the merits. However, my initial research into the matter

revealed that on August 14, 2008, Public Law 110-315 was enacted by Congress repealing the 90/10 Rule. *See,* 20 U.S.C. § 1002 (b) (1) (F). Since the effective date of this statutory repeal predated the initiation of the action before me, I directed the parties to file simultaneous briefs of their respective positions relative to what effect, if any, the repeal had on this proceeding. On June 1, 2010, the parties complied. Not unexpectedly, the parties differ as to the effect of the repeal. FSA posits that the repeal was not, by its terms, made retroactive, therefore, this enforcement action must continue and under 34 C.F.R. § 668.113, I am bound to finalize it. Star, on the other hand, points out that the repeal was based on a questioning of the efficacy and fairness of the 90/10 Rule throughout its history and changed the nature of the 90/10 analysis. Rather than being a component of eligibility, the 90/10 issue is now repositioned into an element of the program participation agreement. As such, Star argues the entire issue needed a new analysis for the purpose of determining whether the repeal has retroactive effect and whether this proceeding should continue.

On the merits, Star takes exception to the recalculation of the 90/10 rates by the IG and claims that it had not violated the 90/10 threshold. Star questioned the IG's position that Star's inclusion of the two subject areas as non-Title IV was improper. Star asserted that there was no statutory or regulatory authority for the IG position and that the IG relied on a sub-regulatory preamble to a regulation as that authority. Also, Star claims that the regulatory language relative to the 90/10 Rule is imprecise as it relates to what constitutes funds derived from Title IV and it acted in good faith and it relied on its auditor for the advice that its practice was correct. Star emphatically argued that had FSA provided any contrary advice, it would have followed it. Star goes further and asserts that the statutory and regulatory creation of the 90/10 rule is violative of the U.S. Constitution as a taking without due process.

Star claims that had it known of the limitations as detailed by the IG, it could have qualified under the 90/10 standard by simply combining its three main schools and associated branches into one school -- the consolidated numbers for all the schools would have qualified all of them under the 90/10 standard for all the award years in issue. Star offered that its three main campuses had been approved as eligible to participate in Title IV federal student aid programs under separate participation agreements and each with its own OPE ID number. To further emphasize its quandary, Star maintains that once it was notified that the Upper Darby campus was in violation of the 90/10 standard, it requested the campuses be merged into one, however, that request was never acted on by FSA.

The assertions by the parties as well as the facts of this case raise both legal issues and equitable considerations. The statutory scheme delineated above and labeled the 90/10 Rule was implemented by Congress in an attempt to increase the quality of the educational programs offered by proprietary schools.[1] A measure of this increased quality would be demonstrated by the enrollment of students who had alternate sources of funding. Although the goal was lofty, experience indicated problems with those assumptions. In fact, ED pronounced that:

[1] FSA offers a different reason for the implementation of the 90/10 Rule. It posits that the Rule was instituted as a protection against fraud.

> Although well- intentioned, the 90/10 Rule has not been shown to be a useful tool in ensuring the quality of education provided by proprietary institutions, and has only served to cause institutions that have a mission of serving the lowest-income students to restrict the number of Pell Grant recipients that they enroll.

See, The Higher Education Act Reform Amendments of 2005: Section-by-Section Analysis (Archived Information), available at http://www2.ed.gov/policy/highered/leg/hea-analysis.pdf.

Although clearly pertinent to the ultimate resolution of this disputed issue, my jurisdiction in deciding this matter is limited -- under the provisions of 34 C.F.R. § 668.113, I am bound by all statutes and regulations and may not waive or rule either invalid. Stated otherwise, I do not have plenary authority -- that power and authority is reserved for the Secretary. The import of the above is obvious on a number of fronts. As an initial matter, I have determined that the August 14, 2008 repeal of the 90/10 Rule was not retroactive. Typically, if a repeal of a statutory provision does not state that it acts retroactively, it will not be construed to do so. *See, Martin v. Hadix,* 527 U.S. 343 (1999). Here, the acts complained of, violating the 90/10 Rule, were committed during the period when the statutory provision was applicable. Even though the enforcement action before me was initiated after the effective date of the repeal, the repeal did not, by its terms, excuse the violations. Therefore I must decide this case under authority of the then existing statutory authority.

Also, in recognition that I do not possess the plenary authority possessed by the Secretary, I cannot excuse a 90/10 Rule violation on the premise that the statutory scheme lacked efficacy. Therefore, the fact that in 2005, Secretary Spellings apparently believed that the 90/10 Rule was not useful when applied to institutions, like the appellant here that served low income students, cannot be considered by me in my deliberations. FSA labels both of these issues as "equitable considerations," and as such they fall outside my authority to decide.

It seems abundantly clear to me that the scheme envisioned by the 90/10 Rule expected constant monitoring of the relative income categories between Title IV and non-Title IV and adjustments to each during the award year to assure compliance with the Rule. Because the remedy exacted against those that fail to satisfy the Rule is so serious, any other scenario would seem unsupportable. As has been recognized in the past, the only way for a school to become compliant with the 90/10 Rule if, during the year the percentages fall outside the prescribed parameters, is to either reduce the draw-down of Title IV funds or, somehow, generate more non-Title IV income.

Given the applicability of the 90/10 Rule to the award years in issue, I must determine on the facts and law whether Star's receipt of monetary gifts from some of its owners and the sale of accounts receivable by Star to a corporation controlled by one of its owners can be categorized as other sources of income for purposes of the 90/10 Rule analysis. As to the receipt of gifts, the Secretary has determined that gifts of money to an institution by the owner thereof, cannot be

included as non-Title IV income in the 90/10 analysis. *See, In the Matter of Gibson Barber & Beauty College,* Docket No. 05-49-SA, U.S. Dep't of Educ. (Decision of the Secretary, November 25, 2009). In its Final Audit Report, dated August 15, 2008, the IG quantifies the amount donated to Star by its owners as $70,925.00, during the period January 1, 2005 to December 31, 2005.

The question of whether the sale of Star's accounts receivable may be counted as other sources of income is not as clear. In the present proceeding, the evidence revealed that certain of Star's accounts receivable were sold to United Financial Group, a collection agency, at what Star asserts was at a market rate and on a non-recourse basis. United Financial Group is a corporation whose sole shareholder is one of Star's owners. FSA argues that such a sale cannot be used to satisfy the 90/10 Rule in this instance because the sale was made to a related party. In the context of the purpose of the Rule, how that matters, or more importantly, why it matters is never made clear. Certainly, such sales if not at market rates or if the buyer had the option to return the accounts receivable, would result in no income to Star. However, here the evidence indicates that actual funds changed hands and the sales were at market rates and on a non-recourse basis.

My decision on this question is complicated by FSA's position, that the sale of accounts receivable by a proprietary institution to an independent company, like Bank of America, would be clearly acceptable if at market value and on a non-recourse basis, while a similar sale to a separate corporation with common shareholders would not. This would be so even if it was clearly established that actual cash flowed to the institution from the finance company. Star vehemently argues twofold that Star and United are both corporations and, therefore, not related parties and that FSA's position is not provided for in any statute or regulation and, it was unaware of that requirement. Star also stresses that on review the only ED published position that it found that remotely addresses this question is a 1999 preamble to the amended 90/10 regulations, however, such preamble is a sub-regulatory statement that does not have regulatory force and effect but is an articulation by the agency of its interpretation of its own rule thus should not be given deference. *See,* 64 Fed. Reg. 58,610 (Oct. 29, 1999). Interestingly, the regulation establishing the 90/10 Rule contains no enforceable definition of the term, related party. Also, as indicated above, Star argues that had it known of that limitation, it could have availed itself of the other alternative options so as to satisfy the 90/10 Rule.

Clearly, the ramifications of failing to satisfy the 90/10 Rule are substantial -- loss of Title IV eligibility. For a proprietary institution, history has shown that this almost certainly amounts to the end of that institution, especially if it serves a high number of disadvantaged or low income students. Since that is so and since the margins applicable to the 90/10 Rule are small, every impact on the ratios established is critical. Due Process requires that, in order to be enforceable, whatever regulatory provision impacts this ratio must be clearly established. Applying that standard and based on the totality of the evidence, I find that Star did not err in its method of accounting for its sale of accounts receivable to United Financial Group. The factors that I considered were: United actually paid market rates for the receivables; the sale was on a non-recourse basis; FSA's position of limitation on the sales to related parties is not provided for in any enforceable regulatory provision; United and its relationship to Star was listed in Star's

financial statements; Star's CPA accounted for these sales under the non-Title IV category; there was no evidence of fraud or other violations; the management of Star believed their treatment of the sales of accounts receivable as non-Title IV was authorized; Star's students were apparently entitled to the Title IV aid they received; and other than through the application of the sanctions for the alleged violation of the 90/10 Rule, Star earned the Title IV income it reported. Again, with reference to the Final Audit Report, the IG fixed the amounts of sales of accounts receivable to United it questioned as non-Title IV as $202,925.00 between January 1, 2003 and December 31, 2003, and $105,447.00, between January 1, 2004, and December 31, 2004.

Violations of the 90/10 Rule are unique -- up until the close of the fiscal year, the validity of all Title IV expenditures is determined on a case-by-case basis. It is only when the 90/10 calculation is made and, the institution fails the test, that all the Title IV aid that was disbursed and previously considered correct, then becomes improper and must be returned to ED. I believe that a further comment is important under the circumstances of this case. Normally, when an institution is determined to be ineligible to participate in the Title IV programs, it must return the federal funds it disbursed during the period of its ineligibility. If the reason for its becoming ineligible is one to which our concept of fault attaches, then the school's losses normally would be accepted as fair. If, however, the loss of eligibility and consequently, the return of all Title IV funding it received, is occasioned by factors not clearly attributable to fault, a different attitude relative to fairness becomes apparent. In such situations, the question soon becomes, can the institution recover its losses from some other source. I have previously raised the question of whether a proprietary institution could seek to recover the tuition it ostensibly earned on behalf of students that benefitted from the education it provided when forced to return the federal funds it received to cover that education.[2] Under contract rules, it seems that they probably could do so. If the respective student had in fact, successfully completed his/her training, what defense could he/she offer in a contract action seeking to recover tuition that was originally funded by the federal government, but which funding was later withdrawn by the government. In the final analysis, through no fault of their own, the students who are the beneficiaries of the Title IV student aid would be forced to pay for that education themselves. This surely is an unintended result of terminating the eligibility of some institutions for 90/10 violations. *See, In the Matter of Bryant and Stratton College,* Docket No. 04-20-SP, U. S. Dep't of Educ. (April 14, 2005).

FINDINGS

To recapitulate my findings in this proceeding: First, as to the FSA finding that Star erred in categorizing direct gifts of $70,925.00, from their owners during 2005 as non-Title IV income when computing its 90/10 ratio, that finding is AFFIRMED. Second, as to the FSA finding that Star erred in categorizing the proceeds of the sale of accounts receivable to United Financial

[2] It is normal practice for proprietary schools to execute contracts with their students that contain a provision that requires a student to pay for his or her education personally if Title IV funding is not provided.

Group in the amounts of $202,925.00 during 2003, and $105,447.00, during 2004, as non-Title IV income in its 90/10 calculation, that finding is not supportable and is DENIED.

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Ernest C. Canellos
Chief Judge

Dated: August 5, 2010

SERVICE

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

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