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The Case of LaMarca vs. DOE

Even the offer of a $1 million letter of credit failed to save the schools

By Barbara A. Schmitz, CER Senior Writer

Technically, Marc LaMarca won the case. But he and the many others involved in the Cleveland, Ohio beauty schools really lost. A lot.

On Oct. 16, 2008, a federal jury acquitted LaMarca, the former vice president of Charmayne Beauty Academy and Vogue Beauty Academy from May 2000 to November 2003, on charges that he failed to refund financial-aid payments to the government when students dropped out of school.

But the family's schools, which were forced to close in 2003 when federal funds dried up, remain closed. Hopefully, the staff and nearly 300 students that once worked or attended school there have gone on to new jobs or other schools. In fact, some students did go on to graduate from other schools, but those students were in the minority. Since the schools were located in the inner city and served a poor black population, it's likely many of the students simply went back to welfare.

Could this mess have been avoided? Undoubtedly, say those involved. But before you can look at what is to be learned, you need to look at what happened and start at the beginning.

In this case, the beginning is 1998, before LaMarca was even employed by the beauty schools, which had been primarily owned by his father, Thomas LaMarca, as well as Anne Kaufman, for more than 40 years.

In1998, the U.S. Department of Education changed its software program for processing Pell grant and other financial aid applications made by students. For nearly two years, the beauty schools experienced computer interface problems with the Department's new software. While the schools thought the Department contractor was receiving their paperwork, it actually was going into a big black hole in cyberspace. It meant that the schools weren't getting financial aid students had qualified for.

Technically, Marc LaMarca won the case. But he and the many others involved in the Cleveland, Ohio beauty schools really lost. A lot.

LaMarca said that his father brought him into the schools in 2000. "The schools couldn't draw any money down and were in debt hundreds of thousands of dollars," he said. "Dad was very sick at the time...and we didn't want the schools to go down.

For 40 years, it had been his life."

So LaMarca agreed to quit his job at a car dealership and go to work for the schools, even though he said he knew nothing or little about Pell or other government grants at the time.

The schools' financial aid director had repeatedly tried to fix the problem, LaMarca said, and had even traveled with the schools' computer to Iowa City, Iowa to meet with the Department's CPS contractor in an effort to identify and resolve the processing problems. But no one could figure out that the school's laptop was incompatible with the USDE's new software, he said.

We were really struggling to keep the lights on. But I got everything going and even got the bills out. I even made a deal with the IRS, paying them off the hundreds of thousands of dollars we owed them.

— Marc LaMarca

Unable to wait any longer for answers, LaMarca hired GEMCORE, Inc., one of the largest third-party servicers in the country, to take over the processing of the papers, as well as Jim Moored, a financial aid specialist. Finally, money started coming in.

But they could not recoup all the funding due to them, mainly because of the passage of time. That's because their student body was so fluid, and moved around a lot, said Thomas Escovar, an attorney with Steuer, Escovar, Berk and Brown Co., L.P.A., who assisted in the trial. In fact, the passage of time and the difficulty locating former students for verification meant that they missed out on nearly one-third of the aid that had been earned, Kaufman wrote in a letter to Sally Stroup, assistant secretary for postsecondary education for the USDE.

Even though Pell grant monies were finally coming in, LaMarca's problems were far from over. He was behind on rent, and they owed the IRS money. Then they got a letter from their downtown school that a renovator had just bought the street and was going to turn it into condos. Although they had been in that building for 40 years, they had to get out. On top of everything else, LaMarca was now moving a school.

"We were really struggling to keep the lights on," LaMarca said. "But I got everything going and even got the bills out. I even made a deal with the IRS, paying them off the hundreds of thousands of dollars we owed them."

But it was a real mess, he recalled. The IRS audited the schools and noted the money owed by the government. In return, they wanted the schools to pay taxes on money that the Department of Education was refusing to pay them.

"That was the kind of mess I was into," LaMarca said. "I felt like I was thrown to the wolves."

In April 2003, LaMarca received a letter from the USDE, notifying the schools that the Department would be doing a full program review and inspection. The end result was that Charmayne and Vogue were put on reimbursement. In other words, the government would pay the school a student's Pell funding only after a student completed his or her training.

In August 2003, LaMarca hired attorney Ron Holt, then with Shughart, Thomson & Kilroy in Kansas City, Mo., to help the schools work out their issues with the Department of Education. Holt first contacted Russell Wolff from the Office of the General Counsel with the USDE, in hopes the two parties could agree on a plan to allow the schools to pay the Pell grant refunds owed for students who had not completed their education. Holt said they hoped to put down a substantial down payment—a number was never put to it—and then pay the rest

over a period of time. But Wolff was hesitant to let the schools enter any long-term plan, Holt said. (Wolff did not return a reporter's phone call; instead, Stephanie Babyak, a USDE spokeswoman, called back. She eventually referred a reporter's calls to Catherine Grant of the OIG since that is the office that brought the case to trial.)

While e-mails kept going back and forth between the two, Title IV money was not moving.

"The schools were really living on their own resources since the middle of June 2003 and now it was September," Holt said. "The owners had been using their own money to pay rent and staff. Things were getting tight."

It was then that the schools learned of the Department's investigation into forgeries in some of the schools' initial disbursement requests, Holt said. What they believe happened, but was never an issue in the criminal trial, was that the schools' financial aid director, in a hurry to finish up paperwork before leaving for another job, signed copies of enrollment agreements for about 10-15 students, he said.

"We told the Department that this was not something we authorized, and that it shouldn't have happened," Holt said. "But it was not fraud. They were real students who were in school."

But Holt admitted it must have made it look as if the schools were guilty. And while the schools did offer to get those students' signatures, the Department wasn't interested.

"They had already made up their minds," Holt said.

Making the schools look even guiltier was that they delayed doing their audits.

"They weren't sure until they got it straightened out with the Department what money they had coming and what receivables were good or not good, so they put off preparing audits," Holt said. "In hindsight, that wasn't the best approach. They should have done a preliminary audit and qualified it."

Then, on Oct. 2, 2003, the Office of Inspector General (OIG) turned up unannounced and seized all of the schools' records.

Escovar noted that in the search warrant, the OIG stated they did not want to interfere with the regular business of the schools and promised to return the schools' records in a timely manner. However, to this day, the records have never been fully returned.

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Despite the absence of their school records, Holt said they still tried to come up with an agreement with the Department, trying to assure that if the schools did pay the estimated $420,000 due to the USDE in refunds, that the Department would not turn around and terminate the schools from Title IV because of the late audits and late refunds.

"I kept telling Russ (Wolff) that no one will loan us money—the shareholders or banks—unless I can assure them we can continue to operate," Holt said, adding that he asked Wolff to commit to what administrative sanctions the Department might impose concerning late audits and late refunds. "But they decided that they couldn't and wouldn't make that commitment once the OIG was involved."

Complicating things even more was the fact that just days before the OIG seized the records, the Department issued the schools its program review, asking them to do a full file review and

reconstruction. In other words, they were to pull files for all the dropped students on which refunds were owed for the two years and create a spreadsheet to show when students started, stopped, how much aid they were awarded, how much aid was disbursed and how much aid should be refunded.

"And this is at the same time that I have Russ Wolff saying we don't know how much is owed on refunds, and until we figure it out or until you come up with a plan to pay we're not going to pay you any reimbursement money," Holt said. "It was a classic Catch 22. They said they needed more information, and we didn't have access to that information because the OIG had taken all our records."

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Holt said he began to ask for meetings between the USDE and the schools. "But I kept hearing back that we don't need to do that," he said. "They said, 'Any proposal you have you can put in writing or an e-mail and send it to us.'"

In fact, e-mails flew between the two parties. The topic on many of those communications was about the amount of refunds. On Oct. 9, 2003, Wolff wrote: "As you know, the Department does not know the precise dollar amount of the schools' failure to pay their required refunds. All it knows is the undisputed fact that the schools failed to pay refunds for two years. The Department has estimated the amount of the schools' liabilities at $427,846, but, of course, the final figure could be $600,000–$700,000. No one knows for sure. If the schools had performed their required annual audits, they would have been compelled to conduct a full file review to establish the scope and magnitude of their dereliction in this regard. Unfortunately, they likewise failed to do that as well. Accordingly, the schools have no one to blame but themselves for the Department's inability to establish the precise amount of their debts."

Still, in his e-mail, Wolff acknowledged that at least some of the students for whom the schools sought reimbursement would likely have been entitled to earn Pell grants. "To the extent that such students can be definitively identified, the Department is prepared to create a list of possible offset amounts that can be applied to the final debt once the students are conclusively established as eligible, and the debt is firm and undisputed."

Meanwhile, the schools continued to ask for copies of their records from the OIG, and in late November, the OIG finally agreed some of the records could be copied. But it ended up costing them 27 cents a page, or about $9,000, La Marca said. "We got about one-third of what they took, but they wouldn't give us the time cards or any financial information. Basically they wouldn't give us anything we could use to further apply for more reimbursement."

The schools weren't the only ones having difficulty accessing the records. At the same time, the beauty schools were going through the reaccreditation process with NACCAS, the National Accrediting Commission of Cosmetology Arts and Sciences. The OIG would not let NACCAS send a person to Chicago to review the records, Holt said.

"I think the problem was they didn't want to spend staff time to watch someone review records," Holt said. "We were dealing with an extreme environment of untrust and unwillingness to cooperate at all."

"The OIG has never denied access to any school records before," LaMarca added. "They treated us differently."

The decision not to allow NACCAS to see the schools' files was basically the final deathblow. "NACCAS needed to look at the school records before they could accredit the school," Escovar said. "Without accreditation, a school can't participate in the Pell grant program. And without Pell grants, the schools couldn't go on because that's how their students paid…."

Unable to get records or put together more reimbursement requests, the schools again turned to Congresswoman Stephanie Tubbs Jones, in hopes that she would urge the Department to meet with or work with the schools. She was a champion for the schools, and earlier when the Congresswoman intervened on their behalf, the Department did find records thought to be lost in cyberspace from 100 of the students; subsequently, the USDE sent the beauty schools a check for $156,000.

In a November 2003 letter to Brian Jones, general counsel for the USDE, Tubbs Jones asked that a meeting be arranged between the USDE and the beauty schools. But when they didn't respond within a week, she sent another letter, writing: "I originally believed that the Department of Education was well-intentioned in its stewardship for Federal Student Aid programs. However, it is unacceptable that the Department and your office would fail to respond to a letter of inquiry from a congressional office in a timely manner. The lack of a timely response and the Department's unwillingness to meet with this constituent has created an impression that the process involving this matter lacks transparency and, therefore, integrity. Situations such as this one raise issues of due process as well as the question of agency abuse of discretion."

But in the end, her help did little good. Four days after her second letter, on Nov. 24, A. Clay Boothby, deputy assistant secretary for Legislative and Congressional Affairs, responded that because of the ongoing criminal investigation by the OIG, such a meeting would be ill advised. (Tubbs Jones died in August 2008, before the case was decided.)

Out of options, in December 2003, the schools' owners issued a press release to local media, announcing they were suspending classes for a week and telling their story why. They made one last offer to the Department—they would put $1 million into an interest-bearing account at a local bank, if the Department would agree not to access that money until there was a final determination into how much was actually owed the government, Holt said.

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— Marc LaMarca

The proposal was rejected, with Department officials saying they no longer had any confidence in the schools' offers. In a Dec. 18, 2003 e-mail, Wolff wrote: "The Department is unable and unwilling to accept the proposal." He noted that since the schools were closed, even if it were only for a week, they lost their Title IV eligibility.

"Moreover, even if the schools were still in operation, the proposal that you offer could not satisfy the Department," Wolff continued. "Promises from the institutions to conduct audits and account for unpaid refunds at an unknown time in the future, after failing to provide those audits and that accounting during the past two years when these responsibilities were owed to the Department, are essentially meaningless and effectively unenforceable. Moreover, the Department could not commit to any clause limiting its ability to remove the schools from

Title IV eligibility prior to the resolution of the criminal case, nor could the Department walk away from its common law right of offset to recoup the schools' outstanding debt prior to releasing yet more monies to the schools.

"Finally, at a minimum, given the other complexities in the draft proposal—to include the establishment of a workable escrow agreement, and the need to coordinate with the U.S. Attorney's office given the existence of a criminal case—any such agreement would take weeks if not months to draft and circulate for comment," Wolff wrote. "We could not make any commitments absent a much more refined proposal…."

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— Thomas Escovar

And so the schools closed for good.

"The owners had already put in $500,000 to operate the school, and were willing to put in another $1 million into the bank and have it sit there as collateral, to make the Department feel more comfortable that it would really be paid," Holt said. "But that wasn't good enough…As far as I'm concerned, the Department's action put these schools out of business. It was very disruptive to students. Some students were able to transition to other schools' programs. But it wasn't like they could just transfer to a community college and pick up where they left off."

LaMarca was taken into custody by federal authorities at his home on Jan. 17, 2007, and indicted on Jan. 24, 2007, with the prosecution claiming that the schools owed $700,000 in student refunds. His father died 40 days later; the case finally went to trial in September 2008.

Attorney Michael Peterson with Steuer, Escovar, Berk and Brown Co., L.P.A. in Cleveland tried the case. Peterson said he tried to look at this case from a human standpoint, rather than one of numbers that the jury members would have trouble understanding. "And from a human standpoint, three schools were put out of business by the Department of Education because they wanted those schools out of business. I wanted the jury to see the human side—the poor indigent people who wanted to better themselves. But for some reason, the Department took a dislike to my client…."

In the trial, Peterson said he blasted the USDE and the OIG for their cruelty in closing the schools. "It's how I tried the case and how I cross-examined the witnesses and how I felt," he said.

He said one of the reasons they won the case was because the government never had an answer exactly what the schools owed in refunds. Initial reviews by the schools showed the number to be close to $430,000, he said. At one time, the Department said the schools owed about $400,000 in refunds, but then they said it could be $600,000 or even $1 million. "They kept saying, 'It could be more.' It was an obvious attempt to close these schools," Peterson said.

In addition, the government never interviewed LaMarca's father, who was the primary owner of the schools, Peterson said. The USDE agent testified in court that they didn't talk to him because they didn't think it was necessary. "Yet his father's name was on all the documents," he said. "Even though he was in Florida, they could have used the telephone or mail."

While LaMarca doesn't disagree that the beauty schools owed the federal government money for students who dropped out of school, he says the federal government owed the schools more. And that turned out to be an important factor in the verdict.

Escovar said the Department of Education has a whole set of regulations to deal with disputes between the Department and schools. If a school disagrees with the Department's program review, the school can appeal, first with the Department and then with an administrative law judge. "When that happens, both sides must go in and explain to the law judge why they think they're correct. The administrative law judge is an expert who understands the USDE rules and regulations, and would make a determination what is owed to the USDE and what, if any, is owed to the schools."

But in this case, a final determination review was never sent out. "If you look at the circumstances, it makes you believe that someone at the Department of Education wanted to put these schools out of business," Escovar said. "But no one will admit to it. This was a total bureaucratic screw up."

In the end, the jury determined there was no criminal intent involved in LaMarca's withholding of refunds. Jurors returned not guilty verdicts on the refund charge and related counts of making false statements and mail fraud.

LaMarca said he won in court because the OIG auditors couldn't be considered experts since they had only attended a six-day seminar. "They didn't even know there was a statute of limitations on refunds. The morning the jury was to begin deliberations, the U.S. Attorney General comes in and gives my lawyer a waiver for indicting me for a three-year period. They didn't realize that the first 18 months were already past the statute of limitations when they indicted me."

While LaMarca said he was upset that the jury believed he owed more than $700,000 vs. the $300,000 it ended up as, he was still confident the jury would decide in his favor. "I risked 20 years of my life on 12 complete strangers and that they would have common sense," he said. "If you made a bet with a bookie and he owes you $600,000, and a week later you make another bet with the same bookie and you lose $400,000, then the following week you make a third bet and you win $500,000, what would the normal person do? Pay the difference."

LaMarca said the Blair Junior College case had set precedent, and that also helped him win the case. "The case quoted a regulation that clearly states that if the Department of Education finds out they owe you money, you're allowed to use that money to offset any future liabilities to the DOE. If there are no future liabilities to the DOE, then you're allowed to get that money in full.

"I never hid the fact that I owed refunds," LaMarca said. "I just said that they owed us more money. I was financially bankrupt and they wanted me to pay their money before they would pay me…."

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Escovar said there were several things that made the jury side with LaMarca—that the USDE owed the schools money and there was a real effort on the part of the schools to accommodate the Department regarding their claimed refunds.

"The schools made at least three different, solid proposals to the Department of Education from August to December 2003," Escovar said. "And they weren't empty proposals. They were solid to ensure the Department

that whatever refunds might be owed, would be, in fact, paid."

With the final jury decision, the Department received nothing.

LaMarca said a jury member came in to his workplace about a week after the trial ended and said the group voted as it did for several reasons. One, the OIG employees had little training in auditing, and didn't call in help from their auditing division. Two, the USDE didn't know how much LaMarca owed them or how much they owed his schools.

While LaMarca doesn't disagree that the beauty schools owed the federal government money for students who dropped out of school, he says the federal government owed the schools more. And that turned out to be an important factor in the verdict.

LaMarca said he believes that the Department went after the schools because they chose to go from a clock-hour school to a credit-hour one. NACCAS approved the switch, and the schools were the first in Ohio to make that change in 2003, he said.

Clifford Culbreath, director of communications for NACCAS, said NACCAS' former CEO promoted schools switching from clock to credit hours; he said many cosmetology schools nationwide have made the switch.

LaMarca said he decided to switch to credit hours, in part, because of the encouragement from NACCAS' CEO. Credit hours offer more opportunities for students to transfer to other colleges and eventually get a higher degree and keep their learning going, he said, noting that their cosmetology courses were college-level. "You have to learn muscles, anatomy, chemistry. This was not an easy thing."

But LaMarca said he knew administrators at the Region 5 office did not approve of the change, based on their comments from the past. "We were the first school NACCAS ever licensed in Ohio and no one has done it since. With what they did to us, everyone else is afraid," he said.

Why would the USDE dislike a switch from clock hours to credit hours?

Peterson said the USDE would have received fewer refunds with the switch. But an OIG report on the Reauthorization of the 1998 *Higher Education Act* hints toward another reason why.

"OIG audits demonstrated that many vocational trade school programs became eligible for the grant and/or loan programs and/or increased their SFA program proceeds by converting their course length measurement from clock hours to credit hours without substantially changing their course content. These vocational trade schools, many of which originally offered programs six months or less in length, inappropriately adopted a longer credit-hour course length measure from two- and four-year academic institutions that is based on the premise that significant out-of-class work is required to complete the academic program."

LaMarca said he also believed his schools were targeted because of the type of school they were and the type of students they served. He cites the same OIG report. It states: "The Office of Inspector General first reported in March 1987 that many students who received SFA funds were being trained for occupations for which there were limited employment opportunities. In March 1993, we again reported that for students enrolled in vocational training programs, the current system affords little assurance that the training provided will lead to gainful employment. Our study focused on supply and demand data from the cosmetology profession. We concluded that the SFA program provided millions of dollars for cosmetology training for students

that never completed their programs, and the supply of licensed cosmetologists being trained annually far exceeded the demand for cosmetologists."

NACCAS surveys, however, show there is a demand for more cosmetologists. Their 2007 survey on job demand, for example, showed that nationally, 53 percent of salon owners reported job openings, with 182,331 newly trained professionals entering the field during 2006. But even then, nearly 75 percent of the salons that tried to fill positions were not able to find qualified applicants, the survey showed, as the supply of skilled professionals in the industry continues to fall short of the demand.

"This is a chronic shortage that has been reported in earlier surveys of the cosmetology industry," the survey noted.

Ohio is also following that trend, with 73 percent of Ohio salon owners who attempted to hire new employees in 2006 reporting they were unable to find properly trained applicants.

Culbreath said their survey did not break down the results geographically within states, but he noted that cosmetology schools tend to see higher enrollment whenever the economy worsens.

Whether there was need for more trained cosmetologists or not, the government has tried to protect taxpayer dollars from abuse. In that same OIG report, it states: "In a February 1997 report that was part of its High-Risk Series, GAO emphasized the need for more attention to the vocational trade school sector in order to improve the integrity of the SFA Programs: 'The programs now serve more students from low-income families and those attending proprietary schools than the more traditional students the programs were intended to serve…The programs' current structure make it difficult for the Department to protect the taxpayers' financial interests.'"

Holt said the government has always been sensitive about not receiving refunds.

"It's almost taken as an absolute inference of fraud, and in many cases that is an appropriate inference," he said. "If someone fails to pay refunds of dropped students for a year or longer, you have to ask yourself what are they doing? That money belongs to the government. If you don't make those payments for a year it looks like you're trying to scam the federal government."

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— Marc LaMarca

But this wasn't most cases, he said, because of the computer interface problems experienced from 1998–2000.

"That delay in realizing they had a problem caused even more problems. It's not uncommon for that particular group of students to move around a lot," he said. "If you can't find students to prove their entitlement to aid—30 percent is subject to verification to back up what the student put in the written application with signatures and tax returns—you lose that money."

LaMarca also didn't have experience in the educational market. "Marc comes in and he doesn't have any Title IV experience; he's only worked in retail auto sales," Holt said. "He thinks the Department still owes him money, and wonders why he should pay them refunds when they still owe him. It's a somewhat reasonable and common-sense approach, but for people in Title IV, you know you can't do it that way."

But the verdict in the LaMarca case does not alter the work of the Office of

Inspector General, said Grant, public affairs liaison for the U.S. Department of Education Office of Inspector General. "Failure to refund monies owed students or taxpayers remains a crime under the *Higher Education Act*. We will continue to investigate and vigorously pursue cases where school officials breach their obligation to return federal student aid funds that are not earned."

If you find yourself in a bind where the government owes you money and you owe the government money, you should sit down and talk to them early on and document it.
— Ron Holt

Grant said, following policy, they do not discuss the details of how they conduct investigative work, nor do they discuss why they select the institutions they review. "Many factors go into our decision," she said. "Any entity receiving federal education funds could be reviewed by Office of Inspector General to ensure that those federal funds are being used in compliance with applicable federal laws, regulations, and in accordance with U.S. Department of Education guidance."

So what is to be learned from this case?

For schools, it is the importance of maintaining communication with the Region team when you fall into problems, Holt said.

"If you find yourself in a bind where the government owes you money and you owe the government money, you should sit down and talk to them early on and document it," he said. "Get consultants involved early on. Charmayne and Vogue schools didn't get consultants involved for two-plus years...When you have these kinds of complicated, unusual problems with the Department, you're better off turning to an outside consultant right away, even if it does cost you money. Generally, consultants know a lot more people at the regional and national level than the school knows, and they can start to open up lines of communication."

Peterson agreed there is a lesson for other proprietary schools to learn.

"Be careful of the government and the Department of Education, particularly if they don't like you," he said. "And do the right thing. If you can't make payments to the USDE for whatever reason, notify the Department and be persistent in putting your position forth. If a problem arises, face it head on. Don't delay or run away from it."

Peterson also encouraged proprietary schools to keep a paper trail and hire knowledgeable people. "Pell grants are a highly technical area," he said. "Make sure you have the right personnel to run the schools and to keep up with the current law because it changes all the time. There are different formulas and you need knowledgeable people...But the Department of Education failed in that respect, too."

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— Michael Peterson

The Department also failed to follow administrative procedure set by Congress. "For whatever reason, they blew that off," Peterson said. "They wanted to close the schools."

While the Department of Education won't admit that they closed the school down, they knew what they were doing, Escovar said. "These people are professionals," he said. "They know what it means to cut a school off with funding. They had to foresee the consequences of each action they took…For them to sit back and say we didn't know it would happen, it's not true."

But the USDE also needs to learn to listen to people, Holt said. "They are strapped for resources in terms of people…because of the moratorium on their operating budget for years. But you can't run an important business like federal student aid—which is around a $85 billion a year business with $14 billion in Pell grants—without listening to people who have problems.

"Problems can be legitimate misunderstandings," Holt said. "The regulations and delivery system is complex. If you force people to operate only through e-mail and through phone calls, and you aren't willing to sit down with them face-to face, you're going to develop the kind of misunderstanding and mistrust that occurred here."

There is one other important lesson, Peterson said: "You can beat the government, if you're in the right."

For LaMarca, however, the story isn't over. He's considering a class action suit against the federal government.

"Pell grants are an entitlement, not a loan. They threw all these students out of school and wouldn't pay their tuition, and I think they have a case here, too. They've been violated, and under federal law, everyone must be treated the same. You can't decide that these students were not the type of students that Pell money was meant to educate."

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And if he files and wins, LaMarca said he wants to reopen his schools and teach those students for free. "This has become personal to me. The government can't decide who in this country gets an education. I want to fight until…those people in office are removed and are replaced by people who know that everyone—even the poor—has a right to get an education."

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Lessons Learned From the LaMarca Case

By Ronald L. Holt

There are four lessons that can be drawn from the unusual and unfortunate circumstances that led to the closing in late 2003 of these long-standing beauty schools, which had operated successfully for some 40 years, serving mostly poor inner city students. While there was a convergence of circumstances that seemingly conspired to undermine these schools, I believe there were some distinct factors that were principally responsible.

First, and foremost, there is the nature of the relationship between the U.S. Department of Education (DOE) and these schools. You have to wonder if the schools' struggles with the "missing" Pell ISIRs and the related hiatus in Pell funding (from 1998 to 2000) would have been more quickly resolved if there had been a better spirit of "partnership" between the DOE and the schools, and if the DOE had truly valued these schools as capable providers of worthwhile vocational training. If a better partnership had existed, better communications likely would have occurred, a solution to Pell delivery problems might have been found sooner, the schools might not have had the pressing cash flow problems that forced them to delay payment of Title IV refunds once the system began functioning, and there might not have been a sequence of increasingly hostile and ultimately fatal oversight measures—the June 2003 program review, the imposition of cash reimbursement, Region V's presumption of fraud from irregularities in a reimbursement request, the OIG's seizure of all the schools' records, the DOE's withholding of any reimbursement funds, and the DOE's refusal to negotiate for a business-like solution. Instead of a good partnership with effective communications, here there seemed to be an inherent distrust by the DOE of these schools and an adversarial tone in so many of the communications between the schools and the DOE.

Second, if an institution finds itself experiencing a breakdown in the financial aid delivery system, its management must respond immediately with tenacious, persistent and unrelenting action. The schools' director here did make efforts during the 1998–2000 time period to address the Pell delivery problems as they continued and became more pronounced over a longer period of time, but it seems that a more concerted response, a literal "full-court press," might have been possible sooner and might have led to an earlier resolution of the IT communication issues that were vexing the schools' connection to the DOE's Title IV Pell

processing system. Ultimately, the schools involved the offices of the late Congresswoman Stephanie Tubbs Jones and also engaged knowledgeable consultants to assist them—actions that proved to be critical to the resolution of IT connection problems. Despite the eventual restoration of a working IT connection between the schools and the DOE processing system by some time in 2000, however, the schools never did recover all of the Pell funds earned by their students during 1998 to 2000 and the passage of time likely contributed to this.

Third, to follow up on the prior point about the institution's response to a breakdown in the delivery of Title IV aid, nearly all institutions, but especially smaller ones with limited staff, would be well advised to immediately engage qualified consultants to help them identify the source of the problem and to communicate with the DOE. I know this may sound like a thinly veiled commercial, since I work with schools facing Title IV regulatory problems, but all too often schools lose precious time and resources trying to put out regulatory fires on their own and only call in the "firefighters" after the building is halfway burned down. Title IV is a remarkably complex world.

Fourth, and finally, despite the regulatory concerns that developed here with the unusual sequence of events, the greater Cleveland metropolitan area did not have to lose these cosmetology schools, which had been offering so many economically disadvantaged Cleveland residents a pathway to better paying jobs as cosmetologists and stylists. If there had been a reasonable commitment by the DOE to find a way to save these schools for their current and future students, the schools would still be operating today and turning out cosmetologists. Even with the unpaid refunds and the late audits and the existence of some irregularities in the schools' initial reimbursement package, the DOE could have fashioned a win-win arrangement through which the government could have been assured of the payment of the late refunds and the schools could have begun to receive Title IV funds being earned by current and future students. And, in fact, the schools made several offers to make substantial up-front payments toward the unpaid refunds (the exact amount of which was going to take some time to determine) and the schools ultimately took the extraordinary step of offering to establish a $1 million escrow, an amount far in excess of anybody's estimate of what was owed for unpaid refunds. The DOE rejected all these offers and refused to have any face-to-face meeting with representatives of the schools. While the DOE claimed that it was unable to enter into any agreement for the resumption of Title IV funding due to the existence of an ongoing criminal investigation—an investigation borne out of blind and misguided distrust of the schools—the reality is that the DOE, not the OIG or the FBI or the Justice Department, controlled decisions about institutional eligibility and the flow of Title IV funds to the schools. And if the DOE truly believed that, no matter what kind of special conditions and limitations might be placed on a renewed flow of Title IV funds to Charmayne and Vogue, those funds would be at great risk because the current owners could not be trusted unless and until the criminal investigation was resolved in favor of the schools (a belief that I believe was not justified), then the DOE should have advised the owners of its views early on (i.e, shortly after the commencement of the criminal investigation in September of 2003) and should have given the owners the opportunity to find a buyer who could have continued the operation of the schools with Title IV aid. In short, these schools never had a chance to survive the regulatory storm into which they had drifted, because the DOE had no interest in their survival.

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