

1989

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Recommended Citation

Alan A. Alop *Representing Victims of Vocational School Fraud*, 1 Loy. Consumer L. Rev. 33 (1989).

Available at: <http://lawcommons.luc.edu/lclr/vol1/iss2/1>

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LOYOLA CONSUMER LAW REPORTER

Loyola University of Chicago School of Law, One E. Pearson Street, Chicago, Illinois 60611
Volume 1, No. 2 / Winter, 1989

Representing Victims of Vocational School Fraud

Alan A. Alop*

The last decade has seen an explosion in the number of vocational schools. Such schools, also known as trade or proprietary schools, offer the promise of careers in diverse areas, such as the cosmetology, secretarial, truck driving, travel and medical assistant fields. Most trade schools now target unemployed young people, especially public aid recipients. The burgeoning number of schools is directly attributable to federally guaranteed student loans and federal grants now available to vocational school students. The dramatic growth of these schools has been accompanied by a growing number of complaints from students regarding misrepresentations by the schools, the quality of education offered and other significant abuses. Students frequently charge that promised training or equipment is not provided; that advertised "big-paying jobs" are illusory; and that some schools are complete shams—four walls, a textbook and little else. This article will explore possible approaches in representing victims of trade school fraud.

I. Statutory and Regulatory Backdrop

The regulatory backdrop and statutory framework in which vocational schools operate include state licensure or approval of vocational schools and regulation of these schools through a state administrative agency. In Illinois, for example, two separate statutes and administrative agencies regulate vocational schools. Illinois cosmetology and barber schools come under the provisions of "The Barber, Cosmetology and Esthetics Act of 1985," Ill. Rev. Stat. ch. 111, pars. 1701-1704 (1987), and the regulation of these schools is the responsibility of the Department of Professional Regulation. All other Illinois vocational schools come within the provi-

sions of the "Private Business and Vocational Schools Act," Ill. Rev. Stat. ch. 144, pars. 136-162 (1987). These schools are regulated by the Illinois State Board of Education.

The effectiveness of state regulation of trade schools, while varying from state to state, has generally been inadequate. These administrative agencies may have limited resources, and the monitoring of vocational school activities may take a low priority in the agency. Moreover, students are usually unaware of the identity of the regulatory agency and so seldom file formal complaints. Even when such complaints are made, the agency may not adequately investigate or adjudicate them. State legislation is frequently insufficient to deter improper activities by proprietary schools, and most state laws do not afford a private right of action to aggrieved students.

There is a second layer of "regulation" of vocational schools—national or regional accrediting agencies. These are nongovernmental, private associations, generally formed by the schools themselves, to provide peer evaluation. The primary function of each accrediting agency, as suggested by its name, is to "accredit" a vocational school or, subsequent to accreditation, to withdraw this status where necessary. A separate accrediting agency exists for each type of school (e.g. cosmetology, travel, etc.). Accreditation is normally *not* a prerequisite for a school to operate in a state; most states allow non-accredited schools to do business so long as the state agency has licensed or approved the school.

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However, accreditation by a regional or national accrediting agency is often the key to a school's financial success because the federal government will only provide federally guaranteed student loans and federal grant monies to students registered in schools accredited by the appropriate private accrediting agency.¹ In fact, the Secretary of the Department of Education ("DOE") is required by federal law to recognize those accrediting agencies which are determined to be reliable authorities as to the quality of training provided by educational institutions.² A listing of all nationally recognized accrediting agencies is published annually by DOE.

Formal complaints can be lodged with the school's accrediting agency in instances of egregious school conduct, particularly where a pattern of misconduct may exist. The accrediting agency will normally have formal rules and regulations regarding student complaints and procedures which can result in sanctions against non-complying schools, including withdrawal of accreditation. Unfortunately, complaint procedures may provide only minimal due process protections for the complainants. For example, complaint procedures of the National Accrediting Commission of Cosmetology Arts and Sciences ("NACCAS"), the national accrediting agency which evaluates beauty schools, do not provide students who file complaints with any notice of the disposition of their grievances and do not allow students or their representatives to attend hearings in which their complaints are adjudicated.³ Accrediting agencies engage in "self-regulation" which cannot be expected to be as rigorous as independent policing. Yet, because the legitimate schools have an interest in weeding out the unscrupulous members of the industry, an accrediting agency may occasionally take strong action where governmental entities have failed to act.

A third layer of regulation of vocational schools is federal legislation and regulations that govern accredited schools whose students obtain guaranteed student loans and/or grants. For example, the federal "Guaranteed Student Loan Program" ("GSLP"), the most common governmental loan available to trade school students, is provided for in 20 U.S.C. §§ 1071-1087 (1982 & Supp. IV 1986). DOE regulations which flesh out the GSLP are set out at 34 C.F.R. § 682 (1987). Federal grant legislation—the Pell Grant Program, formally known as the Basic Educational Opportunity Grant—is found at 20 U.S.C. § 1070a (1982 & Supp. IV 1986). DOE implementing regulations are codified at 34 C.F.R. § 690 (1987).

The GSLP and Pell Grant legislation and their implementing regulations prescribe eligibility rules for students and schools but contain few substantive qualitative standards to which schools must adhere.

While Pell grants are administered directly by DOE to the accredited school, GSLP loans are not. Instead, students enter into GSLP loan agreements with local financial institutions, which generally issue a check in the name of the student and the school. These loan agreements are guaranteed by a "guarantee agency," which is a state governmental agency or a private non-profit organization that has an agreement with DOE to administer the loan guarantee program.⁴ If the student defaults, the financial institution is reimbursed by the guarantee agency. If the guarantee agency is unable to collect the loan, the DOE becomes the ultimate guarantor.

Many students who are defrauded by vocational schools remain unemployed and, as a consequence, ultimately default on their student loan payments. Although DOE stands to lose millions of dollars as the result of fraudulent conduct by vocational schools, historically it has failed to promulgate regulations which substantively govern the education provided by accredited vocational schools. DOE has instead relied on the policing efforts of the accrediting agencies and state administrative agencies. However, as a result of the enormous increase in student loan defaults, the DOE has recently proposed a regulation which would suspend or terminate loans to schools with a student loan default rate in excess of 20 percent.⁵

A fourth source of regulation of vocational schools is the Federal Trade Commission ("FTC"). In 1978, the FTC adopted a broad rule requiring proprietary schools to make numerous disclosures to prospective students regarding employment, earnings and drop-out information of prior students at the school.⁶ Armed with this information, students could avoid schools with abysmal track records. However, the FTC has recently terminated this Rule.⁷ The FTC has, however, also promulgated "Guides for Private Vocational and Home Study Schools" which are in effect.⁸ While these guides do not have the force of law, they are designed to articulate "the factors which would guide Commission decision[s]." *FTC v. Mary Carter Paint Co.*, 382 U.S. 46, 48 (1965). The guides prohibit a wide variety of conduct including, *inter alia*:

- (a) use of a name or insignia which tends to mislead prospective students with respect to the nature of the school;

- (b) misrepresentations regarding state approval or accreditation by a national accreditation agency or association;
- (c) misrepresentations regarding the size, location, faculty, facilities or equipment of the school;
- (d) misrepresentations regarding the nature or extent of any prerequisites for enrollment;
- (e) use of deceptive sales practices; and
- (f) use of deceptive pricing or misuse of the word “free.”⁹

The FTC has also instituted numerous proceedings against vocational schools under § 5(a) of the Federal Trade Commission Act (“FTCA”), 15 U.S.C. § 45(a) (1982), which declares that “unfair or deceptive acts or practices in... commerce” are unlawful. For example, the FTC has challenged schools that misrepresented employment and earnings potential¹⁰ and falsely promised job placement to students.¹¹ FTC decisions hold that schools may not misrepresent school admission policies or terms of federally insured student loans.¹² In other decisions, the Commission has ruled that a school may not misrepresent to prospective students that its graduates will be qualified to practice the trade in which they receive training.¹³ While individuals do not have a private right of action under the FTCA,¹⁴ the decisions of the FTC in this context may, as discussed below, provide precedential value under state statutory counterparts of the FTCA.

II. Litigation Approaches

In the absence of effective governmental or industry regulation, litigation may be the only alternative for victims of trade school abuses. Several causes of action are discussed below.

A. Common Law Fraud

Many vocational schools misrepresent their courses, career opportunities, or other material facts in order to obtain a student’s enrollment. Common law fraud is an appropriate cause of action where a school has: (1) made a statement of material fact; (2) known to be false by the school; (3) made to induce the student to enroll or otherwise act; and (4) the student has relied on the false, material statement. *Steinberg v. Chicago Medical School*, 69 Ill. 2d 320, 333, 371 N.E.2d 634, 641 (1977). In addition to actual damages, a student may recover punitive damages in a fraud action “where the false representations are wantonly and designedly made.” *Home Savings & Loan Association of Joliet v. Schneider*, 108 Ill. 2d 277, 284, 483 N.E.2d 1225, 1228 (1985).

B. “Little FTC Acts”

Every state has adopted some form of legislation designed to afford consumers wide-ranging protection in a broad variety of contexts.¹⁵ These laws are often patterned after § 5(a) of the FTCA, which prohibits unfair and deceptive acts or practices. As a consequence, the state versions are sometimes referred to as “Little FTC Acts.” Typically, Little FTC Acts provide the consumer with an additional litigation tool with several advantages. The Illinois version illustrates the usefulness of a Little FTC Act in the context of a vocational school fraud case.¹⁶ Under the Illinois Little FTC Act provision, the consumer need not allege or prove all the elements of common law fraud in order to prevail.¹⁷ Instead, a Little FTC Act claim may be established by simply showing a “misrepresentation, concealment or omission of a material fact with intent that others rely on that fact.” *Perlman v. Time, Inc.*, 133 Ill. App. 3d 348, 353, 478 N.E.2d 1132, 1136 (1st Dist. 1985). Actual and punitive damages may be recovered, as well as attorney fees.¹⁸ The Illinois statute, like many other state versions, specifically directs the courts to give consideration to FTC interpretations and federal court decisions relating to § 5(a) of the FTCA in construing the Illinois provisions.¹⁹ Incorporation of the broad consumer protection concepts of the FTCA makes state Little FTC Act provisions excellent means to address vocational school misconduct.

C. RICO

Another statute which may provide redress to victims of trade school abuse is the Racketeer Influenced and Corrupt Organizations Act (“RICO”), 18 U.S.C. § 1961-1968 (1982). This federal law provides a private civil action to recover treble damages and attorney fees for injuries resulting from a violation of its substantive provisions.²⁰ Four elements must be present to establish a RICO violation:

- (1) A “racketeering activity” which is defined in terms of violations of specific state and federal criminal statutes (“predicate acts”), such as mail fraud as prohibited in 18 U.S.C. § 1341 (1982 & Supp. IV 1986);
- (2) An “enterprise” which includes any person, partnership, corporation or other legal entity;
- (3) A “pattern of racketeering activity,” which requires at least two acts of racketeering activity to have occurred; and
- (4) injury to business or property.²¹

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While the metaphysical dimensions of RICO's language may be initially disconcerting, the broad application the Supreme Court has given RICO compels a closer look.²² A vocational school may constitute an "enterprise" within RICO's definition. Mail fraud may exist if the school has engaged in fraudulent conduct and has used the mails in furtherance of the fraudulent scheme. For example, where a student is induced to enroll in a course of study by oral or written misrepresentations, and the school uses the mails to receive student loans to finance the course of study, or to secure enrollment applications, mail fraud may exist. A current area of controversy in RICO concerns the issue of what constitutes a "pattern of racketeering activity." Cases examining this question have held the inquiry to be fact-specific.²³ Courts have scrutinized a variety of factors, including the number and variety of predicate acts, the duration of the period in which they were committed, the number of victims, the presence of separate schemes, and the occurrence of distinct injuries.²⁴ Generally, where a systematic abuse is present, with numerous victims and multiple mailings, a RICO violation may exist.

D. State Vocational School Acts

Another litigation tool may be a state statute enabling students to bring a private action for violation of its provisions. Perhaps the most stringent example of such a law was recently enacted by the State of Illinois.²⁵ The new law, effective January 1, 1989, includes broad, substantive requirements for Illinois vocational schools. For example, the law requires the state regulatory agency to conduct an annual review and investigation of each school. The review is required to include a comparison between the school's student graduation or completion rate and similar rates for schools within the particular industry. Schools that fail to maintain graduation rates greater than 50% of the industry average are to be placed on probation for one year.²⁶ If, by the end of the following fiscal year, the school still has not achieved a graduation rate greater than 50% of the industry average, it will lose state approval to operate.²⁷

The Illinois law also mandates the detailed disclosure of pertinent information to students prior to their enrollment.²⁸ Students must be informed that they may cancel their enrollment within five business days; if this right is not disclosed, the student may thereafter cancel at any time and receive a full refund.²⁹ Disclosure must also be made to the student of the number of students who enrolled in the school during the

school's last fiscal year, the number who failed to complete the course, the percentage who did not complete the course, the number and percentage who passed the State licensing examination, the number and percentage of graduates who obtained employment, and the average starting salary of the school's graduates.³⁰ Students will also be notified in the disclosure form of the name, address and telephone number of the appropriate regulatory agency, and that complaints against the school may be filed with the agency.³¹

Further, the Illinois law sets out a schedule which specifies and provides for refunds to students who withdraw based on the time they attend the institution.³² Thus a student who withdraws from the school after the first day of class and before 5% of the course of instruction must only sacrifice the application fee and 10% of the tuition or \$300, whichever is less.³³ This new schedule provides greater refunds to students than under prior Illinois law. If the school discontinues a course while the student is enrolled, the statute mandates a full refund of all tuition, fees and other charges.³⁴ The refund provisions also dictate that all student refunds are to be made by the school within 30 days from the date the student gives notice of withdrawal.³⁵

The Illinois law also prohibits false or misleading statements or promises which tend to influence a student to enroll.³⁶ A school's failure to make the detailed student disclosures, or the making of false or inaccurate disclosures is also prohibited.³⁷ Finally, any person who suffers damage by reason of a school's violation of the law may bring a private civil action against the school for actual damages and treble damages where fraud is proved.³⁸ Injunctive relief and attorney's fees are also made available to aggrieved students.³⁹ This legislation offers practitioners and students important remedies to redress trade school abuses.

III. Conclusion

While numerous legitimate vocational schools offer hope to the unskilled and the unemployed, the availability of federal monies has attracted a large number of unscrupulous school operators to the industry. As a result, students' dreams are shattered daily as they realize they have enrolled in schools which offer little or no meaningful training. State and federal regulatory agencies have moved slowly to cope with the growing problem. Litigation efforts on behalf of students may, in the long run, provide the most effective means of policing the vocational school industry.

1. 34 C.F.R. § 603.1 (1987).
 2. *Id.*
 3. NATIONAL ACCREDITING COMMISSION OF COSMETOLOGY ARTS AND SCIENCES, RULES OF PRACTICE AND PROCEDURES (1987).
 4. 34 C.F.R. §§ 682.200(b) and 682.400-682.414 (1987).
 5. 53 Fed. Reg. 36,216 (1988) (to be codified at 34 C.F.R. §§ 668 and 682) (proposed September 16, 1988).
 6. 16 C.F.R. § 438 (1978) (43 Fed. Reg. 60,796) (1976).
 7. 53 Fed. Reg. 29,482 (Aug. 5, 1988).
 8. 16 C.F.R. § 254 (1988).
 9. 16 C.F.R. §§ 254.2-254.8 (1988).
 10. MacMillan Inc., 96 F.T.C. 208 (1980); Eastern Detective Academy, Inc., 78 F.T.C. 1428 (1971).
 11. Grady L. Rushing, 59 F.T.C. 1182 (1961), *aff'd*, 320 F.2d 280 (5th Cir. 1963), *cert. denied*, 375 U.S. 986 (1964).
 12. MacMillan Inc., 96 F.T.C. 208 (1980); Bell & Howell Co., 95 F.T.C. 761 (1980) (consent order).
 13. MacMillan Inc., 96 F.T.C. 208 (1980).
 14. Fulton v. Hecht, 580 F.2d 1243 (5th Cir. 1978), *cert. denied*, 440 U.S. 981 (1979).
 15. See NATIONAL CONSUMER LAW CENTER, INC., UNFAIR AND DECEPTIVE ACTS AND PRACTICES, App. A at 381-94 (2d ed. 1988).
 16. ILL. REV. STAT. ch. 121 1/2, pars. 261-272 (1987).
 17. Duhl v. Nash Realty Inc., 102 Ill. App. 3d 483, 495, 429 N.E.2d 1267, 1277 (1st Dist. 1981).
 18. Warren v. LeMay, 142 Ill. App. 3d 550, 581-82, 491 N.E.2d 464, 484-85 (5th Dist. 1986).
 19. ILL. REV. STAT. ch. 121 1/2, para. 262 (1987).
 20. 18 U.S.C. § 1964(c) (1982).
 21. Haroco Inc. v. American National Bank and Trust Company of Chicago, 747 F.2d 384 (7th Cir. 1984), *aff'd* 473 U.S. 606 (1985).
 22. Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479 (1985).
 23. Morgan v. Bank of Waukegan, 804 F.2d 970, 976 (7th Cir. 1986).
 24. *Id.* at 975.
 25. Public Act 85-1382, 1988 Ill. Legis. Serv. 2698 (West) (to be codified at ILL. REV. STAT. ch. 111, pars. 1701-4, 1703-5 to 1703-5E, 1703B-1 to 1703-6; ch. 144, pars. 136 to 161-2).
 26. *Id.*, at § 14.1 (to be codified at ILL. REV. STAT. ch. 144, para. 149.1).
 27. *Id.*
 28. *Id.*, at § 15.1 (to be codified at ch. 144, para. 150.1).
 29. *Id.*, at §§ 15.1(5), (11)(a)-(g) (to be codified at pars. 150.1(5), (11)(a)-(g)).
 30. *Id.*, at § 15.1(11)(h) (to be codified at para. 150.1(11)(h)).
 31. *Id.*, at § 15.1(11)(i) (to be codified at para. 150.1(11)(i)).
 32. *Id.*, at § 15.1a (to be codified at para. 150.1a).
 33. *Id.*, at § 15.1a(1)(c) (to be codified at para. 150.1a(1)(c)).
 34. *Id.*, at § 15.1a(7) (to be codified at para. 150.1a(7)).
 35. *Id.*, at § 15.1a(8) (to be codified at para. 150.1a(8)).
 36. *Id.*, at § 16 (to be codified at para. 151).
 37. *Id.*, at § 16(22) (to be codified at para. 151(22)).
 38. *Id.*, at § 26.2 (to be codified at para. 161.2).
 39. *Id.*
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