

Memorandum

To: Department of Education Negotiators
From: California Deputy Attorney General Bernard Eskandari &
Massachusetts Assistant Attorney General Michael Firestone
Cc: Non-Department of Education Negotiators
Date: March 15, 2016
Re: Recommended Revisions to Issues 1-3

The Department’s most recent proposal is a positive step toward achieving its stated aim: “to make the process of forgiving loans efficient, transparent, and fair—and to ensure students receive every penny of relief they are entitled to under law.”¹ The proposal addresses a number of the concerns raised by the Attorney General negotiators and other stakeholders, and incorporates many of the recommendations made to the Department, including recognizing the critical importance of an automatic, group process to discharge loans and reimburse students for payments made on those discharged loans.

We are encouraged by the Department's responsiveness to these concerns and others raised in our previous memo. We particularly appreciate the Department's strong stand against the use by schools of binding arbitration agreements that force students to give up their legal rights. In this final session we are looking forward to a productive discussion and resolving our remaining concerns.

We believe that the following recommendations will greatly strengthen the Department’s proposal and are hopeful that the Department will incorporate them into its final rule.

1. Realize the full potential of a group claims process by opening it to state attorneys general, state and federal enforcement agencies, and legal-aid representatives

We are encouraged that the Department has established a group process that will help victimized students obtain relief more easily than through individual claims. Nevertheless, we remain concerned that the group process will prove inaccessible to borrowers. Under the Department’s current proposal, students would be powerless to initiate a group process because only the Secretary has that authority.² Borrowers with legitimate defenses to repayment should not be forced to choose between the individual-claim process, which would likely prove difficult to the large majority who cannot afford counsel, and awaiting action by the Secretary.

The proposed group-claim process has the potential to provide deserved relief to

¹ <http://www.ed.gov/news/press-releases/education-department-appoints-special-master-inform-debt-relief-process> (June 25, 2015 public statement by Under Secretary Ted Mitchell).

² Proposal § 685.222(f).

defrauded students on a broad basis, but the critical weaknesses in initiating that process threatens to reduce its effectiveness. To actually realize the potential of the group process, the Department should allow attorneys general, state and federal enforcement agencies, and legal-aid representatives to initiate it. Because of their ongoing relationship with students and extensive knowledge of the educational landscape, these representatives are well positioned to identify and propose worthy classes of borrowers.

Proposed revisions to §685.222(f):

(f) Group borrower defense claims, generally. (1) Upon consideration of factors including, but not limited to, common facts and claims, ~~fiscal impact~~ administrative efficiency, and the promotion of compliance by the school or other title IV, HEA program participants, the Secretary may initiate a process to determine whether a group of borrowers ~~identified by the Secretary~~ has a common basis for borrower defense. Upon the written request of a state attorney general, state or federal enforcement agency, or a legal aid representative, the Secretary shall initiate a process to determine, within a reasonable period of time, whether a group of borrowers has a common basis for borrower defense.

2. Fix the imbalance of power in the open-school, group process

The Department should also act to correct a potentially significant imbalance in the relative strengths of the parties in the group-claim process. The current proposal requires the Secretary to appoint “a Department official to present the group’s claim” once the Secretary has determined that the group process is warranted³ but provides no further guidance about the official to be appointed, her professional qualifications, her duties and responsibilities, her independence, her access to Department information, or the resources that she will have at her disposal. And while the Department’s proposal would allow schools to oppose group discharge through “evidence and argument presented” by their attorneys directly to the hearing official,⁴ the draft regulations do not even require that the Department-appointed official who serves as borrowers’ sole representative in the proceedings be an attorney. This disparity in representation is concerning. Fairness demands that borrower groups have independent counsel to zealously advance their cause because they will surely face opposition from coordinated teams of well-heeled lawyers representing schools.

This likely imbalance of power is exacerbated by the Department’s proposal to link group discharge directly to the school’s liability for reimbursement to the Department, incentivizing schools to pour resources into defending against borrower-defense liability.⁵ We are also concerned that, in light of the inherent unfairness of the proposed group process, a student placed by the Secretary in a group that ultimately

³ Proposal § 685.222(f)(2)(i).

⁴ Proposal § 685.222(h)(1).

⁵ Proposal § 685.222(h)(2)(i).

proves unsuccessful will be prevented from bringing an individual claim absent “new evidence.”⁶

We urge the Department to rectify this imbalance in the following ways:

First, the role of the Department official designated to present a group claim should be more clearly defined. The regulations should state that, while so assigned, the official shall be responsible for zealously representing and advocating the interests of the students, even where such interests diverges from that of the Department, and shall have access to all Department information and resources necessary to do so. That official should also be a lawyer.

Second, the Department should allow independent counsel to assist in prosecuting the claim on the group’s behalf or at least appear in the proceeding in an advisory role, in cases where counsel has a hand in initiating the group process. Interested state attorneys general and enforcement agencies should also be permitted to contribute supportive arguments, in much the same way they can currently participate in private litigation as amici. Not only would this potentially level the playing field, but it would also make better use of public resources by reducing the burden on Department officials to develop and present group claims.

Finally, as the Department has done with individual claims, the Department should separate the process for determining whether to grant an open-school, group claim from a subsequent process to determine whether to hold the school liable for reimbursement to the Department. These changes would help prevent schools from overwhelming the Department official or representative advancing a group claim.

3. Expand reliance on the work of state attorneys general and other government agencies by allowing non-contested judgments to serve as a basis for borrower defense

The Department’s most recent proposal requires that judgments establishing a borrower defense be “contested.” This is a marked retreat from the Department’s previous proposal, in which any judgment—not just “contested” judgments—could serve as a basis for borrower defense. Requiring a contested judgment is impractical, unreasonable, and unrealistic. State attorneys general often settle cases or otherwise resolve investigations without obtaining a contested judgment in order to obtain immediate injunctive relief to protect the public, efficiently secure monetary relief for victims, and to minimize taxpayer expense. Attorneys general should not be forced to litigate unnecessarily with schools—to the detriment of students, taxpayers, and the public—just to ensure that investigative findings can form the basis of a defense to repayment for affected students.

⁶ Proposal § 685.222(h)(3) (reconsideration requires “new evidence” under § 685.222(e)(5)).

Proposed revisions to §685.222(f):

(b) Judgment against the school. The borrower has a borrower defense if the borrower, whether as an individual or as a member of a class, or a governmental agency, has obtained against the school a favorable **contested** judgment **or determination** based on State or Federal law in a court of competent jurisdiction, **or an admission by the school**. A borrower may assert a borrower defense under this paragraph (b) at any time.

4. Keep state law as a basis for borrower defense

For loans first disbursed on or after July 1, 2017, the Department’s proposal strips away borrowers’ ability to assert defenses based on violations of state law.⁷ This represents a substantial step back from the Department’s existing regulations, which premise defense to repayment exclusively on state law.⁸ It is also inconsistent with the Department’s public statement, from just last week, that it would “incorporate crucial elements of state consumer protection laws in these regulations.”⁹

By creating a federal standard that excludes violations of state law, the Department’s proposal unreasonably limits the categories of school misconduct that would give rise to a borrower defense. The proposal would allow students to assert a defense in only two circumstances: where the school breached a contract or engaged in “substantial misrepresentations.”¹⁰ While these two categories may be the Department’s focus today, as we and others have discussed, other types of egregious misconduct also harm students and are worthy of borrower defense.¹¹ By failing to recognize state law—which is well developed and provides robust consumer protections—as a basis for borrower defense, the Department’s proposal fails to provide the flexibility necessary to adequately protect students.¹²

⁷ While the proposal does allow students to assert a defense if a state-law “contested judgment” is obtained against a school, this is insufficient: due to the costs and uncertainty inherent in all civil litigation, litigants rarely let a dispute go to trial and almost never proceed to judgment.

⁸ 34 CFR § 685.206(c).

⁹ <https://www.ed.gov/news/press-releases/us-department-education-takes-further-steps-protect-students-predatory-higher-education-institutions>

¹⁰ At the same time, and somewhat inconsistently, a successful discharge results in a transfer to the Secretary of claims under “applicable law,” including state law, that the student has against the school—not just claims for breach of contract or substantial misrepresentation. Proposal § 685.222(k).

¹¹ See, e.g., *People ex rel. Mosk v. Nat’l Research Co.*, 201 Cal. App. 2d 765, 772 (1962) (“[I]t would be impossible to draft in advance detailed plans and specifications of all acts and conduct to be prohibited . . . , since unfair or fraudulent business practices may run the gamut of human ingenuity and chicanery.”).

¹² Allowing borrowers to invoke state law as a basis for borrower defense would not be a novelty that the Department would have to learn to navigate from scratch. As previously noted, borrowers currently invoke state law as a basis for borrower defense under existing regulations, and state law may still be a basis for borrower defense for loans first disbursed *prior to* July 1, 2017—which include millions of borrowers and billions of dollars in loans.

Proposed new subsection (e) to §685.222:

(e) Violation of state law. The borrower has a borrower defense if the school engaged in any act or omission that relates to the making of the loan or the provision of educational services that would give rise to a cause of action against the school under applicable State law.

5. Remove the four-year statute of limitations on borrowers' ability to recoup payments

We appreciate that the Department has removed any limitations period applicable to the discharge of borrowers' loans. The Department's proposal, however, now imposes a four-year statute of limitations on borrowers' ability to recoup payments already made on loans. In this respect, the draft rules retreat from existing regulations, which impose no limitations period of any kind on borrower defenses. The proposal is also inconsistent with the relief provided by the Corinthian Special Master, who has determined that complete relief—both discharge and recoupment of payments—is appropriate for school misconduct occurring outside of four years. The four-year time bar would also represent a departure from regulations governing similar contexts, like closed-school and false-certification discharge, where there is no statute of limitations barring recoupment of improper collections. There is no reason why borrower defense should include a time limit for recoupment.

The Department's inclusion of a discovery-rule exception for substantial misrepresentation is inadequate.¹³ Borrowers without counsel have little hope of properly asserting or even knowing the exception exists. Moreover, applying an objective standard to when a borrower should have discovered the misconduct will lead to additional complications that will further thwart borrower relief. As we have learned from the Special Master's attempt to provide relief to Heald students, even after a school's rampant misconduct has become public, an overwhelming proportion of its victims may not realize they have a right to relief. Imposing a four-year statute of limitations only further harms borrowers who have already been preyed upon.

Proposed revisions to § 685.222(c) and (d):

(c) Breach of contract by the school. The borrower has a borrower defense if the school the borrower received a Direct Loan to attend failed to perform its obligations under the terms of a contract with the student. A borrower may assert a ~~defense to repayment of amounts owed to the Secretary~~ borrower defense under this paragraph (c) at any time after the breach by the school of its contract with the student. ~~A borrower may assert a claim to recover amounts previously~~

¹³ Proposal § 685.222(d).

~~collected by the Secretary under this paragraph (e) not later than four years after the breach by the school of its contract with the student.~~

(d) Substantial misrepresentation by the school. (1) The borrower has a borrower defense if the school or any of its representatives, or any institution, organization, or person with whom the school has an agreement to provide educational programs, or to provide marketing, advertising, recruiting, or admissions services, made a substantial misrepresentation in accordance with 34 CFR part 668, subpart F, that the borrower reasonably relied on when the borrower decided to attend, or to continue attending, the school. A borrower may assert a ~~defense to repayment of amounts owed to the Secretary~~borrower defense under this paragraph (d) ~~of amounts owed to the Secretary~~ at any time. ~~A borrower may assert a claim under this paragraph (d) to recover funds previously collected by the Secretary not later than four years after the borrower discovers, or reasonably could have discovered, the facts constituting the substantial misrepresentation.~~

6. Clarify that the closed-school process is available when a school has ceased to provide educational instruction in all programs

We wholeheartedly applaud the Department’s proposal to include an automatic, group discharge process for closed schools.¹⁴ However, we are concerned that the Department criteria for “closed schools” are too narrow, since the Department does not consider a school closed if (a) it has provided “financial protection,” or (b) there is an “appropriate entity from which . . . [to] recover”¹⁵ In some situations, a school may clearly have ceased to provide educational instruction, such that an automatic, group discharge process is appropriate, yet the school would not be considered “closed” under the Department’s proposal. For example, would a school liquidating in bankruptcy not be considered “closed” because there is an estate for the Secretary to recover against?¹⁶ This would be an absurd result that could delay relief to students for months, if not years, until bankruptcy proceedings wind down. We urge the Department to employ a definition of “closed school” consistent with the closed-school discharge rules.¹⁷

Proposed revisions to §685.222(g):

(g) Procedures for group discharge borrower defense claims with respect to loans made to attend a closed school. For groups identified by the Secretary under paragraph (f) of this section, for which the borrower defense claim is made with respect to a Direct Loan to attend a school that has ~~closed and has provided no financial protection currently available to the Secretary from which to recover any losses based on borrower defense claims made under this section, and for which~~

¹⁴ Proposal §685.222(g).

¹⁵ *Id.*

¹⁶ *See generally* 11 U.S.C. § 541(a) (“The commencement of a [bankruptcy] case . . . creates an estate.”)

¹⁷ 34 C.F.R. § 685.214.

~~there is not appropriate entity from which the Secretary can otherwise recover such losses ceased to provide educational instruction in all programs.~~

7. Individual borrowers should not have to show actual reliance because the definition of “substantial misrepresentation” already incorporates the appropriate reliance standard

The Department’s reliance standard for the individualized process is too narrow and excludes victimized borrowers. The Department’s proposal now requires that the borrower must have “reasonably relied” on a school’s substantial misrepresentation—as opposed to having merely, and subjectively, “relied” on the misrepresentation, as in the Department’s prior proposal.¹⁸ But neither of these standards is necessary because the Department’s own definition of “substantial misrepresentation” already sufficiently captures the appropriate objective reliance standard: “any misrepresentation to a person on which that person *could reasonably be expected to rely . . . to that person’s detriment.*”¹⁹ This definition is consistent with the unfair and deceptive trade practice laws in many states. It is unreasonable to require individuals to establish additional reliance beyond this.

Proposed revision to § 685.222(d):

(d) Substantial misrepresentation by the school. (1) The borrower has a borrower defense if the school or any of its representatives, or any institution, organization, or person with whom the school has an agreement to provide educational programs, or to provide marketing, advertising, recruiting, or admissions services, made a substantial misrepresentation in accordance with 34 CFR part 668, subpart F, ~~that the borrower reasonably relied on when the borrower decided to attend, or to continue attending, the school.~~ . . .

8. Prohibit the Department from recouping from public funds established for students

Under the Department’s proposal, if a borrower defense is granted, the borrower’s right to collect against a public fund is automatically transferred to the Secretary.²⁰ In states that have established student tuition recovery funds for the exclusive benefit of students defrauded by their schools, the Department’s proposal is an affront to state sovereignty. For example, California maintains the Student Tuition Recovery Fund, which “exists to relieve or mitigate economic losses suffered by *a student*”²¹ and is a last

¹⁸ Proposal § 685.222(c).

¹⁹ Proposal § 668.71(c) (emphasis added).

²⁰ Proposal § 685.222(k).

²¹ 5 CCR § 76020 (emphasis added).

resort for *students* who have exhausted other means of recovery.²² Its purpose is not to serve as a backstop for the federal government to seek reimbursement for losses on its own student-relief programs due to bad actors in the Title IV program. In effect, the Department’s proposal preempts state law by overriding a state action to establish funds that help only students.

Proposed revisions to § 685.222(k):

(k) Transfer to the Secretary of the borrower’s right of recovery against third parties. (1) Upon the granting of any relief under this section, the borrower is deemed to have assigned to, and relinquished in favor of, the Secretary any right to a loan refund (~~up~~corresponding to the amount ~~discharged of relief granted under this section~~) that the borrower may have by contract or applicable law with respect to the loan or the contract for educational services for which the loan was received, against the school, its principals, its affiliates, and their successors, its sureties, and any private fund, ~~including the portion of a public fund that represents funds received from a private party which shall not include any portion of a state tuition recovery fund.~~

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We appreciate the opportunity to share these concerns with the Department and fellow members of the negotiated-rulemaking committee.

²² See, e.g., <http://www.bppe.ca.gov/students/guide.shtml> (STRF is for students “who have exhausted all other possible ways to recover lost tuition expenses”); http://www.bppe.ca.gov/students/corinthian_colleges.shtml (instructing defrauded students to first apply for federal recovery, and that STRF “exists to reimburse as appropriate any prepaid tuition that you are otherwise unable to recover”).