

Memorandum

To: Department of Education Negotiators
From: Massachusetts Assistant Attorney General Michael Firestone
& California Deputy Attorney General Bernard Eskandari
Cc: Non-Department of Education Negotiators
Date: March 9, 2016
Re: Recommended Revisions to Issues 1-3 and 5

In our respective states, we have witnessed firsthand the fraud and abuse committed by certain schools in their efforts to secure federal loan funds and the devastation those loans have caused to borrowers. The Department's express aim for this rulemaking is laudable: "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 But the Department's most recent proposal misses the mark.

With the final negotiated-rulemaking session approaching on March 16, we ask the Department to make six changes before releasing updated draft language: (i) remove any statute of limitations for victimized students to raise a borrower defense; (ii) establish a group discharge process so that students subjected to the same abuses can be treated equally and efficiently; (iii) expand the Department's reliance on the work of state attorneys general and other state agencies; (iv) continue to recognize violations of state law as a basis for borrower defense; (v) ensure that the Department's process for granting a discharge is not an adversarial one that pits the victimized borrower against the school; and (vi) identify the use of mandatory arbitration agreements that require students to sign away their legal rights as indicative of a failure to responsibly administer the Title IV program.

We are hopeful that the Department will incorporate these requests in revised draft language on borrower defense.

1. Remove the Statute of Limitations

Under the Department's proposed draft language, a student borrower is offered just a two-year window to raise a breach of contract or substantial misrepresentation by the school as a defense to repayment of a Direct Loan.² This is patently unfair given that there is no corresponding statute of limitations on the ability of servicers and debt collectors to pursue student borrowers and collect on federal student loans. This two-year limit is inconsistent with borrower rights under Massachusetts and California state law³ and the Holder rule, and can only serve to extinguish the legal recourse of aggrieved and deserving students.

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).

² 685.222(b)&(c)

³ See Mass. Gen. L. 93A; 735 ILCS 5/13-207; Cal Code Civ. Proc. § 431.70. The same rule generally applies in federal court. *City of St. Paul, Alaska v. Evans*, 344 F.3d 1029, 1033-35 (9th Cir. 2003) (discussing the concept at length and stating "[i]ndeed, courts generally allow defendants to raise defenses that, if raised as claims, would be time-barred.").

Victimized students in our states are often unfamiliar with their legal rights and unaware of the violations committed against them until many years after the fact, if ever. Two federal agencies and three states had to complete multi-year investigations before Corinthian's Heald, Wyotech and Everest borrowers became aware that they had been deceived regarding placement rates. Indeed, a two-year limitations period would preclude the very discharges that the Department has already approved for certain Heald students. As the Department revises its draft language, we urge it to remove the statute of limitations for raising a borrower defense entirely.⁴

2. Establish a group discharge process

The Department's current proposal does not provide streamlined, automatic debt relief, even when it is clear that a predatory school has deceived and abused large numbers of students. Our investigations and enforcement actions have repeatedly unmasked schools that engaged in systemic practices that subjected all prospective and enrolled students to the same, egregious abuse and deception. Group process is necessary if the Department seeks to provide relief to all students with a rightful claim, and it is consistent with the Department's current regulations and state consumer-protection laws.

The Department's own experience with implementing borrower defense for students at Corinthian's Heald College is the strongest argument in favor of an automatic group process. On June 8, 2015, the Department announced that the seriously misrepresented job placement rates at Heald campuses between 2010 and 2014 "entitle the defrauded students enrolled in these programs to a discharge of their Federal Direct Student loans,"⁵ provided they complete an attestation form. The Department estimated that 50,000 students were eligible for a full discharge,⁶ but reported last December that just 1,312 students had navigated the process for seeking relief as of September 30, 2015—less than 3.0% of those eligible.⁷ The challenge of reaching student borrowers in the Department's "first major action" against schools, described by then-Secretary Duncan as bringing the "ethics of payday lending into higher education,"⁸ requires the rule-makers to develop a new, more effective approach that removes the burden from students. In the absence of a group process, only those few students assisted by legal counsel or lucky enough to stumble independently upon the Department's attestation forms will ever secure their rightful relief.

Fortunately, a streamlined, automatic group approach to providing student borrower relief is consistent with Department's current discharge practices and Secretary Duncan's promise to "make this [borrower defense] process as easy as possible for them

⁴ Alternatively, consistent with the equitable principle of many state laws, allow borrowers to raise a defense for as long as the Department seeks repayment of student loans. As noted, presently the Department may collect on federal student loans in perpetuity.

⁵ <http://blog.ed.gov/2015/06/debt-relief-for-corinthian-colleges-students/>

⁶ <https://www2.ed.gov/documents/press-releases/report-special-master-borrower-defense-1.pdf>

⁷ <https://www2.ed.gov/documents/press-releases/report-special-master-borrower-defense-2.pdf>

⁸ http://www.nytimes.com/2015/06/09/education/us-to-forgive-federal-loans-of-corinthian-college-students.html?_r=0

[student borrowers], including by considering claims in groups wherever possible.”⁹ Under the rules for seeking a closed school discharge, “[t]he Secretary *may discharge a loan under this section without an application from the borrower* if the Secretary determines, based on information in the Secretary’s possession, that the borrower qualifies for the discharge.”¹⁰ This language, explicitly permitting automatic, group discharges, is also found in the regulations authorizing discharge for false certification.¹¹ We urge the Department to adopt similar language in § 685.222(j) to avoid the unfair and duplicative burdens of the current Heald procedure, which has left over 97% of eligible students without the benefits they are entitled to under law.

Proposed Language to add to § 685.222(j): *The Secretary shall discharge a loan under this section without an application from the borrower if the Secretary determines, based on information in the Secretary’s possession, that the borrower qualifies for the discharge based on a breach of contract or a [qualifying] substantial misrepresentation.*

Congress’s direction to the Secretary to provide for borrower defenses against repayment empowers the Secretary to adopt this provision.¹² There is nothing inconsistent about recognizing a defense to repayment on behalf of a group of borrowers, especially where one borrower representative of the group has made such a claim.

Relatedly, we ask that the Department to amend § 685.222(d) to allow for group determinations of eligibility based upon a school’s “substantial misrepresentation” by removing the unnecessary requirement of individual reliance contained in the final clause of the first sentence.¹³ The Department’s own definition of a “substantial misrepresentation” giving rise to borrower defense is “any misrepresentation to a person on which that person *could reasonably be expected to rely . . . to that person’s detriment,*”¹⁴ a definition much more consistent with the unfair and deceptive trade practice laws in many states, which have long-recognized the importance of objective standards in determining honest statements from fraudulent ones. If the Department feels the need to raise the threshold for granting group determinations, we ask that, in place of an individualized standard, the Department consider defining a “qualifying substantial misrepresentation,” as “any misrepresentation to a group of persons on which a person could reasonably be expected to rely to their detriment.”

3. Expand reliance on the work of state attorneys general and other government agencies

⁹ http://www.nytimes.com/2015/06/09/education/us-to-forgive-federal-loans-of-corinthian-college-students.html?_r=0

¹⁰ § 685.214(c)(2) (emphasis added).

¹¹ § 685.215(c)(7).

¹² 1087e(h) “the Secretary shall specify in regulations which acts or omissions of an institution of higher education a borrower may assert as defense to repayment of a loan....”

¹³ § 685.222(d) (“The borrower has a defense to repayment under this section 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 relied on when the borrower decided to attend, or to continue attending, the school.*”) (emphasis added).

¹⁴ § 668.71(c).

The Department’s draft proposed rule allows distressed student borrowers to secure debt relief on the basis of an investigation or enforcement action by a state or federal agency only if the agency obtains a judgment against the school.¹⁵ This rule is far too narrow to be effective and is inconsistent with the Department’s commitment to “whenever possible, . . . rely on evidence established by appropriate authorities in considering whether whole groups of students (for example, an entire academic program at a specific campus during a certain time frame) are eligible for borrower defense relief.”¹⁶ State attorneys general often settle cases or resolve investigations in order to secure monetary relief that aids both students and taxpayers. Attorneys general should not be forced to forego restitution and litigate with schools in order to ensure that investigative findings can form the basis of a defense to repayment for affected borrowers. We therefore urge that the Department amend § 685.222(b) to grant borrowers a defense to repayment if the government agency has secured “any judgment or determination in a court of competent jurisdiction or an admission by the school.”

We also recommend that findings by state agencies shared with the Department should trigger an automatic review by the Department under § 685.222(j). Given the role of state regulators and state attorneys general in protecting consumers and enforcing state trade practices laws,¹⁷ and our recognized role in the “triad” of higher education oversight, we believe that this practical change will help streamline and strengthen borrower defense implementation.

4. Keep state law as a basis for borrower defense

The Department’s proposal unreasonably limits the categories of school misconduct that would give rise to a defense to repayment, by creating a federal standard that excludes violations of state law. The proposal limits students’ rights to only those circumstances where the schools either breached a contract or engaged in “substantial misrepresentations,” ignoring other categories of egregious school misconduct that violate state law.

Breach of contract and substantial misrepresentation fall short of capturing all the misconduct covered by state laws that protect students from exactly the sort of abuse that borrower defense seeks to remedy. We are concerned that the Department’s proposal would exclude, for example, (a) violations of state law related to affirmative-disclosure obligations, debt collection, and *per se* prohibitions on certain advertising techniques, such as the use of government and military seals; (b) violations of other federal laws that are incorporated into state law (through, for example, the unlawful prong of California’s

¹⁵ § 685.222(b).

¹⁶ <http://www.ed.gov/news/press-releases/fact-sheet-protecting-students-abusive-career-colleges>

¹⁷ These statutes generally make unlawful any unfair or deceptive trade practices as defined by state law. *See, e.g.*, Mass. Gen. Law c. 93A, § 2 (“ . . . unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful.”); 815 Ill. Comp. Stat. 505/2 (“ . . .unfair or deceptive acts or practices . . . in the conduct of any trade or commerce are hereby declared unlawful whether any person has in fact been misled, deceived or damaged thereby.”). Indeed, many trade practices statutes look to the Attorneys General not only as the primary enforcers of their terms, but also as the regulators who clarify the meaning of their statutory provisions. *See, e.g.*, Mass. Gen. Law c. 93A, §§ 2, 4.

Unfair Competition Law¹⁸), such as recruiter incentive-compensation bans; and (c) state-law theories of liability predicated on aiding and abetting and conspiracy.

We do not oppose the creation of a national, uniform standard, so long as it serves as a federal floor applicable to all borrowers. But to ensure that maximum, long-standing consumer protections remain in place for borrowers, we urge the Department to retain the further protections of state law in any new standard.¹⁹

5. *Avoid a process that pits victimized students against the school is unfair*

In cases where the school has not already closed down, the Department proposes that the decision to grant a discharge be made by pitting the student against the school in an adversarial process, effectively requiring the student to hire a lawyer and allowing the school to interfere with the student's right to obtain relief on a government loan. Any fair process should be sufficiently simple and straightforward so that a student can navigate it successfully without a lawyer. To ensure this, we urge the Department to create two separate and distinct processes—one process to determine a successful borrower defense that is easily navigable for students without the assistance of legal counsel; and a second process, between the Department and the school, to determine whether to hold the school liable for reimbursement if the borrower defense is successful. Fair and effective defense-to-repayment procedures must not permit schools to make the process burdensome and expensive for borrowers.

6. *Stop predatory schools from forcing students to sign away their legal rights*

We join with the consumer and legal aid representatives on the rulemaking committee in asking the Department to revise the administrative capability regulations (34 C.F.R. § 668.16) to identify the use of pre-dispute arbitration agreements and similar restrictions on students' legal rights as an indication of an institution's failure to responsibly and capably administer Title IV loan funds. The drafters wrote, "when predatory schools bind their students to arbitrate any and all disputes that they may have against the school, it functions on the whole to suppress meritorious student complaints."²⁰ Although these contractual traps cannot thwart a law-enforcement action brought by an attorney general, they do silence aggrieved students by cutting off their private legal rights and access to the court system. The efforts of government agencies and the attorneys general cannot effectively counter this misconduct alone and students seeking loan forgiveness need access to publicly available complaints and court

¹⁸ See Cal. Bus. & Profs. Code § 17200 et seq.

¹⁹ Moreover, any perceived burden of interpreting the laws of the various states will not be eased by excluding state law. Under the Department's existing regulations, violation of state law is the *only* basis for borrower relief, and ED proposes not to apply any new DTR standard retroactively. Thus, billions of dollars of outstanding federal student loans dispersed before July 2017 will remain subject to a standard for which state law remains the *only* avenue for relief.

²⁰ Proposal of Eileen Connor on behalf of the Legal Aid Community, February 11, 2106 (available at <http://www.legalservicescenter.org/project-attorney-urges-department-of-education-to-prohibit-for-profit-colleges-from-using-forced-arbitration-to-hide-fraud-and-deception-of-students/>).

documents to achieve the relief they are owed. For these reasons, we ask the Department to adopt the recommendation.

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As negotiators, we appreciate the opportunity to share these recommendations with the Department and our fellow members of the negotiated-rulemaking committee.