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SLBA Student Loan Borrower Assistance

Comments of
National Consumer Law Center
(on behalf of its low-income clients)
to the
Department of Education
Re: Intent to Establish Negotiated Rulemaking Committee;
on Borrower Defense and Gainful Employment
(Docket ID ED-2017-OPE-0076)

Submitted: July 12, 2017

Introduction

The National Consumer Law Center (NCLC) submits these comments on behalf of its low-income clients. NCLC is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of civil legal aid, government, and private attorneys and their clients, as well as community groups and organizations that represent low-income and older individuals on consumer issues. NCLC's Student Loan Borrower Assistance Project provides information about rights and responsibilities for student borrowers and advocates. We also seek to increase public understanding of student lending issues and to identify policy solutions to promote access to education, lessen student debt burdens, and make loan repayment more manageable.[1]

Persistent abuses and fraud, particularly apparent in the for-profit college sector, shatter the hopes and aspirations of many students seeking higher education. At NCLC's Student Loan Borrower Assistance Project, we see the harm to students on a regular basis through our direct client representation work. We also consult with civil legal aid and other attorneys across the country who represent borrowers, many of whom have been harmed by for-profit schools.

The Department's borrower defense and gainful employment rules provide critical protections to students and taxpayers. As we have written during prior comment periods, these rules need to do more—not less—to protect student loan borrowers. Therefore, we oppose any actions that weaken either the borrower defense rules that were finalized on November 1, 2016, or the gainful employment rules finalized on October 31, 2014. We further oppose delaying

[1] See the Project's web site at www.studentloanborrowerassistance.org. NCLC also publishes and annually supplements treatises which describe the law currently applicable to all types of consumer transactions, including Student Loan Law (5th ed. 2015).

implementation of the rules and the Department's intention to redo the lengthy process of negotiating and writing the rules before they are even implemented.

Our comments on these rules are not based on a belief that there should be just one particular model of education. As lawyers for low-income clients, we agree that there is a need to offer educational programs that meet the needs of many low-income and "non-traditional" students. Most of our clients are older than "traditional" students, often with their own children. We understand that many seek career education programs that provide practical, job-oriented training that will help them secure a steady job. For that reason, we are keenly aware of the need to hold schools accountable for delivering the kind of education and assistance they promise. These rules are essential to help ensure that these individuals will be given a real opportunity to succeed if they choose to pursue career training. The Department has a responsibility to help students distinguish between effective and predatory programs. By fulfilling that responsibility, the Department will protect not only students, but also taxpayers and the schools that play by the rules.

In addition to borrower defense and gainful employment, the Department has indicated that it intends to review, as part of these rulemakings, the authority of guaranty agencies in the Federal Family Education Loan Program to charge collection costs to defaulted borrowers who enter into repayment agreements. The Department has explained that its regulations forbid the imposition of collection costs on borrowers who act swiftly to cure default by entering into rehabilitation agreements. The Department should not change course now.

To avoid repetition, we are not submitting detailed comments on the specifics of the regulations. Instead, we incorporate the written comments we previously submitted regarding the proposed gainful employment rule published March 25, 2014,[2] which are attached as Appendix A, and regarding the proposed borrower defense rule published June 16, 2016,[3] which are attached as Appendix B.

Instead, these comments will focus on the reasons why these regulations are urgent and necessary. The first section details how delaying these rules harms borrowers and taxpayers. The second section explains why the gainful employment regulations are critical for holding schools accountable and preventing harm to future students. Third, we explain how the borrower defense regulations provide borrowers who have been harmed by abusive practices with much needed relief. Fourth, we discuss the negative impact of predatory programs on students of color and how weak rules will disproportionately drive wealth from communities of color. Finally, we address why guaranty agencies in the Federal Family Education Loan Program should be prohibited from charging collection costs to borrowers who quickly cure loan defaults through rehabilitation.

Ultimately, we believe that the Department must implement strong rules to protect students, prevent them from becoming distressed borrowers, and ensure that their efforts to repay are not stymied by unnecessary penalties.

[2] 79 Fed. Reg. 16,426 (March 25, 2014).
[3] 81 Fed. Reg. 39,330 (June 16, 2016).

I. Delaying and Revising the Rules Harms Borrowers and Taxpayers.

Contrary to the Department's statement in the federal register, delaying in the borrower defense and gainful employment rules will cause significant harm to student loan borrowers, both those who have been the victims of fraud and abuse, and future students who will borrow thousands of dollars to attend programs that do not live up to their promises. As will be discussed in greater detail in Section IV below, African American and Latino students and student loan borrowers bear the brunt of these predatory practices.

The delay effectively allows the Department to deny relief to borrowers whose schools closed. These borrowers are eligible for and would receive automatic discharges of their student loans if the rules were implemented on schedule.

If the rules had gone into effect, borrowers whose schools shut down before they could complete their studies would have had $381 million dollars of loans cancelled.[4] These are borrowers saddled with student loan debt and no degree because their schools failed them. Many of these borrowers are currently experiencing financial distress because of these loans. They may be suffering the harsh consequences of student loan default, including negative credit reporting, wage garnishments, tax offsets, and the offset of their federal benefits. Due in large part to the Department's failed outreach efforts, few of these borrowers know that they have a right to cancel their loans. Delay of this regulation will cause significant harm to these borrowers. To do so in the name of avoiding costs[5] would be unconscionable.

The Department has claimed that borrowers with borrower defense claims are not being harmed by delaying implementation of the rules because it continues to process borrower defense applications.[6] This claim is not supported by the evidence. As reported by the Associated Press, the Department has failed to approve a single borrower defense application since the change in administration.[7] Given the 64,301 outstanding borrower defense applications, we urge the Department to immediately begin discharging more loans and to provide full and automatic relief to all borrowers who have been identified as presumptively eligible for cancellation of their loans.

Additionally, the Department does a disservice to future students and taxpayers by delaying the gainful employment rule and allowing programs to continue to receive federal aid dollars even when those programs cannot demonstrate that their graduates land well enough paying jobs that set them up to repay the debts they incurred. Delaying warnings to prospective students that specific career programs do not actually result in jobs sufficient to pay their student

[4] 82 Fed. Reg. 27,621 (June 16, 2017) (citing "$381 million for cohorts 2014-2016 attributable to the regulations providing for a three-year automatic closed school discharge").
[5] *Id. ("*Postponing the effectiveness of the final regulations will help to avoid these significant costs to the Federal government and ultimately the Federal taxpayer.").
[6] *Id.* ("[T]he postponement of the final regulations will not prevent student borrowers from obtaining relief because the Department will continue to process borrower defense claims under existing regulations that will remain in effect during the postponement.").
[7] Collin Binkley, *Promised college loan forgiveness, borrowers wait and wait*, AP News (June 26, 2017), *available at* https://apnews.com/c57f0c42e39243f184ed52ef22a5e7b5

loan bills simply means that yet another year of students will be denied information that would help them avoid taking on unaffordable student loan debt.

Delaying the regulations will hurt rather than benefit taxpayers. The borrower defense and gainful employment regulations provide important protections to taxpayers. These rules prevent predatory schools from lining their pockets by funneling taxpayer dollars through defrauded students. And, importantly, the rules help ensure that when schools commit fraud or fail, the schools and their Wall Street investors pay for the harm they do rather than leaving taxpayers holding the bag. Thus, implementing these rules immediately is critical to protecting taxpayers. Further, engaging in another round of negotiated rulemaking—when these rules were only recently finalized through full negotiated rulemaking processes involving borrowers, schools, and the Department—is a waste of time, a waste of taxpayers' resources, and ultimately harmful for students and student loan borrowers.

II. The Gainful Employment Regulations are Critical to Holding Schools Accountable

To participate in the federal aid programs, federal law requires career education programs to "prepare students for gainful employment in a recognized occupation." The regulations published on October 31, 2014, are essential because they define this standard so that it can be enforced and so that the government has a consistent measurement to use in holding schools accountable. Most importantly, this will help ensure that borrowers have a reasonable expectation that they are in fact attending programs that are likely to lead to gainful employment. The rule also provides for a consistent and transparent set of information about whether investing in a particular program is worthwhile, which helps students make better choices about which programs to attend and how much debt to take on.

Among the hundreds of clients we have represented over the years who have enrolled in for-profit schools, only a handful have reported finding a job in the field related to their program of instruction. A large part of the blame clearly lies with schools that aggressively recruit students with false promises of job placement and employment, and then fail to deliver. The gainful employment rule can go a long way toward eliminating the worst programs that waste student and taxpayer dollars.

Allowing career education programs that do not in fact prepare the majority of their students for gainful employment to enroll more students with federal funds—even after they have failed the gainful employment standard and continue to do so for up to 2 out of 3 additional years—is a huge disservice to the students and taxpayers who would end up with more defaulted student debt. We urge the Department to end the delay and fully implement the gainful employment regulations.

III. Borrower Defense Regulations

i. Defense to Repayment Regulations

The borrower defense rules published on November 1, 2016, created a much-needed—and long-overdue—process for borrowers harmed by illegal conduct at predatory schools to get the loan relief they are entitled to under the Higher Education Act ("HEA"). Although the HEA has long provided that students harmed by illegal school conduct should not be liable for their federal student loans, the Department has failed to provide a process for eligible student borrowers to get this relief. The rule explains how defrauded students can apply for loan discharge based on misconduct by their schools, creating much needed clarity for borrowers, taxpayers, and schools alike.

The borrower defense rule is of critical importance to the individuals we serve, as well as to the hundreds of thousands of other borrowers in identical circumstances. In addition to having limited economic means, our clients overlap with the populations most often targeted by unscrupulous and predatory schools. They are often among the first in their family to pursue higher education. They include people of color, immigrants, non-native English speakers, single mothers, and the formerly incarcerated.

For example, the borrower defense rule should provide a path to relief for a group of clients at a civil legal aid organization in Los Angeles who were defrauded by a for-profit school. The school encouraged these individuals to enroll by representing that its medical assisting program would be conducted entirely in Spanish. Upon enrollment, the students, none of whom read or understood English, discovered that instruction, class materials, and even exams were all in English. In addition, although the school claimed it would offer placement in internships in the field, placements often were in internships that did not require the use of medical assisting skills, but instead required janitorial work. Further, because school officials misrepresented the students' rights to withdraw, all of the students struggled through the entire course—and took out loans to cover it—in the hopes that they would learn the skills they needed to obtain a medical assisting job. Only one student, out of about 40 legal aid clients, found a medical assisting job. These borrowers should not be burdened by loans made to attend a fraudulent school. Instead of subjecting these borrowers to the government's vast collection powers, the Department should be focusing its resources on holding this shameful school accountable.

Borrowers have a right under the HEA to raise claims and defenses to loan repayment at any time.[8] These borrowers need a clear and fair process for pursuing that relief.

ii. Closed School

It is important for the borrower defense regulations to go into effect now because they provide automatic, and much needed, closed school discharges for some students. Currently, after a school closes, the loan holder is required to provide discharge applications to borrowers who appear to have been enrolled at the time of the school's closure or to have withdrawn not

[8] 20 U.S.C. § 1087e(h).

more the 120 days prior to closure.[9] This often happens one to six months after the school has closed. Despite these requirements, the Department receives closed school loan discharge applications from only 6 percent of eligible borrowers.[10] This relief rate is unacceptable. As the Department observed, "[m]any borrowers eligible for a closed school discharge do not apply."[11] The low response rate is due to a lack of understandable and accessible information about closed school discharges, as well as lack of effective outreach.[12]

The borrower defense rule strengthens existing closed school discharge regulations by requiring improved, prompt communications to eligible borrowers about their rights when their school is closing—helping to ensure that more students are informed of their options and can get their loans discharged quickly. Even with better communication efforts, many eligible borrowers will not find out about their right to discharge. Therefore the rule also provides automatic discharges of federal student loans taken out to attend the closed school by borrowers who have not re-enrolled in another school by three years after the closure. This provides efficient and equitable relief to eligible borrowers harmed by their school's closure.

Many of these borrowers who attended schools that closed and are eligible for a closed school discharge are currently experiencing financial distress on these loans and suffering the harsh consequences of student loan default. The delay of this regulation will cause significant harm to these borrowers—who may be experiencing wage garnishment, seizure of their tax refunds, and problems obtaining housing or employment due to the impact of their student loan debt on their credit report. We urge the Department to implement these regulations that provide for automatic discharges to students whose schools closed on or after November 1, 2013, and who do not re-enroll at another school within three years of their school's closure.[13]

iii. False Certification

The borrower defense regulations published on November 1, 2016, also provided long overdue updates to the false certification regulations. For example, the current false certification regulations allow discharges for borrowers who have not earned a high school diploma or GED only when the school did not properly administer an ability-to-benefit (ATB) test.[14] The HEA ATB provisions, however, changed in 2012[15] but the current false certification regulations do not reflect the changes. Therefore, without these regulations, borrowers are in the untenable position of having been falsely certified, but not eligible for a false certification discharge under current regulations.

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[9] 34 C.F.R. §§ 674.33(g)(8)(v) (Perkins), 682.402(d)(6)(ii)(H), 685.614(f).
[10] Paul Fain, *Best of a Bad Situation?,* Inside Higher Ed (Dec. 9, 2014), *available at* https://www.insidehighered.com/news/2014/12/09/feds-respond-criticism-bid-ecmc-buy-most-corinthian.
[11] 81 Fed. Reg. at 39,369 (June 16, 2016).
[12] *Id.*
[13] 81 Fed. Reg. 75,926, 76,078, 76,080-81 (Nov. 1, 2016) (34 C.F.R. §§ 674.33(g)(8)(iv), 682.402(d)(8)(ii) (FFELs) and 685.214(c)(2)(ii) (Direct Loan)).
[14] See 34 C.F.R. § 685.215.
[15] 20 U.S.C. § 1091(d)(1)(A).

The new regulations also provide relief in some circumstances when a school falsified a student's satisfactory academic progress.[16] This conduct, which we have found to be endemic to predatory institutions that see students only in terms of profit, provides no benefit and serves only to burden unprepared students with unmanageable debts. These students are typically unable to obtain or maintain jobs in the occupations for which they trained.

These borrowers need urgent relief.

iv. Arbitration

The Department's rules on forced arbitration, class action bans, and mandatory internal dispute resolution processes provide critical protection to ensuring that schools are not forcing student borrowers to arbitrate their claims alone in secret, private tribunals.[17] Delaying the arbitration provisions in the borrower defense rule leaves millions of students without the opportunity to hold lawbreaking schools accountable in court.

To prevent students from successfully seeking relief, and to prevent the Department of Education, accreditors, and law enforcement agencies from learning about complaints and settlements, predatory schools frequently require students to waive their right to participate in class actions against the school to resolve their disputes. These schools require students to waive these rights before even knowing what disputes they might have with the school. These same requirements force the few students who might have the resources to bring individual claims to pursue those claims in a private arbitration forum and to agree not to disclose anything about the dispute.

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[16] 81 Fed. Reg. 76,045, 76,082 (Nov. 1, 2016).

[17] "Pre-dispute arbitration" or "forced arbitration" refers to a contractual provision, agreed to in advance of any dispute or claim, which requires a party to take any claims that may later arise to arbitration instead of to a court, for resolution by a private company chosen by the author of the contract.

"Class action bans" are terms in contracts that purport to preclude a party from participating in a class action lawsuit or other class proceeding, either as a lead plaintiff or as member of the class; companies often attempt to use these terms to limit their liability exposure and to prevent consumers from banding together to leverage their resources as a group in asserting claims that may not be economically viable or otherwise feasible to pursue individually.

"Mandatory internal dispute process" terms often purport to require students to notify their school of any disputes they have and to submit to an internal institutional process for attempting to resolve the dispute before a student can assert their dispute in court or in an administrative or arbitration proceeding. This can delay or prevent students from asserting their rights to a neutral third-party, especially when the internal process is not reasonably timely or accessible, and can create opportunities for sophisticated schools to suppress public information about student complaints and misconduct and to coerce students not to pursue their rights.

These provisions are often found in contracts of adhesion—standardized, preprinted form contracts that are presented to students or other consumers on a take-it-or-leave-it basis, with no opportunity to bargain. In binding arbitrations, the arbitrator is empowered to issue a final, binding ruling on the merits of a suit, subject only to sharply limited judicial review.

Although most schools do not use these types of clauses,[18] predatory schools use them to prevent borrowers from obtaining relief from their schools. This practice leaves injured borrowers with few options but to struggle with unaffordable loans or attempt to seek relief from the government instead.[19] Because borrowers facing forced arbitration clauses cannot obtain redress from the schools that defrauded them, the government and taxpayers are often left on the hook for the fraud. This is why so many speakers in the public hearings prior to the establishment of the most recent borrower defense rulemaking committee raised a ban on forced arbitration as a way to promote relief for borrowers and to protect taxpayers.[20]

These clauses cause enormous harm to student loan borrowers. Pursuing claims individually against a school is not only expensive—often preclusively so—but also time-consuming and intimidating. And it is made even more difficult because borrowers and their advocates do not have access to prior arbitration decisions. Even when such decisions do exist, they are typically shielded by contractual confidentiality requirements.

Arbitration clauses, class waivers, and attendant confidentiality requirements also greatly reduce the likelihood that a school's fraudulent activities will result in any significant liabilities. By limiting student rights, these schools prevent information about valid disputes from reaching the Department, accreditors, and other law enforcement agencies. The result—because of the inability of students to pursue their claims—is that students' rights are curtailed, and indicators of a failing school are suppressed.

Further, some schools insist on arbitration requirements that blatantly "overreach" by including terms that likely violate state law and further chill borrower claims. For example, a large, publicly-traded for-profit college used an enrollment agreement that, contrary to Massachusetts law, purported to preclude incidental, special, consequential, or punitive damages and to require that any claims be brought by the student within just two years. The agreement also provided that the school could recover its attorneys' fees from the student if the student brought an unsuccessful action in court to challenge the arbitration provision or to challenge or correct the arbitration award. Though none of these terms should be found enforceable if challenged in court, they make it extraordinarily unlikely that a low-income borrower will be able to find an attorney to help pursue her claims, or that she would risk trying to pursue them in light of the expressed limitations on relief and threat of liability for a school's legal fees.

We therefore urge the Department to maintain all provisions limiting participating institutions' use of forced arbitration, class action bans, and mandatory internal dispute processes, and not to delay implementation of this important student protection.

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[18] *See, e.g.,* Tariq Habash and Robert Shireman, *The Century Foundation Report: How College Enrollment College Contracts Limit Students' Rights, available at* https://tcf.org/content/report/how-college-enrollment-contracts-limit-students-rights/.

[19] *See, e.g.*, Comments of the Project on Predatory Student Lending & the National Consumer Law Center to the Department of Education on Intent to Establish Negotiated Rulemaking Committee for Pay as You Earn, ID: ED-2014-OPE-0124-0115.

[20] *See, e.g.*, Statement of Pamela Banks, Senior Policy Counsel, Consumers Union, Transcript of Public Hearing in Washington D.C., Sept. 10, 2015, at p. 96; Statement of Debbie Cochrane, Institute for College Access and Success, Transcript of Public Hearing in San Francisco, Sept. 16, 2015, at pp. 20-21; Statement of Nick Campins, California Department of Justice, Transcript of Public Hearing in San Francisco, Sept. 16, 2015, at p. 43.

IV. Impact of Predatory Programs on Students of Color

i. Tactics Predatory Schools Use Harm Students of Color

African American and Latino students make up a disproportionately large portion of students at for-profit colleges, meaning that the issues facing this sector have a higher impact on students of color—including higher average loan balances and default rates.[21] As The Leadership Conference documented in its 2014 paper *Gainful Employment: A Civil Rights Perspective*, African-American and Latino students are over-represented in for-profit colleges, making up 41 percent of the student body.[22] This disproportionate concentration means that the issues present in this sector have a higher impact on students of color. In the previous sections, we have noted the high debt levels and poor outcomes that many for-profit students experience. These problems are also consistently worse for African American and Latino students who attend for-profit colleges. A report by the Center for Responsible Lending shows that African Americans and Latinos at for-profit schools borrow more than their peers attending public or private, non-profit schools.[23] Moreover, its report found African Americans and Latinos at for-profit colleges borrow more even when we compare borrowers of similar income levels attending schools in other sectors.[24]

African Americans and Latinos attending for-profit colleges are far less likely to graduate than their peers at other schools. Nearly 8 out of 10 African American and two out of three Latino students do not complete for-profit programs. Default rate data reported by race or ethnicity is not publicly available, so we cannot observe variations in cohort default rates for students of color. However, because one of the predictors of delinquency and default is whether the student is able to complete his or her program, it is likely that African Americans and Latinos attending for-profit colleges are more likely to experience distress in paying back their loans than those who borrowed to attend other schools.

The over-representation of African Americans and Latinos was particularly extreme at the now defunct Corinthian Colleges ("Corinthian"). An analysis of Corinthian's 2014 enrollment numbers shows that people of color comprised the majority (62 percent) of its students, women comprised 71 percent of its students, and African American women comprised 26 percent.[25] The Department has estimated that some 125,000 former Corinthian students may

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[21] Peter Smith & Leslie Parrish, Center for Responsible Lending, Do Students of Color Profit from For-Profit College? Poor Outcomes and High Debt Hamper Attendees' Futures, (Oct. 2014) http://www.responsiblelending.org/student-loans/research-policy/CRL-For-Profit-Univ-FINAL.pdf.

[22] Leadership Conference on Civil and Human Rights, et al, "Gainful Employment: A Civil Rights Perspective," October 2014, available at http://www.protectstudentsandtaxpayers.org/wp-content/uploads/2014/10/Gainful-Employment-Civil-Rights-Perspective_WhitePaper_October2014.pdf.

[23] Peter Smith & Leslie Parrish, *supra* note 21.

[24] *Id*.

[25] Leadership Conference analysis of National Center for Education Statistics, "Integrated Postsecondary Education Data System," available athttps://nces.ed.gov/ipeds/datacenter (last accessed October 2016), examining 12-month 2014 enrollment by race/ethnicity.

be eligible to have their debts discharged due to the Department and the California Attorney General's findings of misrepresentation by the school.[26]

ii. Data Necessary for Borrower Defense and Gainful Employment

Given the over-representation of African American and Latino students at for-profit schools, especially at those known to have predatory practices, in order for the negotiators and public to make a full and fair consideration of any changes to these regulations, the Department should make the following data available before proposing a revision to either the borrower defense or gainful employment rules:

1) Enrollment numbers, broken down by race, of the institutions (both by institution and in aggregate) that have passed the gainful employment requirements, are in the "warning zone," or have failed the requirements since the regulations were implemented on July 1, 2015.
2) The total amount of outstanding student loan debt, including Parent PLUS amounts, attributable to institutions (both by institution and in aggregate) that have passed the gainful employment requirements, are in the "warning zone," or have failed the requirements since the regulations were implemented on July 1, 2015.
3) The average debt load of students, including Parent PLUS amounts, attributable to institutions (both by institution and in aggregate) that have passed the gainful employment requirements, are in the "warning zone," or have failed the requirements since the regulations were implemented on July 1, 2015.
4) Enrollment numbers, broken down by race, of the institutions that closed since November 1, 2013.
5) The total amount of outstanding student loan debt, including Parent PLUS amounts, attributable to schools (both by institution and in aggregate) that closed since November 1, 2013.
6) The average debt load of students, including Parent PLUS amounts, attributable to schools (both by institution and in aggregate) that closed since November 1, 2013.
7) Number of borrowers (by race if available) who have applied for a closed school discharge related to attendance in a school that closed since November 1, 2013.
8) A complete list of the schools attended by borrowers who have submitted applications to cancel their loans based upon a defense to repayment, including a breakdown in enrollment of those schools.
9) Enrollment numbers, broken down by race, of the institutions (both by institution and in aggregate) attended by borrowers who have submitted applications to cancel their loans based upon a defense to repayment.

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[26] See: "Arne Duncan Transcript: Some For-Profit Colleges Have 'the Ethics of Payday Lending,'" Huffington Post, June 10, 2015, available at http://www.huffingtonpost.com/davidhalperin/arne-duncan-transcript-so_b_7557408.html. ("[W]e believe that there are about 40,000 borrowers who are impacted by today's decision"); and U.S. Department of Education, "Department of Education and Attorney General Kamala Harris Announce Findings from Investigation of Wyotech and Everest Programs," November 17, 2015, available at http://www.ed.gov/news/press-releases/department-education-and-attorney-general-kamala-harris-announce-findings-investigation-wyotech-and-everest-programs. ("The Department's findings apply to Corinthian campuses that served approximately 85,000 Wyotech and Everest students.").

V. Collection Fees

The Department should also retain the regulations that prohibit assessing collection fees on borrowers who enter repayment agreements within 60 days following default. The government and guaranty agencies have expansive powers to collect on the nearly $1.4 trillion in outstanding defaulted student loans. They can garnish a borrower's wages without obtaining a judgment, offset a borrower's Social Security benefits, seize a borrower's tax refund, and deny a borrower new education loans. Furthermore, student borrowers cannot discharge their federal student loans in bankruptcy and there is no statute of limitations for the collection of student loans. In short, the loan holders can and do pursue borrowers in default for decades.

Given the vast collection powers, the amount lenders charge in collection fees is unreasonable and excessive. Borrowers should only be charged for collection fees that are bona fide and reasonable and actually incurred. Currently, the Department uses a "cost-averaging" basis to calculate an individual borrower's collection fees.[27] The Department calculates the fees, which may be as high as 25% of outstanding principal and interest, based on the average collection cost per student loan borrower. The fees are not in any way related to the actual costs incurred in collecting from any particular borrower. This "cost-averaging" approach often leads to unfair results since the number of defaulting borrowers from whom recovery is made bear the brunt of all the government's collection expenses. These fees would be especially excessive if charged to borrowers who immediately enter into rehabilitation agreements following default.

In many circumstances the Department adds these exorbitant collection fees to the principal balance, a standard practice known as capitalization. Capitalization leads to ballooning loan debts even in cases where collection activity is minimal. This practice of adding collection fees, which are often unrelated to the minimal amount of work actually performed by the collection agency, to the principal balance makes it even harder for borrowers to make a dent in paying off their debts.

As noted by the Seventh Circuit, because the Department was concerned about recent graduates facing these adverse consequences without first being given an opportunity to cure their defaults, it created protections in 34 C.F.R. § 682.410(b)(5)(ii).[28] The Department has further made clear that its regulations forbid the imposition of collection costs on borrowers who enter into rehabilitation agreements in a timely manner. In a brief filed in *Education Credit Management v. Barnes*, attached as Appendix C, the Department stated that "the regulations therefore direct guarantors to charge collection costs only to those debtors who cause the guarantor to incur collection costs by failing to agree promptly to repay voluntarily."[29]

[27] 34 C.F.R. § 30.60(d).
[28] *Bible v. USA Funds*, 799 F.3d 633, 646 (7th. Cir. 2015).
[29] Appendix C at 22 (emphasis in original).

The HEA regulations require that:

> The guaranty agency, after it pays a default claim on a loan but before it… assesses collection costs against a borrower, shall… provide the borrower with... [a]n opportunity to enter into a repayment agreement on terms satisfactory to the agency.[30]

The regulations require that the opportunity for a borrower to enter into the agreement and avoid collection costs remain available for 60 days.[31] To explain further, 34 C.F.R. § 682.410(b)(5)(ii)(D) lists a number of tasks which a guaranty agency must complete before imposing costs, including providing the borrower with the opportunity to repay, quoted above. It also requires that the guaranty agency give the borrower an opportunity for an administrative review of the enforceability of their loan.[32] Critically, 34 C.F.R. § 682.410(b)(5)(iv)(B) requires that borrowers be given at least 60 days to request such a review. Because costs cannot be imposed for the 60 days in which a borrower may request administrative review of the loan, the Department has concluded that, in that 60-day time period, borrowers can also exercise their right to enter into a repayment arrangement and avoid collection costs.[33] A "rehabilitation" agreement is one type of authorized "repayment agreement."[34]

As the Department proceeds with its proposal to consider changes to its policy around collection fees, in order for the negotiators and public to make a full and fair consideration of any changes to these regulations, the Department should provide the following data:

1) The total amount collected in collection fees, separated by amounts collected by the Department of Education and the amounts collected by guaranty agencies ("GAs") per year for the last five years.
2) For the last five years, the total amount collected in the first 60 days following
    a. A loan transferred from the servicer to the Debt Management and Collection System ("DMCS"), or
    b. A claim paid by a GA to the lender.
3) For the last five years, the amount of collection fees attributable to:
    a. Administrative Wage Garnishments
    b. Treasury Offsets
    c. Voluntary Payments
    d. Consolidations
    e. Rehabilitations
4) For the last five years, the number of borrowers who rehabilitate their loans within the first 60 days following:

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[30] 34 C.F.R. § 682.410(b)(5)(ii)(D) (emphasis added).

[31] 34 C.F.R. §§ 682.410(b)(5)(ii)(D), 682.410(b)(5)(iv)(B); see also *Educ. Credit Mgmt. Corp. v. Barnes*, 318 B.R. 482, 490-9, n. 9, App. 383-384.1 (S.D. Ind. 2004), aff'd sub nom. *Black v. Educ. Credit Mgmt. Corp.*, 459 F.3d 796 (7th Cir. 2006).

[32] *Id*.

[33] 34 C.F.R. § 682.410(b)(5)").

[34] See 34 C.F.R. § 682.405(a)(2) (a loan is "rehabilitated" after the borrower has voluntarily "made and the guaranty agency has received nine of the ten payments required under a monthly repayment agreement") (emphasis added); see also 20 U.S.C. § 1078-6(a)(4) (provision authorizing loan rehabilitation refers to borrower making "scheduled repayments").

    a. A loan transferred from the servicer to the DMCS, or
    b. A claim paid by a GA to the lender.
5) For the last five years, the number of borrowers who consolidated their loans within the first 60 days following:
    a. A loan transferred from the servicer to the DMCS, or
    b. A claim paid by a GA to the lender.
6) For the last five years, the number of borrowers who entered into some other "satisfactory repayment arrangement" on their loans within the first 60 days following
    a. A loan transferred from the servicer to the DMCS, or
    b. A claim paid by a GA to the lender.
7) A copy of the audit for USA Funds (the entity that has sued the Department about these collection fees) and all other GAs for the past five years indicating whether they were charging collection fees during this time period.

We ask that the Department retain its regulations that prohibit assessing collection fees on borrowers who enter repayment agreements within 60 days following default. We also ask that it consider replacing its "cost-averaging" collection fee system so that it is more fair and equitable to borrowers.

Conclusion

The gainful employment and borrower defense rules protect federal student loan borrowers—including a disproportionate share of low-income students, women, and people of color—from predatory schools and abrupt school closures. Tens of thousands of students have applied for borrower defense discharges, but most are still waiting for the Department of Education to review their claims or grant promised relief. Delaying the rules is causing significant harm to student loan borrowers and taxpayers. We therefore urge the Department to implement, as written, the existing regulations. The Department should also retain its prohibition of collection fees for borrowers who rehabilitate within 60 days after defaulting, and should take other steps to make its collection fee system more equitable.

Thank you for your attention to these comments. Please feel free to contact Joanna Darcus or Persis Yu if you have any questions or comments. (Ph: 617-542-8010; E-mail: jdarcus@nclc.org, pyu@nclc.org).

Appendix A

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National Consumer Law Center
Comments on
Program Integrity: Gainful Employment
Proposed Regulations
Docket ID ED-2014-OPE-0039

Submitted: May 27, 2014

I. Introduction

On behalf of our low-income clients, the National Consumer Law Center (NCLC) is responding to the Department of Education's proposed gainful employment regulations, published on March 25, 2014 (79 Fed. Reg. 16426).

NCLC is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys and their clients, as well as community groups and organizations that represent low-income and older individuals on consumer issues. Our Student Loan Borrower Assistance Project focuses on providing information about rights and responsibilities for student borrowers and advocates. We also provide direct legal services to low-income student borrowers. We seek to increase public understanding of student lending issues and to identify policy solutions to promote access to education, lessen student debt burdens and make loan repayment more manageable.[1]

At NCLC, we see first-hand the harm caused by abusive proprietary school practices. A large percentage of the many clients we have represented attended for-profit schools. Most of these clients defaulted on federal and private student loans. Only a handful reported finding a job in the field related to their program of instruction. We also consult with legal services and other attorneys across the country who represent borrowers and report that many of their clients have been similarly harmed by for-profit schools. In addition, a large percentage of the complaints we receive through our Student Loan Borrower Assistance web site involve for-profit schools.

A large part of the blame clearly lies with schools that aggressively recruit students with false promises of job placement and employment and then fail to deliver. We therefore strongly support the Department's efforts to curb abuses in the for-profit school sector and believe that

[1] See the Project's web site at www.studentloanborrowerassistance.org. NCLC also publishes and annually supplements practice treatises which describe the law currently applicable to all types of consumer transactions, including *Student Loan Law* (4^{th} ed. 2010 and Supp.). These comments were written by Robyn Smith, Of Counsel with NCLC.

strong gainful employment standards are a critical part of these efforts. Borrowers who take on student debt to enroll in career education programs in all higher education sectors should have a reasonable expectation that they are in fact attending a program that is likely to lead to gainful employment.

The proposed gainful employment rule, particularly if it is strengthened as recommended below, can go a long way toward eliminating the worst programs and giving students a real chance to succeed. While we recommend a few key ways the proposed gainful employment standards should be strengthened, we primarily focus on the critical issue of borrower relief. First, we urge the Department to provide full loan discharges for borrowers who enroll in a program which a school falsely certifies will prepare graduates for employment in an occupation requiring licensure or certification. Second, we recommend that the Department provide borrowers who enroll in zone or failing programs with full loan discharges if those programs lose Title IV eligibility.

These regulations will be most effective if they are part of a comprehensive strategy to challenge fraud and abuse. We therefore urge the Department of Education to work cooperatively with other federal agencies, including the Federal Trade Commission and the Consumer Financial Protection Bureau, to challenge persistent problems and legal violations in this sector. Comprehensive and aggressive enforcement is essential at all times, but we urge particular vigilance during the implementation period for this new gainful employment system. Enforcement is necessary to reduce the rampant fraud and abuse in the proprietary school sector and ensure that federal dollars are spent productively and efficiently.

Our comments on the proposed regulations are not based on a belief that there should be just one particular model of education. As lawyers for low-income clients, we agree that there is a need to offer educational programs that meet the needs of many low-income and "non-traditional" students. The majority of current college students are "non-traditional." Most of our clients are older than "traditional" students, often with their own children. They are looking for flexible schedules and in some cases on-line courses. These regulations are essential to help ensure that these individuals will be given a real opportunity to succeed if they choose to pursue career training.

II. The Proposed Standards and Consequences for Programs That Fail the Standards Must be Stronger

The proposed rule is long overdue in setting a definition of gainful employment. We generally support the framework in the proposed rule, which requires each of a school's career education programs to meet debt-to-earnings and cohort default rate standards to remain eligible for federal aid. However, as described in greater detail below, we believe that the Department has gone too far in allowing schools to continue to offer programs that are failing the gainful employment standards and harming students. It is shocking that the proposed regulations would allow programs to continue to profit from federal student aid when a third of their students are in default or a majority of their students do not earn enough money to repay their student loans.

It is not only possible, but essential to set a high bar. Otherwise, the regulations will allow the current race to the bottom to continue. Thus, although we generally support the gainful employment framework that the Department proposes, we recommend that the regulations should be strengthened in a number of ways. Although our comments focus on the need for borrower relief provisions, we also recommend (1) lowering the debt-to-earnings thresholds, (2) shortening the amount of time before a program becomes ineligible for Title IV funds, (3) capping the number of students a school may enroll in a zone or failing program; and (4) revising the certification requirement to cover all states where gainful employment programs are offered, including through distance education. Rather than providing detailed comments about each of these areas, we support the comments of The Institute for College Access and Success (TICAS) which address most of these recommendations.

A. The Debt-to-Earnings Thresholds are Too High (34 C.F.R. § 668.403(c)(1)(i)-(iii))

The Department has defined a "passing" annual debt-to-earnings rate (D/E rate) as 8% or less, while it has defined a "failing" annual D/E rate as higher than 12%.[2] Annual D/E rates that are greater than 8% but less than or equal to 12% are in "the zone."[3] The Department justifies the 8% annual D/E passing standard by pointing to its use by mortgage lenders and other creditors.[4] However, this standard is usually intended to cover all non-mortgage debt, including car payments, credit cards and other debts. The threshold for passing annual D/E rates should be lower since most borrowers with student loans are also struggling to pay other essential debts and expenses. This is certainly true of most of our clients. Furthermore, based on this reasoning, the 12% rate is far too high for a failing standard. We recommend that the Department eliminate the zone and adopt a single threshold -- an annual D/E rate of 5% -- as a more realistic standard.

The D/E rates based on discretionary income are also too high. The Department has defined a passing discretionary D/E rate as 20% or less, while it has defined a failing discretionary D/E rate as higher than 30%.[5] The Department has defined the discretionary D/E zone as rates between 20% and 31%.[6] The Department justifies the passing discretionary D/E rate of 20% or lower based on the research of Sandy Baum and Saul Schwartz.[7] However, it does not accurately reflect the research. Baum and Schwartz concluded that the percentage of income borrowers can reasonably be expected to devote to student loan repayment increases with earnings. They noted that borrowers with earnings near the median should not devote more than about 10% to education debt repayment and that the payment-to-earnings ratio should *never* exceed 18 to 20%. Thus, once again, the Department has far exceeded these rates with its proposed passing discretionary D/E rate of 20% and its failing D/E rate of 30%. We therefore propose that the Department eliminate the zone and adopt only a single threshold -- a discretionary D/E rate over 18% -- as the standard defining a failing program.

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[2] Proposed 34 C.F.R. § 668.403(c).
[3] Id.
[4] 79 Fed. Reg. 16425, 16443 (citing Sandy Baum and Saul Schwartz, "How Much Debt is Too Much? Defining Benchmarks for Manageable Student Debt" (2006)).
[5] Proposed 34 C.F.R. § 668.403(c).
[6] Id.
[7] 79 Fed. Reg. 16425, 16443 (citing Sandy Baum and Saul Schwartz, "How Much Debt is Too Much? Defining Benchmarks for Manageable Student Debt" (2006).).

We are not submitting further detailed comments regarding the thresholds or calculations of the D/E rates or other proposed gainful employment measures, but instead support the detailed comments on these issues submitted by TICAS.

B. Schools Are Allowed Too Much Time to Improve Zone and Failing Programs Before They Lose Title IV Eligibility (34 C.F.R. § 668.403(c)(1)(iv))

Under the proposed regulations, career education programs can continue to receive federal aid for many years after the Department knows that the program is not succeeding, *i.e*. is not achieving a passing D/E rate or program cohort default rate (pCDR). A program will lose eligibility only if it fails both D/E rate measures for two out of three consecutive years[8] or fails the pCDR measure for three consecutive years.[9] A school could therefore enroll up to three years of students, without any enrollment cap, after the Department knows the program is failing. A program will also lose eligibility if its D/E rate measures are failing or in the zone for four consecutive years, thus enrolling four years of students without any cap after the Department knows that the program is in the zone or failing.[10] It is also possible under the Department's proposal for a school to remain eligible indefinitely by passing a D/E measure one out of every four years, even if outcomes for three out of four cohorts of completing students fall into the zone or fail. These examples do not even include the four-year period after the regulations first go into effect during which schools with zone or failing D/E rate measures could use an alternative D/E rate calculation based on the median loan debt of more recent graduates.[11]

The proposed rule would thus allow schools to continue to profit from federal student aid when over 30% of its students are in default or when its graduates' D/E rates are too high. Allowing schools so much time to continue to offer zone or failing programs is a recipe for disaster and could impact a large number of borrowers. These borrowers are already being harmed by a school that has failed a gainful employment measure. Most of these borrowers will end up with enormous debt and little likelihood of ever being able to pay it off. The Department's proposal goes too far and allows the schools too much time to improve. It should be first and foremost concerned about the needs of borrowers and taxpayers and the regulations should reflect these priorities.

Our clients' experiences illustrate the harm done by prolonging an unproductive, debt-ridden school experience. We have countless stories of clients staying in a program, despite very early warnings that the program would not prepare them for employment. Often these clients complained to the school while they are enrolled. Among other things, they have complained about unqualified instructors, a school's failure to provide books or other materials, the lack of up-to-date, operational or sufficient instructional equipment, and internships that do not involve any of the skills the students have learned. When they raise concerns, school staff tell many of our clients that they might as well try to finish because they have to pay back their loans anyway. Although they might in fact qualify for partial refunds, our clients often believe these

[8] Proposed 34 C.F.R. 668.403(c)(1)(iv).
[9] Proposed 34 C.F.R. 668.403(c)(2).
[10] Proposed 34 C.F.R. 668.403(c)(1)(iv).
[11] Proposed 34 C.F.R. 668.404(g).

misrepresentations and stay in school. When they try to find work after completing, they cannot find or keep jobs because they lack the necessary skills to do so. Many of our clients are told by employers that they never hire graduates from the for-profit schools they attend.

These clients are devastated by the time and resources they waste at these schools. Even worse, they are saddled with student loan debts they cannot repay. We strongly recommend that the Department stop these programs as soon as possible. To they extent the Department allows borrowers to enroll after a program is in the zone or failing, the Department should provide full loan discharges for all such borrowers if that program loses Title IV eligibility. We discuss this recommendation in more detail in Section III(B) below.

C. Schools Are Allowed to Enroll Increasing Numbers of Students in Poorly Performing Programs

The proposed gainful employment regulations afford few protections to students. The regulations will allow programs which the Department has determined will *not* lead to gainful employment to enroll unlimited numbers of students for up to four years (and possibly longer) before they finally lose Title IV eligibility. The regulations should be amended to require that when a program is either in the zone or failing any gainful employment measure, the school's future enrollment numbers be capped, at a minimum, at the number of enrollees the prior year.

The Department decided not to cap enrollments because it believes that the proposed mandatory warnings provide "meaningful" student protection.[12] The proposed regulations require schools to provide a written warning to enrollees and prospective students when programs are in danger of losing eligibility for the following award year.[13] The Department believes that this warning "will sufficiently enable students and their families to make informed decisions about their education investment."[14]

Although we do not object to the provision of warnings, we believe that they are unlikely to have much impact for a number of reasons. First, disclosures and warnings are generally ineffective. As we have stated repeatedly in the context of consumer credit products and other contexts, no amount of disclosure can adequately protect the public from the failure to underwrite for the basic affordability of loans and in this case for the failure to properly educate students.

The fiction that disclosures are sufficient to regulate markets and impact consumer decision making is especially apparent for less sophisticated consumers. For example, we assisted a client who was pressured into signing up for a proprietary school medical assistant program even though she dropped out of school in ninth grade and had only a sixth grade reading level. She did not complete the course, has never found work in the medical assistant field, has been in and out of homelessness and went into default on the student loans. Individuals with limited English skills are often exploited as well, including one of our clients who signed up for a

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[12] 79 Fed. Reg. 16426, 16470.
[13] Proposed 34 C.F.R. § 668.410(a).
[14] 79 Fed. Reg. 16426, 16470.

cosmetology course after the Spanish-speaking school representative misrepresented that the instructors were bilingual.

Second, many consumer behavior researchers find that there is an optimism bias that affects most decision making. Consumers may hear the warnings, but assume that they do not apply to them. This is especially true when consumers are also facing hard sell tactics that contradict the message in the disclosures. The Department itself has cited its concern about aggressive, high-pressure sales techniques used by for-profit recruiters based on an investigation by the Government Accountability Office, the 2012 Senate Health, Education, Labor and Pensions Committee report regarding an investigation of 30 for-profit education companies, and numerous state attorneys general actions.[15] Many of our clients tell us that although they have been provided with disclosures, they believed the school employees' assurances that they should disregard those warnings for any number of reasons. There is no assurance that the same will not happen with the proposed warnings for failing programs

Warnings will not provide sufficient protection for students from poorly performing programs. The regulations should be amended to require that when a program is either in the zone or failing any gainful employment measure, the school's future enrollment numbers be capped, at a minimum, at the number of enrollees the prior year. In addition, as described in Section III(B) below, both the warnings and the caps must be supplemented with complete loan discharges for all borrowers who enroll in zone or failing programs that eventually lose Title IV eligibility.

D. Clarify That Schools Must Certify that Gainful Employment Programs Meet Licensure and Certification Requirements in Each State Where They Are Offered (34 C.F.R. § 668.414)

We support the Department's proposal to require schools to certify, in their program participation agreements, that each of their gainful employment programs meets state accreditation, certification and licensure requirements necessary for a student to obtain employment in the occupation for which the program provides training.[16] This is an outcome-oriented requirement that directly connects to gainful employment. The proposed regulation does not in any way dictate the content or curriculum of a program, but appropriately requires that graduates meet the legal requirements necessary to be gainfully employed in the occupations for which they train.

We recommend, however, that this regulation be strengthened by requiring schools to make this certification for: (1) all states and metropolitan statistical regions (MSRs) in which campuses under an Office of Postsecondary Education Identification code (OPEID) are located; and (2) distance education programs in all states and MSRs where a minimum number of distance education students enroll. The Department should also require schools to certify that their gainful employment programs prepare graduates for the certifications required by a majority of employers in the applicable state and MSR. For further details, we support the comments submitted by TICAS.

[15] 79 Fed. Reg. 16426, 16435.
[16] Proposed 34 C.F.R. § 668.414.

III. The Regulations Must Provide for Borrower Relief

Regulations aimed at shutting off the federal financial aid stream to career education programs that do not adequately prepare graduates for gainful employment will prevent future students from obtaining insurmountable debt to attend those programs. The gainful employment regulations, however, should also provide relief for borrowers who enroll at or near the time such programs lose their eligibility to receive Title IV funds. We appreciate the Department's request for comment on borrower relief issues and hope that it will incorporate the following recommendations into the final regulations.

A. Supplement Program Certification Requirements with a False Certification Loan Discharge Provision (34 C.F.R. § 668.414)

As discussed in Section II(D) above, we support the proposed regulation requiring schools to certify that each gainful employment program meets all accreditation, certification and licensure requirements necessary for a graduate to obtain employment, especially if it is clarified as we recommend.[17] It is critical, however, that the Department also supplement this regulation with a loan discharge regulation. Borrowers who enroll in falsely certified programs should be eligible for the cancellation of their student loans.

The Department has the authority to grant false certification discharges in these circumstances. The Higher Education Act (HEA) requires the Secretary to discharge a borrower's liability on a loan "if such student's eligibility to borrow…was falsely certified by the eligible institution."[18] When a school falsely certifies a program's eligibility, it also falsely certifies a borrower's eligibility. The Department has defined an eligible student as "a regular student enrolled or accepted for enrollment in an eligible institution . . . ."[19] The HEA therefore authorizes the Department to add this type of false certification discharge regulation.[20]

The Department's compromise authority also provides it with authority to discharge these borrowers' loans. The HEA grants the Secretary broad authority to "compromise, waive or release any right, title, claim, lien, or demand, however acquired . . . ."[21] This broad authority is reflected in the regulations, which state that "the Secretary may compromise a debt, or suspend or terminate collection of a debt, in any amount if the debt arises under the Guaranteed Student Loan Program authorized under Title IV, Part B of the Higher Education Act of 1965, as amended . . . ."[22]

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[17] Proposed 34 C.F.R. § 668.414.
[18] 20 U.S.C. § 1087(c)(1).
[19] 34 C.F.R. § 668.32(a)(1)(i).
[20] 20 U.S.C. § 1087(c)(1).
[21] 20 U.S.C. § 1082(a)(6).
[22] 34 C.F.R. § 30.70(h).

B. Provide Full Loan Discharges and Restore Pell Grant Eligibility to All Borrowers Who Enroll in Zone or Failing Programs that Lose Title IV Eligibility

During negotiated rulemaking, the Department proposed providing partial relief to borrowers who are unable to complete their programs before they lose Title IV eligibility. It proposed paying down the loans of each eligible student by an amount that would reduce his/her individual D/E rate to a passing gainful employment D/E rate.[23] Because it felt that the borrower relief issues are complex, the Department dropped this provision from the proposed regulations. The Department instead decided that these issues warranted "further exploration" and invited comment.[24]

1. The Regulations Should Provide for Full, Rather than Partial, Student Loan Discharges and Reinstatement of Pell Grant Eligibility

The Department's partial discharge proposal would not adequately compensate students who enroll in a program that is failing or in the zone and loses Title IV eligibility. The harm that for-profit school borrowers will experience is *not* the difference between a passing and a failing D/E rate, which is likely to be a tiny fraction of the debts they incur. The harm goes far beyond that. Borrowers who complete their credential while the program is failing or in the zone will most likely have earned a worthless degree that will not lead to employment. Borrowers who are unable to complete because a program loses eligibility will not even earn a credential. In both cases, it is likely that the credits earned will also be worthless and non-transferable. This means that borrowers who want to continue their education will have to start over as freshmen.

Many borrowers will not re-enroll in better programs because they are reluctant to take on more debt or because they have defaulted and are ineligible for financial aid. Moreover, as the Department itself points out, federal law sets lifetime limits on the amount of grant and loan assistance students may receive. For low-income students who cannot afford to attend college without this aid, the grants and loans that were used to pay for their worthless education will constrain their options to move to higher-quality education programs. These limitations make it even more critical that students who are not able to transfer their credits obtain a full discharge of all student loans and have their Pell grant eligibility reinstated.

These borrowers will also be stuck with debts they cannot afford to repay. If they default, they will be subject to a lifetime of the government's harsh debt collection methods. In addition, as the Department notes, student loan defaults damage credit ratings and therefore affect borrowers' ability to rent or buy homes, purchase cars, and obtain credit.[25] To the extent defaulted borrowers qualify for credit, they will be required to pay higher interest rates. In addition, because employers are increasingly considering credit records in making hiring decisions, they will face an additional barrier to finding employment.

Borrowers who enroll in a poorly performing programs that loses Title IV eligibility need a fresh start. They should have the opportunity to follow their dreams and go back to school on a

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[24] 79 Fed. Reg. 16426, 16471.

clean slate. Otherwise, their decision to enroll in a low-quality career education program, often based on a lack of information or on school misrepresentations, will haunt them for the rest of their lives and make it almost impossible to improve the economic circumstances of their families.

We therefore strongly recommend that, in the event the Department decides to maintain the zone/failing D/E rate program measures, the Department provide full loan discharges to all borrowers:

(1) whose programs lose eligibility; and
(2) who are enrolled at any time after a school receives a notice from the Department that the applicable programs are passing or in the zone, pursuant to 34 C.F.R. § 668.409.

If the Department changes the measures and stops funding programs as soon as they fail a strict gainful employment standard, the Department should provide full loan discharges to all borrowers unable to complete their programs due to loss of eligibility. Under either scenario, the Department should also reinstate the borrowers' Pell grant eligibility.

Moreover, schools should be required to refund to the Department all Title IV funds paid on behalf of all borrowers who are eligible for loan discharges and grant reinstatement. It is important, however, that borrower relief be independent of any such refund provision. The Department should grant loan discharges and restore Pell grant eligibility regardless of whether a school is able to pay the required refunds. In addition, if a school fails to compensate the Department for its losses, the Department should ensure there are consequences to a school's continued Title IV eligibility.

Even full federal loan cancellations will not be enough to fully compensate many borrowers. The recommendations above are critical, but in our experience, such relief will be far from complete because so many borrowers also have private loans and institutional debts. We urge the Department to work with other federal agencies to seek solutions for these debt burdens as well, including by supporting full bankruptcy relief for private student loan borrowers.

2. Full Loan Discharges Funded by Schools will More Equitably Allocate the Financial Risk of Failing Programs to Schools

Our loan discharge proposal has the advantage of reallocating the risks of failing career education programs in a more equitable manner that aligns school incentives with the proposed regulation's goals. The Department's stated policy objectives are to (1) increase the likelihood that career education programs funded by the federal government will lead to gainful employment;[26] (2) reduce the likelihood that career education program borrowers will take on unsustainable student loan debt and end up in default;[27] and (3) prevent the use of misleading

[26] 79 Fed. Reg. 16426.
[27] Id. (Dep't is concerned that low-quality career education programs are "leaving students with unaffordable levels of loan debt in relation to their earnings or leading to default.").

recruitment tactics.[28] Without a complete loan discharge provision and school liability for all Title IV funds paid on behalf of borrowers who are enrolled after a program is in the zone or failing, the proposed regulations will not achieve these goals with respect to these borrowers.

As drafted, the regulations essentially place the entire burden of understanding and avoiding the risk of failing programs on borrowers. The Department proposes to allow schools to continue to enroll students in failing or zone programs for up to four years.[29] Yet, as detailed in Section II(C) above, the only "protections" the Department has proposed for these borrowers are written warnings which it unrealistically expects students to heed by withdrawing or refraining from enrolling.[30] Otherwise, the student must face the harsh consequences. Because the debt obligations will constitute a far greater share of a low-earning or unemployed borrower's income than it will of the government's or school's incomes, borrowers are least able to afford the financial risk for failing programs.

Schools, on the other hand, are in the best position to assess and avoid the risk of failing programs. They are also in a better position than individual students to absorb the financial risk. Yet, under the Department's proposal they will not incur any risk for borrowers who enroll before a program loses Title IV eligibility. While the risk of losing Title IV eligibility provides some incentive to improve a program, there is little incentive for a school to voluntarily cease operating a program even when it knows it will not be able to meet the standards. The regulations may actually encourage for-profit schools to bring in as much federal financial aid as possible by increasing enrollments (and possibly using misleading high pressure sales techniques to do so) just before the program loses eligibility.

While the government is also in a better position to absorb the financial risk, a regulation providing for full loan discharges and school liability for Title IV funds is also more equitable to taxpayers. Ultimately, taxpayers are on the hook for defaulted loans of borrowers who enroll in poorly performing programs. They benefit when those programs are shut down quickly and borrowers are provided full loan discharges which enable them to complete legitimate programs, obtain employment, repay their student loans and contribute to the economy.

3. The Department Has the Authority to Provide for Loan Discharges

The Department has the authority to provide for loan discharges through two alternative processes. First, the Department could move zone or failing programs into provisional eligibility status while those programs continue to receive Title IV funds. Provisional eligibility is not a new concept; the regulations provide for provisional eligibility in other circumstances. The Department, for example, may provisionally certify and later revoke institutional eligibility.[31]

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[28] Id. (Dep't is concerned that "many gainful employment programs are engaging in aggressive and deceptive marketing and recruiting practices. As a result of these practices, prospective students and their families are potentially being pressured and misled into critical decisions regarding their educational investments that are against their interests.").

[29] See Section III(B), supra.

[30] Proposed 34 C.F.R. § 668.410(a).

[31] See 34 C.F.R. § 668.13(c) and (d).

If a program eventually loses eligibility under the gainful employment regulations, the Department could then revoke the program's provisional eligibility and provide false certification loan discharges to all borrowers who enrolled during the provisional eligibility period. The Department has the authority necessary to provide for such false certification discharges. As described in Section III(A) above, the HEA requires the Secretary to discharge a borrower's liability on a loan if his/her eligibility was falsely certified.[32] If the provisional eligibility of a program is revoked, then all borrowers who enrolled during the provisional eligibility period would have enrolled in an ineligible program and been falsely certified. The Department's compromise authority also provides it with authority to discharge these borrowers' loans, as described in Section III(A) above.

As a second proposal, the Department has discretion to decide which school acts or omissions constitute a defense to loan repayment and how borrowers may assert that defense.[33] The Department could define such acts or omissions to include (1) enrolling students after a school has received notification, pursuant to 34 C.F.R. § 668.409, that a program is either failing a gainful employment measure or in the zone and (2) failing to bring the program into compliance with the gainful employment measures causing it to lose Title IV eligibility.

The Department could allow borrowers to affirmatively raise this defense through an expanded discharge process. For this process, it could send simple applications to all potentially eligible borrowers. The Department should not impose high evidentiary burdens on borrowers, but instead should recognize a borrower's defense unless it has credible evidence to contradict his or her application. If the borrower meets the loan discharge eligibility requirements, the Department should fully discharge the borrower's loans.

Whatever method is used to provide borrower relief, the school should be required to fully refund to the federal government all Title IV funds for all borrowers who successfully seek discharges of their student loans. It is the school that has failed both the students and the taxpayers. It is the school that decided to continue offering a poorly performing program to students, knowing the risks of doing so. And it is the school that is in the best position to predict whether its program will become ineligible. But borrower relief must not depend in any way upon a school's refund of Title IV funds to the Department.

In other areas, the Department requires a school to assume the financial risk that a future event will retroactively affect its Title IV eligibility. For example, schools are required to repay all Title IV funds received by or on behalf of borrowers enrolled in a gainful employment program that the school incorrectly concluded did not need to be approved by the Department as a "new program."[34] In order to ensure these schools have sufficient funds to pay the required refunds, the Department could impose financial guarantees. The HEA provides that "to the extent necessary to protect the financial interests of the United States," the Secretary may require financial guarantees in an amount "sufficient to satisfy the institution's potential liability to the

[32] 20 U.S.C. § 1087(c)(1).
[33] 20 U.S.C. § 1087e(h).
[34] 34 C.F.R. § 600.10(c)(3).

Federal Government [and] student assistance recipients."[35]

To mire borrowers in insurmountable debt for programs that the Department knows are poorly performing is the exact opposite of the primary purpose of the proposed regulations. Borrower relief is therefore critical to the proposed gainful employment system. We urge the Department to establish some method for providing full relief to borrowers who end up in programs that do not meet the Department's gainful employment standards.

We thank the Department for its courage and persistence on the gainful employment issues and for its consideration of our comments. Please feel free to contact Robyn Smith with any questions or comments. (Phone: 617-542-8010; E-mail: rsmith@nclc.org).

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[35] 20 U.S.C. § 1099c(e).

Appendix B

Comments from the Legal Aid Community to the Department of Education re:

Proposed Regulations on Borrower Defenses and Use of Forced Arbitration by Schools in the Direct Loan Program, and Proposed Amendments to Closed School and False Certification Discharge Regulations

Docket ID ED-2015- OPE-0103

August 1, 2016

Comments submitted on behalf of:

National Consumer Law Center (on behalf of its low-income clients)

Project on Predatory Student Lending of the Legal Services Center of Harvard Law School

Legal Aid Foundation of Los Angeles

Housing and Economic Rights Advocates

New York Legal Assistance Group

Legal Services NYC

Empire Justice Center

National Center For Law and Economic Justice, Inc.

Legal Aid Society of San Diego, Inc.

East Bay Community Law Center

Health, Education, and Legal Assistance Project: A Medical-Legal Partnership

Community Legal Services, Inc. of Philadelphia

Western New York Law Center

Civil Justice, Inc.

Bay Area Legal Aid

LAF (formerly known as Legal Assistance Foundation of Metropolitan Chicago)

Public Counsel

Introduction

These comments, submitted on behalf of organizations across the country that provide free legal assistance to low-income student loan borrowers, address the Department's proposed regulations to protect federal student loan borrowers and taxpayers from misconduct by schools, including through provision of a new process and standards to adjudicate borrower defenses to repayment.[1] Our comments are informed by our work as legal aid practitioners. We strive to meet the legal needs of individuals and families with limited economic means, who otherwise would be without professional legal assistance.

The proposed rule is of critical importance to the individuals we serve, as well as to the hundreds of thousands of other borrowers in identical circumstances. In addition to being of limited economic means, our clients overlap with the populations most often targeted by unscrupulous and predatory schools. They are often the first in their family to pursue higher education. They include people of color, immigrants, non-native English speakers, single mothers, and the formerly incarcerated.

Below, we share the experiences of our clients who have unmanageable debt after having been subjected to unfair, deceptive, and predatory practices of for-profit schools. We wholeheartedly agree with the stated purpose of the rule: "to protect student loan borrowers from misleading, deceitful, and predatory practices of, and failures…of institutions participating in the Department's student aid programs."[2] For every client we see, there are dozens more who remain unaware of their legal rights. It is therefore critical that a borrower defense rule be strong, transparent, and accessible to those who need it most. We also share the legal expertise that we have developed as legal aid practitioners in the laws that affect our clients and that have bearing on these regulations—including the common law of tort and contract, statutory consumer protections, and existing student loan regulations.

Additionally, it is critical that the closed school and false certification discharge regulations be broadened to provide relief to as many borrowers harmed by school conduct as possible, especially to the extent these loan discharge processes may continue to be more accessible to most borrowers.

Our comments make several points concerning the proposed standards and procedures for borrower defense:

- **<u>First, the borrower defense standard should encompass the most robust consumer protections available under state law</u>**, including by making the federal standards for relief a

[1] Student Assistance General Provisions, Federal Perkins Loan Program, Federal Family Education Loan Program, William D. Ford Federal Direct Loan Program, and Teacher Education Assistance for College and Higher Education Grant Program, 81 Fed. Reg. 39330 (proposed June 16, 2016).

[2] 81 Fed. Reg. at 39330.

floor and not a ceiling that eliminates state bases for relief. This also includes reading an implied contractual covenant of good faith and fair dealing into the relationship between students and Title IV institutions. With respect to misrepresentations, such standard must take into account the circumstances of the individual borrower in assessing whether conduct was likely to mislead, and should not complicate relief for defrauded borrowers who relied on statements likely to mislead. Additionally, we urge that the Department align the borrower defense standard with the consumer protections available under state and federal law by designating unfair and abusive practices, and not just deceptive ones, as an independent basis for borrower defense.

- **Second, the Department should ensure that the process is accessible and fair to unrepresented borrowers.** To this end, we emphasize both that unrepresented borrowers will need guidance as to what information to include in their applications and that applications submitted pro se should be liberally construed. We also stress that any evidentiary requirements that would make relief contingent on production of evidence beyond the borrower's testimony would pose insurmountable barriers for many borrowers with meritorious claims. As many applicants will not have access to documentary evidence to support their claims, or will present claims based on oral rather than written representations or misconduct, the Department should not require that borrowers submit documents along with an application. The Department should also consider applications for borrower defense in light of documents and evidence already in its possession.

- **Third, the Department should not impose time limits on a borrower's right to be returned money already paid toward a loan.** The Department is correct to allow borrowers to apply for a defense at any point in time to be relieved of outstanding student loan debt. But imposing a limitation on amounts already paid is unfair and inconsistent with the Department's practice with respect to other discharge programs. Further, the policy justifications underpinning limitations periods are inapplicable here. Borrowers have no incentive to delay pursuing claims; they are simply unaware of their rights. Moreover, for current borrowers, there has been no borrower defense process to avail themselves of until now, and it is unfair to penalize them for the Department's delay in creating a process. And as the overseer of the federal student loan program, the Department cannot justly claim a right to "repose" from borrower defense claims in the same way as could a private litigant.

- **Fourth, the Department should abandon its attempt to limit the relief available to borrowers through "partial relief" calculation methodologies.** The methods of calculating a borrower's right to relief, found in Appendix A to § 685.222, simply do not make sense in relation to the harms experienced by our clients, and would create unnecessary burden, complexity, and inconsistency of outcomes. The Department should instead adopt the approach used in the false certification and closed school discharge programs of providing full discharges for all meritorious claims.

- **<u>Fifth, we strongly support the Department's proposal to offer group-based relief to borrowers, and to allow for automatic, opt-out relief without the need for individual applications or attestations.</u>** The Department should make clear that this is how it will operate in all group discharge proceedings. Additionally, the process should be made more efficient, transparent, and accountable by providing a process through which attorneys general, law enforcement authorities, and non-profit legal assistance organizations may petition the Department to initiate a group-relief process.

- **<u>Sixth, we urge the Department to open individual and group borrower defense relief processes to FFEL borrowers without requiring consolidation or proof of any special relationships between their schools and FFEL lenders.</u>** The Department's proposed regulation is insufficient to address the needs of borrowers under the FFEL program for a number of reasons, including that not every borrower is eligible to consolidate into a Direct Loan in order to take advantage of the procedures outlined in this regulation.

- **<u>Seventh, we strongly support the Department's proposal to prevent Title IV schools from forcing students to adjudicate grievances against schools in arbitration.</u>** Unscrupulous schools have used these agreements to discourage students from raising their claims, and prevent them from doing so on a class-wide basis. The result has been an unfair shifting of the burden of illegal conduct from schools to the taxpayers. The Department should ensure that the proposed ban on arbitration is as effective as possible by eliminating loopholes such as so-called "opt out" provisions and by banning use of any binding pre-dispute arbitration agreements, not just those required as a condition of enrollment.

- **<u>Eighth, we support the Department's proposal with respect to closed school discharges.</u>** Too few borrowers who are eligible for closed school discharges apply, primarily because they are unaware of their rights. Amending the regulations to provide additional closed school discharge information to borrowers, make relief automatic and mandatory for borrowers who do not reenroll within one year, and provide for review of guaranty agency denials, will ensure that eligible students get relief.

- **<u>Ninth, we support the Department's proposal to clarify the availability of false certification discharges for borrowers who enroll after July 1, 2012 and who lack a high school diploma,</u>** and recommend revisions regarding unfair evidentiary burdens to ensure that individuals whose eligibility has been falsely certified by schools are able to obtain relief.

I. The Standard for Borrower Defenses

The Department has proposed eliminating existing state law bases for borrower defenses and allowing defenses based only on new federal standards for loans made after July 1, 2017 as well as for existing loans that are consolidated after that date. While we support addition of federal standards as a floor for borrower relief, we strongly urge the Department to reconsider incorporating other state law bases for defenses to repayment into the borrower defense standard to ensure that these regulations do not eliminate important existing bases for borrower defenses. We therefore recommend that the Department both explicitly allow defenses based on state law violations and consider state and federal consumer protection law when refining and interpreting the proposed new federal standards.

Prior to and during the negotiated rulemaking process, representatives of legal aid organizations recommended that the Department create a federal standard as a floor, above which state consumer protection law is recognized, rather than a ceiling that eliminates important bases for borrower defense relief under current law.[3] We are disappointed that the proposed rule does not reflect this recommendation, and believe that this is a mistake. State law traditionally provides the most comprehensive consumer protections to students. When we see clients who have been wronged, it is to state law that we turn as a matter of course. We work in collaboration with the state agencies that have been charged with enforcing state consumer protection laws. And every institution accepting Title IV funds, now and in the future, must already conform its practices to the requirements of state law, wherever it operates. To the extent that the Department's borrower defense regulation is disconnected from state law, it will ignore this legal landscape and deprive borrowers of their current rights to defend against repayment based on school misconduct that violates state law.

Additionally, contrary to the suggestion that including state law standards would introduce confusion into the borrower defense determination process,[4] we submit that doing so would provide much-needed clarity. State laws are regularly interpreted and applied in the courts, and these precedents provide valuable clarity to all relevant parties—students, schools, and lenders alike—as to what these laws mean and to the rights and responsibilities of the parties. Perversely, the Department proposes to detach from state law at the very time that it

[3] *See, e.g.*, Comments on Borrower Defenses Against Loan Repayment, Docket ID No. ED-2015-ICD-0076, *available at* http://www.studentloanborrowerassistance.org/wp-content/uploads/2013/05/comments-borrower-defenses-2015.pdf.

[4] *See* 81 Fed. Reg. at 39339 (asserting that the need to interpret varying state laws presents "significant burden" to Department). The Department asserts that the growth of "distance education," *i.e.* online programs, at proprietary schools has changed the "landscape" of higher education and consequently has "had an impact on the Department's ability to apply its borrower defense regulations." *Id.* at 39336. At the same time, the Department acknowledges that, to date, the borrower defense regulation has "rarely been used." *Id.* at 39335; *accord* Agency Information Collection Activities; Comment Request; Borrower Defense Against Loan Repayment, 80 Fed. Reg. 32944, 32945 (June 10, 2015) ("In the 20 years prior [to 2015], the Department received 5 claims for borrower defense."). Existing practice cannot, under these circumstances, support the change that the Department is proposing to make.

paves the way for the development of state law in this area. Under the Department's proposed ban on mandatory arbitration, a significant proportion of students at for-profit schools will now, for the first time, be able to pursue claims against their schools in state court. Further, because the Department will continue to apply state law standards in assessing borrower defenses to repayment of loans taken out prior to July 2017, the Department will necessarily need to understand and apply state law standards regardless of whether they are eliminated from the process for new loans. For all of these reasons, we urge the Department to make the new federal standards a floor above which state law protections may provide additional bases for relief.[5]

Short of that, we urge the Department to consider state consumer protection law in interpreting and applying the federal standards it has articulated. As discussed in more detail below, the Department has proposed breach of contract and substantial misrepresentation as the primary standards that will govern borrower defense claims for new loans.[6] We agree that these are two key areas of illegal conduct experienced by our clients, and urge that, in applying these standards, the Department adopt the decisional rules and interpretations that have been developed in the context of predatory schools and their impact on consumers under state law. Below we offer additional comments and recommendations on the proposed breach of contract and substantial misrepresentation standards; the importance of providing relief when students are subject to conduct that is unfair or abusive conduct even if not deceptive; and the importance of continuing to provide relief based on other violations of state law.

a. Breach of Contract: Comments on the Proposed Standard

We agree that the Department should allow a borrower to establish a defense to repayment upon a showing of a breach of contract; however, the rule must go further to ensure that borrowers are not harmed by schools that use bad faith and hidden fine print. Because contract law is generally a matter of state law, state law provides an important guide. As the Department correctly observed, states consistently consider "catalogues, bulletins, circulars, and regulations of the institution made available to the matriculant" to constitute contract terms.[7]

In developing a breach of contract standard, we urge the Department to consider two points. First, the majority of states read into contracts implied terms of good faith and fair dealing. Second, in our experience, unscrupulous schools use fine print disclaimers upon which

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[5] Adopting a federal standard as a floor, but not a ceiling, to borrower relief would address the problem, rightly identified by the Department, that existing standards could "provide uneven relief to students affected by the same bad practices but who attended schools in different States," particularly states with weak consumer protection laws. 81 Fed. Reg. at 39339.

[6] *See* Proposed 34 C.F.R. § 685.222(c)-(d). The Department also proposes that a borrower defense claim may be founded on a "nondefault, favorable contested judgment" obtained against the school. Proposed 34 C.F.R. § 668.222(b). Although such judgments should undoubtedly provide a clear basis for a borrower defense, in our experience contested nondefault judgments are exceedingly rare and so we expect that this prong will rarely be invoked unless it is expanded to encompass more dispute outcomes.

[7] 81 Fed. Reg. at 39341.

they later rely to disclaim the existence of contractually binding terms. Taken together, we urge the Department to make clear in the final rule that it will view unfair and abusive tactics as breaches of contract.

b. Good Faith and Fair Dealing

The duty of good faith and fair dealing is an especially important aspect of contract law, and we urge the Department to make clear that it will interpret the breach of contract standard to provide for borrower defenses premised on a breach of the duty of good faith and fair dealing.

The Uniform Commercial Code defines "good faith" as "honesty in fact and the observance of reasonable commercial standards of fair dealing."[8] Likewise, the Restatement of Contracts provides: "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."[9] This duty of good faith and fair dealing in performance of contractual duties precludes the use of "subterfuges and evasions" at a minimum, and indeed goes further:

> [B]ad faith may be overt or may consist of inaction, and fair dealing may require more than honesty. A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of power to specify terms, and interference with or failure to cooperate in the other party's performance.[10]

Good faith and fair dealing is generally implied into contracts in the majority of states. For example, in California, every contract contains an implied covenant of good faith and fair dealing "that neither party will do anything which will injure the right of the other to receive the benefits of the agreement,"[11] and breach of this covenant "is necessarily a breach of contract."[12] Further, the breach of the implied covenant of good faith and fair dealing may in many circumstances constitute an "unfair" act proscribed by the California Business and Professions

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[8] U.C.C. § 1-201(b)(20). The U.C.C. applies to contracts for the sale of goods. Contracts involving the sale of both goods and services are governed by the U.C.C. to the extent that the sale of goods "predominates" the transaction. Regardless of whether the U.C.C. would strictly apply to transactions between schools and students, courts have looked to the terms of the U.C.C. in addressing implied contract terms governing such transactions. *See, e.g., Ramthun v. Bryan Career College-Inc.*, 93 F.Supp.3d 1011, 1029 (W.D. Ark. 2015).

[9] Restatement (Second) of Contracts § 205. This provision is consistently cited as persuasive authority by state courts. *See, e.g., Davidson v. Gen. Motors Corp.*, 57 Mass. App.Ct. 637, 647 (2003) ("We have recently expressed our preference for the terminology of the Restatement (Second) of Contracts § 205"); *Ford Motor Co. v. Edgewood Properties, Inc.*, 2008 WL 4559770 *7-8 (D.N.J. Oct. 8, 2008) (discussing New Jersey state court adoption of § 205); *GNC Franchising, Inc. v. O'Brien*, 443 F.Supp.2d 737, 750 (W.D. Pa. 2006) (observing that Pennsylvania state courts have "repeatedly embraced this fundamental principle of the Restatement").

[10] Restatement (Second) of Contracts §205, Comment (d).

[11] *Comunale v. Traders 7 General Ins. Co.*, 5 Cal.2d 654, 658 (1958).

[12] *Digerati Holdings, LLC v. Young Money Entertainment, LLC*, 194 Cal. App. 4th 873, 885 (2011).

Code Section 17200.[13] Similarly, New Jersey recognizes an implied covenant of good faith and fair dealing in every contract.[14] As in California, this covenant bears especially on the conduct of the party to a contract who possesses a high degree of "discretionary authority."[15] There is no doubt that the discretion in performance in these contracts rests largely with the schools.

c. Fine Print Disclaimers and Fair Dealing

It is critical that contracts be read in light of the implied covenant of good faith and fair dealing in order to provide borrowers with meaningful relief. Most educational service contracts will include the same basic terms: students agree to pay money for the provision of educational services in accordance with certain specifications, usually within an agreed-upon time frame. In the case of career schools, the contractual undertakings of the school will extend not just to the provision of educational services but accompanying services in placing students in jobs in their fields of study.

Many predatory schools, however, have the power to write "contracts" in a way that is nearly impossible to breach unless a meaningful covenant of good faith and fair dealing is applied. For example, one of the most common practices that schools engage in is to induce students to enroll through promises of job placement assistance. Students often later find that the school provides entirely ineffective placement assistance, which may satisfy minimal terms, but not the spirit, of the promise. Below are just a few examples:

- "George" enrolled in ITT Tech in California based on the school's promises of job placement assistance and representations that its Animation and Game Design program had connections with employers such as Disney and Universal Studios. Upon completion of that program, and after incurring $80,000 in debt, George was not provided any leads for jobs with employers such as Disney or Universal Studios. In fact, he was provided almost no assistance aside from being directed to Craigslist postings for jobs.
- Many of the clients legal aid has worked with who attended Heald College describe their job placement assistance as consisting entirely of a "counselor" simply forwarding *all* local job listings from Craigslist and Monster.com, no matter what they pay or the student's field of study. Clients who graduated from the Medical Assisting program have

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[13] *See, e.g., Nat'l Rural Telcoms. Co-op. v. DIRECTV, Inc.*, 319 F. Supp. 2d 1059, 1074 (C.D. Cal. 2003). California's unfair competition statute prohibits practices that are either unfair, unlawful, or fraudulent. The applicability of unfair practices to the borrower defense regulation are discussed *infra* Section I(c).

[14] *See, e.g., Wilson v. Amerada Hess. Corp.*, 168 N.J. 236, 244 (2001).

[15] *Id.* at 251 ("A party exercising its right to use discretion…under a contract breaches the duty of good faith and fair dealing if that party exercises its discretionary authority arbitrarily, unreasonably, or capriciously, with the objective of preventing the other party from receiving its reasonably expected fruits under the contract."); *see also Carma Developers (Cal.) Inc. v. Marathon Development California, Inc.*, 2 Cal.4th 342, 371-72 (1992) ("The covenant of good faith finds particular application in situations where one party is invested with a discretionary power affecting the rights of another.").

presented emails from Heald representatives "assisting" them with leads from these sites for jobs including dishwasher, cashier at gas station, and security guard.

Similarly, predatory schools often seek to undermine the specific promises they make to students through fine print disclaimers. As just one of many examples, enrollment agreements used by the New England Institute of Art ("NEIA"), a branch of the Art Institute schools operated by EDMC, contain a number of fine print disclaimers that appear intended to defeat breach of contract claims. Clients tell us that NEIA enrolled them with promises of being taught in a selective environment by faculty with industry experience. Client "C.W." enrolled in a bachelor degree program in Fashion and Retail Management. Her glossy enrollment papers describe the purpose of the program and program sequence: "Courses are designed to develop a student's passion for the fashion and retail industry through in-depth training in business, sales, and marketing." The upper right hand corner of this paper contains the disclaimer, "Subject to Change."

C.W., like many other clients, had been told that credits from NEIA were transferable to other reputable programs. The enrollment agreement that she was required to sign, however, contained fine print attempting to disclaim that promise. The fine print language included: (i) "the fact that a school is licensed and accredited is not necessarily an indication that credits earned at that school will be accepted by another school;" (ii) "[t]he New England Institute of Art does not imply, promise, or guarantee transferability of its credits to any other institution;" and (iii) "it is unlikely that the academic credits that you earn at the New England Institute of Art will transfer to another school." This language from the enrollment agreement between NEIA and its students was likely included in an attempt to defeat a breach of contract or misrepresentation claim that a student might bring based on the verbal promise of a recruiter. The Department should ensure that such fine print does not have the effect of precluding relief for borrowers who were falsely promised their credits were transferrable.

The importance of transferable credits is vividly illustrated by the case of NEIA, given that in 2015 EDMC made the decision to stop enrolling students in NEIA (as well as in more than a dozen Art Institute campuses nationwide). Even though NEIA was required to submit a "teach out plan" to its accreditor, NEASC, and the state authorizing agency, the Massachusetts Board of Higher Education, the hundreds of students still at the school have the worst of both worlds. These students are not eligible for a closed school discharge[16] and are not able to transfer their credits to other area institutions. Documents submitted to the Massachusetts Board of Higher Education indicate that NEIA attempted to secure articulation agreements between itself and other area art schools, so that students could transfer and complete their degrees at other institutions. Tellingly, reputable schools such as the School of the Museum of Fine Arts would not enter into a broad articulation agreement, and other schools that did enter into an

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[16] *See* discussion *infra* Section VIII, urging for expansion of closed school discharge to cover such scenarios.

articulation agreement had an understanding that NEIA students would be given a $15,000 scholarship, presumably paid for by NEIA to account for the fact that its students would have to essentially start over again at the receiving school.[17]

Additionally, some NEIA clients understood that part of the bargained-for deal they had with the school turned on NEIA placing them in jobs within their fields of study. Here too, NEIA documents attempt to use fine print to limit any contractual obligation, noting: "The New England Institute of Art does not guarantee employment or any particular level of compensation following graduation." This fine print may be related to the fact that all but one of NEIA's programs was poised to fail the gainful employment regulations because graduates did not earn enough after completing the program to justify the massive amount of debt that they incurred. For example, graduates of the Recording Arts Technology program would have to spend **87.98%** of their discretionary income towards loan repayment.[18] And even provision of job placement assistance is framed in fine print as gratuitous, providing only that the school will "offer assistance" in job searches." When students fail to find a job, NEIA's fine-print language shifts the blame away from the school: "Graduates who confine employment considerations within the metropolitan area served by The New England Institute of Art may limit the particular employment opportunities available to them."

With respect to even the most basic elements of the provision of educational services—the schedule of classes and location of such classes—NEIA reserves to itself "the right to change a class session schedule . . . without notice."[19] Notably, this is illegal under many state statutes.[20] Finally, all enrollment agreements contain the fine print warning that "The New England Institute of Art reserves the right to add, delete, or modify its policies and procedures without notice." These types of disclaimers, designed to indemnify NEIA against legal claims for false or broken promises made to students, make contracts essentially illusory and are illegal under the laws of many states.[21]

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[17] Documents on file with the Legal Services Center.
[18] The failure of these programs does not translate into relief for students whose poor outcomes comprise the debt-to-earnings metrics. The Department considered proposals, including from the legal aid community, for student relief in relation to failing gainful employment programs, but explained in the preamble to the final rule: "We acknowledge the desire to ease the debt burden of students attending programs that become ineligible and to shift the risk to institutions that are enrolling students in these programs. [ ] The comments we received confirms that this issue requires further consideration. Accordingly, the Department is not addressing these concerns in the final regulations, and will continue to explore ways to provide debt relief to students in future regulations." Program Integrity: Gainful Employment, 79 Fed. Reg. 64890, 64971 (Oct. 31, 2014).
[19] The schedule of classes was particularly relevant to "M.N.", who signed up for a degree in Media Arts & Animation at NEIA after being told that there was "an abundance" of evening classes available to work with her schedule as a parent. After she signed up, she found that the scheduled had changed and no evening classes were offered.
[20] *See, e.g.*, Cal. Ed. Code § 94898.
[21]*See, e.g.,* Cal. Ed. Code § 94898. The inclusion of such unfair contract terms may also be a violation of state unfair and deceptive practices laws. *See infra* Section I(c)(i).

d. Substantial Misrepresentation: Comments on the Proposed Standard

Based on the experiences of so many of our clients who were induced to enroll in predatory schools based on false promises and assurances, we also believe it is essential that the borrower defense rules provide for relief based on misrepresentations. The Department's proposed rule generally provides for a borrower defense when a school makes a misrepresentation—including through an act or omission likely to mislead under the circumstances—that the borrower reasonably relied upon to her detriment in deciding to attend or continue attending the school. Below we offer comments on four details of the proposed substantial misrepresentation standard: (1) the standards by which acts and omissions should be considered misleading, (2) the standards for assessing borrowers' reliance on a misrepresentation, (3) the inclusion of omissions as predicate misconduct, and (4) the irrelevance of intent to borrower relief.

e. The Department Correctly Recognizes that Acts or Omissions that Have a Tendency to Mislead under the Circumstances are Misrepresentations

We support the Department's proposal to recognize that whether or not a statement or omission is actionably misleading should be assessed based on the circumstances, which should include the student's vulnerabilities and the context in which such statements are made.[22] As discussed below, this approach is consistent with state and federal law, and reflects the experiences of our clients.

First, we emphasize that just as the Department recognizes, in addressing the reasonableness of a student's reliance on a misrepresentation, the circumstances relevant to whether an act or omission is likely to mislead should include the circumstances of the audience or population to which that misrepresentation or omission is directed.[23] Such "circumstances" should thus correctly include a "borrower's distress or lack of knowledge or sophistication,"[24] "limited English proficiency,"[25] and other characteristics that may make a borrower more or less

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[22] *See* 81 Fed. Reg. at 39342 ("we believe it is appropriate that, in reviewing a borrower defense claim based on a substantial misrepresentation, we similarly consider the totality of circumstances in which the statement or omission occurs, including the specific group at which a statement or omission was targeted, or to determine whether the statement or omission was misleading under the circumstances. A statement made to a certain target group of students may not lead to reliance and injury; however, when the statement is made to a different target group that may not be the case.") (citing 1983 FTC Policy Statement on Deception).

[23] *Cf.* 81 Fed. Reg. at 39343.

[24] 81 Fed. Reg. at 39343; *see also id.* at n.16 (quoting Restatement (Third) of Torts: Liab. For Econ. Harm § 11 TD No 2 (2014)).

[25] *Cf. Id.* It is especially critical that limited English proficiency be taken into consideration under the substantial misrepresentation prong in light of the Department's decision against recognizing the same as a basis for false certification discharge. *See* 81 Fed. Reg. at 39378 ("Some of the non-Federal negotiators recommended including limited English proficiency (LEP) as one of the characteristics that would disqualify a borrower from working in a

susceptible to school deception. Similarly, the situation in which the statements or omissions were made can also render a statement or omission misleading, including when a school official has encouraged a prospective student to trust him, or is rushing a student through enrollment.

Second, we note that this approach is consistent with that of other federal agencies charged with ensuring protection of consumers, including the Federal Trade Commission (FTC), the Consumer Financial Protection Bureau (CFPB), and the Office of the Comptroller of the Currency ("OCC"). For example, the FTC requires that banks affirmatively "tailor[] advertisements, promotional materials, and marketing scripts to take into account the sophistication and experience of the target audience."[26] The FTC "unfairness" standard looks to, among other factors, whether a defendant "exercise[s] undue influence over highly susceptible classes of purchasers."[27] Similarly, the CFPB observes the principle that "when representations target a specific audience, such as older Americans or financially distressed consumers, the communication may be considered from the perspective of a reasonable member of the target audience."[28] Likewise, the OCC evaluates an act or practice "from the perspective of any specific audience to which it was targeted or which was reasonably foreseeable."[29]

This approach is also in accord with state law. For example, in assessing whether an act was unfair or deceptive in New York, courts focus on whether the conduct is "likely to mislead a reasonable consumer acting reasonably *under the circumstances, i.e. the plaintiff's circumstances*."[30] Similarly, in California, when trade activity is "aimed at a particularly susceptible audience," its deceptiveness or unfairness "must be measured by the impact it will likely have on members *of that group*."[31] New Jersey's consumer protection law takes special consideration of whether "a professional seller is seeking the trade of those most subject to exploitation—the uneducated, the inexperienced and people of low incomes."[32] Texas keys its consumer protection law to "specific circumstances" bearing on consumers' "vulnerability," "the most common being the buyer's lack of knowledge with regard to a specific product, service, or transaction."[33]

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particular profession and serve as the basis for a false certification loan discharge. We reviewed this proposal, but determined that it would not be practical to determine a borrower's English language proficiency at the time the borrower enrolled in the program.")

[26] Federal Reserve Board, Federal Trade Commission Act Section 5: Unfair and Deceptive Acts or Practices Manual, *available at* https://www.federalreserve.gov/boarddocs/supmanual/cch/ftca.pdf.

[27] *CFPB v. ITT Educ. Servs., Inc.*, -- F.Supp.3d --, 2015 WL 1013508, at *28 (S.D. Ind. Mar. 16, 2015).

[28] CFPB Bulletin 2013-07 (July 10, 2013), *available at* http://files.consumerfinance.gov/f/201307_cfpb_bulletin_unfair-deceptive-abusive-practices.pdf.

[29] OCC Advisory Letter AL 2002-3, *available at* http://www.occ.gov/static/news-issuances/memos-advisory-letters/2002/advisory-letter-2002-3.pdf.

[30] *Solomon v. Bell Atl. Corp.*, 777 N.Y.S.2d 50, 54 (App. Div. 2004) (emphasis added).

[31] *Lavie v. Proctor & Gamble Co.*, 105 Cal.App.4th 496, 506 (2003) (emphasis added).

[32] *Assocs. Home Equity Servs. V. Troup*, 343 N.J. Super. 254, 278 (App. Div. 2001).

[33] *Thrall v. Reno*, 695 S.W.2d 84 (Tex. App. 1985).

Finally, our experience working directly with student loan borrowers has impressed upon us the need to consider the circumstances surrounding misleading statements. Many of the clients we represent have told us they were in vulnerable situations or "low places" when they were recruited, including being homeless, and many were the first in their family to attend post-secondary schools and had little idea what to expect from higher education. We share below some of their stories, which drive home the need to recognize that people in specific circumstances are more likely to a) trust what is being said to them by those offering "education," and b) be taken in by promises tailored to speak directly to their desperate circumstances.[34]

- "Lynn" was recruited into Robert Fiance, a notorious beauty school that is now closed, by a recruiter standing outside a welfare office in New York City. The recruiter said that Lynn (like others coming out of the welfare office) was "entitled" to "financial aid" which would afford them a "free" education. Lynn was a recent immigrant from a Latin American country where higher education is in fact covered in its entirety by government subsidies. In these circumstances, Lynn reasonably believed that the "financial aid" came with no requirement that it be repaid.

- Similarly, a client who attended Salter school reported that, "After I made it clear that I did not want to pay back any student loans at all, I was told that because of my financial situation and that I was receiving public assistance, the majority of my schooling would be covered by financial aid and grants and if I was to take out a loan it would be about $300 if that." This was untrue. In fact, the financial aid was primarily student loans, and the student later found she had significant student loan debt. According to her statement, "I have not been able to find work in the field and I was not aware until recently that I had rights to get the loans cancelled or get a refund. . . . I did not try to get a refund right away from Salter because I did not know I could and because the school had told me . . . that credits could be transferred. However, when I tried to transfer the credits to other schools, no one would accept them."

- The Commercial Programming Unlimited ("CPU") school in New York City, operating despite being subject to a 1976 FTC consent order regarding misrepresentations of

[34] Under such a tailored standard, the converse is true as well. For example, law school students (who, by definition, have a bachelor degree) face a higher bar when seeking to establish that literally true but arguably misleading statements by law schools about graduate employment outcomes are in fact deceptive or unfair. *See, e.g.*, *Gomez-Jimenez v. New York Law School*, 36 Misc.3d 230 (Sup. Ct. N.Y. Cty. 2012), *order affirmed by* 103 A.D. 3d 13 (App. Div. 1st Dept. 2012), *leave to appeal denied* 20 N.Y.3d 1093 (Mar. 28 2013) ("The court does not view these post-graduate employment statistics to be misleading in a material way for a reasonable consumer acting reasonably. By anyone's definition, reasonable consumers—college graduates—seriously considering law schools are *a sophisticated subset of education consumers*, capable of sifting through data and weighing alternatives before making a decision regarding their post-college options, such as applying for professional school. *These reasonable consumers* have available to them any number of sources of information to review when making their decisions.") (emphasis added).

employment opportunities to potential students,[35] regularly had its recruiters set up shop outside welfare centers. "It's free," one CPU recruiter told a woman carrying a baby. "You don't have to pay. You don't have to get a loan. We put you in computer programming, bookkeeping."[36] These statements enticed client "Genny," who was on public assistance when she enrolled and had been working to support herself and her nine siblings since dropping out of high school in the tenth grade. They were not true: Genny has nearly $20,000 in debt from her time at CPU. Genny finally learned computer skills only after she withdrew from CPU and took a free, publicly-funded certificate program.

- Many of our clients were recruited by predatory schools while they were homeless or receiving disability benefits. For example, "T.B." was living in a shelter when he was recruited into a pharmaceutical tech program at Lincoln Tech. He signed up because he needed a place to stay during the day when the shelter was closed. He has a severe learning disability and the school promised it would accommodate him, but then failed to provide any educational support. T.B. dropped out of the program with significant federal student loan debt.

- Similarly, a client who enrolled in a criminal justice program at Heald had been on SSI since childhood for serious intellectual disabilities. When she told her counselor that she could not follow the classes, she was encouraged to transfer to the Medical Assisting program. She did, but was unable to follow along in that program either, and withdrew with a significant amount of debt.

- Schools may specifically target people who are feeling desperate and thus are especially susceptible to marketing promises. For example, affidavits collected by the Massachusetts Office of the Attorney General indicate that many students requested information about Everest Institute after seeing a television advertisement, which featured an African-American man standing on a bridge who urged watchers to make a dramatic change in their lives. One student, "R.M.," described this advertisement as depicting "supposedly a graduate of Everest Institute, a black male telling you to just pick up the phone and call. You're just sitting on the couch . . . If you want to change your life . . . make the call." Another, "I.R.," described this ubiquitous ad in more direct terms: "The one with the black guy telling us to pick up the phone and call" because "it will change your life."

The Department's borrower defense standard must recognize that predatory schools deliberately target and exploit individuals who are in difficult to desperate circumstances.

[35] *In the Matter of Commercial Programming Unlimited, Inc., et al.*, Consent Order, 88 F.T.C. 913 (Dec. 9, 1976).
[36] Joseph Berger, *Changes in Welfare a Boon to Trade Schools*, N.Y. Times (Aug. 6, 1988).

f. Borrowers Should Receive Relief if they Relied on Misrepresentations or Reasonably Would Have Relied

In light of the various vulnerabilities and circumstances discussed above that may render an act or omission misleading to some borrowers and not others, we urge the Department to reconsider its proposal to limit relief to only those borrowers whose reliance on a misleading statement was "reasonable."[37] So long as a borrower actually relied to her detriment on a statement that was "misleading under the circumstances," she should be entitled to relief.

To the extent the Department does maintain a requirement that reliance be "reasonable," it should make clear that the reasonableness of reliance will be judged according to the circumstances surrounding the misrepresentation and the characteristics of the audience targeted by the misrepresentation, for the same reasons discussed above. This is consistent with the practice in those states for which the UDAP law imposes a requirement that plaintiffs prove the reasonableness of their reliance.[38] Further, in tailoring the reasonableness analysis based on the circumstances of the misrepresentation, it will often be appropriate to consider the role of high-pressure sales tactics, such as those described in proposed § 685.222(d)(2). However, we emphasize that these factors should not become *de facto* requirements for proving reasonableness of reliance and thus additional hurdles to satisfy to attain relief. Rather, significant misrepresentations alone, even without additional unfair or abusive practices, warrant borrower relief.

g. The Department Correctly Recognizes that Omissions Can Be as Deceptive as Statements

For related reasons, we support the Department's inclusion of "omission" in the definition of misrepresentation to capture circumstances "where the borrower should have been able to rely upon the school to provide accurate information."[39] Especially when it comes to technical issues such as accreditation and financial aid, our clients have no reason to expect anything other than fair dealing from their schools, and are often encouraged by officials to trust them to look out for the students' best interests. Unfortunately, unscrupulous actors are able to exploit the asymmetry in information and bargaining power between themselves and our clients in countless ways. Below we provide just a few examples of how schools have deceived students through omissions:

- "Nick" enrolled in St. Paul's School of Nursing. During the enrollment process, he noticed that plaques from the respected nursing accreditor National League for Nursing

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[37] Proposed 34 C.F.R. § 685.222(d)(1).

[38] *See, e.g.*, *Office of Attorney Gen., Dep't of Legal Affairs v. Commerce Commercial Leasing, LLC*, 946 So.2d 1253, 1259 (Fla. Dist. Ct. App. 2007) (tailoring the reliance analysis where victims "were targeted specifically because they were technically unsophisticated").

[39] 81 Fed. Reg. at 39342.

(“NLN”) were prominently displayed in the school’s building. When he asked a recruiter directly if the school was accredited, the recruiter responded, “We are accredited.” This statement was literally true, but omitted the key information that the school was not currently accredited *by NLN* as suggested by the plaques. Later, when Nick brought a *pro se* case for breach of contract against St. Paul’s, the school asserted that these plaques showed expired accreditation were displayed as “historical memorabilia.”[40]

- “M.T.” attended Career Education Institute (later Lincoln Tech) after being guaranteed that she would get a job as a medical coder. Although this was the entire premise of her being enrolled in the program, and she was upfront about that with recruiters, she later found out from a teacher that the job she thought she was preparing for required certification and that she would not be eligible to sit for certification because the Institute did not have the required accreditation. Nobody from the school made a representation that the school *was* accredited, but the failure to inform prospective students who were specifically enrolling to attain a job that would be unavailable due to the lack of accreditation seriously harmed students.

- “J.G.,” a teenager, informed recruiters and financial aid officers at the Art Institute that she was homeless and concerned about how she could afford school. She cried with relief when they told her that her education would be covered entirely by financial aid. She joyfully enrolled based on this. She decided to withdraw after the first year based on disappointment and distrust in the program, and was surprised to be hit then with an additional bill for over $1000 by the school. The school claimed that under its projections, “aid” (mostly loans) would have covered the full amount if J.G. had completed all four years of the program, but would not cover the cost if she, like many Art Institute enrollees, did not complete. The school failed to mention this when assuring J.G. that she would have no out-of-pocket expenses.

- “A.M.” enrolled in a medical assisting program at Everest in 2009. She became disillusioned and suspicious of the program’s legitimacy early on. For example, students did not have enough equipment and were asked to practice drawing blood on each other without being shown how to do it first. She asked the school about what would happen if she withdrew, given that she had already paid tuition, and was told that she would “still owe money.” While this is literally true, the school representatives omitted the critically relevant fact that if she withdrew at that time, she would be entitled to a partial refund of her tuition and the school would be obligated to return her loan proceeds. Because A.M. understood the school’s answer to mean that she would still be on the hook for the full amount if she withdrew, she chose not to withdraw and thus became liable for the full cost of tuition.

[40] *Papaspiridakos v. Education Affiliates, Inc.*, Case No. 13-3843, Brief of Appellant at 13 (2d Cir. Jan. 13, 2014).

- “R.M.” was a 25-year-old single mother with a criminal record at the time she enrolled in Everest Institute, and she disclosed her conviction to the school. While she was told repeatedly about the program’s great job placement rates, she was not told that she would be ineligible for many of the health care jobs for which the program purportedly trained students due to her criminal record.

Further, we emphasize that omissions should be understood and judged in the context of the specific audiences targeted. This is especially true when schools target immigrants without any context for understanding how the system of higher education works in the United States, and/or who speak limited English. To cite just a few examples from our clients, Meadows College of Business (which closed in 1990) and CIT College (which closed in 2010) both targeted non-English speaking students who had not completed high school before they enrolled. Clients understood that these programs would be free, when in fact they were rushed through signing English language federal student loan agreements without knowing what they were signing.

Similarly, the Attorney General of Massachusetts investigated and documented the deliberating targeting of individuals with limited English proficiency by Everest Institutes in Massachusetts, which included omitting disclosure of the critical fact that classes would be in English when the relevance of that fact was clear. Below are examples of evidence the state collected from Everest teachers and employees:

- “S.K.” reported that admissions and financial aid representatives were encouraged to speak to prospective students in their native Spanish in order to convince them to enroll, despite the fact that they had no proficiency in English—the language of instruction at Everest.
- “A.S.” reported that Everest would translate for potential students when they were taking a basic literacy test prior to enrollment.
- “J.M.” reported that “Finance Planners” at Everest prepared financial aid packages for students who did not speak English and did not understand the content of the documents they were signing.
- “K.K.” observed that many of her students in the Dental Assistant program at Everest could barely understand English. When she raised this fact with school officials, she was told to “work around it.”

h. The Proposed Rules Properly Reflect that Borrowers Should Not Have to Bear the Cost of Substantial Misrepresentations When Intent Cannot Be Proven

We agree with the Department that an institution is responsible for the harm to borrowers caused by misrepresentations, even if such misrepresentations cannot be attributed to institutional intent. Providing otherwise would unfairly leave injured borrowers to bear the cost of harms caused by their schools, rather than placing the cost of that harm on the institution that created it. Requiring proof of intent would also, as a practical matter, often be nearly impossible for borrowers, who would have little way of accessing and presenting evidence as to what recruiters or other school officials knew or intended when telling them falsehoods, and could create significant barriers to resolution of defenses on a group basis. An intent requirement could thus effectively close off relief for many borrowers, and torpedo the proposed rules.

In expressly recognizing that intent is not necessary to support a borrower defense for substantial misrepresentation,[41] the Department aligns the rule with existing legal precedent. For example, the FTC definition of deception does not require intent; a practice is deceptive even if there is no intent to deceive.[42] Likewise, intent is generally not necessary under state UDAP statutes.[43] Indeed, as one court explained in interpreting a state UDAP law, to require proof of intent "would effectively emasculate the act and contradict its fundamental purpose."[44]

i. The Standard Should Encompass a Prohibition on Unfair, Abusive, or Otherwise Unlawful Conduct

We urge the Department to adopt a stand-alone borrower defense standard that addresses unfair, abusive, or unlawful conduct. "Unfair" and "abusive" acts and practices are distinct from "deceptive" practices such as substantial misrepresentations. Similarly, acts may violate state laws intended to protect consumers without constituting a breach of contract or misrepresentation. But just like substantial misrepresentations, these practices result in significant harm to targeted students—typically substantial student loan debt for an education of little to no value. Because there are well-established precedents defining unfair and abusive practices that can be applied in the borrower defense context, and because students are often harmed by unfair, abusive, or otherwise unlawful school practices even in the absence of actionable misrepresentations, the Department can and should include unfair, abusive, or unlawful practices in its standard for borrower defenses.

j. Ample Precedent Exists for Applying Unfair or Abusive Conduct Standards

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[41] *See* 81 Fed. Reg. at 39342.

[42] *See, e.g., Fed. Trade Comm'n v. Freecom Communications, Inc.*, 401 F.3d 1192, 1203 (10th Cir. 2005) (key question is not intent to deceive, but "the likely effect of the claim on the mind of an ordinary consumer"); *Fed. Trade Comm'n v. Amy Travel Serv., Inc.*, 875 F.2d 564 (7th Cir. 1989) (intent unnecessary even for action for monetary redress). *See generally* National Consumer Law Center, *Unfair and Deceptive Acts and Practices* § 4.2.4.1 (8th ed. 2012), *updated at* http://www.nclc.org.

[43] *See generally* National Consumer Law Center, *Unfair and Deceptive Acts and Practices* § 4.2.4.1 (8th ed. 2012), *updated at* www.nclc.org/library (citing cases from majority of states); *see also* National Consumer Law Center, *Consumer Protection in the States: A 50-State Report on Unfair and Deceptive Acts and Practices Statutes* (Feb. 2009), *available at* http://www.nclc.org (state-by-state survey of UDAP statutes' features, including intent requirements).

[44] *Thomas v. Sun Furniture & Appliance Co.*, 399 N.E.2d 567 (Ohio Ct. App. 1978).

There is substantial precedent in state and federal law defining "unfair" acts or practices on which the Department can rely in adopting and apply an unfair conduct borrower defense standard. Most states, either by statute, or as clarified in case law, have adopted a definition of "unfair" patterned after the Federal Trade Commission Act,[45] as interpreted by the Supreme Court in *FTC v. Sperry & Hutchinson Co. (S & H),* 405 U.S. 233 (1972). Generally, an unfair act or practice is one which offends established public policy; is unethical, oppressive, or unscrupulous; or causes substantial injury to consumers.[46] Additionally, the Consumer Financial Protection Bureau has interpreted the scope of "unfair" practices in the Dodd-Frank Act as "reflect[ing] the unfairness standard under the FTC Act."[47]

Over the years, unfairness standards have taken more concrete shape through court decisions and agency rulemakings. The Department can pull from this existing body of law in establishing and applying an unfair practices standard in the borrower defense context. For example, the following types of practices have all been found to be unfair, and could be readily applied to the context of school recruitment, enrollment, and financial aid practices:

- Coercive high-pressure sales tactics;
- Unfair provisions in contracts of adhesion;
- Taking advantage of disparate knowledge;
- Taking advantage of a vulnerable group; and
- Illegal conduct.[48]

Contrary to its belief, the Department would not need to break new ground in tailoring or applying this standard to address protection of students.[49] For example, Massachusetts recently promulgated definitions of unfair as well as deceptive practices specifically "to address problems

[45] 15 U.S.C. § 45(a)(1).
[46] *See generally* National Consumer Law Center, *Unfair and Deceptive Acts and Practices* § 4.3.3.3.1 (8th ed. 2012), *updated at* www.nclc.org/library; *see also FTC v. Sperry & Hutchinson Co. (S & H),* 405 U.S. 233, 244-45 (1972); See Statement of Basis and Purpose of the FTC Trade Regulation Rule, Unfair or Deceptive Advertising and Labeling of Cigarettes in Relation to the Health Hazards of Smoking, 16 C.F.R. pt. 408, 29 Fed. Reg. 8355 (1964), since rescinded.
[47] Consumer Financial Protection Bureau, Payday, Vehicle Title, and Certain High-Cost Installment Loans Proposed Rules, Docket No. CFPB-2016-0025, at p. 131 (May 29, 2016), *available at* http://files.consumerfinance.gov/f/documents/Rulemaking_Payday_Vehicle_Title_Certain_High-Cost_Installment_Loans.pdf.
[48] National Consumer Law Center, *Unfair and Deceptive Acts and Practices* § 4.3.1 (8th ed. 2012), *updated at* www.nclc.org/library.
[49] *See* 81 Fed. Reg. at 39343 ("The Department believes it would face significant challenges in determining which cases of such conduct warrant relief. A wide variety of conduct can be considered deceptive, unfair, or abusive, under both State and Federal law, and characterizing particular conduct as falling under such standards would require the Department to engage in a nuanced application of complex legal doctrines that vary across jurisdictions and that often have not been subject to a degree of judicial development sufficient to make their application to the borrower defense context clear.").

experienced by consumers when they seek or are enrolled in for-profit schools or occupational programs."[50]

In defining and applying an abusive practices standard, we encourage the Department to look to the definition in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), as well as the CFPB's application of the law to protect student loan borrowers. The Dodd-Frank Act defines as abusive conduct that:

> (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
> (2) takes unreasonable advantage of—
>> (A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
>> (B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or
>> (C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.[51]

Both the CFPB and the State of Illinois have recently applied this abusive practices standard to protect student loan borrowers from predatory school conduct. The CFPB alleged ITT took advantage of students by putting them in a position where they had little choice but to take out high-priced private loans with the school.[52] ITT required students to repay loans before the program was completed, even though students had no reasonable way to make payments while still in school. Students thus had to either take out new loans from the school or withdraw and lose out on any value of what they had already invested. The CFPB further alleged as abusive ITT's practice of encouraging students to rely on the school's financial aid staff to act in the students' interests and then taking advantage of this reliance to push students into high risk loans. The federal court hearing the case agreed with the CFPB that a cause of action for abusive conduct could be based on a school's taking unreasonable advantage of the students' reliance on the school if the students believed the financial aid staff was acting in their interests.[53] Similarly, in Illinois' case against Alta Colleges, the court agreed that Illinois could state a claim for abusive practices based on allegations including that the school targeted unsophisticated students, characterized salespeople as admission representatives, and used high pressure sales techniques.[54]

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[50] 940 C.M.R. 31.01 *et seq.; available at* http://www.mass.gov/ago/docs/regulations/940-cmr-31-00.pdf.
[51] 12 U.S.C. § 5531(d).
[52] Complaint, *Consumer Fin. Prot. Bureau v. ITT Educ. Services, Inc.*, Case No. 1:14-cv-292 (S.D. Ind. Feb. 26, 2014), *available at* http://files.consumerfinance.gov/f/201402_cfpb_complaint_ITT.pdf.
[53] *Consumer Fin. Prot. Bureau v. ITT Educ. Services, Inc.*, 2015 WL 1013508 (S.D. Ind. Mar. 6, 2015).
[54] *People v. Alta Colleges, Inc*. (N.D. Ill. Sept. 4 2014), *available at* www.nclc.org/unreported.

k. Unfair and Abusive Conduct Harms Student Loan Borrowers Even in the Absence of Misrepresentations

Currently, the Department has declined to authorize borrower defenses based solely on unfair or abusive practices,[55] instead proposing to consider unfair or abusive conduct, such as high-pressure sales tactics, solely as bearing on whether a borrower's reliance on a misrepresentation was reasonable.[56] As discussed above, unfair or abusive conduct, such as high-pressure sales tactics, are relevant to breach of contract and substantial misrepresentation, as those doctrines have been applied to consumer-oriented conduct under state law. With respect to breach of contract, this conduct goes to whether there has been an implied breach of covenant of good faith and fair dealing. With respect to misrepresentations, which overlap with conduct that would also be considered deceptive under state consumer protection law, the fact that a school targets particularly vulnerable consumers is relevant to assessing whether a misrepresentation or deception in fact occurred.

However, our clients experience unfair or abusive conduct that is actionable under state law but that would not be encompassed in the Department's breach of contract or substantial misrepresentation standards. Under the Department's proposal, high-pressure, manipulative and abusive sales tactics—central to the business plans of predatory schools—are irrelevant to a borrower's decision to enroll unless the borrower can *also* point to actionable misrepresentations and show why such tactics rendered their reliance on misrepresentations reasonable. This would fail to capture much of the unfair and abusive conduct that occurs in predatory recruiting.[57] In particular, we anticipate that many statements typically made in the context of high-pressure sales pitches may be dismissed by the Department as "puffery" and thus not considered actionable misrepresentations. Indeed, state and federal governments alike have overwhelmingly made "unfair" as well as "deceptive" practices actionable because certain practices do not mislead, but only take advantage of consumers.

Common themes emerge from schools whose business model is predicated on meeting enrollment targets. The tactics we frequently hear about are unfair or abusive—particularly

[55] *See* 81 Fed. Reg. at 39343.

[56] Proposed 34 C.F.R. § 685.222(d)(2); *see also* 81 Fed. Reg. at 39343. ("We have determined that reliance on a misrepresentation may be appropriately viewed as more reasonable when the misrepresentation is made in the context of certain circumstances, including those that may be considered to be high pressure or aggressive sales tactics.").

[57] For example, after a client who attended the Heald criminal justice program graduated and was unable to find work, she sought job placement assistance from Heald. Instead of offering her help, the school pressured her into enrolling in another Heald program in Medical Assisting, telling her this was in her best interest because "being in school is better than unemployment." This statement is not actionable as a misrepresentation, and indeed may not even be provably false, but in the context, it unfairly took advantage of the student's shame regarding her situation and trust in the school, and was highly coercive—and effective.

when targeted at young, disabled, uneducated, unemployed, or otherwise vulnerable individuals—and saddle students with thousands of dollars in loans for educations that are ultimately worthless to them. Importantly, these tactics do not depend on specific misrepresentations or contractual breaches, and so borrowers taken advantage of by these practices may not be eligible for relief unless the Department supplements its proposed standards to include unfair or abusive practices. Consider what has been uncovered about the high-pressure and abusive sales tactics engaged in by Everest Institute in Massachusetts, where the philosophy of one Director of Admissions was, succinctly, to put "asses in classes":

- *Extreme persistence in recruiting*: "I.R." reported that representatives called her every day, urging her to enroll. "A.B." received five calls per day from Everest about enrolling. "M.C." received 15 calls per day. "K.M." observed an admissions representative at Everest Brighton pressure a woman who could not understand basic communications and was under guardianship to sign enrollment agreements.

- *Creation of pressure and a sense of urgency:* "J.L." enrolled in Everest's medical assisting program after the recruiter told her there was "one open spot" that would "fill up very quickly," and it was "extremely urgent to sign up right away." "T.T." received multiple calls per day asking her to come in to Everest for an interview. When she explained that she did not have child care for her children, she was told that she needed to start classes immediately or else the price was going up and she would have to make higher monthly payments. After she expressed hesitation about enrolling, "L.T." was told that if she did not enroll immediately in Everest Brighton's medical assistant program, she would have to wait an entire year for the chance to enroll.

- *Boiler-room sales environments*: Everest had recruiting and enrollment quotas. "C.K." reported that Everest Brighton set monthly enrollment targets, and that pressure to meet these targets increased as the month passed. Employees were taught to do whatever necessary to get students to return to campus within 24 or 48 hours of first contact for the best chance of getting them to enroll before they had time to consider otherwise. "N.N." was told to call each student "continuously" until they agreed to come to the campus for an "interview." When students did come in, she was trained to get them to enroll on the spot, before they "had time to think about it." "E.M." observed that Everest Chelsea instructed its admissions representatives to call potential recruits repeatedly and to ignore no-call requests until the student submitted three formal requests that the school stop calling him or her.

These types of high pressure sales tactics are often "unfair" and thus actionable under state UDAP laws, even if they are not deceptive.[58]

Unfair and abusive sales tactics are the result of systematic recruiting efforts by for-profit colleges, in service of a business model that requires significant churn and growth in enrollment in order to meet profitability targets. These practices are not confined to Corinthian-operated schools.[59] Our experience shows that many schools continue to engage in unlawful conduct that is unfair or abusive, but is not tied strictly to any specific statement or omission of fact and thus may not satisfy the substantial misrepresentation or breach of contract standards. For example:

- Our clients report that the financial aid process is like a "whirlwind," and they are encouraged to "just fill out" loan documents in order to "get the ball rolling" without reviewing them. When one client, "Melissa," asked to bring the documents home so that she could review them with her family, she was told that was not necessary because they were "just formalities."

- A number of clients have told us about similar tactics used to coerce them to sign loan documents once they were already enrolled. For example, many have told us that New England Art Institute gave teachers lists of students to send to the financial aid office as class was beginning. The financial aid officers would tell the students that before they could return to class, they must sign paperwork that the students had not seen before. Because of the school's strict attendance policy, which penalized students for missing even a few minutes of class, our clients felt compelled to sign paperwork that they never had a chance to read and to borrow loans that they did not want, or risk all of the money, work, and hope they had already poured into their education.

- Similarly, many students at the Art Institute discovered in their last semester that they owed additional money. Although the school inserts the fine-print caveat that their financial aid projections are just that, and subject to change, young and otherwise

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[58] *See, e.g.*, 940 C.M.R. 31.06(9) ("Engaging in High-pressure Sales Tactics. It is an unfair or deceptive act or practice for a school to initiate communication with a prospective student, prior to enrollment, via telephone (either voice or data technology), in person, via text messaging, or by recorded audio message, in excess of two such communications in each seven-day period to either the prospective student's residence, business or work telephone~ cellular telephone, or other telephone number provided by the student.").

[59] Indeed, in the past year, the Department settled a whistleblower lawsuit against EDMC, in which the school was alleged to use illegal incentives to compensate its recruiters. Order of Dismissal, *United States ex rel. Washington v. Educ. Mgmt. Corp.*, No. 2:07-cv-461 (W.D. Pa. Dec. 8, 2015). Recruiters for EDMC reported that company management handed down "revamped telemarketing scripts designed to prey on poor and uneducated consumers": "You probe to find a weakness," and "basically take all that failure and all those bad decisions and you spin around and put it right back in their face as guilt[.]" Colin Woodard, *Charity Group Funded School Network Led by Former Gov. McKernan*, PORTLAND PRESS HERALD (July 31, 2016). This is similar to the "pain funnel" method used by ITT to train recruiters to "dig in and get to the pain of each and every prospective student." *See* United States Senate Health, Education, Labor and Pensions Committee, *For-Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success* at 527 (July 30, 2012).

vulnerable students, who were reassured during recruiting that they should not worry about the cost based on their aid projections, are later faced with the proposition of taking out more loans or wasting all of the time and money they had already invested:

    - "Melissa" learned that the financial aid projection did not cover her last semester, just prior to the start of classes for that semester. She scrambled to take out a private loan, adding to the $100,000+ that she had already borrowed.
    - "David" had one semester left when he learned that he would have to take out an additional loan to pay for his remaining classes. He took out a private loan that had such onerous terms that even the school's financial aid officer cautioned him against it, while at the same time advising that it was David's "only option." He needed to graduate, so he signed the loan with his father as a co-signor.
    - "Diane" learned prior to her last semester that she needed to pay an additional $5000. This was contrary to her belief that the final semester had already been covered by existing loans. She feared that she would be unable to graduate, and ended up borrowing the money from her grandmother.

- "R.H.," a student who submitted an affidavit in support of the Massachusetts Attorney General's case against Corinthian, described enrolling in Everest Chelsea at 45 years old, just after getting out of jail. He did not have a high school diploma or a G.E.D. He disclosed his criminal conviction to the Everest representatives, as well as his desire to work in a hospital setting. He was told that, because his criminal convictions included operating under the influence and assault and battery, "he wasn't a sex offender or abusive to the elderly" and he would "have no problem getting a job." His criminal record was a barrier to him getting a job—after all the loans and time he put into school, he never obtained a job in his field of study. But the Department may interpret the assurances the school provided to him as non-actionable "puffery" even though they were unfair and took advantage of R.H.'s relative lack of information about the job market and expectation that the school would be truthful about his prospects.

- "Amparo," a client of the Legal Services Center, experienced high pressure tactics by Everest Institute. She went to a campus location in Massachusetts to meet her sister, who was a student at Everest. When she entered the building, she was immediately taken to a separate room to watch a promotional video. She made it clear that she was only there to meet her sister, but she was told it was just for "informational purposes." After, she was told to go into another room and speak with a counselor. The counselor asked her questions about which program was the most interesting to her. Amparo speaks very limited English, and just wanted to avoid an unpleasant situation. After Amparo indicated a program, she was given paperwork to sign and told she could "always change her mind." She wasn't sure exactly how it happened, but she was enrolled and signed up for loans. When she attended classes, she could not follow along because they were taught in English. When she tried to withdraw, she was told that she would have to pay anyway, and if she did not pay, the school would use her social security number to collect from her. She remained enrolled even though she could not understand the classes.

- Many of our clients are the first in their families to go to college, and rely heavily on financial aid officers, whom they believe to be acting in a fair and forthright manner. For example, clients who attended Heald schools report developing rapport with the recruiter who walked them through the process of financial aid at the school. Even years later, they can remember the person's name, after forgetting other details. They trusted the person, and did not question that they were being provided forms to sign, being told, "sign here, sign here, and sign here," and being given assurances such as "Everything is taken care of," or "don't worry, we will give you a copy later," and "Don't worry about the loans, because with a stable job the loans can be paid off in 1 or 2 years. After this education, you will be making so much money…."

Especially if the Department does away with the ability to raise state consumer protections as a basis for borrower defenses, we strongly urge it to include unfair and abusive practices as a distinct basis for borrower relief. Rather than jettisoning this basis for relief through the elimination of state-law based claims, the Department should take this opportunity to expand relief opportunities to borrowers in all states who are preyed upon through these types of unfair and abusive conduct.

iii. Violations of State Law Harm Student Loan Borrowers Even in the Absence of Misrepresentations or Omissions

Finally, we emphasize again that the borrower defense standard should encompass the most robust consumer protections available under state law, preferably by making the federal standards for relief a floor and not a ceiling that eliminates state bases for relief. Adopting a federal standard as a floor, but not a ceiling, would address the problem rightly identified by the Department that existing standards do not adequately protect students in states with weak consumer protection laws, without eliminating existing protections for students in other states.[60]

The HEA has imposed a consumer protection role on the states by requiring state authorization standards for Title IV eligibility. Because it leaves to the states the primary responsibility for regulating institutions and protecting students from abusive school conduct, states have enacted detailed laws with which schools are required to comply for the benefit of students.

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[60] 81 Fed. Reg. at 39339.

The following are examples of common state law violations that seriously harm students, but would not be covered by the Department's proposed standards:[61]

- Failure to comply with state refund rights.
- Failure to comply with state cancellation rights.
- Failure to comply with state laws that require the provisions of enrollment agreements in the students' primary language.
- Failure to comply with state tuition recovery fund laws.
- Failure to comply with laws prohibiting the changing of class formats, locations, times, etc. without student consent.

In light of the important student loan borrower protections provided in state law—both through general consumer protection laws, including unfair and deceptive acts and practices laws, as well as through laws and regulations specifically developed to protect against abuses in the higher education and student loan context—we urge the Department to make new federal standards a floor above which state law protections may provide additional bases for relief.

II. Process for Individual Borrowers and Evidentiary Burdens

We applaud several elements of the Department's proposal regarding the process for individual borrowers to pursue borrower defenses, and urge the Department to consider the needs of borrowers who cannot afford legal representation when finalizing and implementing these proposals.

a. Protections the Department Should Keep in the Final Rule

Elements of the borrower defense proposals that provide due process protections for borrowers and help ensure a fair and accessible process should be included in the final rule.

In particular, we strongly support the Department's proposal to separate the adjudication of an individual borrower's application for a defense from the question of whether to undergo a recoupment process against the school.[62] This is critical to ensuring that unrepresented borrowers need not face off against sophisticated, represented, schools that may have a significant stake in the proceeding that goes well beyond the few thousand dollars of loan relief sought by the individual.

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[61] For specific citations to these types of state laws, *see* National Consumer Law Center, Student Loan Law Manual § 13.6.3.2 and Appx. E (5th ed. 2015), *updated at* www.nclc.org/library. *See also* National Consumer Law Center, Ensuring Educational Integrity: 10 Steps to Improve State Oversight of For-Profit Schools (June 2014) and Update: Step 2: Protecting Online Education Students (Dec. 2015); and National Consumer Law Center, State Inaction: Gaps in State Oversight of For-Profit Higher Education (Dec. 2011), *all available at* http://www.studentloanborrowerassistance.org/advocacy/reports/.

[62] *See* Proposed 34 C.F.R. § 685.222(e) (Procedure for an Individual Borrower); Proposed 34 C.F.R. § 685.222(e)(7) ("The Secretary may initiate a separate proceeding to collect from the school the amount of relief resulting from a borrower defense under [the individual process]").

We also support the Department's commitment to providing written determinations on claims as well as to permitting reconsideration of denied borrower defense applications. These protections are critical for unrepresented borrowers, who quite often will not know what information to provide in an initial application. We do, however, urge the Department to alter the proposed language to provide a clear right to reconsideration, rather than merely allowing borrowers to "request" reconsideration and leaving any response to the Department's discretion.

We believe that the proposed preponderance of the evidence standard is appropriate and in line with the burden of proof in civil adjudications. As discussed below, we urge the Department not to require documentation beyond the borrower defense application when applying this standard. We also urge the Department to recognize a borrower's statement attesting to the elements of a borrower defense, signed under penalty of perjury, as sufficient evidence of a defense unless the Department possesses evidence that conflicts with the statement.

Finally, we support the Department's proposal to grant applicants forbearance (with information about options to decline and instead utilize income-driven repayment plans) and suspension of collections while their applications are pending, though we continue to urge that this relief should apply to all loan types.

b. The Department Must do More to Meet the Needs of Unrepresented Borrowers in Structuring the Process and Evidentiary Standards

In implementing these borrower defense process provisions, the legal aid community urges the Department to consider the needs of borrowers who cannot afford legal representation. One important way to do so is by granting relief pursuant to the group process, as discussed *infra* Section V. But the process for individual borrowers to seek relief must also be fair and accessible to unrepresented borrowers. In our experience, clients targeted by fraudulent, for-profit schools are the least prepared to navigate the Department's forms and systems, even when those forms and systems are significantly simpler than those likely to be involved in borrower defense.

For example, when the American Career Institute shuttered its campuses in Massachusetts and Maryland without warning in January 2013, thousands of students were in attendance. We found that very few students in Massachusetts were aware of their entitlement to a closed school discharge. Of the few who were aware of their rights, many needed the help of the Legal Services Center to complete their closed school discharge applications or to address erroneous denials of closed school discharges they received after they attempted to apply on their own.

Compared to a closed school discharge application—for which the relevant facts are limited and clear—applying for a borrower defense discharge is far more complicated. Indeed, those of us who have worked with students who are eligible for "fast track" relief after attending a Corinthian school have found that many struggle to navigate even this "streamlined" attestation form. Many borrowers do not know what information they need to attach or how to obtain it, where to look for the dates of attendance and programs, or that they may still use the form even if they do not have copies of the false job placement numbers they were shown. Borrowers applying outside a fast track or group relief process are likely to face even more challenges in figuring out how to present and support a claim, given that they are unlikely to have the highly specialized legal knowledge generally needed to frame misconduct in legal terms.

Towards that end, we make the following recommendations for the individual borrower defense process. These recommendations draw on those we made last summer in response to the Department's request for comments on the proposed borrower defense information collection,[63] as well as our experience over the past year in working with clients on developing and submitting borrower defense claims:

First, we urge the Department to conform to the uniformly recognized principle that pleadings from *pro se* litigants are to be liberally construed.[64] Requirements that applicants submit legal justification or reasoning, or even know the difference between a breach of contract and a misrepresentation, will stand between defrauded borrowers and necessary borrower defense relief.

Second, we urge the Department to bear in mind that even seemingly simple requests for documentary evidence will pose insuperable barriers for many borrowers with meritorious claims. We thus recommend that the Department therefore limit requests to only that information truly necessary to approve a borrower's claim and, whenever possible, not require documentation beyond the application itself.[65] The Department has access to records of federal student loan borrowers' identities, loan information, schools attended, and years attended, and should not require borrowers to submit this information that it already possesses. While some of this information is also available to borrowers via NSLDS, we regularly serve clients who do not have access to the internet and therefore have difficulty accessing information about their own loans on NSLDS. Almost none of our clients are even aware of NSLDS before we tell them about it.

Former students also often have significant difficulty getting any records from their schools (and rarely have school records of their own). Records from schools that closed after the student attended are often unobtainable. We have also found that many schools that have

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[63] *See* Comments on Borrower Defenses Against Loan Repayment, Docket ID No. ED-2015-ICD-0076, *available at* http://www.studentloanborrowerassistance.org/wp-content/uploads/2013/05/comments-borrower-defenses-2015.pdf.

[64] *See, e.g., Erickson v. Pardus*, 551 U.S. 89, 93 (2007) ("A document filed *pro se* is to be liberally construed, and a *pro se* complaint, however inartfully pleaded, must be held to less stringent standards than formal pleadings drafted by lawyers.") (internal citations and quotations omitted).

[65] *See* Proposed 34 C.F.R. § 685.222(e)(1)(i)(B) (requiring individual borrowers to "[p]rovide evidence that supports the borrower defense"), *id*. at (e)(1)(ii) (requiring individual borrowers to "[p]rovide ay other information or supporting documentation reasonably requested by the Secretary").

engaged in misconduct resist legitimate requests for records from former students, unless that request is submitted by a lawyer on behalf of a student.[66] Even then, we have found that after an attorney request, schools have often taken months to respond even with repeated follow-ups, or responded that they could not locate the records sought, or demanded payment of unaffordable record fees. Many defrauded borrowers also do not have stable living situations and may not have permanent mailing addresses, a fact which makes it difficult for them to request documentation from their schools be sent to them.

Additionally, the Department should consider other information already available to the federal government, including other claims submitted about the school, state and federal investigations, reports such as the 2012 Senate Health, Education, Labor and Pensions Committee Report and GAO reports, lawsuits, audits, and other data sources. Doing so will reduce the burden on borrowers for whom it is often difficult, if not impossible, to access evidence beyond their own testimony of a school's misconduct. By using all available resources to verify a borrower's claim before denying an application or requesting further documentation from a borrower, the Department can better ensure that it meets its goal of providing all defrauded borrowers with the relief they deserve.

Third, in many cases, the borrower's claim will be based on oral statements (or omissions) made by school representatives, for which no documentary evidence is available. Again and again, clients have told us that recruiters from various career programs made unsupported job placement claims or guarantees to them verbally in one-on-one recruiting calls or in person meetings that went further than the more general assertions of job readiness made in their advertisements. These borrowers often cannot recall any written documentation of these promises, but remember what they were told and how it convinced them to enroll.

The Department should therefore ensure that neither its application form nor its review procedures suggest to borrowers or officials that evidence of written misrepresentations or other violations are necessary for a successful claim. The Department should track similar claims by other students and take note of this evidence when reviewing borrower defense applications. More generally, the Department should take all necessary steps to ensure that such borrowers receive the relief to which they are entitled through the borrower defense process.

III. Limitation Periods

We concur with the Department's determination that no limitation period applies to borrowers' ability to obtain relief from outstanding student loan debts. Given that there are no

[66] For example, one client came to a legal aid office while living in a domestic violence shelter. She could not use her address for regular mail. She went in person to her former school, Salter, to request her school file on two separate occasions, and was denied. She called and number of times as well and was told that records could only be sent by mail. It was not until she came to legal aid and was able to use her attorney's address that she obtained her records.

time limits on the government's ability to collect student loan debt, fairness and longstanding legal doctrines, including the doctrine of recoupment, require that borrowers be allowed to defend against such collection without a time limit.

a. Applying a Time Limit to Recovering Amounts Paid Unnecessarily Harms Borrowers

We urge the Department to reconsider its proposal to limit a borrower's ability to recover monies already paid or collected on loans when the Department later determines that the borrower has a defense to that loan.[67] It is especially egregious that the Department proposes to impose time limits on existing borrowers for whom there has been no process available to submit their claims.[68] As will be described more fully below, the Department has been collecting money on fraudulent loans for many years without providing borrowers a path for relief.

Applying time limits to new and existing borrowers would have a raft of negative consequences. First, and most fundamentally, it would deprive borrowers of the full relief they are due.

Second, it would lead to treating similarly harmed borrowers inconsistently based solely on whether or not they have been making payments or have been subject to garnishment or offset. Perversely, this would penalize those who have worked hard to make payments and those who have suffered harsh involuntary collection of loans founded in fraud.

Third, applying time limits would add a legally and factually complex collateral issue of "timeliness" to the assessment of borrower defense claims. This would include complicated questions of when breaches occurred and when a borrower discovered or "reasonably could have discovered" facts constituting a substantial misrepresentation. In our experience, defrauded

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[67] Proposed 34 C.F.R. § 685.212(k)(2)(iii) (applying retroactive statute of limitation to borrower defenses asserted under existing § 685.206(c)); proposed 34 C.F.R. § 685.222(c) ("A borrower may assert a right to recover amounts previously collected by the Secretary under [the breach of contract borrower defense prong] not later than six years after the breach by the school of the contract with its student"); proposed 34 C.F.R. § 685.222(d) ("A borrower may assert a claim under [the substantial misrepresentation borrower defense prong] not later than six years after the borrower discovers, or reasonably could have discovered, the information constituting the substantial misrepresentation."). We note that several states apply a statute of limitations to common-law claims such as breach of contract of ten years, longer than the six-year limitation period proposed by the Department. *See, e.g.*, 735 Ill. Comp. Stat. 5/13-201 *et seq.*; Ind. Code Ann. § 34-11-2-1, *et seq.*; Iowa Code Ann. § 614.1 *et seq.*; Ky. Rev. State. Ann. § 413.080 *et seq.*; La. Civil Code § 3492 *et seq.*; Mo. Rev. Stat. § 516.097 *et seq.*; R.I. Gen. Laws § 9-1-12 *et seq.*; W. Va. Code § 55-2-1 *et seq.*; Wyo. State. § 1-3-102 *et seq.*; *see also* Mont. Code Ann. § 27-2-202 *et seq.* (applying 8 year statute of limitation to contract claims); Ohio Rev. Code Ann. § 2305.03 *et seq.* (same).

[68] Specifically, for pre-2017 loans, the Department proposes applying "applicable state law as to the limitations period pursuant to § 685.206(c), to any claim for return of payments made or recovered on the underlying loans." FR 39357. *See* § 685.212(k)(1)(ii)(A) (stating that the Secretary may return borrower payments "if the borrower asserted the claim not later than—(A) For a claim subject to 685.206(c), the limitation period under applicable law to the claim on which relief was granted"). If the Department did not intend to apply the time limits applicable to affirmative state law claims to recovery through the borrower defense process of amounts already paid on pre-2017 loans, we urge the Department to so clarify.

borrowers generally do not discover that their schools have defrauded them or breached a contract with them until well after the fact. And some false or misleading acts or omissions, such as fabricated job placement rates, may not come to light until years after they attended. Even once these misrepresentations do come to public light, we know that harmed students often do not learn of them until much later. Adding this additional inquiry would significantly and unnecessarily complicate the process for borrowers and the Department alike, and would waste significant resources that could instead be used to provide injured borrowers relief.

The law authorizing borrower defenses does not require imposition of a statute of limitation—and indeed makes no reference to any time limits on relief.[69] Further, as described below, the justifications for statutes of limitations in legal proceedings are inapplicable in the borrower defense context. The Department therefore can and should avoid these negative consequences by allowing borrowers who succeed in demonstrating a borrower defense to recover amounts already paid without time limits.

b. Policy Justifications for Statutes of Limitations Do Not Apply to Borrower Defense

Statutes of limitations are intended "to provide an adequate time for a diligent plaintiff to bring a cause of action, as well as to punish those parties who sit on their rights."[70] Statutes of limitation have thus commonly been justified with reference to two principles: promoting repose for a defendant that would be subject to liability on a claim, and deterring plaintiffs from sitting on their claims.[71] Neither of these principles, however, would be served by imposing a time limit on when borrowers may recover pursuant to a borrower defense.

The first principle—promotion of repose—is concerned with allowing a defendant to move forward without a cloud of lingering liability. Because this principle is concerned with stale disputes between private parties, it does not map onto the borrower defense process. So long as the loan may be collected, a dispute about the validity of a loan should not be considered stale. Likewise, during this period, it is reasonable and fair to make the lender subject to claims regarding the loan. Even for loans that have been paid in full, there are indications placing the Department on notice that claims may later be asserted.

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[69] Section 455(h) of the Higher Education Act, codified at 20 U.S.C. § 1087e(h), provides, in full: "Notwithstanding any other provision of State or Federal law, the Secretary shall specify in regulations which acts or omissions of an institution of higher education a borrower may assert as a defense to repayment of a loan made under this part, except that in no event may a borrower recover from the Secretary, in any action arising from or relating to a loan made under this part, an amount in excess of the amount such borrower has repaid on such loan."

[70] 51 Am. Jur. 2d Limitation of Actions § 5.

[71] *See, e.g.*, *Shain v. Sresovich*, 104 Cal. 402, 406 (1894); *accord Lilly-Brackett Co. v. Sonnemann*, 157 Cal. 192, 197 (1910). Others, including Oliver Wendell Holmes, Jr., have asked, "What is the justification for depriving a man of his rights, a pure evil as far as it goes, in consequence of the lapse of time?" *The Path of the Law*, 10 Harv. L. Rev. 457, 476 (1897).

The Department's explanation that there is no "justification to depart from the requirement that Federal and State courts generally apply to affirmative claims to recover amounts already collected on a debt"[72] is misplaced. Borrower defenses do not directly implicate a private-party defendant. Although the Department may separately decide to pursue recoupment against a school based on the fact of an individual borrower's application for a borrower defense discharge, the school is not the defendant in the borrower's claim, and consequences to the school do not inexorably flow. The precedents for applying time limits to recovery of amounts already collected, correctly interpreted, apply only to claims between private parties.

A more appropriate analog would be the Department's practice with respect to statutory discharges, including those that are predicated on the actions of a school, such as the closed school and false certification discharges. No limitations periods apply to such discharges, and the Department routinely returns (or orders returned, when the loan is a FFEL loan) amounts already paid on loans discharged under those provisions. The Department has not articulated why it would deviate from *this practice* with respect to borrower defense.

The second justification for imposing a limitation—to deter plaintiffs from sitting on their claims—is inappropriate and inapplicable in the borrower defense context. There is no strategic reason for borrowers to delay in prosecuting their claims, while suffering the stress, financial obligations, and often negative credit consequences of being in debt on student loans in the meantime. Rather, borrowers who submit discharge claims after six or more years of enrolling in a predatory school do so because they were not previously aware of the scope of their school's misconduct, or of their rights and how to pursue them. This fact is regularly borne out in our experience working directly with student loan borrowers who have suffered for years after being taken advantage of by their schools without realizing they had a right to have their loans discharged. For example:

- The New York Legal Assistance Group represents a group of borrowers who attended Wilfred Beauty Academy, another notorious beauty school that closed in the 1990s. These clients were eligible for false certification discharges, but had no idea that such a thing existed. The experience of Ana Salazar, the lead plaintiff in the case, is typical. She initially borrowed $6,625 to attend Wilfred. By 2014, she had made thousands of dollars in involuntary payments, and still owed a remaining balance of $16,372. Her discharge application was granted in 2014. In addition to having her outstanding balance discharged, she received a refund of amounts she had paid over the years on the basis of involuntary collection, exceeding $14,000. This is significant relief that would be denied individuals in similar circumstances asserting borrower defense claims if a time limit is applied to relief on amounts already paid or collected.

[72] 81 Fed. Reg. at 39345.

- Genny, who as discussed above enrolled at CPU based on false claims that she would not need loans to cover the cost, is currently 60 years old. She earns $450 per week as an administrative assistant for a New York City government agency. Over many years, she made both voluntary and involuntary payments on her loans, but still had an outstanding principal balance of over $17,000 by the time a legal aid lawyer made her aware that she was eligible for both a false certification and a closed school discharge. Under the proposed time limits, a borrower like Genny who suffered school misconduct that she did not know entitled her to relief until many years later would be precluded from recovery of much needed funds already taken from her.

Our experience working with former Corinthian students eligible for "fast track" relief similarly shows that borrowers eligible for a borrower defense are frequently unaware of their right to relief or how to obtain it before being advised by a legal aid attorney, despite the Department's attempts to inform eligible borrowers, and the relatively high level of publicity surrounding the collapse of Corinthian. For example:

- "Amparo" attended Everest Institute in Chelsea, MA in 2011. She is unemployed and does odd jobs whenever opportunity arises to earn money. Due to her financial difficulties, her student loans have been a great source of distress for a long time. She was unaware that her federal loans were eligible to be discharged through the fast-track Corinthian process until she spoke with the Legal Services Center.

- "Caroline" also attended the Everest Institute in Chelsea, MA. Until Caroline's friend Julie persuaded Caroline to contact the Legal Services Center for help, Caroline had no idea that her federal loans were eligible to be discharged through the fast-track Corinthian process. Only after speaking with the Project and learning of her eligibility did Caroline submit for relief.

- Together, Housing and Economic Rights Advocates, Bay Area Legal Aid, and East Bay Community Law Center have conducted nine half-day workshops to provide information and advice to former Corinthian (Heald, WyoTech, and Everest) students. The workshops ranged in size from 10 to 55 former students, all of whom lacked basic information on their right to discharge as a result of their school's misconduct. Nearly 100 workshop participants were eligible for fast-track borrower defense, but prior to attending the workshop, they were unaware that they could apply for relief on their loans.

"Fast-track" borrower defense applies to Corinthian students who enrolled as far back as 2010. These defrauded students could find themselves unable to recover money paid or offset on their loans under the proposed rules. These borrowers and others like them should not be penalized if the Department's communication attempts fail to reach them in time, or where there are no group findings and thus no targeted communications by the Department at all.

Additionally, in our experience servicers and debt collectors—the primary points of contact for borrowers regarding their loans—have failed to inform borrowers of their rights to pursue loan discharge. For example, in speaking with former Heald students eligible for "fast track" borrower defense relief, a Bay Area Legal Aid attorney found that many had called their servicers to find out how they could seek assistance with discharging their loans. They reported that their servicer told them they were not eligible for any type of relief because they had graduated from Heald prior to its closure or were not attending close to the time of the school closure. In other words, their servicers were only screening people for eligibility for closed school discharges and not acknowledging the existence of any type of borrower's defense. Unfortunately, our clients are more likely to have been contacted by debt-relief scammers than to have gotten accurate information about the availability of relief through the borrower defense process—even when those students are eligible for "fast-track" relief—from their loan servicers.

Limitations periods in student loan regulations are thus entirely unlikely to "deter" borrowers from delaying making claims. Borrowers who do not assert borrower defenses early on do not for the simple reason that they do not know about their right to do so. These borrowers certainly will not know about arbitrary and arcane time limits that may apply to some portion of their relief, and so time limits will have no deterrent effect. Rather, they will simply punish twice-over borrowers who have already been mistreated once.

Applying a statute of limitations to existing borrowers is particularly unfair and unwarranted given that up until now there has been no process through which borrowers could avail themselves of their right to a borrower defense discharge. Indeed, the Department is only now creating a process and has encouraged borrowers to delay in submitting borrower defenses until a universal application form is created.[73] Based on this Department guidance, many legal aid practitioners have delayed in preparing and submitting borrower defense applications pending instruction from the Department on how best to do so, and its confirmation that such applications would be processed. Existing borrowers have no practical way to submit their claims before a process to do so is created. They should not be penalized for the many years it has taken the Department to create such a process.

Further, the Department implicitly recognizes that many borrowers are—quite reasonably and understandably—unaware of their rights. This is why, as discussed below, the Department is correct to extend automatic relief to those who attended and are eligible for closed school discharges, even if they do not apply for a discharge. It is also true that borrowers are often

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[73] *See* https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation/borrower-defense ("More information on borrower defense to repayment, including a borrower defense claim form for borrowers to use, and how to get your loan discharged will be made available on this page at a later date. Borrowers may therefore wish to wait for those updates before applying for a Borrower Defense to Repayment Loan Discharge.") (last visited July 29, 2016).

misinformed by those charged with servicing and/or collecting on their federal student loans.[74] In light of these facts, and in light of the Department's practices with respect to other statutory discharges, it is highly unfair and unnecessary to restrict the rights of borrowers with meritorious defenses with a statute of limitations.

IV. Borrower Relief

We object to the Department's proposed methods for determining the amount relief given to students both in principle and as to the specifics, as these methods would authorize denial of full relief to borrowers with meritorious defenses to repayment. Under the proposed regulations, after the Department has determined that a borrower has a meritorious borrower defense to repayment, it would not automatically discharge the eligible loans. Instead, the Department would engage in a newly-created, secondary process to determine the amount of relief to provide. Sections 685.222(i) and Appendix A of the proposed regulations set forth methods by which the Department proposes to "calculate" the amount of injury a borrower has suffered and the amount of partial loan relief the Department will provide, and provides the Department unchecked discretion to use other undisclosed methods to limit relief.[75]

As detailed below, we urge the Department instead to provide full federal loan discharges to all borrowers with meritorious borrower defenses, consistent with its practice of providing full discharges for school closure or misconduct in falsely certifying loans. At minimum, the Department should take steps to simplify the process for all parties and provide better assurance that borrowers will consistently receive the relief to which they are entitled.

a. Even Full Discharge of Federal Loans Cannot Make Victims of Predatory and Illegal Practices Whole

The extent of the injury borrowers suffer significantly exceeds their federal student loan debt or even the cost of attendance. For many reasons, students who were lured into predatory schools on the basis of false promises and abusive and unfair recruiting tactics will never be

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[74] *See, e.g.*, Federal Student Loans: Oversight of Defaulted Loan Rehabilitation Needs Strengthening: Testimony Before the H. Subcomm. on Higher Educ. and Workforce Training, Comm. on Educ. and the Workforce, 113th Cong. 8 (2014), available at www.gao.gov (statement of Melissa Emrey-Arras, Dir., Educ., Workforce, and Income Sec., U.S. Gov't Accountability Office) (finding that the Department's oversight of its collection agencies provides "little assurance that borrowers are provided accurate information" and documenting a range of errors in providing borrowers inaccurate information about their options); *see also* National Consumer Law Center, Comment to the Consumer Financial Protection Bureau Re: Request for Information Regarding Student Loan Servicing, Docket No. CFPB-2015-0021 (July 13, 2015) at pp.15-16, *available at* http://www.nclc.org/images/pdf/special_projects/sl/NCLC_Comments_Student_Loan_Servicing_Jul2015.pdf (providing examples of inaccurate information servicers provided to borrowers about school-related cancellations).

[75] *See* Proposed 34 C.F.R. § 685.222(i)(1)(iii) ("In determining the appropriate method for calculating relief, the Department official or the hearing official, as applicable . . . [m]ay use one or more of the methods described in Appendix A . . . or such other method determined by the official . . . .").

made whole by the borrower defense process, even if they are granted a full discharge of their federal student loans:

First, a complete borrower defense is an inadequate remedy *even for just the damage that borrowers have suffered vis-à-vis the Title IV program*: borrowers who attend fraudulent schools lose out on portions of their lifetime federal loan and grant eligibility, which the Department does not propose to restore as a borrower defense remedy. This means that borrowers effectively lose several thousands of dollars in critical Pell grants that could be used to support a second chance at a better education.

Second, many of our clients incurred additional private student loan debt and out-of-pocket costs that are not addressed through the borrower defense process. Indeed, a Senate committee report concluded that private loans are a predictable consequence of manipulative practices by predatory institutions to inflate tuition beyond federal aid limits to maximize revenue while masking noncompliance with the 90/10 rule.[76]

Third, our clients also suffer consequential economic damages as a result of attendance at predatory schools, including lost wages and other economic opportunity loss and childcare expenses. For example, when "Julia" enrolled in Everest's night program, an admissions representative told her that the school would find her an after-hours externship so that she could continue to work at her existing job during the day. When the deadline for completing the 160 hours of externship work that was required for graduation loomed, and the school had not found her an externship site that offered night hours, Julia became desperate. She took leave from her job so that she could attend an externship site during the day, and was subsequently fired from her job because "school was getting in the way." She not only never obtained a job in her field of study after attending Everest, but lost much-needed income from the job she had but lost due to Everest.

Fourth, many of our clients have suffered consequential losses related specifically to hardships they have experienced with their student loans after attending a fraudulent school, including lost housing, job, or credit opportunities related to negative student loan credit history; seizures of much-needed wages and Earned Income Tax Credits that led borrowers to miss rent payments and face eviction for their families;[77] and other financial hardship stemming from the loan obligations. For example, "J." was homeless when she was recruited by Everest. After she

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[76] *See* United States Senate Health, Education, Labor and Pensions Committee, *For-Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success* at 9, 39-40 (July 30, 2012) ("Some schools increase tuition in order to create a gap between the total amount of Federal aid a student can receive and the cost of attending."); *see also* Proposed 34 C.F.R. § 685.222(i)(5) ("The total amount of relief granted with respect to a borrower defense cannot exceed the amount of the loan and any associated costs and fees . . . .").

[77] *See* National Consumer Law Center, *Stop Taking the Earned Income Tax Credit from Struggling Student Loan Borrowers* (May 2016), *available at* http://www.studentloanborrowerassistance.org/wp-content/uploads/2013/05/ib-stop-taking-earned-income-tax.pdf (sharing stories of borrowers harmed by offset of the Earned Income Tax Credit following student loan default).

incurred thousands of dollars of federal student loan debt for a certificate without value, her subsequent inability to pay that debt damaged her credit. When she finally obtained a Section 8 voucher for subsidized housing for herself and her daughter, after years on the waiting list, she was unable to find a landlord who would rent to her because of negative credit reporting related to her student loans. As another example, "Scott" took out federal and private loans and his parents took out Parent PLUS loans to pay for his education at Audio Engineering. Scott graduated but was never able to get a paid job in his field of study (despite his school's false claim otherwise—a spot check of the school's job placement statistics revealed that the school had reported him as "employed" by a hobby bar band he had formed while in school but never made any money from). Scott's parents struggled to pay back the PLUS loans, and the financial stress they created were a factor in their decision to file for bankruptcy. Scott blames himself for this.

Fifth, many borrowers have also experienced significant emotional distress from the manipulation they experienced, their embarrassment and loss of hope when they found they had sacrificed so much for a false promise of a better future, and from the stress of crushing student loan debt. The proposed borrower defense rules specifically exclude this type of injury from relief determinations.[78]

Under the state unfair and deceptive practices laws that have traditionally provided the primary basis for borrower defense claims, all of these types of harm—direct and consequential, pecuniary and emotional—may provide a basis for relief, including relief that exceeds the amount paid for a service or good.[79] We understand that pursuant to section 455(h) of the HEA, a borrower is not authorized to recover *more* from the Secretary than the borrower has paid on their loan, along with cancellation of outstanding amounts due on the loan. However, in light of all these legally cognizable—and very real—injuries borrowers suffer above and beyond the amount of their federal student loan debt, failing to provide full relief even from that debt for harmed borrowers would result in a completely inadequate remedy.

b. The Methods the Department Proposes for Calculating Borrower Relief Will Unnecessarily Complicate the Process and Provide Inadequate and Inconsistent Relief

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[78] Proposed 34 C.F.R. § 685.222(i)(5) ("The relief to the borrower may not include non-pecuniary damages such as inconvenience, aggravation, emotional distress, or punitive damages.").

[79] *See generally* National Consumer Law Center, *Unfair and Deceptive Acts and Practices* §12.3.3 (8th ed. 2012), *updated at* www.nclc.org/library. *See, e.g.*, *Gent v. Collinsville Volkswagen, Inc.*, 116 Ill. App. 3d 496, 504, 451 N.E.2d 1385, 1390 (1983) (affirming award of $6000 for UDAP claim based on concealment of problems with car; although plaintiff only paid defendant $3,879.75 for the car; expenditures on towing, repairs, auto loan interest, and rental of a substitute vehicle supported larger compensatory award); *Hale v. Basin Motor Co.*, 795 P.2d 1006 (N.M. 1990) (noting with regard to relief that "[c]ertainly, high among the factors motivating legislatures to enact [UDAP laws] is the frustration experienced by consumers having to run around to straighten out unfair or deceptive trade practices").

As a practical matter, calculating precise amounts of harm pursuant to the methodologies in the proposed rules is likely to be difficult if not impossible. Attempts to do so will likely lead to unfair and inconsistent outcomes for similarly situated borrowers, particularly given the proposal to permit officials to pick and choose to apply "one or more" of the methods provided in any given case, or even to use any "other method determined by the official."[80] This is contrary to the Department's stated goal—and rationale for excluding non-pecuniary damages—of avoiding subjective damages calculations and producing consistent and fair results for borrowers.[81] It will also unnecessarily complicate the borrower defense process for borrowers, schools, and the Department alike. Unrepresented borrowers, in particular, are likely to have difficulty identifying what evidence or arguments would support the relief to which they are entitled or gathering such evidence.

The methods that the Department proposes in Appendix A for calculation of such relief illustrate these problems. The Department has wisely abandoned some of the misguided calculation methods it proposed during the rulemaking meeting drafts, such as those to allow officials to limit relief to the "difference in tuition between the program attended by the student and the average tuition for a comparable pool of programs" (which would have provided a ready basis to deny relief to defrauded students so long as the tuition they were charged was an "average" amount) or to the "difference between (i) the student's earnings one year after leaving the program" and the expected salary for occupations in the field "using the lowest decile of earnings for that occupation" (which would provide basis to deny relief to defrauded students who attended programs—like beauty programs—for which lowest decile occupation earnings may not significantly exceed the minimum wage). The latest iterations, however, are also flawed.

For example, proposed method (C) in Appendix A limits relief to the amount by which a borrower's "economic loss" outweighs the value of the benefit obtained. However, the proposed rules arbitrarily cap the amount of economic loss at the cost of attendance, even though—as demonstrated above—real and legally cognizable losses often exceed the cost of attendance. At the same time, the proposed rules suggest officials should discount relief if the borrower obtained any "transferrable credits"[82] or a job in the field related to a career program. Based on our experience with defrauded borrowers, discounting relief in this way would be unfair and would fail to reflect the true harm they experienced.

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[80] Proposed 34 C.F.R.§ 685.222(i)(1)(iii).

[81] 81 Fed. Reg. at 39351.

[82] Although the proposed rules specify that the value of the benefit of the education may include "transferrable credits obtained *and used* by the borrower," Proposed Appendix A (C) (emphasis added), the Department's explanation of the rule suggests that officials may discount relief for transferrable credits that may be used in the future. *See* 81 Fed. Reg. at 39352. Assuming the Department intends the words "and used" to mean transferrable credits should only be counted as a benefit if the borrower actually used them to attend another school, it should clarify this.

With regard to transferrable credits, many of our clients never use and place no value on any transferrable credits—indeed, their negative experience with a predatory school and student loan debt often discourages them from further pursuing higher education. Additionally, even for those clients who think they might want to transfer their credits or do transfer their credits, their transfer options are often limited to predatory or low-value schools—the only schools likely to accept credits from ill-regarded programs. Although the Department suggests that hearing officials may consider limitations on transferability of credits and "assign due value" accordingly, borrowers rarely know of the limitations on transferability of their credits. Indeed, one of the common misrepresentations predatory schools make to borrowers is that their credits will be broadly transferable. Additionally, when schools shut down, such as many Corinthian schools did, students are often funneled into equally bad schools through the teach-out process. The proposal to discount borrower defense relief where borrowers receive transferrable credits could thus penalize students with meritorious borrower defenses who, for example, opted to take a "teach out" from a Corinthian school into a Zenith-operated school, under a deal orchestrated by the Department.[83]

As for the proposal to discount relief if a borrower obtains a job in the field with typical wages, doing so would punish students who succeed at finding work *despite* the failings of their program rather than *because* of any program value, even when their job was obtained entirely on their own. Especially for occupations that do not require a school certificate or degree, attendance at a predatory institution that is not respected in the field may not offer any benefit in landing a job—to the contrary, our clients have often told us that their attendance at Corinthian programs was considered a mark *against* them when interviewing for jobs.[84] Finding work after attendance at a predatory school often depends on the student's personality, prior work experience, networking, or simply luck, rather than credentials or help provided by the school. For example, "George" attended ITT's Animation and Game Design program. The school's advertised job placement assistance ended up being nearly non-existent. After conducting his own job searches, George concluded that having ITT on his resume was in fact hurting his

[83] *See* Press Release, U.S. Dep't of Educ., More than 50 Corinthian Campuses Transition to Nonprofit Status under Zenith Education Group (Feb. 3, 2015) (describing Department role in Zenith purchase of Corinthian schools), available at http://www.ed.gov/news/press-releases/more-50-corinthian-campuses-transition-nonprofit-status-under-zenith-education-group; *see also* http://www.zenith.org/schools/teach-schools/ (listing Everest schools Zenith is closing and teaching out, and noting that Zenith may teach out and close a school for a number of reasons, including "unacceptable student outcomes").

[84] In fact, studies suggest that credentials from for-profit education providers *impair* the earning power of graduates. *See, e.g.*, Stephanie Riegg Cellini, Nicholas Turner, *Gainfully Employed? Assessing the Employment and Earnings of For-Profit College Students Using Administrative Data*, National Bureau of Economic Research Working Paper No. 22287 (May 2016) (on average, associate's and bachelor's degree students experience a decline in earnings after attendance at a for-profit college, relative to their own earnings in years prior to attendance); David Deming, Claudia Goldin, Lawrence F. Katz, *The For-Profit Postsecondary School Sector: Nimble Critters or Agile Predators?*, J. OF ECON. PERSPECTIVES vol. 26 n. 1 (Winter 2012) (finding that for-profit students end up with higher unemployment and "idleness" rates and lower earnings six years after entering programs than do comparable students from other schools, and that they have far greater student debt burdens and default rates)

chances of obtaining work. After he removed this credential, he obtained an entry-level job in graphic design on his own, but he needed to self-teach the skills required for the position.

Further, the income bar for an "expected salary" in some fields is often very low. For example, the entry-level wage for medical assistants in Massachusetts is $12-$14.00 per hour. This means that, although they enrolled on the promise of well-paid employment, any student who manages to get a job at or just above minimum wage after attending Everest's Massachusetts medical assisting program could potentially be deemed to have suffered little or no injury under the Department's proposed method.

Finally, while the Department's addition of language to method (C) making clear that officials "will consider any evidence indicating that no identifiable benefit of the education was received by the student" is a step in the right direction, the language still may be read to place a burden on the borrower to come up with such evidence—and to present it for the subjective consideration of an official. A fairer process would presume full relief should be provided.

Other proposed methods of injury calculation are also inadequate in the context of students who have been scammed by predatory schools. For example, we oppose attempting to determine what the borrower would have paid if the borrower had been given an accurate understanding of the subject of the substantial misrepresentation, as suggested in method (A) to Appendix A. While this method may sound reasonable in theory, in practice it would require officials to engage in the necessarily speculative task of valuing a counterfactual—essentially assessing how much a reasonable borrower would have paid if things had been different. This approach is almost guaranteed to result in inconsistent outcomes for similarly situated borrowers. Officials have little way of determining how much consumers would pay for a service if it had been presented in a materially different way than it was actually presented. It also fails to provide adequate relief to borrowers who would not themselves have paid any amount for a school if they had been told the truth about it, even if some other "reasonable borrower" may have chosen to buy at that price.

Finally, while the proposed regulation does not require use of these methods for calculating relief, stating that relief "may be calculated using one or more of the[se] methods or such other method as the Secretary may determine,"[85] this fails to alleviate the problem. Rather, it opens the door to other bases to deny or limit relief and to inconsistent treatment of borrowers.

In light of all these problems, it is easy to see why, in comparable discharge programs, including those for false certification and closed school, the regulations do not require any such inquiry into remedy. Rather, the rules in other discharge programs provide that all meritorious applications shall result in full discharge, including cancellation of obligation to pay outstanding

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[85] Proposed 34 C.F.R. § 685.222(i)(1)(iii).

balances and refund of all amounts previously paid on the loan voluntarily or involuntarily.[86] Providing full relief for all meritorious claims without proof of the specific amount of harm is also consistent with other legal approaches to relief for fraudulent inducement or deceptive practices. For example, about half of states allow private plaintiffs who prevail on UDAP claims to obtain a minimum damage awards of as much as $10,000 even if their actual damages are lower, and many do not require proof of injury either at all or in a specific amount to receive these minimum damages.[87] Existing relief law thus offers further support for providing full discharges without attempting the complex and often impossible task of calculating precise injury.

c. Recommendations for Improving Relief Provisions

As stated, we recommend that the Department amend the proposed regulations to provide individuals with meritorious borrower defenses with full discharges on eligible loans, including cancellation of outstanding balances and refunds of amounts already paid, just as is provided for false certification and closed school discharges. Providing full relief to all such borrowers is far and away the best and simplest solution for meeting the Department's commitment of "ensur[ing] that students who have been defrauded by their college receive every penny of the debt relief to which they are entitled, as efficiently and easily as possible."[88]

If, however, the Department is unwilling to commit to full discharges in all cases of meritorious defenses as recommended, we urge it to take other steps to simplify the process for all parties and provide better assurance that borrowers will consistently receive the relief to which they are entitled. One way to do so is to eliminate Appendix A and amend proposed § 685.222(i) to indicate that when an individual or group borrower defense is approved, the Secretary ordinarily will discharge all amounts owed to the Secretary on the loan at issue and afford the borrower recovery of all amounts previously collected on the loan. In the unusual circumstance where such relief is not warranted, the Department must explain in writing the basis for its determination and allow the borrower the opportunity to respond. The Department should also strike the portion of § 685.222(i)(5) that reads "The relief to the borrower may not include non-pecuniary damages such as inconvenience, aggravation, emotional distress, or punitive damages." By definition, the relief provided—wiping out loan obligations and returning

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[86] *See* 34 C.F.R. §§ 682.402(d)(2) (FFEL), 685.214(b) (Direct Loan).

[87] *See* National Consumer Law Center, *Unfair and Deceptive Acts and Practices* §12.4.1.1 & App'x A (8th ed. 2012), *updated at* www.nclc.org/library. *See, e.g.*, *Mulford v. Altria Group, Inc*., 242 F.R.D. 615, 621 (D.N.M. 2007) (statutory damages available without proof of actual damages); *Perez v. Anderson*, 98 B.R. 189 (E.D. Pa. 1989) (awarding statutory damages despite no actual damages); *Clayton v. McCary*, 426 F. Supp. 248 (N.D. Ohio 1976); *White v. Mock*, 104 P.3d 356, 363–364 (Idaho 2004) (awarding statutory minimum damages even though consumers failed to prove actual damages); *Carter v. Lachance*, 766 A.2d 717 (N.H. 2001) (statutory damages are required even without proof of actual damages).

[88] Borrower Defense to Repayment Negotiated Rulemaking Committee Meetings, Opening Remarks of Jeff Appel, Deputy Under Secretary U.S. Department of Education (Jan. 12, 2016) at 4, *available at* https://www2.ed.gov/policy/highered/reg/hearulemaking/2016/bd-appelremarks-011216.doc

amounts already collected—constitute pecuniary damages; this provision thus unnecessarily injects confusion.

In the event that the Department retains Appendix A and the discretion to use the methods of calculation provided therein, we urge the Department to, at minimum, exempt borrower defense claims predicated on substantial misrepresentations from such calculations, and adopt a presumption of full discharge relief for those claims. Because the Department's substantial misrepresentation standard requires borrowers to establish that any misrepresentation is "substantial" and that the borrower reasonably relied to her detriment upon it in deciding to enroll or continue enrollment,[89] it is always inappropriate to provide less than a full discharge in these cases.[90]

V. Group Process

We strongly support the inclusion of a group process in this rule,[91] and agree that it will "promote greater efficiency and expediency in the resolution of borrower defense claims."[92] Based on our experiences working with borrowers, we believe that the vast majority of students entitled to relief will never know of the opportunity to apply for such relief. The inclusion of a group process is therefore critical to ensuring that as many borrowers as possible who are entitled to relief actually get it, and that borrowers who were victims of the same illegal conduct by a school are treated similarly by the government.

To ensure that a group relief process reasonably achieves the goals of efficiency, consistency, and provision of relief for borrowers when there is sufficient evidence of systemic wrongdoing by a school, we offer the following suggestions for strengthening the final rule:

First, the group process should be automated once it is clear that relief is warranted for a particular cohort. Despite massive outreach efforts by the Department, attorneys general, and legal aid organizations such as Housing and Economic Rights Advocates, Bay Area Legal Aid, and East Bay Community Law Center, the response rate for cohorts of Heald borrowers pre-approved for relief are in the single digits. In speaking to borrowers who are aware of applications, we have found that most find the application process confusing or daunting to navigate. Likewise, based on the time it has been taking for borrowers to receive a determination on their applications, it seems clear that it takes the Department a significant amount of time to process these forms.

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[89] Proposed 34 C.F.R. § 685.222(d)(1); *see also* 81 Fed. Reg. at 39342-44.

[90] In contrast, the Department has specifically declined to adopt a materiality requirement into the breach of contract standard. 81 Fed. Reg. at 39341-42.

[91] *See* Proposed 34 C.F.R. § 685.222(f)-(h).

[92] 81 Fed. Reg. at 39347.

A better approach is to make relief automatic. The Department recognizes that reliance may be presumed in the group process[93] and proposes to allow identification of groups without applications and to make relief available to group members on an opt-out rather than opt-in basis. We believe the current rules provide for such automatic relief, and we encourage the Department to ensure both that this automatic relief provision is clearly included in the final rule and that there is sufficient guidance to ensure this authority will be exercised when warranted.

Second and relatedly, the group process would be significantly enhanced by greater transparency. The Department's proposal allows it to identify groups, but does not set forth any automatic triggers for when a group will be identified. Nor does it allow for those outside of the Department, such as attorneys general and legal aid organizations, to request that the Department consider and decide whether evidence supports the existence of a group for purposes of borrower defense, as discussed during the rulemaking meetings. Although the Department suggests that "such cooperation is more effective when it is conducted through informal communication and contact,"[94] we are not convinced that such channels of communication are open and available to our clients or us as legal aid practitioners. But even if such informal channels were sufficient to allow us to share the information that we learn from seeing a volume of students who may have attended the same schools and been subject to patterns of misconduct, informal back-channels, no matter how effective, do not promote the values of transparency and accountability. We urge the Department to:

1. Define a non-exhaustive list of circumstances that would warrant group treatment; and
2. Adopt the language under consideration at the close of negotiated rulemaking, specifically:

A state attorney general, state or federal enforcement agency, or a nonprofit organization that provides legal representation may submit a written request identifying a group of borrowers for

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[93] Proposed 34 C.F.R. § 685.222(f)(3). We note that presuming that members of a group or class of consumers who were subjected to broadly-disseminated, fraudulent misrepresentations reasonably relied on such misrepresentations is consistent with longstanding legal authority under consumer protection laws. For example, in one of the recent class action lawsuits against Trump University, a federal district court rejected the University's argument that individualized inquiry would be necessary to assess whether class members' relied on alleged verbal misrepresentations, explaining that reliance may be presumed upon evidence that members of the class were exposed to the same alleged misrepresentations and that those misrepresentations were material. *See Makaeff v. Trump University, LLC*, 2014 WL 688164, at *1, 12-13 (S.D. Cal. Feb. 21, 2014). Likewise, providing relief—in the form of rescission or otherwise—to class members without individual inquiry into the specific injury they suffered, is also consistent with consumer protection law and due process. *See, e.g., Massachusetts Mutual Life Ins. Co. v. Superior Court*, 97 Cal. App. 4th 1282, 1289 (Cal. Ct. App. April 29, 2002) ("[O]ur courts have not departed in any manner from the principle that liability for restitution under either the specific false advertising provisions of [the UCL] may be found without any individualized proof of deception and solely based on the basis that a defendant's conduct was likely to deceive consumers."); *State ex rel. Webster v. Areaco Inv. Co.*, 756 S.W.2d 633, 637 (Mo. Ct. App. Sep. 6, 1988) (consumers who brought class claim under Missouri's UDAP not obligated to show individual reliance on specific representations in order to be entitled to restitution).

[94] 81 Fed. Reg. at 39348.

the Secretary to initiate the process described in either paragraphs (g) or (h) of this section. The Secretary will issue a written determination, within a reasonable period of time, whether such a process, as appropriate, will be initiated.

VI. Equal Access for FFEL Borrowers

There can be little question that Federal Family Education Loan ("FFEL") borrowers deserve and need equal access to a fair borrower defense process alongside that provided for Direct Loan borrowers. Unfortunately, the proposed regulations fail to deliver such equity, and would leave many FFEL borrowers out in the cold. We therefore urge the Department to open the individual and group relief process to FFEL borrowers without requiring consolidation.

a. FFEL Borrowers Should Have the Same Rights As Direct Borrowers

Borrowers whose federal student loans happened to be made through the FFEL program rather than the Direct program should not face barriers to relief as a result. Pursuant to § 455(a) of the Higher Education Act, Direct Loans and FFEL loans are to have the same terms, conditions, and benefits. Consistent with that principle, the Department of Education has long reassured schools that it intends to provide "equitable determinations" of borrower defense liability under the Direct and FFEL programs.[95] Borrowers similarly deserve equitable treatment in this process regardless of which program their federal loans were made through. Indeed, unlike schools, which prior to July 2010 could choose which loan program to participate in, borrowers generally had no choice as to which program their federal loans were made through.[96]

In our experience, borrowers rarely know whether their loans are Direct or FFEL—they simply know that they were told to sign paperwork to obtain financial aid, and that now they owe student loans. This is especially true for borrowers who have been harmed by school misconduct. For example, a client who attended Everest Brighton recalled that she was rushed through signing a pile of forms without opportunity to read them in an enrollment process that took less than 30 minutes. Though she was told that the papers were only for school purposes and that she was receiving "government grants," in fact she unknowingly took out various federal loans. Moreover, many borrowers whose school years spanned the discontinuation of the FFEL program in July 2010 took out both FFEL and Direct loans for their education. To provide them relief on only some of their loans would arbitrary, confusing and unfair.

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[95] *See, e.g.*, 60 Fed. Reg. 37768-69 (Jul. 21, 1995) (reassuring schools in the context of borrower defense regulations that "[t]he Direct Loan regulations are intended to ensure that institutions participating in the FFEL and Direct Loan Programs have a similar potential liability" and that "[t]he Department intends to perform its oversight responsibilities for both loan programs in a manner that provides equitable determinations of institutional liability").

[96] *See, e.g.*, Federal Student Aid Handbook 2-13 (2008-2009), *available at* http://ifap.ed.gov/sfahandbooks/attachments/Vol2Ch20809.pdf (explaining that schools can apply to participate in either or both the FFEL and Direct programs; students that attended schools that only participated in one program did not have a choice as to the source of federal Stafford or other loans they received).

The lack of relief for FFEL borrowers is a major issue. According to the Department's statistics, over 17.5 million individuals have outstanding FFEL loans.[97] And as advocates have noted, many of the federal loans disbursed to former students of Corinthian Colleges are FFEL loans, including more than 90 percent of the federal loans disbursed to Heald College students in 2009-2010.[98]

b. The "Consolidation Path" Does Not Provide Sufficient Protection to FFEL Borrowers

We appreciate that the proposed rules confirm that Direct Consolidation loans are eligible for discharge through the borrower defense process. While this is critical for the many borrowers who have consolidated their loans or may do so to access new repayment plans or emerge from default, there are several problems with the proposal to make consolidation a necessary prerequisite for FFEL borrowers to access the borrower defense process.

First, not every FFEL borrower is eligible to consolidate into a Direct Consolidation loan.[99] For example, a borrower who has already consolidated into a FFEL Consolidation loan and who is current on it generally may not consolidate into a Direct Consolidation Loan unless she has additional loans that can be included in the consolidation.[100] Given that consolidation has been encouraged by servicers and the Department at various times, many FFEL borrowers may fall into this bucket. Additionally, FFEL borrowers cannot consolidate if their wages are currently being garnished or if there is a judgment on the loan.[101] Unless ED changes the rules to permit these borrowers to consolidate, these FFEL borrowers will be unable to access the borrower defense process.

Second, a borrower can only consolidate portions of a loan that have not been paid. As such, as the Department makes clear in its explanation of § 685.212,[102] borrowers who consolidate FFEL loans into a Direct Consolidation loan are largely ineligible for relief on the portion of the loan already paid. This is again unfair to FFEL borrowers and arbitrarily provides different relief to FFEL borrowers based on when they consolidate their loans. Most perversely, it penalizes those FFEL borrowers who have diligently made payments on their loans, and makes it such that a borrower would receive more relief by not making payments when they were

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[97] *See* https://studentaid.ed.gov/sa/about/data-center/student/portfolio.

[98] *See* Coalition letter to Secretary King re: Recommendations to Improve Proposed Borrower Defense Regulations (March 11, 2016), *available at* http://www.studentloanborrowerassistance.org/wp-content/uploads/2013/05/CoalitionLetterOnBorrowerDefense_2016.pdf.

[99] For a discussion of limitations on eligibility to consolidate, *see generally* National Consumer Law Center, *Student Loan Law* § 7.2.2 (5th ed. 2015), *updated at* www.nclc.org/library.

[100] 34 C.F.R. § 685.220(d)(2).

[101] 34 C.F.R. § 685.220(d)(1)(ii)(B)-(C). The loan can only then be consolidated if the garnishment order is lifted or the judgment is vacated, respectively.

[102] *See* 81 Fed. Reg. at 39356.

required. FFEL borrowers who have paid back all of their loans—either through voluntary payments or through involuntary seizures of their wages or tax refunds—would generally not be eligible for relief at all. Unless the Department wishes to encourage the non-payment of FFEL loans and penalize those who have made payments, the borrower defense process must allow for refunds of amounts already paid on FFEL loans.

Third, even when borrowers are able to consolidate, it may be risky for them to do so unless they have certainty that the loans will be discharged. For example, consolidation is one of the few ways borrowers are able to get their loans out of default. Many of our clients who would be interested in submitting borrower defense claims also struggle financially and are at risk of delinquency or default. Borrowers who have consolidated all of their loans into a Direct Consolidation loan prior to defaulting, however, are not eligible to reconsolidate.[103] For at-risk borrowers, consolidation thus generally means giving up a key option for addressing a potential future default. Additionally, consolidation may make FFEL borrowers financially worse off. Borrowers in an income-driven repayment plan who consolidate would lose credit for their payments made toward forgiveness.[104] Some borrowers would lose their interest rate reductions for on-time payments. And borrowers consolidating Parent PLUS loans with other federal loans would be ineligible for most income-driven repayment programs.[105] Borrowers should not have to risk losing legal and financial protections in order to assert a borrower defense claim.

Fourth, as these rules are expected to go into effect in July 2017, FFEL borrowers who consolidate after that date to access the borrower defense process will be required to assert a defense under the new federal standards and to relinquish any state law claims for borrower defense that are otherwise available to borrowers who took out loans during the pre-2010 FFEL "era." As discussed above, the new federal standards are in many instances less generous than the state law standards applicable to existing borrowers. Not only is this unfair to FFEL borrowers, who will be forced to forgo their state law claims in order to assert a borrower defense, but it will lead to inconsistency and complication. Borrowers who attended schools run by the same company, in the same state, at the same time would nonetheless be subject to different standards based on whether the borrower had to consolidate into a new Direct Consolidation loan to access relief.

Fifth, and perhaps most importantly, requiring borrowers to consolidate prior to accessing the borrower defense process may preclude application of the group discharge process to FFEL borrowers. The proposed group discharge rules specify that they apply to borrower defenses "asserted with respect to Direct Loans" and authorize the Secretary to identify members of

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[103] 34 C.F.R. § 685.220(d)(2)-(3).

[104] 34 C.F.R. §§ 685.209(a)(6)(iii), (c)(5)(v)B), 685.221(f)(3); *see also* National Consumer Law Center, *Student Loan Law* § 3.3.3.8 (5th ed. 2015), *updated at* www.nclc.org/library.

[105] 34 C.F.R. §§ 685.209(a)(1)(ii), (c)(1), 685.221(a)(2) (providing that Parent PLUS loans and consolidation loans that repaid a Parent PLUS loan cannot be repaid using REPAYE, PAYE, or IBR).

groups of impacted borrowers without application.[106] We are concerned this could be read to exclude FFEL borrowers who have not already consolidated from the group or to limit the possibility of group relief for borrowers in programs that made only FFEL loans. This could exclude wide swathes of defrauded borrowers from the scope of federal enforcement and relief, based only on the unlucky fact that they had FFEL rather than Direct loans.

Including FFEL borrowers in the group discharges is insufficient if their relief is contingent on consolidating. In our experience working with vulnerable borrowers, the extra step of completing a lengthy and legalistic consolidation application is likely to significantly depress relief—at least among borrowers who are not being assisted by counsel. Again, the group process is necessary because most defrauded borrowers, quite understandably, do not know their legal rights or how to navigate the various processes to vindicate them, and are focused on addressing the everyday crises of living on a low or no income. Indeed, we have seen that the requirement placed on defrauded Corinthian borrowers to submit a shorter attestation form to obtain relief has resulted in fewer than 3,787 borrowers being approved for relief out of the approximately 335,000 eligible borrowers the Department has attempted to contact.[107]

To address these problems and ensure FFEL borrowers have equal access to the borrower defense process, we recommend that the process should remain open to FFEL borrowers even if they do not consolidate. As the Department acknowledges, it alone "has the ultimate discretion to grant or deny a discharge application."[108] The Department should exercise that authority to consider borrower defense applications and automatic group relief for FFEL borrowers on equal footing with applications and group relief for contemporaneous Direct Loan borrowers, and without any requirements to consolidate into Direct Loans or any limitations on FFEL borrowers' recovery of amounts already paid. This is the most straightforward and just solution to ensure FFEL borrowers defrauded by their schools do not face arbitrary barriers to relief. At minimum, the Department should stipulate to or presume a referral relationship for FFEL borrowers who have proven a borrower defense under the existing or proposed standard.

Finally, though we strongly urge the Department to open up the newly proposed borrower defense process to FFEL borrowers directly, without requiring consolidation, if it does not do so, we urge that the Department commit to a "pre-approval" process whereby it will determine FFEL borrowers' eligibility for discharge—contingent upon consolidation—prior to requiring consolidation or advising borrowers to consolidate to access relief. The Fourth Special Master Report suggests that this is the Department's current practice, but the Department should make a

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[106] Proposed 34 C.F.R. § 685.222(g), (h).

[107] *See* Fourth Report of the Special Master for Borrower Defense (June 29, 2016), *available at* http://www2.ed.gov/documents/press-releases/report-special-master-borrower-defense-4.pdf.

[108] Brief for Defendant-Appellee, *Salazar v. Duncan*, No. 15-832, at 8 n.4 (2d Cir. Jun. 22, 2015) (citing 34 C.F.R. § 682.402(e)(7)(iii)(B)(2) and further explaining that the Department "manages the FFEL and Direct Loan programs as a whole").

formal and enduring commitment to pre-determination if it is going to require consolidation for relief. This is important to protect against encouraging borrowers to consolidate—and forfeit certain rights and benefits—when consolidation may not result in relief. This type of pre-approval would also be essential to including FFEL borrowers in the process for group relief—the Department could assess the eligibility of all FFEL borrowers in a group and notify them of the relief they would receive if they consolidate, inform them of how to consolidate, and advise as to alternative avenues for relief if they do not consolidate.

VII. Forced Arbitration, Class Action Bans, and Mandatory Internal Dispute Processes

The Department's proposed rules on forced arbitration, class action bans, and mandatory internal dispute resolution processes are an enormous step in the right direction—*away* from forcing student borrowers to arbitrate their claims alone in secret, private tribunals.[109] Although most schools do not use these types of clauses,[110] predatory schools use them to prevent borrowers from obtaining relief from their schools—leaving injured borrowers with few options but to struggle with unaffordable loans or attempt to seek relief from the government instead.[111] Simultaneously, because borrowers facing forced arbitration clauses cannot obtain redress from the schools that defrauded them, the government and taxpayers are often left on the hook for the fraud. This is why so many speakers in the public hearings prior to the establishment of this rulemaking committee raised a ban on forced arbitration as a way to promote relief for borrowers and to protect taxpayers.[112] We therefore applaud the Department's proposal to strengthen the

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[109] "Pre-dispute arbitration" or "forced arbitration" refers to a contractual provision, agreed to in advance of any dispute or claim, which requires a party to take any claims that may later arise to arbitration instead of to a court, for resolution by a private company chosen by the author of the contract.

"Class action bans" are terms in contracts that purport to preclude a party from participating in a class action lawsuit or other class proceeding, either as a lead plaintiff or as member of the class; companies often attempt to use these terms to limit their liability exposure and to prevent consumers from banding together to leverage their resources as a group in asserting claims that may not be economically viable or otherwise feasible to pursue individually. "Mandatory internal dispute process" terms often purport to require students to notify their school of any disputes they have and to submit to an internal institutional process for attempting to resolve the dispute before a student can assert their dispute in court or in an administrative or arbitration proceeding. This can delay or prevent students from asserting their rights to a neutral third-party, especially when the internal process is not reasonably timely or accessible, and can create opportunities for sophisticated schools to suppress public information about student complaints and misconduct and to coerce students not to pursue their rights. These provisions are often found in contracts of adhesion—standardized, preprinted form contracts that are presented to students or other consumers on a take-it-or-leave-it basis, with no opportunity to bargain. In binding arbitrations, the arbitrator is empowered to issue a final, binding ruling on the merits of a suit, subject only to sharply limited judicial review.

[110] *See, e.g.,* Tariq Habash and Robert Shireman, *The Century Foundation Report: How College Enrollment College Contracts Limit Students' Rights, available at* https://tcf.org/content/report/how-college-enrollment-contracts-limit-students-rights/.

[111] *See, e.g.*, Comments of the Project on Predatory Student Lending & the National Consumer Law Center to the Department of Education on Intent to Establish Negotiated Rulemaking Committee for Pay as You Earn, ID: ED-2014-OPE-0124-0115.

Direct Loan program participation agreement by limiting participating institutions' use of forced arbitration, class action bans, and mandatory internal dispute processes.

To ensure these proposed rules have their intended effect, however, it is critical that the Department strengthen them and close loopholes that predatory schools could exploit. Most importantly, as detailed below, the Department should amend the rules to preclude schools from relying on any pre-dispute arbitration agreements—not just those that are formal conditions of enrollment. Otherwise, predatory schools would likely simply use other means to continue to suppress and hide borrower claims through arbitration agreements that skirt this line, including by using pre-dispute arbitration agreements that contain "opt-out" provisions, or are presented in a large stack of other documents for enrolling students to sign "voluntarily" without time to review, or are pushed on students at times other than enrollment. Therefore, we urge the Department to remove any opportunity for schools to bind students to arbitrate and to eliminate their rights to go to court and to pursue their claims on a class basis.

a. Predatory Schools Use Forced Arbitration to Shield Their Practices from Scrutiny

To prevent students from successfully seeking relief, and to prevent the Department of Education, accreditors, and law enforcement agencies from learning about complaints and settlements, predatory schools frequently require students to waive their right to participate in class actions against the school to resolve their disputes—students are required to waive these rights before even knowing what disputes they might have with the school. These same requirements force the few students who might have the resources to bring individual claims to pursue those claims in a private forum and to agree not to disclose anything about the dispute.

These requirements cause enormous harm to student loan borrowers. Pursuing claims individually against a school is expensive—often prohibitively so—time consuming, and intimidating. And it is made even more difficult because borrowers and their advocates do not have access to prior arbitration decisions. Even when such decisions do exist, they are likely shielded by contractual confidentiality requirements. This lack of information about prior decisions and evidentiary rules being applied in arbitration, and the guarantee that the impact of any favorable ruling will be to future clients or to the public will be minimal, persuades many borrower advocates to focus our efforts on cases that can be brought to court.

Arbitration clauses, class waivers, and attendant confidentiality requirements also greatly reduce the likelihood that a school's fraudulent activities will result in any significant liabilities, and they prevent information about the disputes from reaching the Department, accreditors, and

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[112] *See, e.g.*, Statement of Pamela Banks, Senior Policy Counsel, Consumers Union, Transcript of Public Hearing in Washington D.C., Sept. 10, 2015, at p. 96; Statement of Debbie Cochrane, Institute for College Access and Success, Transcript of Public Hearing in San Francisco, Sept. 16, 2015, at pp. 20-21; Statement of Nick Campins, California Department of Justice, Transcript of Public Hearing in San Francisco, Sept. 16, 2015, at p. 43.

other law enforcement agencies. The result—because of the inability of students to pursue their claims—is that students' rights are curtailed, and indicators of failing administrative capability are suppressed.

Further, some schools insist on arbitration requirements that blatantly "overreach" by including terms that likely violate state law and further chill borrower claims. For example, a large, publicly-traded for-profit college uses an enrollment agreement that, contrary to Massachusetts law, purports to preclude incidental, special, consequential, or punitive damages and to require that any claims be brought by the student within just two years. The agreement also provides that the school may recover its attorneys' fees from the student if the student brings an unsuccessful action in court to challenge the arbitration provision or to challenge or correct the arbitration award. Though none of these terms should be found enforceable if challenged in court, they make it extraordinarily unlikely that a low-income borrower will be able to find an attorney to help pursue her claims, or that she would risk trying to pursue them in light of the expressed limitations on relief and threat of liability for a school's legal fees.

b. Forced Arbitration and Class Action Bans Prevent Consumers from Obtaining Relief from Fraudulent Entities, Even When "Opt-Out" Clauses Are Included

Empirical research confirms that forced arbitration prevents relief for consumers who have been harmed by illegal practices. After three years of study, the Consumer Financial Protection Bureau (CFPB) reported that consumers brought fewer than 1,500 arbitration claims across six consumer financial markets from 2010 to 2012, and claims filed with the largest arbitration firm resulted in decisions providing combined relief of less than $400,000.[113] By contrast, about 32 million consumers obtained about $220 million from class action settlements in each of those years.[114] Furthermore, 90% of the arbitration clauses examined for the CFPB study waived class action proceedings—precluding consumers from obtaining the relief through class actions, or from holding companies responsible for the full extent of their illegal conduct against consumers as a whole.[115] These data show that forced arbitration clauses frequently pose insurmountable barriers to consumers seeking relief.

The same CFPB study also demonstrates the illusory nature of opt-out clauses, which purport to allow borrowers to retain their rights to go to court by submitting a letter or form within a set number of days—usually thirty or sixty—after entering a contract. Of the more than 400 credit card contracts examined by the CFPB report, 27% contained an opt-out provision, but *none* of the consumer subjects had opted out of arbitration.[116] This is not because consumers for

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[113] *See* Consumer Fin. Prot. Bureau, *Arbitration Study*; 1:11-13 (2015).
[114] *Id.*
[115] *Id.* at 1:13.
[116] *Id*. at 1:31; 3:20-21.

some reason like being bound to pre-dispute arbitration, rather, a survey found that none of those borrowers were aware of the opt-out provision.[117]

c. Student Loan Borrowers are No More Likely than Other Consumers to Opt Out of Arbitration or to Understand that a Pre-Dispute Binding Arbitration Agreement Waives their Right to Go to Court

Our clients frequently tell us about the tall stacks of papers they are given to sign upon enrollment in a for-profit school. In what is, for many, the most significant financial transaction in their lives up to that point, they are often alone in a room with a recruiter from the school standing over them, rushing them through, encouraging them not to read and not to worry, but simply to trust the recruiter and to sign more forms. More often than not, our clients have no idea the number, type or total dollar amount of their student loans. They frequently do not receive copies of enrollment agreements, and when they do, they have often been told that they should throw them away.

An enrollment agreement with fine print allowing our clients to "opt out" of binding arbitration within one or two months is functionally identical to a contract with no opt out. Similarly, fine print stating that the student need not sign the arbitration agreement to enroll or purporting to tie the arbitration provision to some other non-mandatory agreement with the student would not change the result for students who regularly sign large stacks of papers they do not understand or even have a chance to read. Such legalistic fine print—rarely if ever read, much less understood—should not be understood to turn forced arbitration into voluntary arbitration. The Department should not permit schools, by regulation, to turn unacceptably coercive contracts into Department-approved, voluntary contracts.

Instead, the Department should preclude schools that participate in the Direct Loan program from using any pre-dispute arbitration agreements with students because all such agreements force students to arbitrate any claims that may later arise, to the detriment of students and taxpayers alike. The Department should thus amend the proposed rules to provide a clear, bright-line rule requiring schools to agree not to enter into or rely on any pre-dispute arbitration agreements with students.

d. The Scope of Claims Covered by the Proposed Rule Should be Clarified

As currently drafted, the proposed regulation uses a few different formulations in describing what types of claims are protected against forced arbitration, class action bans, and internal dispute resolution process requirements. To avoid any confusion, we urge the Department to clarify the scope of protected claims. To protect borrowers, taxpayers, and the integrity of the federal student aid program, the scope of protected claims should be broad and

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[117] *Id*. at 3:20-21.

clear. And to support the integrity of the borrower defense process and the ability of borrowers to obtain relief for injuries beyond the amount of their federal student loans, the rules should at minimum cover claims founded in facts that could give to a borrower defense claim. This should include all claims relating to the making of a Direct Loan or to the educational services or programs provided by an institution participating in the Direct Loan program.

VIII. Closed School Discharges

We support the Department's proposal with respect to closed school discharges, but strongly recommend several modifications to further the Department's goal of increasing the numbers of eligible students who receive closed school discharges.

a. The Department Should Clarify that Closed School Discharge Information Must be Provided with a Monthly Payment Statement when Collection Begins or Resumes After the 60-day Forbearance Period

Currently, after a school closes, the Department or guaranty agency is required to provide discharge applications to borrowers who appear to have been enrolled at the time of the school's closure or to have withdrawn not more the 120 days prior to closure.[118] This often happens one to six months after the school has closed. Then, the Department or guaranty agency must refrain from collecting on the loans obtained to attend the closed school for sixty days. If the borrower does not apply for a closed school discharge during that time, the Department or guaranty agency is required to resume collection on his/her loans if the loans are not still within the 6-month grace period.

The Department observed that despite these requirements, "[m]any borrowers eligible for a closed school discharge do not apply,"[119] Indeed, the Department receives closed school loan discharge applications from only 6% of eligible borrowers. [120] This response rate is unacceptable.

The low response rate is due to a lack of understandable and accessible information about closed school discharges, as well as lack of effective outreach.[121] In order to address this lack of information, the Department proposes that it or the guaranty agency provide the borrower with another discharge application and information about how to obtain a discharge "[u]pon resuming collection of any affected loan."[122]

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[118] 34 C.F.R. §§ 674.33(g)(8)(v) (Perkins); 682.402(d)(6)(ii)(H); 685.614(f).
[119] 81 Fed. Reg. at 39369.
[120] Paul Fain, *Best of a Bad Situation?,* Inside Higher Ed (Dec. 9, 2014), *available at* www.InsideHigherEd.com.
[121] *Id.*
[122] Proposed 34 CFR §§ 674.33(g)(8)(vi) (Perkins), 682.402(d)(6)(ii)(I) (FFEL), and 685.214(f)(5) (Direct)).

We strongly support this proposal. In our experience, the reason that many borrowers do not respond to the first notice regarding closed school discharge from the Department or guaranty agency is that it is provided at a time when the borrower is focused more on her school's closure than dealing with her debt burden. This first notice is typically provided within the 6-month grace period. Providing another closed school discharge application when the loan is actually being collected, and the borrower faces the burden of loan payments, is likely to increase the response rate.

We also urge the Department to make revisions to address two issues. First, the 60-day forbearance period may expire while the borrower is still within her 6-month grace period. In this situation, it is unclear when the loan discharge information should be provided, as collection will not "resume." We therefore urge the Department to revise the regulation to clarify that the closed school discharge information must be provided when collection first begins (when a borrower enters repayment after the grace period and will be more inclined to exercise her discharge rights) or is resumed, whichever is applicable.

Second, the Department should clarify that the closed school discharge information must be provided, upon beginning or resuming collection, *with* the borrower's monthly statement. Many of our Corinthian Colleges clients have been receiving payment statements from their servicers, along with emails from the Department regarding defense-to-repayment options. They are also being bombarded with calls, letters, and emails from fraudulent debt collection companies offering "Obama's debt forgiveness" for Corinthian borrowers for a fee, some even representing they are from the Department of Education. Many other closed school borrower we represent have also been bombarded with similar fraudulent solicitations. As an example, many of the closed school clients of the Legal Aid Foundation of Los Angeles from Marinello Schools of Beauty received the attached solicitation.[123]

Our clients are consistently confused about which notifications are legitimate and which are not. They are most likely to trust and pay attention to the monthly payment statement from their loan servicer. Therefore, to increase the numbers of borrowers who respond to the closed school discharge information provided by the Department or the guaranty agency, it should be included with the monthly payment statement from the loan servicer (or appropriate entity if the borrower is in default).

We suggest the following revisions to implement the above recommendations. While we have only suggested language for the Direct Loan program, this language should also be included in the Perkins and FFEL regulations.

§ 685.214 Closed school discharge.

[123] *See* Attachment A.

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(f) * * *

(4) If a borrower fails to submit the application described in paragraph (c) of this section within 60 days of the Secretary's providing the discharge application, the Secretary resumes collection and grants forbearance of principal and interest for the period in which collection activity was suspended. The Secretary may capitalize any interest accrued and not paid during that period.

(5) Upon ***beginning or*** resuming collection on any affected loan, ***whichever is applicable,*** the Secretary provides the borrower another discharge application and an explanation of the requirements and procedures for obtaining a discharge ***with the borrower's monthly repayment statement.***

b. The Department Should Make Discharges Mandatory for Students Who do Not Reenroll Within One Year After their Schools' Closure, Expand Eligibility for this Relief, and Provide an Opt-out Notice

We also support the Department's proposal to allow loan holders to grant closed school discharges, without applications, to borrowers who do not reenroll in a new institution within three years of their schools' closures.[124] Although better notice will increase the number of closed school discharge applications submitted by eligible borrowers, there are nonetheless likely to be many borrowers who do not respond. As discussed above, non-profit legal services organizations have met with thousands of borrowers in the wake of numerous for-profit school closures for many years, including many recent closures. Even students who receive information on their rights from state agencies and the Department are confused by contradictory information from their schools, aggressive solicitations of other for-profit schools and fraudulent student loan debt relief companies. We also see a constant influx of clients whose schools closed five to 30 years ago and who have no idea that they are eligible for a discharge.

We therefore support the Department's proposal to allow automatic closed school discharges, without any application, for borrowers who have not re-enrolled in a Title IV eligible institution within three years of their schools' closures. We strongly urge the Department, however, to incorporate the following revisions:

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[124] *See* Proposed 34 CFR §§ 674.33(g)(3)(iii) (Perkins), 682.402(d)(8)(iii) (FFEL), and 685.214(c)(2) (Direct).

Make Discharges Mandatory. The Department's proposal is entirely discretionary. The proposals for all three types of loans are subparts to language that states the loan holders "may" grant discharges in certain circumstances.[125] Given that the Department and guaranty agencies have conflicting duties and motivations to collect on loans, rather than discharge them, this discretionary language could make this regulation meaningless. In addition, there is no mechanism allowing an organization, borrower, or attorney general to demand that the Department or guaranty agency implement this provision. We therefore recommend that the Department make this provision mandatory, as it proposed to do during negotiations.[126]

Shorten Reenrollment Period from 3 Years to 1 Year. In our experience, the vast majority of closed school borrowers who are able to transfer their credits do so within several weeks to several months after a school closes. Immediately upon a school closure, the closed school as well as state agencies may bring in other schools to market their programs to impacted students. It is also within the first few weeks after a closure that other schools reach out to students, including community colleges, and that students actively search for a new school to accept their closed school credits. Beyond this, very few students transfer their closed school credits. We therefore propose that all closed school borrowers who do not reenroll in a Title IV institution within one year, rather than three years, be granted a closed school discharge without any application. Forcing these harmed borrowers to wait three years, to make payments during these three years, and to face burdensome involuntary debt collection tactics if they default is unfair to these borrowers.

Provide Opt-Out Procedure. While we anticipate that the vast majority of eligible borrowers would want a closed school discharge if they knew about it, some borrowers may not. This possibility can be readily addressed through an opt-out procedure, in which students are provided notice about the consequences of the discharge and are granted a closed school discharge unless they opt-out within 60 days of receiving the notice.

Offer Closed School Discharges to Borrowers Who Reenroll but Who May Still be Eligible for Relief. Relief should not be limited to students who do not re-enroll in a Title IV institution. The HEA and current regulations provide that a borrower is eligible for closed school discharge if she did not complete a program due to school closure and did not subsequently *complete* it through a teach-out or by transferring credits.[127] Students who participate in a teach-out or transfer credits but do not complete their program are still eligible for closed school discharge. So are students who reenroll in a different institution but do not transfer credits or who transfer some credits to an entirely different program. This clarification is particularly important in light of the widespread misinformation we have seen both closing

[125] *See* Proposed 34 C.F.R. §§ 674.33(g)(3) (Perkins), 682.402(d)(8) (FFEL), and 685.214(c) (Direct).

[126] *See* Dep't of Educ., Issue Paper 10 for Session 3 (March 16-18, 2016) ("The Secretary *discharges* the borrower's obligation to repay . . .").

[127] 20 U.S.C. § 1087(c)(1); 34 C.F.R. § 685.214(c)(i)(C).

institutions and for-profit recruiters give to students threatened with school closure, which are discussed in more detail in the next section. We therefore propose that after one year, the Department or guaranty agency provide a closed school discharge application and information to borrowers who have re-enrolled in a Title IV institution. This information should explain the circumstances under which borrowers who re-enroll are still eligible for closed school discharges.

c. The Department Should Require All Closing Schools to Provide Students with Information Regarding their Discharge Rights on Forms Provided or Approved by the Department and Require Schools to Include the Expected Date of Closure

We support the Department's proposal to require closing schools to provide discharge information to students.[128] When schools announce that they are closing, they currently have no obligation to inform their students about their loan discharge rights and options. As a result, students are compelled to continue their educations in ways that may not be in their best interests. For example, when a teach-out is offered, students often believe they are obligated to participate, even though they have a right to opt for a closed school discharge instead. Or, although instruction is seriously deteriorating, students may feel compelled to complete the program at the closing school, unaware they have a right to withdraw within 120 days of the closure and receive a closed school discharge. Students may also feel compelled to accept another school's offer to accept a few credits, without understanding that by doing so they may be ineligible for a closed school discharge.

We therefore support the Department's proposal to require schools to provide borrowers with notice about closed school discharge rights when they submit a teach-out plan after the Department initiates an action to terminate Title IV eligibility or other specified events. This regulation, with the modifications we recommend below, will help to ensure that borrowers in this difficult situation are able to make better-informed choices over how they proceed with their higher education.

The Department's proposal does not go far enough to ensure that borrowers of closing schools receive accurate, complete and useful information. In order to ensure closed school students receive this information, the Department should modify this regulation as follows:

The Department Should Provide or Approve the Written Disclosures. The proposed rule states that the closing "*institution* will provide enrolled students with a . . . written disclosure, describing the benefits and consequences of a closed school discharge as an alternative to completing their educational program through a teach-out agreement . . . ."[129] The

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[128] *See* Proposed 34 C.F.R. § 668.14(b)(32).
[129] Proposed 34 C.F.R. § 668.14(b)(32).

Department should not rely on failing schools to ensure that students are given this important information prior to closure. Because these schools can be liable for the closed school discharges, closing schools often provide inaccurate closed school discharge information or provide information in a format that students are unlikely to read or notice.

As an example, Westwood College provided a letter to students impacted by its closure.[130] This letter emphasized students' transfer options without mentioning discharge options until the second page. In addition, it provided inaccurate information by stating, "If you apply for and receive a Federal discharge, you will forfeit any Westwood credits earned and these credits will not be transferable to a partner school." In fact, students may transfer credits to a different program at a different school and still be eligible for a closed school discharge.[131]

More recently, ICDC College in California closed and arranged for a teach-out with a distance education provider, including for brick-and-mortar students.[132] In its letter to students, it emphasized the teach-out, did not even mention students' rights to closed school discharges of their federal loans, and provided confusing information to them about the state tuition recovery fund at the end of the letter. Many of the students that the Legal Aid Foundation of Los Angeles assisted were unhappy that they could only complete a teach-out through an online program and did not know they could instead seek a closed school discharge.

To prevent these types of misleading disclosures, which defeat the purpose of the proposed regulation, the Department should amend proposed section 668.14(b)(32) to require that the written disclosure the school gives to its students be "*in a form provided or approved by the Secretary*."

The Disclosures Should Be Provided on a Timely Basis. The Department's proposal does not address a situation in which the school fails to provide the required information. Most schools close due to financial problems. By the time they submit teach-out plans (if they are even able to do so), most schools have lost significant personnel and their operations are in disarray. It is therefore likely that some schools will fail to provide the required notices. The Department should clarify that, if a school fails to provide the notice required within five days after submission of a teach out plan as described in proposed section 668.14(b)(32), the "*Secretary shall provide the disclosures in a timely manner before any student agrees to or participates in a teach-out plan affecting his or her eligibility for discharge...*"

[130] *See* Attachment B.

[131] *See* 34 C.F.R. § 685.214(c)(1)(i)(C); *see also* www.studentaid.gov/closedschool ("Q. I transferred credits from a closed school and enrolled in a completely different program of study at a new school and completed the new program. Are the previous loans from the closed school dischargeable? A. Yes, because the program of study at the new school is completely different than that of the closed school, for which the loans were intended.").

[132] *See* Attachment C.

The Disclosures Must Clearly Explain Students' Closed School Discharge Rights. As noted above, closed schools often obfuscate a borrower's discharge rights and options. As worded, the Department's proposal will only encourage this continued obfuscation. It states that a school must provide a disclosure "describing the benefits and consequences of a closed school discharge as an alternative to completing their educational program through a teach-out agreement…" A school can comply with this regulation by providing a long, complicated disclosure about consequences and benefits, while burying a borrower's right to obtain a closed school discharge instead of participating in a teach-out. To prevent obfuscation and confusion, and therefore achieve the purpose of the regulation, the Department should revise proposed section 668.14(b)(32) to require a clear and conspicuous written disclosure that students "may seek a closed school discharge as an alternative to a teach-out."

The Department Should Broaden the Regulation to Apply to Any Planned School Closure. In the experience of legal service organizations, very few schools that close arrange for teach-outs at other schools. Many of the recent school closures—for example, Corinthian Colleges, Career Colleges of America, Marinello Schools of Beauty—did not involve teach-outs. The proposed regulation, however, only applies when a school "submit[s] a teach-out plan."[133] As a result, the regulation fails to ensure that students at other schools with planned closures receive accurate, complete and unbiased information about their rights prior to the school closure. These students, who are often upset and panicked, are particularly vulnerable to misleading information about their options.

Corinthian's Heald College, and the for-profit schools that it invited onto its closing California campuses to recruit, aggressively pushed students to transfer credits rather than seek closed school discharge. Many former Heald students transferred to other suspect for-profit schools because of this misinformation, exchanging their discharge eligibility for a valueless degree and unknowingly exposing themselves to still more debt and predatory practices. DeVry College, which our clients have told us was ubiquitous in its on-campus recruiting during Heald's closure, was itself sued by the FTC for predatory practices less than a year later.

The regulation should be revised to require that whenever a school notifies the Department that it intends to close, it must provide a written notice to students about the expected date of closure and their closed school discharge rights, including their right to a discharge if they withdraw within 120 days prior to closure and obtain a closed school discharge. As with teach out notices, the Department should be required to provide the notice if the school fails to do so within 5 days of informing the Department of closure.

The Disclosure Should Include the Expected Closure Date. When schools announce that they are closing but plan on teaching out all the existing programs themselves, they currently have no obligation to inform their students about the expected date of closure. As a result,

[133] Proposed 34 C.F.R. § 668.14(b)(32).

students who experience a deterioration in the level of instruction are hesitant to withdraw and in many cases do not know they have the right to withdraw. If they are aware of this right, they do not know when they can withdraw and still be eligible for a closed school discharge.

To provide borrowers in this difficult situation with more choice over how they proceed with their higher education, the regulations should be amended to require that the school provide written disclosures to students. The regulation would state that whenever a school notifies the Department that it intends to close but to teach out all existing students, it must provide a written notice to students about the expected date of closure and their right to a discharge if they withdraw within 120 days prior to closure.

In addition, if Department adopts this recommendation, the discharge regulations for Perkins and Direct Loans should be amended to extend the 120-day look back period by the number of days between the expected and actual date of closure whenever the actual closure date is later than the expected and disclosed date.

d. The Department Should Retain Current Language Requiring the Guaranty Agency to State the Reasons for its Denial in its Proposal to Provide for the Review of Guaranty Agency Denial of Closed School Discharge Applications

We support the Department's proposal to provide for the review of guaranty agency denials of closed school discharge applications for FFEL loans.[134] FFEL borrowers whose loans are held by guaranty agencies should have the same right to challenge an erroneous unpaid refund or closed school discharge decision as Direct Loan and FFEL Loan borrowers whose loans are held by the Department. Current FFEL Loan regulations do not provide borrowers with any right to seek review of guaranty agency denials of closed school discharges.[135]

Even when FFEL borrowers are able to get administrative review, unlike Direct Loan borrowers, their right to seek further review in court is not clear. The Administrative Procedure Act (APA) does not provide for judicial review of decisions by private, non-governmental entities such as guaranty agencies. Nor is there any explicit right to judicial review of guaranty agency decisions in the Higher Education Act.

As a result, FFEL borrowers whose loans are held by guaranty agencies have no clear way to challenge an erroneous closed school discharge decision from a guaranty agency. Only Direct Loan and FFEL Loan borrowers whose loans are held by the Department may seek judicial review of administrative unpaid refund or closed school discharge denials. The Department's proposed rule will address this arbitrary denial of borrower due process.

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[134] Proposed 34 C.F.R. § 682.402(d)(6)(ii)(K).
[135] 34 C.F.R. § 682.402(d).

We recommend one modification. Under current section 682.402(d)(6)(ii)(H), if a guaranty agency denies a closed school discharge application, it must "notify the borrower in writing of that determination *and the reasons for it* . . ." In its proposal, the Department has deleted the italicized language. Yet, the whole purpose of a Department of Education review of a guaranty agency decision is to allow a borrower to argue or present evidence about why he believes the decision was incorrect. He cannot do so if the guaranty agency does not explain the reason for its decision. The Department should therefore add this requirement back into the regulation.

IX. False Certification Discharges

a. The Department Should Clarify that that Students Whose Schools Falsely Certify they have High School Diplomas, Including Schools that do so by Falsely Certifying Financial Aid Applications, are Eligible for Discharge

We support the Department's proposal to clarify that students can discharge their loans if their schools falsely certify that they have a high school diploma or equivalent.[136] The Department states that proposed § 685.215(a)(1)(ii) would allow a borrower to discharge their loan if her "school falsified the borrower's high school graduation status; falsified the borrower's high school diploma; or referred the borrower to a third party to obtain a falsified high school diploma." This is a critical improvement.

Some unscrupulous for-profit schools direct students who have not earned high school diplomas to fraudulent online diploma mills. These businesses typically administer an online multiple-choice test for a fee, and then provide a fake transcript and high school diploma that the school uses to qualify the students for federal aid.[137] Many students do not understand that they need a high school diploma to qualify for federal aid, that the test is for obtaining a high school diploma, or that the diploma is invalid. In February 2016, the Department announced enforcement actions against Marinello School of Beauty campuses throughout California and Nevada for precisely these sorts of violations.[138]

Many schools, unbeknownst to the student, simply falsify the student's financial aid application by completing the application for the student with false high school diploma information. While the Department's stated intent for proposed section 685.215 is to give relief to all students whose schools falsely certify they have high school diplomas, the rule is drafted in such a way that relief could be denied to students whose schools falsify high school diploma information on their financial aid applications. Proposed section 685.215(a)(i)(A) states that a

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[136] *See* Proposed 34 C.F.R. § 685.215.

[137] *See* Press Release, Fed. Trade Comm'n, *FTC Action Halts Online High School Diploma Mill That Made $11 Million Selling Worthless Diploma to Students* (Sept. 19, 2014).

[138] Press Release, U.S. Dep't of Educ., *U.S. Department of Education Takes Enforcement (sic) Against Two School Ownership Groups* (Feb. 1, 2016).

student who has *reported* having a high school diploma or its equivalent will not be eligible for discharge. The Department is presumably trying to ensure that students who lie to their schools about having a diploma are not rewarded for doing so. While this is a reasonable position, this proposed language could technically exclude even the most deserving students from discharge relief.

Students at predatory schools do not typically prepare their own financial aid applications. Instead, recruiters and financial aid representatives fill out the applications for them and instruct the students to sign. The federal student loan (FAFSA) application, which the student signs, specifically asks about education to determine eligibility.[139] Schools that defraud students by misrepresenting their eligibility necessarily forge these misrepresentations on their FAFSA applications as well. A student who unknowingly signed an application that misrepresented their eligibility would appear to be ineligible for discharge under the proposed rule, because that student, like every other student, has "reported" their educational history on their FAFSA application.

For example, the Legal Aid Foundation of Los Angeles recently submitted the false certification discharge applications for 21 non-English speaking students whose for-profit school falsely certified on their FAFSA applications that they had high school diplomas. In fact, none of these students had earned a valid high school diploma, all had reported this to the school, none of them completed their own FAFSA forms, and the school instructed all of them to sign off on all their loan documents without allowing them time to review the documents. Although this was done prior to the end of the ability-to-benefit program, this illustrates a common abusive school practice.

We urge the Department to not exclude students in this situation from relief. The Department can ensure that the benefit of the proposed rule is not illusory by changing the language of proposed section 685.215(a)(i)(A) as follows: "(A) Reported not having a high school diploma or its equivalent *to his or her school…*" (changes in italics).

b. The Department Should Allow Students Whose Satisfactory Academic Progress was Falsely Certified to Apply for Discharge

We strongly support the Department's proposed clarification that students whose schools falsely certified their satisfactory academic progress (SAP) may receive automatic discharges.[140] This conduct, which we have found to be endemic to predatory institutions that see students only in terms of profit, provides no benefit and serves only to burden unprepared students with unmanageable debts. These students are typically unable to obtain or maintain jobs in the occupations for which they trained.

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[139] OMB # 1845-0001.

[140] Proposed 34 C.F.R. § 685.215(c)(8).

We urge the Department to clarify that students may also apply for a discharge on this basis, rather than force them to wait for the Department to grant discharges without applications. While there are often False Claims Act and government cases involving false certification of SAP, many students also know when their academic progress was falsified by schools, but are not covered by such cases. Information provided by students in discharge applications would also allow the Department to identify bad-acting schools and prevent abuse of Title IV funding. The Department should therefore revise the proposed rules to provide a means for students to individually apply for discharge when their SAP is falsely certified by their school.

c. The Department Should Not Narrow Discharge Eligibility for Borrowers Whose Schools Falsely Certify that They Meet the Requirements for Employment in the Occupations for which their Programs are Intended to Train Them

We oppose the Department's proposal to narrow discharge eligibility for students whose schools falsely certify that they meet the requirements for employment in the occupations their programs are intended to train them for. Existing rules provide that the Department will discharge a loan where a school "[c]ertified the eligibility of a student who, because of a physical or mental condition, age, criminal record, or other reason accepted by the Secretary, would not meet the requirements for employment (in the student's State of residence when the loan was originated) in the occupation for which the training program supported by the loan was intended."[141] For the sake of profit, predatory schools frequently recruit students they know will be barred from employment in their field after program completion.

Proposed section 665.215(a)(iv) would narrow discharge eligibility to students who "would not meet *State* requirements for employment . . . ." (emphasis added). That is, it looks only to requirements imposed by the state, not by the profession. To the extent that this discharge provision is intended to provide relief to students whose schools recruit and enroll them despite the fact that they cannot conceivably benefit from the program, it makes no sense to limit the scope of this protection. While most professional licensing is founded in state law and regulation, others—such as those from trade specific entities—are not. The proposed change would unnecessarily restrict relief to students who are unemployable because they ineligible for certifications not provided by a state.

This change would also be inconsistent with the Department's gainful employment regulations, which requires schools to certify that each of their career education programs "satisfies the applicable educational prerequisites for *professional licensure or certification requirements* in that State so that the student who completes the program and seeks employment in that State *qualifies to take any licensure or certification exam that is needed* for the student to

[141] 34 C.F.R. § 685.215(a)(iii).

practice or find employment in an occupation that the program prepares students to enter."[142] As the Department rightly noted in its comments to the proposed gainful employment rules, students who enroll in a program to prepare themselves for a career they cannot be certified in "can have grave consequences for students' ability to find jobs and repay their loans after graduation."[143]

The consequences are equally grave for students who are unwittingly enrolled in programs that they personally can never benefit from, though their classmates might. It is therefore unnecessary and unfair to narrow the standard for relief here.

d. The Department Should Create a Fair Preponderance of the Evidence Standard for False Certification Discharge Cases.

The Department must amend its rules to give harmed students a fair chance to make their case for false certification discharges, particularly students whose ability to benefit (ATB) was falsely certified by their schools. The Higher Education Act broadly authorizes the Department to grant a discharge whenever a student's eligibility to borrow has been falsely certified, but the proposed rules leave intact the Department's baseless presumption that students who claim ATB fraud are not telling the truth about their false certification unless they submit independent corroborating evidence to support their discharge application.[144]

While the Higher Education Act broadly authorizes the Department to grant a discharge whenever a student's eligibility to borrow has been falsely certified, the Department or the guaranty agency will deny the discharge unless the borrower submits additional corroborating evidence. Corroborating evidence may include statements by school officials or rely on statements made in other borrower claims for discharge relief.

In a 1995 Dear Colleague Letter, the Department stated that an absence of findings of improper ATB practices by authorities with oversight powers "raises an inference that no improper practices were reported because none were taking place."[145] The Department's reasoning is that responsible authorities should have discovered ATB fraud, and the fact that these agencies did not issue such a report implies that no ATB fraud occurred. But many borrowers cannot provide proof of federal or state investigations of particular schools because enforcement has been so lenient in this area that no such investigations exist. In fact, Congress in 1992 provided for the false-certification discharge and overhauled the student loan system because such supervising authorities had failed to do their job.[146]

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[142] 34 C.F.R. § 668.414 (emphasis added).
[143] Program Integrity: Gainful Employment, 79 Fed. Reg. 16478 (proposed March 25, 2014).
[144] U.S. Dep't of Educ., Dear Colleague Letter Gen 95-42 (Sept. 1995).
[145] *Id*.
[146] Abuses in Federal Student Grant Programs: Hearings Before the Permanent Subcomm. on Investigations of the Comm. on Governmental Affairs, 103d Cong. S. Hearing 103-491 (Oct. 1993).

The Department's current approach to false certification disregards student statements, even though students must submit their statements under penalty of perjury. If a borrower is unable to provide investigative findings, the Department or the guaranty agency will deny the discharge unless the borrower submits additional corroborating evidence. Corroborating evidence may include statements by school officials or rely on statements made in other borrower claims for discharge relief.[147] Moreover, although a 2007 Dear Colleague Letter requires guaranty agencies to consider "the incidence of discharge applications filed regarding that school by students who attended the school during the same time frame as the applicant,"[148] students have no way of knowing whether a guaranty agency has done so in evaluating their applications.

Students do not have access to school employee statements and do not know whether other borrowers have filed similar claims for relief. When borrowers are able to find attorneys to help them, attorneys are often unable to obtain the required evidence through Freedom of Information Act requests. Furthermore, the Department does not have possession of all false certification discharge applications and does not ensure that copies are retained when guaranty agencies go out of business. Nor does it retain all evidence that could serve as corroborating evidence.[149]

Many students carry their debt for years before learning of their right to a false certification discharge. By this time, the original school is often long gone, closed due to its unscrupulous practices, and all key documents and "corroborating" evidence are destroyed. With no ability to meet the demanding evidentiary requirements, these students are permanently denied relief and must continue to bear the debt burden of a worthless education.

As just one example, a legal aid organization has several clients whose ability to benefit was falsely certified by Meadows College of Business. In order to obtain the required corroborating evidence, the legal aid organization requested that the Department provide a copy of all prior false certification discharge (ATB) applications. In response, the Department stated that 85 discharge applications had been submitted by Meadows Business College students, but it could only provide a copy of 13. The other 72 had been processed by the California Student Aid Commission or EdFund. CSAC ended its guaranty agency responsibilities in the 1990s, passing those responsibilities and loan documents to EdFund. In 2010, EdFund went out of business and transferred its guaranty responsibilities to ECMC. The Department does not know whether those records are now retained by ECMC. And, as a private entity, ECMC has no obligation to provide those records directly to borrowers pursuant to the Freedom of Information Act.

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[147] U.S. Dep't of Educ., Dear Colleague Letter Gen 95-42, (Sept. 1995).

[148] U.S. Dep't of Educ., Dear Colleague Letter FP-07-09 (Sept. 20, 2007).

[149] A legal aid organization has submitted a FOIA request to the Department regarding its document retention policies. The Department did not provide any records in response to this request. The legal aid organization submitted an administrative appeal which has been pending for over a year.

A former WyoTech student who recently submitted a false certification application was first told by his servicer that he needed a letter from the now closed school, on its letterhead, verifying that he had not attended the school prior to taking out loans. He explained that he could not because the school no longer existed but was then told he would need to obtain a copy of the ability to benefit test he took before his application would be reviewed. He recalled being given a test of some sort when enrolling, but that it consisted of several grammar school level math questions and that he was told it would be impossible for him not to pass. He was never given a copy.

It is inequitable that a student's sworn statement regarding her mistreatment should be essentially disregarded for lack of unobtainable documentation. The Department should amend its proposed regulations to specify that a student may establish a right to a false certification discharge through "preponderance of the evidence", as it has proposed for borrower defense claims. In addition, borrowers should be presumptively eligible for discharge after application in the following circumstances:

- The school's academic and financial aid files do not include a copy of test answers and results showing that the borrower obtained a passing score on an ability-to-benefit test approved by the Secretary;
- No testing agency has registered a passing score on an ability-to-benefit test approved by the Secretary for the borrower; or
- The school directed the borrower to take an online test to obtain a high school degree, the borrower believed the test to be legitimate, and the high school diploma is invalid.

X. Conclusion

Thank you for consideration of these comments. We welcome any opportunities to work with the Department in strengthening protections for borrowers. If you have any questions about these comments, please contact Abby Shafroth (ashafroth@nclc.org), Eileen Connor (econnor@law.harvard.edu), or Robyn Smith (rsmith@lafla.org).

Legal Aid Coalition Comments on Proposed Regulations, Docket ID ED-2015-OPE-0103

Attachment A

Marinello
SCHOOLS OF BEAUTY

Loan Forgiveness Experts

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Email Us At: Info@postgradservices.com

"Loan Forgiveness Experts who get you the most out of forgiveness"

Legal Aid Coalition Comments on Proposed Regulations, Docket ID ED-2015-OPE-0103

Attachment B

WESTWOOD COLLEGE®

January 25, 2016

Dear Student:

We hope all of you had a wonderful holiday season and we are excited to see you back.

As promised when we communicated with you in December, Westwood has worked hard to create a robust transition plan for the continuation and completion of your education. Over the coming weeks, we will introduce you to the partner schools that will assist you in completing your education and you will have full opportunity to explore what benefits each may offer to you. When you meet with them, each partner school will be able to provide you with specific information on your individual academic circumstances and answer your questions. We will ask you to make your transfer choice no later than February 19. The January 2016 term will be the last one taught at Westwood College, and upon completion of this current term, Westwood will close.

Starting on January 27th, partner schools will be on all Westwood campuses to facilitate transfer arrangements. As part of this process, Westwood will work with you and the partner schools to make your transition at the end of this term as seamless as possible. We are impressed with the quality of schools that have offered to assist you in achieving your goal of graduation and the terms they have agreed to offer Westwood students. Our main focus in negotiating with the partner schools was to ensure that you would be in the same academic and financial situation had you continued at Westwood to complete your education. I believe that we more than accomplished this goal for your benefit.

Most programs will have multiple accredited partner schools from which to choose, including several regionally accredited schools. Each of the partner schools has a campus located within a reasonable distance from your current campus. All partner schools have agreed to accept the transfer of Westwood credits. In most cases all credits will transfer into comparable programs offered by the partner school. In addition, these schools have agreed to charge you the same amount for your program as reflected in your Westwood enrollment agreement. But, if a school has a lower tuition cost than Westwood, you will get the benefit of that lower tuition. Unless completion of this term will allow you to graduate from Westwood, you will get your degree from the partner school to which you transfer. That school will provide you with career services and will maintain your academic records. It is important that you continue on track to complete all of your courses for the January Term. This will make for a smoother transition, and lower your future cost of attendance. Everyone at Westwood College remains focused on your goal of graduation. Some of you will be graduating at the end of the current term and we look forward to helping you celebrate this great accomplishment in your life.

We could not be prouder of our current students and future graduates. This has been a tough time on all of us - students, faculty and staff alike - and we have appreciated your patience as we developed the best possible transition plan for your academic future. It has been our greatest privilege to see you grow and develop through your academic experience at Westwood. Thank you for your commitment to Westwood and for allowing us the privilege to know and educate you.

As always, if you have any questions please feel free to contact the campus president or other campus staff.

Sincerely,

Lou Pagano
Chief Operating Officer
Alta Colleges

Additional Important Information:

Important notice if you have a Federal student loan: You have separate rights if you have a Federal loan:

You may be eligible for forgiveness ("discharge") of the federal student loans you received to attend Westwood if one of the following happens:

- Westwood closes before you complete your program, or
- If you withdraw from Westwood less than 120 days before Westwood closes.

This Federal discharge will cancel your Federal loan. If you **complete** your program either at Westwood or at another school, you **will not** qualify for this Federal discharge. Westwood encourages you to explore all options for continuation and completion of your education with partner schools before considering a Federal discharge. If you apply for and receive a Federal discharge, you will **forfeit** any Westwood credits earned and these credits **will not** be transferable to a partner school.

For more information on Federal loan discharge eligibility and the application process, go to: studentaid.gov/closedschool.

Legal Aid Coalition Comments on Proposed Regulations, Docket ID ED-2015-OPE-0103

Attachment C

ICDC COLLEGE®

Corporate Headquarters – Main Campus – Online Campus

6812 Pacific Blvd., Huntington Park, CA 90255 Ph. (323) 277-0240 Fax (323) 277-9284

May 20, 2016

Dear ICDC College Student:

This letter is meant to update you on the closure of ICDC College that was announced on March 31, 2016.

We at ICDC College are committed to your success and want to help you in any way we can to help you succeed. In that regard, we are proud to have worked very hard to reach an agreement with Trident University International to conduct a "teach-out" of your current program. The teach-out plan has received approval of ICDC's accreditor, Accrediting Commission of Career Schools and Colleges, and Trident's accreditor, WASC Senior College and University Commission, and it has been acknowledged by the U.S. Department of Education and the California Bureau for Private Postsecondary Education.

In order to conduct the teach-out with a seamless transition for students, Trident agreed to employ many of ICDC College's instructors and staff, and to offer ICDC's current programs. There will be no interruption in your education; you will continue to have primarily the same instructors, support staff, and program that you are used to and currently taking at no additional charge beyond the charges agreed to in your enrollment agreement with ICDC. Trident will begin overseeing the teach-out of your courses on May 23, 2016. Should you wish to participate in the teach-out and continue your education, you will login to your account and class in the same manner in which you have always logged into your classes. You are not required to participate in the teach-out with Trident.

In the event that you choose to discontinue your program prior to the closure of ICDC College and not take part in the teach-out, a refund may be requested pursuant to ICDC College's Refund Policy as found in your Enrollment Agreement and Catalog. In the event you funded any part of your education with Federal Title IV funds, a refund of those funds may be requested pursuant to ICDC College's Return of Title IV Funds Refund policy which is also found in your Enrollment Agreement and Catalog.

Also, for California residents only, when you enrolled you paid an assessment to the Student Tuition Recovery Fund (STRF). The State of California created STRF to relieve or mitigate economic losses suffered by California residents who were students while attending certain schools regulated by the Bureau for Private Postsecondary Education.

You may be eligible for STRF if you are a California Resident; prepaid tuition, paid the STRF assessment, and suffered an economic loss as a result of any of the following:

1. The school closed before the course of instruction was completed.
2. The school's failure to pay refunds or charges on behalf of the student to a third party for license fees or any other purpose, or to provide equipment or materials for which a charge was collected within one hundred eighty (180) calendar days before the closure of the school.
3. The school's failure to pay or reimburse loan proceeds under a federally guaranteed student loan program as required by law or to pay or reimburse proceeds received by the school prior to closure in excess of tuition or other cost.
4. There was a decline in the quality of the course of instruction within thirty (30) calendar days before the school closed or, if the decline began earlier than thirty (30) calendar days prior to closure, the period of decline determined by the Bureau.
5. An inability to collect on a judgment against the institution for a violation of the California Private Postsecondary Education Act of 2009.

However, no claim can be paid to any student without a social security number or a taxpayer identification number.

The Bureau's physical address is 2535 Capitol Oaks Drive, Suite 400, Sacramento, California, 95833 and its website address is www.bppe.ca.gov.

For more information on Federal loan discharge, go to: https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation/closed-school.

If you choose to participate in the teach-out, you will receive a welcome letter from the President of Trident University International shortly which will provide additional information about the teach-out process.

If you have any questions or need any help with this process please do not hesitate to contact me at (424) 666-5116 or you can e-mail me at rene.nunez@icdccollege.edu.

Yours Very Truly,

Rene C. Nuñez
Vice-President Compliance/Student Relations
ICDC College

Enclosures

Appendix C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
NEW ALBANY DIVISION

EDUCATIONAL CREDIT MANAGEMENT CORPORATION, et al.,	)	
Plaintiff,	)	
v.	)	Cause No. NA 00-0241-C-B/S
DAVID A. BARNES and NANCY K. BARNES,	)	
Defendants.	)	

INITIAL BRIEF OF SECRETARY OF EDUCATION

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INTRODUCTION

The Chapter 13 Trustee has challenged the legality of 34 C.F.R. § 682.410(b)(2), a regulation of the Department of Education, as applied in the bankruptcy of David A. Barnes, who owes several defaulted student loans. The regulation addresses how collection costs are to be assessed on defaulted loans, including those in bankruptcy. The case was removed from bankruptcy court because the Trustee's challenge requires the interpretation of non-title 11 law. The Secretary of Education submits this brief regarding the application and basis for 34 C.F.R. § 682.410(b)(2), and submits, for the reasons explained here, that this regulation is not arbitrary, capricious, or contrary to law, either as written or as administered by the Department.

STATEMENT OF THE CASE

This case originated in bankruptcy court. Barnes is indebted on several Federally-financed student loans. Barnes had previously defaulted on those loans. The Educational Credit Management Corporation ("ECMC"), holder of the loans, filed a Proof of Claim for $7714.73 in unpaid principal and interest, and included a claim for $1394.08 in collection costs. The collection costs were claimed pursuant to 34 C.F.R. § 682.410(b)(2). The trustee objected to the cost on the ground that the costs are unreasonable. *See* Objection to Claim of ECMC. ECMC defended by arguing that §484A(b) of the Higher Education Act of 1965, as amended ("HEA"), 20 U.S.C. § 1091a(b), required ECMC to charge costs, and that Federal regulations, particularly 34 C.F.R. § 682.410(b)(2), required ECMC to charge these costs in the manner and amount objected to by the trustee. ECMC's Response to Trustee's Objection to Claim, pp. 6ff. The trustee responded by contending, as pertinent here, that use of a percentage-based collection cost amounts to a default penalty and that the regulation is thus arbitrary, capricious, and contrary to the statute, which provides that debtors are liable for "reasonable collection costs." Trustee's Reply to Response of ECMC, at p. 6.

Upon motion by ECMC, on February 26, 2001, this court determined that the challenge required the interpretation of non-title 11 law. On that basis this court withdrew the reference of the case to the bankruptcy court in order to consider the Trustee's challenge to the legality of the 34 C.F.R. §682.410(b)(2).

ISSUES PRESENTED

Consistent with that ruling, the government addresses here two issues regarding the Trustee's challenge to the rule:

1. Whether, as determined under applicable law, 34 C.F.R. §682.410(b)(2) is arbitrary, capricious, or manifestly contrary to statute.

2. Whether, as administered by the Secretary of Education, 34 C.F.R. § 682.410(b)(2) is arbitrary, capricious, or manifestly contrary to statute.

The Department now submits that this regulation both on its face and as applied by the Secretary with respect to ECMC is consistent with applicable law, and that the Trustee's challenge should be dismissed. The regulation provides a reasonable method of calculating collection cost charges that properly includes both direct and indirect costs. The Department further submits that the regulations produce reasonable costs, in the nature of contingent fees, which are incurred and paid as collections actually occur.

STATEMENT OF FACTS

Barnes Student Loans

Barnes received two Federal Family Education Loan Program ("FFELP") loans in 1987; he defaulted on them in 1989. See Education's GSL Program Specific Screen (Ex. 1).

Upon default, the holder of the loans filed a default claim against the Great Lakes Higher Education Corporation, which had guaranteed the loans. Great Lakes paid the claim and took assignment of the loans from the lender. Great Lakes was reimbursed by the Department of Education ("Department"), and attempted to recover the amounts owed on the debt. Ex. 1.

In 1995, reporting to the Department that it had received no payments in the six years it held the loans, Great Lakes assigned the loans to the Department. Ex. 1.

The Department attempted collection until the debtor filed for relief in this proceeding. The Department then assigned the debts to ECMC. Education's Collector Note Pad, Ex. 2.

Role of Guaranty Agencies under the Federal Family Education Loan Program

Under the Federal Family Education Loan Program (FFELP) authorized under Title IV, part B of the Higher Education Act of 1965, as amended, the Federal government subsidizes loans made by banks and other financial institutions and guaranteed by State or private non-profit agencies, and reinsures those loans for losses caused by the default, death, disability, or bankruptcy of the borrower. 20 U.S.C. § 1071 *et seq*. Under this arrangement, upon default by the borrower, the guarantor takes assignment of the loans from the lender or subsequent holder, and is in turn reimbursed by the Secretary pursuant to the Federal reinsurance commitment. 20

U.S.C. § 1078(c)(1)(A). Guarantors currently receive reinsurance coverage for up to 95 percent of their loss in paying a default claim to the lender. 20 U.S.C. §1078(c)(1)(A).

After the government pays the guarantor reinsurance, the guarantor must use due diligence to collect that loan. 34 C.F.R. 682.410(b)(6). From any amounts recovered directly by the guarantor, HEA §428(c)(2)(D), (6) requires the guarantor to remit to Education 76 percent,[1] and permits the guarantor to retain 24 percent of those recoveries. 20 U.S.C. § § 1078(c)(2)(D), (6); 1072b(d)(1).

FFELP regulations require the guarantor to perform at least a specified series of activities to collect the defaulted loan after payment of a default claim. 34 C.F.R. §682.410(b)(6). The Department does not require guarantors to document individually every activity taken to comply with this required due diligence in collection, and regards some collection costs as calculable only by means of averaging those costs. Deposition of Pamela Moran, Division of Program and Policy Development, Federal Student Assistance (formerly, the Office of Student Financial Assistance), Department of Education (Moran Dep.), p. 14, lines 6-16; p. 15, lines 15-16; p. 44, line 17 through p. 45, line 6; p. 51, line 18 through p. 52, line 16. Exhibit 4.

Education requires guaranty agencies to charge collection costs to those defaulters who do not, after an initial opportunity, agree to repay their defaulted loans voluntarily, 34 C.F.R.§682.410(b)(2), Moran Dep. p. 23, line 19 through p. 24, line 3; and to include all collection costs, both direct and indirect, in the flat-rate formula used to compute that cost.

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[1]Direct recoveries exclude amounts collected by Federal offset, which funds remain in the Federal treasury.

Moran Dep. p. 19, lines 5-8, 16-21; p. 36, line 17 through p. 37, line 15. HEA §428(c)(8) authorizes the Department to direct a guarantor to assign a defaulted, reinsured loan to the Department when the Federal fiscal interest so requires. 20 U.S.C. §1078(c)(8).

Guarantors must use their own funds to meet the costs of collecting defaulted loans, but can use some or all of the 24 percent retained from collections on those loans to cover these costs and any other operating or education-related expenses they incur. 20 U.S.C. §1072b(d)(1).

If a borrower files Chapter 12 or 13 bankruptcy petition, or, in any other bankruptcy, files an adversary complaint to have a loan discharged, the lender may claim payment from the guarantor, which is then reimbursed by the government. 20 U.S.C. § 1087(b). Upon payment of a bankruptcy claim, the guarantor takes assignment of the loan, pursues recovery on the claim in bankruptcy, and defends the loan against discharge in the bankruptcy. 34 C.F.R. §682.402(f), (i). If the loan is not discharged, the guarantor puts the loan back to the original lender, and remits the proceeds of the sale to Education. 34 C.F.R. §682.402(j).

If a borrower already in default seeks discharge of the loan in bankruptcy, the guarantor is to file a claim in the bankruptcy proceeding and defend the loan against discharge. 34 C.F.R. 682.402 (i). If the loan is discharged, Education reimburses the guarantor for any amount not covered under the initial reinsurance payment. 34 C.F.R. §682.402(k)(2).

The HEA and implementing regulations provide specific rules governing guaranty agency performance; however, guaranty agencies may apply to Education to waive or vary almost any of those requirement by entering into a "Voluntary Flexible Agreement" (VFA) under HEA §428A. 20 U.S.C. §1078-1. Four guaranty agencies have entered into VFAs; five others applied but were not selected or withdrew their applications. GAO-02-254, Federal Student Loans: Flexible Agreements with Guaranty Agencies Warrant Careful Evaluation, General Accounting Office, January 2002, at 6.

If Education grants an applicant guaranty agency a waiver through a VFA, Education must grant an identical waiver upon request to any other guarantor also operating in the same state as the VFA guarantor that received the initial waiver. 20 U.S.C. §1078-1(a)(2).

ECMC's Functions with Respect to FFELP Loans in Bankruptcy

ECMC is a guaranty agency reinsured by the Department. Deposition of Kathleen King, Vice President for Finance, ECMC ("King Dep."), p. 7, lines 15-24. Exhibit 5.

Pursuant to designation from the Department, ECMC provides student loan guarantee services for the state of Virginia. King Dep., p. 21, lines 20-24.

Since 1994, Education has assigned defaulted FFELP loans it holds when the debtor files petition for relief iu Chapter 13. King Dep., p. 24,, line 3. Education did not select ECMC for these assignments by a competitive bidding process. King Dep. p. 24, lines 4-11. Other guarantors also use ECMC to handle their loans when debtors file for relief in bankruptcy on loans they hold. King Dep. p. 16, lines 10-16; p. 74, lines 19-25.

Pursuant to agreement between ECMC and Education, ECMC deposits all recoveries it makes on loans assigned to ECMC by Education into its Federal Reserve Fund, which is property of the United States. 20 U.S.C. § 1072a(e). ECMC Response, Interrogatory No. 12. Pursuant to this agreement, ECMC may use funds from the Federal Reserve Fund to defray expenses ECMC incurs in handling bankruptcy cases. King Dep. p. 34, lines 11-13; p. 61, lines 17-21.

ECMC charges defaulters, including those in bankruptcy, collection costs, which it determines by considering the cost of collecting its defaulted loans not in bankruptcy. King Dep. p. 45, lines 2-12.

ECMC has determined its cost of collecting with respect to loans in bankruptcy, and those costs, as a percentage of recoveries on loans in bankruptcy, are greater than the costs of collecting defaulted loans not affected by bankruptcy. King Dep. p. 59, line 5 through p. 61, line 12.

Therefore, ECMC has concluded that if it were to charge defaulters in bankruptcy a collection cost rate that was based on costs of collecting with respect to loans affected by bankruptcy, or one that included bankruptcy-related costs with other collection costs, the resulting charge would be greater than that based solely on costs for loans not affected by bankruptcy. King Dep., p. 61, lines 8-12.

ECMC maintains no records to show precisely which individual activities and expenses are attributable to individual debts; ECMC derives a single rate based on aggregating all costs. King Dep. p. 28, lines 18-20. ECMC believes that tracking individual expenses on a per-debt basis would increase costs. King Dep. p. 65, lines 1-4.

ECMC deposits all bankruptcy recoveries, including amounts paid as a result of collection cost charges, into its Federal Reserve Fund. ECMC Response, Interrogatory No. 11. Exhibit 6.

ECMC uses funds from its Federal Reserve Fund to defray its bankruptcy-related expenses; the amount taken from the Fund simply covers those costs. King Dep. p. 47, lines 2-5; p. 69, lines 1-4.

Therefore, the net effect of ECMC charging debtors in bankruptcy a collection cost rate based on the cost of collecting loans not affected by bankruptcy, rather than a rate based on, or including, costs of handling loans affected by bankruptcy, is a decrease in that reserve fund. King Dep. p. 62, lines 8-10.

ECMC believes, based on information gathered in its contacts with other guaranty agencies, that its collection cost charges are lower than those charged by several of the largest guaranty agencies. King Dep. p. 62, line 19 through p. 63, line 11.

Education's Practices in Charging Collection Costs

Education takes assignment of defaulted FFELP loans from guarantors if the guarantor has not been successful in collecting after holding the loan for at least four years after payment of a default claim. Deposition of Gary Hopkins, Director, Students Channel-Collections, Federal Student Assistance (formerly Office of Student Financial Assistance), Education Department (Hopkins Dep.), p. 28, lines 9-14. Exhibit 3. Education charges those defaulters whose loans it holds the costs of contingent fee charges of the private collection agencies it retains to collect those loans, as well as fees charged by Treasury Department for Federal payment offsets. Hopkins Dep., p. 23, lines 8-14.

Education currently charges debtors whose loans it recovers through private collection agency action collection costs at the rate of twenty percent of gross amount paid, which equals a rate of twenty-five percent of the net amount of the payment applied to interest and principal. Hopkins Dep. pp. 49, lines 11-17; p. 60, lines 4-5.

Education uses competitive bidding to retain collection contractors, and because of the very large volume of debts involved in that collection activity, considers the commission rates obtained through that bidding process to set the "market rate" for contingent fee charges on loans in this stage of delinquency. Moran Dep. p. 54, lines 11-12. Education therefore uses that rate as the maximum rate a guarantor may charge a debtor for collection costs. Moran Dep. p. 54, lines 12-15.

Collection Cost Rules for FFELP Loans: Applicable Statutes and Regulations

FFELP regulations addressing collection cost charges provide as follows:

34 C.F.R. § 682.410 Fiscal, administrative,.and enforcement requirements

* * * *

> (b)(2) Collection charges. Whether or not provided for in the borrower's promissory note and subject to any limitation on the amount of those costs in that note, the guaranty agency shall charge a borrower an amount equal to reasonable costs incurred by the agency in collecting a loan on which the agency has paid a default or bankruptcy claim. These costs may include, but are not limited to, all attorney's fees, collection agency charges, and court costs. Except as provided in §§ 682.401(b)(27) and 682.405(b)(1)(iv), the amount charged a borrower must equal the lesser of–
>
> > (i) The amount the same borrower would be charged for the cost of collection under the formula in 34 C.F.R. 30.60; or
> >
> > (ii) The amount the same borrower would be charged for the cost of collection if the loan was held by the U.S. Department of Education.

* * * *

(5) Credit bureau reports.

* * * *

(ii) The guaranty agency, after it pays a default claim on a loan but before it reports the default to a credit bureau or assesses collection costs against a borrower, shall, within the timeframe specified in paragraph (b)(6)(ii) of this section, provide the borrower with–

(A) Written notice that meets the requirements of paragraph (b)(5)(vi) of this section regarding the proposed actions;

(B) An opportunity to inspect and copy agency records pertaining to the loan obligation;

(C) An opportunity for an administrative review of the legal enforceability or past-due status of the loan obligation; and

(D) An opportunity to enter into a repayment agreement on terms satisfactory to the agency.

* * * *

34 C.F.R. §682.404 Federal reinsurance agreement

* * * *

(f) Application of borrower payments. A payment made to a guaranty agency by a borrower on a defaulted loan must be applied first to the collection costs incurred to collect that amount and then to other incidental charges, such as late charges, then to accrued interest and then to principal.

* * * *

A. Section 484A of the Higher Education Act

Section 484A(b) of the HEA, enacted in 1986 in section 16033 of the Student Loan Collection Improvement Act, Title XVI of the Consolidated Budget Reconciliation Act of 1985, Pub. L. 99-272, April 7, 1986, provides as follows:

(b) Assessment Of Costs And Other Charges—Notwithstanding any provision of State law to the contrary—

(1) a borrower who has defaulted on a loan made under this title shall be required to pay, in addition to other charges specified in this title, reasonable collection costs.

20 U.S.C. § 1091a(b).

The Title IV loans included within this provision include: i) Perkins loans, made by schools from a Federally-capitalized loan fund under the Perkins Loan Program, some of which are assigned to the Department after default; ii) FFELP loans, held and enforced after default by the guaranty agencies and, later, by the Department, which routinely takes assignment of defaulted loans from guarantors, and iii) Direct loans made by the Department itself under the Federal Direct Loan Program. Title IV, Part D of the HEA. 20 U.S.C. §§ 1087a - 1087j. The HEA itself does not define the term "reasonable collection costs," nor does it set standards for making that determination. This HEA provision rests on the strong Federal interest in both recovering the amounts owed on Federally-financed student loans and transferring the cost of collection efforts from the taxpayer to the borrower.

B. The Debt Collection Act of 1982, as implemented by the Federal Claims Collection Standards

The Debt Collection Act of 1982 requires Federal agencies to charge and recover collection costs incurred on delinquent Federal claims for which the agencies are directly responsible. Pub. L. 97-365, codified, as pertinent here, at 31 U.S.C. §§ 3717, 3718. Claims for repayment of defaulted, Federally-reinsured student loans, including those held by guarantors like ECMC, are Federal claims. 31 U.S.C. §3720A(a)(1). Section 3717(e) directs Federal agencies to charge delinquent debtors administrative costs incurred by the agencies in handling the delinquencies, and §3718 expressly authorizes use of contingent fee collection contractors.

The Federal Claims Collection Standards, 4 C.F.R. Parts 101 - 104 (FCCS), issued jointly by the Attorney General and the Comptroller General under authority of 31 U.S.C. § 3711, implement the Debt Collection Act. As in effect prior to recent changes, the FCCS provide that

> An agency shall assess against a debtor charges to cover administrative costs incurred as a result of a delinquent debt - that is, the additional costs incurred in processing and handling the debt because it became delinquent as defined in §101.2(b) of this chapter. Calculation of administrative costs should be based upon actual costs incurred or *upon cost analyses establishing an average of actual additional costs incurred by the agency in processing and handling claims against other debtors in similar stages of delinquency.*

4 C.F.R. § 102.13(d)(1999)(emphasis added).[2] OMB directives that set credit policies for all Federal agencies explain the term "administrative costs"as including "both direct and indirect costs incurred in collecting debts...based on actual costs incurred or upon an analysis establishing an average of additional costs incurred by the agency," and require the agencies to charge those "administrative costs" on delinquent debts in accordance with FCCS Part 102, and to use contingent fee contractors to collect all accounts six months or more past due, and to pass on the costs of those contingent fees. OMB Circular A-129, Appendix A.V, §§ 3.d, 4.a(1), 58 Fed. Reg. 5774 (1993).

C. Department of Education practice in assessing collection costs pursuant to 34 C.F.R. 30.60 on defaulted loans held by the Department

In 1988, the Department adopted collection cost rules, codified in Section 30.60, that apply directly to its own collection activities. 34 C.F.R. § 30.60, 53 Fed. Reg. 33425 (1988). Education's rule lists specific kinds of direct and indirect costs that the Department may charge a

[2]The FCCS were recently recodified at 31 C.F.R. Parts 901-904; the italicized text was modified to further emphasis the discretion available to creditor agency, providing that costs could be determined "based on estimates by the assessing agency." 31 C.F.R. §901.9(c)(2000).

debtor, 34 C.F.R. § 30.60(a)[3], and states a method for calculating the total amount needed to satisfy a debt and make Education whole, if Education incurs a contingent fee charge for those payments. § 30.60(b).

In fiscal year 2001, the Department recovered $1.4 billion in collections on defaulted Federally-financed student loans held directly by the Department.[4] Two sources account for 88 percent of that revenue: Treasury offsets produced 32 percent of that total, while the Department's collection contractors generated 56 percent. In practice, the Department has charged debtors only those costs from these two sources: the cost charged by Treasury for offsets (a fee of $11.75 per offset for calendar 2001)[5], and the cost of contingent fees charged by its contractors (up to, currently, a maximum of 25 percent of the principal and interest defrayed by voluntary payments or garnishment recoveries). Education does not pass on to the debtor other

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[3]The rule further explains how the payoff amount is computed when Education uses several different collectors, with differing contingent fee rates; a weighted average of the applicable rates is used to compute the payoff amount.

[4]The Department also recovered $524 million by Treasury offset in 2001 on defaulted, Federally-reinsured loans held by guaranty agencies, and guarantors recovered an additional $3.2 billion by other means, a large portion of which is remitted by the guarantors to Education.

[5]Amounts collected by Treasury offset are retained in the Federal Treasury and credited to the account of the Federal agency responsible for the account; Treasury notifies the agency of the amount collected, and retains the amount of the fees charged to the creditor agency, which credits the debtor's account with the net amount recovered by offset. The Department collects by Treasury offset both loans it holds and claims based on defaulted loans held by guaranty agencies on which the Department has already paid Federal reinsurance. The Department reports to the respective guarantors the amount collected by offset for each individual debt referred by the guarantor, which in turn credits to the debtor's account the net amount recovered by Treasury offset. That payment is applied to accrued interest and outstanding principal; no part of that net payment can be applied to other collection costs.

costs incurred by the Department to collect indebtedness. Charges for both offset fees and contractor commissions are contingent charges, because both are incurred by the Department and imposed on the debtor only when a recovery occurs. The Department deducts the amount of the Treasury offset charge from the amount of each individual offset; the Department applies the first 20 percent of each individual contractor-generated recovery to defray contingent fee costs incurred for that recovery, and then applies the remainder to interest and outstanding principal. The 20 percent limit on contingent fee charges is used because a majority of the promissory notes the Department now holds contain terms that limit the debtor's liability for contingent fee collection costs to amounts not exceeding 25 percent *of the unpaid principal and interest.* Applying the first 20 percent of each payment to defray collection costs leaves 80 percent of that payment to be applied to accrued interest and outstanding principal; the amount thus charged as a collection cost thus does not exceed 25 percent of the amount of principal and interest satisfied with that payment. The Department's actual average contingent fee costs have consistently exceeded this average, and the Department must use other funds to defray the portion not satisfied from the debtor's payment.

D. Mandated collection cost procedures for student loan guarantors

In 1992, the Department adopted 34 C.F.R. §682.410(b)(2), to require guarantors to pass on to defaulters the costs incurred by the guarantor to collect their defaulted FFELP loans. The rule included other provisions that expressly encourage guarantors to use contingent fee collectors, 34 C.F.R. §682.410(b)(7), but directed guarantors to offer each debtor an opportunity to repay voluntarily without incurring these charges. 34 C.F.R. §682.410(b)(5). The rule set a limit on collection costs - the guarantor may not charge more than the Department would charge if it held the loan, 34 C.F.R. §682.410(b)(2)(ii) - but did not mandate any particular method of computing those costs. The Department has, however, encouraged guarantors to use a flat rate charge, computed in a manner that will cover the guarantor's costs for all similarly delinquent loans, and applied to each payment received, much like a contingent fee charge.[6]

ARGUMENT

Standard of Review

An administrative regulation must be upheld unless it is "arbitrary, capricious, or manifestly contrary to the statute." *Chevron v. Natural Resources Def. Counsel*, 467 U.S. 837, 844 (1984). HEA § 432(a) gives the Secretary "broad enforcement authority to implement the provisions of the HEA," *Pelfrey v. Educ. Credit Mgmt. Corp.*, 71 F.Supp. 2d 1161, 1164 (N.D. Ala. 1999), *aff'd*, 208 F.3d 945 (11th Cir. 2000), including express authority to promulgate regulations to carry out the purposes of the FFELP, such as the regulations at issue here.

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[6]The rule does not purport to sanction costs without regard to their amount; under 20 U.S.C. §1091a(b), costs must be "reasonable." The Department recognized that contingent fee charges may logically be challenged as excessive if the rates exceed market rates for those services, as negotiated in an arms-length transaction. The Department has long contended that the obvious method of obtaining competitive and reasonable contingent fee rates is through competitive bidding. See 52 Fed. Reg. 45553 (1987) (Perkins regulations); 53 Fed. Reg. 5136 (1988) (addressing the Department's own collection costs, noting that "the legislative history of 31 U.S.C. § 3718 shows that Congress based the reasonableness of contingent fee charges not on whether the charges exceeded the amounts that Federal agencies might have spent to perform the task themselves, but rather on results of competitive bidding among potential contractors. Sen. Rep. No. 378, 97th Cong. 2d Sess. (1982) at 19, 30." The Department has regularly procured its own collection contractors through competitive bidding. The Department now holds almost $ 12 billion in defaulted student loans, more than twice that held by the next largest holder. The Department's competitive bidding process, therefore, establishes the "market rate" for collecting defaulted student loans, at least thoee on which no payments have been made in several years. By limiting the total collection costs that guarantors may charge any debtor to the contingent fee rate charged to debtors by the Department, the regulation is designed to ensure that no debtor is charged more than the "market rate."

20 U.S.C. §§ 1082(a)(2), 1091a(b). Under that authority the Secretary promulgated the rule challenged here. Because Congress gave the Secretary "authority ... to make rules carrying the force of law," because this regulation "was promulgated in the exercise of that authority ... to make rules carrying the force of law," *United States v. Mead Corp.,* 533 U.S. 218, 121 S.Ct. 2164, 2171 (2001), the regulation challenged here is entitled to full deference under *Chevron. Id.* Furthermore, an agency's construction of its own regulations is entitled to substantial deference. *Martin v. Occupational Safety and Health Review Comm'n*, 499 U.S. 144 (1991) *quoting Lyng v. Payne*, 476 U.S. 926 (1986). The scope of review under this standard is narrow and "a court is not to substitute its judgment for that of the agency." *Motor Vehicle Mfrs. Ass'n v. State Farm Ins.*, 463 U.S. 29 (1983). Under these standards, the regulation lawfully implements the HEA provisions and should be upheld here.

Summary of Argument

Student loan defaulters are liable for reasonable collection costs by virtue of HEA §484A(b). 20 U.S.C. §1091a(b). FFELP collection cost regulations properly implement §484A(b) because they produce a reasonable allocation to individual defaulters of the costs incurred by the guarantor in collecting defaulted FFELP loans. Moreover, because no significant factual or legal difference exists between defaulters who pay while in bankruptcy and those who pay but are not in bankruptcy, the collection cost rule properly directs guarantors to charge defaulters in bankruptcy at the same rate charged defaulters not in bankruptcy.[7]

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[7]This brief addresses the effect and operation of the collection cost rule in the context of bankruptcy payments as the rule is applied in the case before the court involving ECMC, the claimant and plaintiff in this action. The relationship between Education and other guarantors produces some differences, but only with regard to the Federal share of guarantor recoveries in

Federal law recognizes that defaulters can be charged at a rate that makes the creditor whole for the direct and indirect costs incurred to collect, and that to do so, those costs must be charged to individual debtors on the basis of average costs incurred to collect similarly-situated debts. The FFELP regulations challenged here encourage guarantors to allocate collection costs among individual debtors by a flat-rate method based on the size of the particular payment collected, but expressly require the guarantor to assess that charge only as a percentage of the payment actually received - in effect, as a contingent fee. The guarantor - like the Department - is free to notify the debtor of the projected total amount of costs that are expected to be incurred and charged for the entire debt, but the rule directs that the guarantor apply only a portion of each payment to those costs. 34 C.F.R. §682.404(f). When implemented by a flat-rate charge to each payment received on a FFELP debt, the regulations provide a reasonable way to determine the collection costs an individual debtor must pay. For these reasons, the regulations as interpreted by the Secretary are reasonable and entitled to deference here; the regulations thus applied properly implement the statutory mandate that debtors bear the costs associated with collecting these defaulted loans.

The FFELP collection cost rule governs how guaranty agencies are to collect from debtors whose defaulted loans they hold.[8] The rule requires guarantors to pass collection expenses on to the defaulter, but this rule does not set the rate or amount that the guarantor may

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bankruptcy, not the calculation of the amount charged the defaulter as collection costs.

[8]Guarantors also handle loans not in default, but on which the borrower has filed for relief in bankruptcy. These borrowers, not in default, are not charged collection costs on their debts. Moran Dep. p. 35.

retain from collections received from those defaulters. The statute itself sets that rate: HEA §428(c)(6), 20 U.S.C. §1078(c)(6), requires guarantors to remit to the Department 76 percent of guarantor recoveries on loans like Barnes' guaranteed before 1992. By doing so, the HEA ensures that the guarantor has the right - as against the Federal government - to retain at least 24 percent of *any* amounts recovered by the guarantor from the defaulter. Unless the guarantor charges collection costs, the amount the guarantor collects will simply equal the principal and interest owed on the debt, and the guarantor retains 24 percent of the amount paid.
Unless the guarantor charges both costs and principal and interest, the Federal government would receive, at most, 76 percent of the amount the government had paid through reinsurance.

Therefore, because the guarantor retains its statutory 24 percent share of payments, the Federal taxpayer bears any cost of collection that the guarantor does not charge and recover from the defaulter in addition to principal and interest on the debt. The Department has referred to the rate that should be charged to debtors as the rate needed to "make whole" the guarantor for its costs of collection; in fact, the Federal taxpayer is the party "made whole" when FFELP defaulters are charged the costs of collecting their debts.

This statutory guarantor share of recoveries *approximates* the guarantor's collection costs, which the guarantor must first pay from its own funds. To the extent that the guarantor succeeds in reducing its actual costs below 24 percent, it derives income that can be devoted to other guarantor activities and related educational support activities. ECMC states that it does so. King Dep. p. 76.

This regulation, as interpreted and applied by the Department, is reasonable if it produces reasonable collection cost charges. To show how the rule produces reasonable charges, the government will show that rules dictated for collection action by Federal agencies, including the Department, produce similar kinds of charges for debtors similarly-situated to those, like Barnes, subject to this FFELP regulation. The regulation expects guarantors to be able to support the amount they charge debtors just as Federal agencies, including Education, justify the amount charged to Federal debtors. Education makes extensive use of contingent fee contractors to collect loans it holds, and selects those contractors through an extensive competitive bidding process. The contingent fee charged by the contractor is paid by Education and then passed on by Education to the debtor (with limits explained later). In contrast, the amount paid by Education to guarantors on defaulted loans, including loans affected by bankruptcy, is set by statute and not by competitive bidding or negotiation.[9] The manner in which Education pays guaranty agencies has no effect on guarantor charges to debtors, and the process used by Education to compensate ECMC or other guarantors has no bearing on the costs imposed by guarantors on debtors.

1. Federal regulations produce reasonable collection charges by basing those charges on the amount needed to make the guarantor whole for costs incurred to collect the defaulted loans it holds.

Debtors must bear the costs of collecting their defaulted student loans. If the debtor does not, the taxpayers bear those costs, either directly or indirectly.[10] Section 484A(b) was enacted to

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[9]In a handful of instances, guarantors have negotiated different reinsurance coverage under " voluntary flexible agreements" authorized by HEA §428A, 20 U.S.C. §1078-1.

[10]This discussion refers to making the creditor or guarantor whole; for FFELP debts, one can with greater accuracy refer to making the Federal fisc, and the Federal taxpayer, whole. As noted earlier, the guarantor is required by HEA §428(c)(2)(D), (c)(6), 20 U.S.C. § 1078(c)(2)(D), (c)(6) to remit to the Department 76% of the amount recovered by the guarantor on defaulted

make the debtor, not the taxpayer, bear the cost of trying to collect defaulted student loans. H.R. Rep. No. 241, 99th Cong. 2d Sess. (1986) 274. To shift this cost to the debtor, the rate charged the defaulting debtor must be sufficient to make the Department or guarantor whole. The 1992 FFELP regulations, which directed guarantors to charge collection costs, also encouraged guarantors to use contingent fee contractors; that context framed the way the Department explained how the collection cost rule was expected to operate:

> The formula referenced in §682.410(b)(2) specified that the amount charged will be the lesser of the costs of collection under the formula in 34 C.F.R. 30.60, or the amount the borrower would be charged if the loan was held by the Department. This amount will be a percentage of the principal and interest outstanding, may be calculated annually, and would be a flat rate assessed against all borrowers with defaulted loans held by that agency.

57 Fed. Reg. 60312 (1992). By referring to the formula in §30.60 to set the mandated minimum charge, the Department lists permissible costs and encourages guarantors to use a "make-whole" approach to recouping those costs.[11] Section 30.60(b) provides that if the Department uses a contingent fee contractor to collect, it uses the equation in §30.60(c)(1) to calculate the "make-whole" amount charged to the debtor: the amount needed to recover both the outstanding principal and interest on the debt and the cost of contingent fees incurred by the Department for

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Federally-reinsured FFELP debts it holds. To the extent collection costs are not paid by the debtor, the amount collected from the debtor and remitted to the Department is reduced, in effect these costs are netted out of the borrower payments remitted to the Department. This increases the amount that the government needs to raise from other sources - taxes and Federal borrowings - to cover the costs of subsidizing and reinsuring FFELP loans. This increases the cost to the taxpayer of financing FFELP support.

[11] The Department thus expressly rejected industry proposals that debtors not be charged collection costs at all, or charged only a limited part of those costs on the theory that such charges would deter repayment.

that recovery. By mandating in §682.410(b)(2) that guarantors charge collection costs of the lesser of the "formula" in §30.60 or the amount that would be charged if the debt were held by the Department, the Department intended that guarantors use a "make-whole" approach to all collection charges. Obviously, the Department did not intend to prevent guarantors from charging actual costs of the kind recognized in §30.60(a) merely because the Department, for its own administrative convenience, did not actually charge some of those costs on debts it held. [12] Similarly, by referring to the formula in §30.60, the Department hardly intended to prevent those guarantors that did not use contingent fee contractors from charging the debtor for the direct and indirect costs incurred in collecting "in-house," using the guarantor's own staff. For these reasons, by requiring guarantors to use a "make-whole" approach to charging collection costs, §682.410(b)(2), as interpreted by the Department in practice, achieves the congressional objective that the debtor, not the taxpayer, bear the cost of repaying his or her defaulted loan.

2. Federal regulations produce reasonable collection charges by imposing those charges only on those defaulters who fail to promptly agree to repay the guarantor voluntarily.

FFELP borrowers have a range of options that allow some modification of repayment terms to deal with financial difficulties, including economic hardship deferments, forbearances, and income-sensitive repayment plans. Nevertheless, some borrowers cannot or will not use these options, and default. Department rules require the guarantor who acquires a loan by reason

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[12]As noted earlier here, although the FCCS as interpreted by OMB direct agencies to charge debtors a portion of indirect costs incurred to collect delinquent debts, and §30.60(a)(1) and (5) expressly authorize charging for an allocated portion of salaries and computer costs associated with collection, the Department has generally not done so. Nevertheless, these are real and legitimate costs incurred in collecting a debt.

of the default of the borrower (in this instance, Great Lakes Higher Education Corporation) to charge collection costs only after providing the debtor an opportunity to contest the debt and to enter into a repayment arrangement for the debt.[13] 34 C.F.R. § 682.410(b)(5). The guarantor, moreover, is not bound by the original loan repayment schedule, but can agree to any repayment arrangement that the debtor can afford, regardless of the amount of time needed to pay the debt off under that arrangement. *See* 20 U.S.C. § 1078-6(a) (defaulter may have loan rehabilitated and default status cured after 12 installment payments to the guarantor); §1078-6(b) (defaulter may regain eligibility for new student aid after six reasonable and affordable payments based on the borrower's total financial circumstances).

The regulations therefore direct guarantors to charge collection costs *only* to those debtors who cause the guarantor to incur collection costs by failing to agree promptly to repay voluntarily. The Department follows the same procedure when it takes assignment of defaulted loans from guarantors - loans that in some instances are later assigned to ECMC if the borrower files for Chapter 13 relief. Only those defaulters who ignore this opportunity face collection cost charges. See Moran Dep. pp. 36, 37. Liability for collection costs is therefore not merely a foreseeable and logical consequence of the defaulter's breach of the loan contract, but one that the honest and cooperative debtor can easily avoid. Debtors whose defaulted loans are transferred to ECMC by other parties have even less standing than other FFELP defaulters to

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[13] The regulations do not force the debtor to choose between contesting the debt or agreeing to repay; the debtor may challenge the debt, and obtain a review of that challenge by the guarantor, before agreeing to repay the debt as adjusted by that review. If the debtor timely agrees to repay after completion of the review, the debtor can repay without collection cost charges.

object to costs, since they have already received this "cost-free" repayment option at least once (from the default claim guarantor), and often twice (again, from the Department after it takes assignment), and failed to repay voluntarily either time. The regulations challenged here adopt a reasonable method of assessing collection costs because they ensure that charges are imposed only on those debtors who fail to cooperate and thereby cause the guarantor to incur collection costs.

3. Federal regulations produce reasonable collection charges by allowing the guarantor to allocate its costs among debtors in similar stages of delinquency by using averages derived from experience collecting similar debts from similar debtors.

Federally-reinsured student loan debts, whether held by the Department or by guaranty agencies, are Federal claims. As noted in the legislative history of the Cash Management Improvement Act, Pub. L. 102-589, which amended 31 U.S.C. § 3720A, the Treasury offset statute, "individual federal debt includes debt held by guarantee agencies on which reimbursement or reinsurance payments have been made by the federal government." Sen. Rep. No. 420, 102d Cong. 2d Sess. (1992) 6. Federal Claims Collection Standards then allowed Federal agencies to calculate collection costs either as actually incurred on an individual loan or "upon cost analyses establishing an average of actual additional costs incurred by the agency in processing and handling claims against other debtors in similar stages of delinquency." 4 C.F.R. §102.13(d)(1999). All debtors who are charged collection costs pursuant to 34 C.F.R. §682.410(b)(2) are in similar stages of delinquency: as explained by Pamela Moran, the rule requires guarantors to charge collection costs to those defaulters who have already defaulted, whose loan has been assigned to the guarantor based on that default, and who fail to make satisfactory arrangements to repay within an initial grace period after an initial demand by the guarantor. All these defaulters are in a similar stage of delinquency. Moran Deposition, p. 36, 37. Borrowers whose loans are not in default, but are held by the guarantor solely because the lender filed a bankruptcy claim, are not charged collection costs. Moran Deposition, p. 35.

Some costs, particularly indirect costs, cannot easily be allocated among debts except by dividing the total cost among debtors, so that each bears an averaged share of those expenses. The trustee's view that Education should simply purchase a Quicken product from the local computer store to track precise costs incurred to collect each individual payment misses the reality of managing three million debts. The primary benefit of averaging all collection costs is avoiding the significant administrative expense of attempting to track and allocate costs for individual debtors. Moreover, most of the charges regularly assessed to debtors by the Department itself – even if they appear on their face to be itemized – are really based on averages.

For example, Treasury offset fees are determined by the Treasury Department's average cost incurred to perform an offset, regardless of the cost in effecting a particular offset. The contingent fees of contractors, typically generating a major portion of total recoveries of both Education and guarantors, are also based on the average cost incurred by the contractor to collect all its debts, plus its profit margin. The preamble to the 1992 cost regulations reflects the Department's expectation that guarantors, like the Department, will commonly use contingent-fee contractors, and that those contractors will generate a major portion of the guarantor's total recoveries.[14] Because collection contractors earn contingent fees on the amount they recover and

[14]This excludes credits resulting from Federal Treasury offsets, which in fiscal 2001 accounted for $524 million in recoveries on Federally-reinsured defaulted loans held by guaranty

charge the guarantor accordingly, the guarantor incurs what the Department expected would be the major portion of its collection costs based on averages of collection costs. By urging guarantors to charge costs as a "flat rate" of the payment, the Department implicitly urged guarantors to include all their collection costs into the body of costs used to derive the average charge to be imposed on individual defaulters.

Basing charges on an average of all guarantor collection costs, including contingent fees charged on some of its debts, is a reasonable way to allocate those costs among all similarly-delinquent debtors for several reasons. Obviously, the first and immediate benefit is reducing the expense, modern software notwithstanding, of tracking, allocating, and billing specific costs. That cost-saving in itself reduces costs for all debtors. *See* King Dep. p.65. Charges based on averaged costs may still result in charges to some debtors that may exceed the actual costs incurred to collect their individual debts. This difference alone does not make averaging costs unreasonable under the law. Some differences between individual and average costs are *de minimis*; in other instances, below-average costs incurred for some payments will be offset by above-average costs incurred for other recoveries from the same debtor.

Even where these differences are not offset with regard to the same debtor's costs, averaging produces a reasonable method of achieving the congressional objective for the greatest number of defaulters. The Department and guarantors operate under a Federal mandate to maximize recoveries from student loan defaulters, especially by inducing defaulters to repay voluntarily, see, e.g., 20 U.S.C. § 1078-6, but charging collection costs plainly tends to deter

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agencies. As explained earlier, these recoveries remain in the Federal Treasury, and cannot be used to defray any costs incurred by the guarantors themselves.

voluntary payment, as commenters who objected to the proposed rule argued. 61 Fed. Reg. 60481 (1996). Those borrowers who, either through obstinacy or financial inability, require much greater and more costly efforts to pursue will ultimately be more likely to repay under an averaged-cost mechanism than if they had been charged the full cost of their pursuit. Charging averaged costs to all defaulted borrowers who fail to repay within the post-default "grace" period promotes the dual congressional objectives of encouraging voluntary repayment even from those who initially resist cooperation, while still shifting the cost of collection to the defaulter.

4. Federal regulations produce reasonable collection charges by encouraging the guarantor to use a "flat rate" to allocate costs among expected payments.

The Department has encouraged guarantors not merely to compute the cost charged to an individual debtor based on average costs incurred by the guarantor, but also to apply collection costs by means of a "flat rate" charged on each individual payment.[15] The "flat rate" method produces reasonable cost charges for two principal reasons. First, much of the readily-itemized "direct" charges for which debtors are unquestionably liable are in fact now computed using a "flat rate." Second, and perhaps more significant, only use of a "flat rate" charge will, as a practical matter, transfer to the debtor the cost of collection and make the guarantor whole for its costs of collection.

As noted earlier, much of the cost for which debtors are already liable are charges for contingent fees incurred by the guarantor to collect. The collection contractor earns a

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[15] "This amount will be a percentage of the principal and interest outstanding, may be calculated annually, and would be a flat rate assessed against all borrowers with defaulted loans held by that agency." 57 Fed. Reg. 60312 (1992).

contingent fee based on a percentage of the amount of a payment it secures from the debtor, without regard to the expense incurred by the contractor itself in obtaining that particular payment from that particular debtor, which may far exceed the fee earned for that payment. The contractor must set the commission rate it charges so that it will earn enough from the payments it recovers to meet all its actual direct and indirect costs on all the debts it handles, including those debts on which its efforts generate no payments, together with a profit.

A debtor may object that a contractor incurred only modest costs in generating a particular payment, and that the contingent fee earned by the contractor for that payment exceeds the "actual costs" of collecting that amount. Such an objection misses the point: the creditor incurs a negotiated contingent fee owed to the contractor for that payment, regardless of the effort needed by the contractor to secure that particular payment. The creditor must pay the contractor, and that cost is a real expense for the guarantor, and one incurred solely because the debtor previously has failed to pay the debt.[16] Because the guarantor incurs that fee, the guarantor can, and must, pass that real cost on to the debtor. Debtors whose loans have been referred by guarantors to contingent fee contractors for collection action have no basis for objecting to liability for a contingent fee charge as a "flat rate" percentage of the payment recovered.

The contingent fee process demonstrates that the "flat rate" approach is universally used

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[16] As explained earlier, FFELP regulations require the guarantor to give the debtor ample warning that failure to make repayment arrangements within a 60-day "grace" period may result in use of contingent fee contractors and liability for all collection costs. 34 C.F.R. § 682.410(b)(5).

to make whole the party that directly incurs the collection expense - the contractor, who earns a commission from the guarantor based on that "flat rate."[17] By stating that it expected the guarantor to charge the debtor the costs of collection as a "flat rate" - a percentage of the debt - the Department encouraged the guarantor to use the same approach to establishing its own collection cost charges as the collector does in establishing its fee: to charge each defaulter an amount that will generate enough revenue to cover all of the collection costs incurred by the guarantor. To do so, the guarantor must estimate both the costs it will incur to collect and the amount of payments likely to result from those efforts that will be available to defray those costs; costs not met from those payments will be subsidized by the Federal taxpayer. The guarantor may use reasonable methods to estimate both costs and recoveries; the obvious method is to compare the costs incurred and recoveries achieved in the prior year. Assuming that costs and recoveries will be similar in the current year, the guarantor will meet those costs by charging

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[17]The Department recognized that contingent fee charges may logically be challenged as excessive if the rates exceed market rates for those services as negotiated in an arms-length transaction. The Department has long noted that the obvious way to obtain competitive and reasonable contingent fee rates is through competitive bidding. See 52 Fed. Reg. 45553 (1987) (Perkins regulations); 53 Fed. Reg. 5136 (1988) (addressing the Department's own collection costs, noting that "the legislative history of 31 U.S.C. § 3718 shows that Congress based the reasonableness of contingent fee charges not on whether the charges exceeded the amounts that Federal agencies might have spent to perform the task themselves, but rather on results of competitive bidding among potential contractors. Sen. Rep. No. 378, 97th Cong. 2d Sess. (1982) at 19, 30. The Department has regularly procured its own collection contractors through competitive bidding. The Department now holds almost $12 billion in defaulted student loans, more than twice that held by the next largest holder. Department typically takes assignment when the guarantor has held the loan for at least four years, but been unable to recover any payment for last year. The Department's competitive bidding process, therefore, establishes the "market rate" for contingent fee rates to collect from debtors in this stage of delinquency. By limiting the total collection costs that guarantors may charge any debtor to the contingent fee rate charged to debtors by the Department, the regulation is designed to ensure that no debtor is charged more than the "market rate."

each defaulter a "flat rate" equal to the percentage of recoveries needed in that prior year to meet costs. By encouraging guarantors to implement the regulation by charging each defaulter costs as a "flat rate" percentage of that individual's debt, the regulations promote a reasonable method of effectively recouping from defaulters the full cost of collecting their loans.

5. Federal regulations produce reasonable collection charges by requiring the guarantor to recover costs by no more than a "flat rate" share of each payment received from a defaulted borrower.

In 1996, the Department expressly stated its intention regarding the way the cost regulation was meant to operate. It did so by amending §682.404(f)[18] to direct that:

> (f) *Application of borrower payments.* A payment made to a guaranty agency by a borrower on a defaulted loan must be applied first to the collection costs incurred to collect that amount and then to other incidental charges, such as late charges, then to accrued interest and then to principal.

In this 1996 rulemaking, the Department noted that some guarantors had interpreted the original, 1992 collection cost rule as requiring them to charge the borrower immediately the full amount of collection costs expected to be incurred to collect the debt in full, well before costs were actually incurred.[19] The Department clarified its intention that the guarantor was to charge the borrower only those costs that have been incurred *as allocated to the particular payment*:

> The loan industry commenters are correct that the proposed change precludes agencies from continuing to assess collection costs up-front at a time when the agency has not yet incurred those costs. The Secretary notes that the

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[18]As originally adopted, this provision allowed the guarantor to apply payments either to "collection costs on the loan" or reinsured interest. 34 C.F.R. §682.404(f), 57 Fed. Reg. 60352 (1992).

[19]Under this reading of the 1992 regulations, all payments would have been applied to collection costs computed on the entire debt until those costs were paid in full, and only then would payments be applied to interest and principal.

> borrower is not legally obligated to pay costs which have not been incurred. This regulatory change is intended to require the guaranty agencies to charge only those costs that have been incurred *and to prohibit the up-front loading of collection costs to the borrower's account* because it discourages repayment and *does not reflect the agencies' actual collection expenses.*

61 Fed. Reg. 60482 (1996) (*emphasis added*). This does not mean that the guarantor cannot compute and display an *estimated* total amount of costs that will be *probably* incurred in collecting the total amount of principal and interest. The Department also stated that it calculates and displays in billing statements the amount of collection costs that will be incurred and charged for contingent fees *if the full amount of principal and interest owed were to be repaid immediately* through contractor efforts, and it shows the "payoff" amount for the debt based on that estimate. However, the Department incurs a contingent fee cost only as the borrower repays and then passes that cost on to the borrower as it is incurred on a payment-by-payment basis. 61 Fed. Reg. 60482 (1996). Together, this clarification and the change regarding the way borrower payments are applied restricts the amount of collection costs that the guarantor may actually charge the debtor at any time to those costs that the rule deems to be incurred to recover that particular payment.

6. Federal regulations produce reasonable collection cost charges for defaulted borrowers in bankruptcy as for other debtors.

The trustee argues that the collection cost regulation cannot produce reasonable collection cost charges for defaulters in bankruptcy, because collection actions are stayed by the automatic stay imposed by 11 U.S.C. §362(a) during the pendency of the bankruptcy proceedings. The trustee's claim misstates the effect of the automatic stay and the kinds of costs incurred in handling debts in bankruptcy. Much more basically, the claim urges that borrowers in bankruptcy who pay their defaulted student loans should be excused from paying the same share of collection costs as that paid by defaulters not in bankruptcy. Because the method of allocating costs among defaulters by "flat rate" applied to each payment is reasonable, there is no basis for excusing those defaulters in bankruptcy from sharing that burden.

First, costs directly related to handling defaulted loans in bankruptcy include much more than the expense of filing a proof of claim. The automatic stay does no more than enjoin creditors from taking action outside the bankruptcy proceeding against the debtor to enforce the debt. Student loan creditors must take actions directly related to asserting and defending their claims within the bankruptcy proceeding itself. Obviously, the creditor must maintain records needed to establish the debt - for assertion in the proof of claim - and to properly credit payments that may be received from the estate, or from the debtor directly, if the debt is paid "outside the plan" directly by the debtor. The student loan creditor must defend the debt against attempts to discharge the debt by claims that repayment would impose an undue hardship, pursuant to 11 U.S.C. §523(a)(8), or to evade that requirement by attempting to discharge the debt by provisions of a chapter 13 plan. *See, e.g., Anderson v. UNIPAC-NEBHELP*, 179 F.3d 1253 (10th Cir. 1999).

Second, the trustee challenges the application of the regulation through a "make-whole" flat-rate charge to student loan defaulters in bankruptcy like that charged other defaulters, but he fails to show why these defaulters should be excused from their reasonable share of the guarantor's collection costs. As the government has demonstrated earlier, the regulation mandates that guarantors pass on collection costs to all defaulters, without regard to whether they are in bankruptcy, and reasonably interprets the amount of collection costs to be based on average costs allocated by a "make-whole" formula. The Department applies the regulation equally to defaulters in bankruptcy as to defaulters not in bankruptcy. If that "make-whole" method is reasonable for defaulters generally, then the trustee bears the burden of showing why this reasonable method is unreasonable when applied to defaulters who pay while in bankruptcy.

No practical difference exists between defaulters who pay voluntarily outside bankruptcy and those who pay while in bankruptcy. To restate the obvious: guarantors can recover funds needed to defray collection costs *only from defaulters who actually repay their loans*. The trustee stresses that there is little cost to filing a proof of claim in a Chapter 13 bankruptcy and receiving and handling payments made by a Chapter 13 trustee on that claim. In fact, the same can be said for most regular payments, whether made by debtors in bankruptcy or otherwise. A great many defaulted borrowers repay the Department by similar regular, recurring payments, either voluntary[20] or from wage garnishment action,[21] and collection costs are routinely charged by the Department and recovered from most of those voluntary and garnishment payments. Payments from Chapter 13 trustees (and debtors) are similarly regular, recurring payments. The cost of handling regular, recurring payments is the cost of receiving and posting payments – a task that is the same for any payments, whether from defaulters in or outside bankruptcy. Thus, regardless of the expenses incurred in attempting to locate some of these debtors in order to

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[20]Education, for example, itself received some $293 million in voluntary payments in fiscal year 2001, a significant part of its voluntary recoveries; another $498 million was also received from voluntary refinancing defaulted loans through new Consolidation Loans, or from sales of loans which had been rehabilitated.

[21] Education's wage garnishment recoveries, which like many voluntary payments are regular, recurring payments, totaled $123 million in 2001.

secure these payments, once the payments actually commence, there is no difference in costs in handling those payments that could justify charging defaulters in bankruptcy less than defaulters not in bankruptcy.

To restate the problem which the regulation addresses: the student loan guarantor must recover enough to meet its collection costs, or those costs will be charged to the taxpayer - exactly what §484A was intended to prevent. The guarantor can recover enough to be made whole for costs incurred to collect student loans *only if the guarantor, first, charges those costs, and second, defrays them from payments from defaulted borrowers*. The trustee would have the guarantor give special treatment to all defaulters in bankruptcy, by excusing them from sharing the same portion of the guarantor's default collection costs that every other defaulter reasonably bears. It is not clear whether the trustee would require the guarantor to divide defaulters in bankruptcy according to the kind of bankruptcy (Chapter 7 or Chapter 13); it is fairly clear that the trustee would have the guarantor itemize those costs incurred on each individual case, and charge each defaulter in bankruptcy only those costs incurred with respect to their individual debt. Obviously, this would increase the guarantor's administrative costs, but more importantly, the trustee's position would ensure that bankrupt defaulters would not bear the costs of collecting their loans, even if those costs were to be counted as he argues.

Debtors in bankruptcy, whether Chapter 7 or Chapter 13, typically do not pay their scheduled debts in full. A guarantor frequently receives no payments at all from a bankrupt debtor: the debtor may have no assets (a common phenomenon in Chapter 7) or may owe secured and priority creditors amounts that consume his or her disposable income (in a Chapter 13). The guarantor may also incur very substantial expenses to defend against attempts by these debtors to have their loans discharged in bankruptcy,[22] but even if the debtor does not seek discharge of the loan, the guarantor will always incur at least some costs in handling those debts. Even if these costs were as minimal as the trustee claims, a great many debtors will not pay them. If the guarantor receives no funds from non-payors, it must derive funds for those expenses elsewhere. The only obvious source is payments recovered from paying defaulters - most of which is owed back to the Federal government, which had paid the cost of their defaults. The trustee's position necessarily shifts to others the cost of collecting debts owed by defaulters in bankruptcy, in disregard of both the terms of HEA §484A(b) and the congressional intent that defaulters bear the costs of enforcing their loans. No legal or practical reason compels such special treatment.

As a practical matter, under the rule, the defaulter in bankruptcy is treated exactly like the defaulter outside of bankruptcy.[23] Payments from both are treated in exactly the same way - to defray a share of the total amount of collection costs incurred by ECMC to collect all the defaulted loans it holds. It is reasonable to allocate costs among debtors based on a make-whole, averaged cost applied to, and defrayed from, each payment received. Because there is no significant difference between a debtor paying directly to the guarantor and a debtor paying

[22]FFELP regulations require the guarantor to oppose discharge under 11 U.S.C. §523(a)(8), and to oppose plans (in Chapter 13) that would attempt discharge of the debt, unless the expected cost of litigation exceeds one-third of the amount that would be lost if the loan were discharged. 34 C.F.R. §682.402(i)(1)(iii), (2)(iv).

[23]Bankruptcy law does no more than bar creditors from certain collection actions outside bankruptcy, and bar governmental entities from discriminating against a debtor solely because the debtor is in bankruptcy, 11 U.S.C. §§362(a), 525(a); the Trustee's special treatment argument would require guarantors to discriminate in favor of defaulters in bankruptcy.

through a bankruptcy proceeding, it is reasonable to apply the regulation in this manner to defaulters in bankruptcy as to other defaulters. The challenged regulation, on its face and as applied by the Department with respect to collection action by ECMC on Barnes's loans, produces a reasonable collection cost and constitutes a reasonable and lawful implementation of HEA §484A.

CONCLUSION

For the reasons stated above, the Department submits that 34 C.F.R. §682.410(b)(2) reasonably and properly implements applicable provisions of the Higher Education Act, both on its face and as applied by the Department with respect to defaulted borrowers in bankruptcy. The Department has a rational basis for promulgating this regulatory scheme, and these regulations, including 34 C.F.R. §682.410(b)(2), achieve the congressional mandate to pass collection costs to debtors who default on their loans rather than the Federal taxpayer. The Department respectfully requests this court to reject the trustee's challenge.

Respectfully submitted,

SUSAN W. BROOKS
United States Attorney

By: Jeffrey L. Hunter
Assistant United States Attorney

Of counsel:

Fred J. Marinucci
Office of General Counsel
U.S. Department of Education

CERTIFICATE OF SERVICE

This is to certify that I have served a copy of the foregoing INITIAL BRIEF OF SECRETARY OF EDUCATION upon the parties herein by mailing a copy thereof to the following counsel of record, on this __14th___ day of March, 2002:

David C. Ollis
201 W. Main Street
New Albany, Indiana 47150

Edward M. King
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U.S. Trustee
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Indianapolis, Indiana 46204-3048
Telephone: 317-226-6333

SUPPLEMENTAL APPENDIX

(R107) GSL PROGRAM SPECIFIC SCREEN ED0701 03/12/02
REGION: 05 ACCT OWNER: ED090 11:37
ACCT NO:
Redacted ACCT NAME: BARNES DAVID A
PREV NAME:
STUDENT NAME:
STUDENT ID:
Redacted

PAGE 1 OF 2
DEBT NO: Redacted DATE ENT: 08/29/95
PRINCIPAL: INTEREST: PENALTY: ADMIN: FEES:
2,000.00 1,265.72
ENDORSER: P TOTAL: 3,265.72
LENDER: ORGAGY: SID: LNGUARDT: LOANTPE: DEFTDTE: CBOCCDATE: GA BAL DAT
823617 WI755 022920 11/03/87 SLS 02/07/89 02/07/89 08/07/95

ORGCLMPAYDTE: PRINPDLENDER: INTPDLENDER: INTCAPBYGA: AMTCOLBYGA: LAS
02/07/89 2,000.00 51.17 217.41

ORGSOLDT: LITIND: JUDMTDT: JUDMTEXPDT: WITHDRAWAL: DISB AMOUNT: DISBDTE:
12/01/93 N 11/03/87 2,000.00 11/17/87 9.13%

PF13-R101 14-R102 15-R103 16-R104 17-R105 18-R106 19-R107 20-R108 21-R109

(R107) GSL PROGRAM SPECIFIC SCREEN ED0701 03/12/02
REGION: 05 ACCT OWNER: ED090 11:37
ACCT NO:
Redacted ACCT NAME: BARNES DAVID A
PREV NAME:
STUDENT NAME:
STUDENT ID:
Redacted

PAGE 2 OF 2
DEBT NO: Redacted DATE ENT: 08/29/95
PRINCIPAL: INTEREST: PENALTY: ADMIN: FEES:
2,611.87 1,219.44
ENDORSER: P TOTAL: 3,831.31
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04/04/89 2,611.87 167.60 273.10

ORGSOLDT: LITIND: JUDMTDT: JUDMTEXPDT: WITHDRAWAL: DISB AMOUNT: DISBDTE:
12/01/92 N 10/28/87 2,625.00 10/29/87 8.00%
LAST PAGE
PF13-R101 14-R102 15-R103 16-R104 17-R105 18-R106 19-R107 20-R108 21-R109

EXHIBIT
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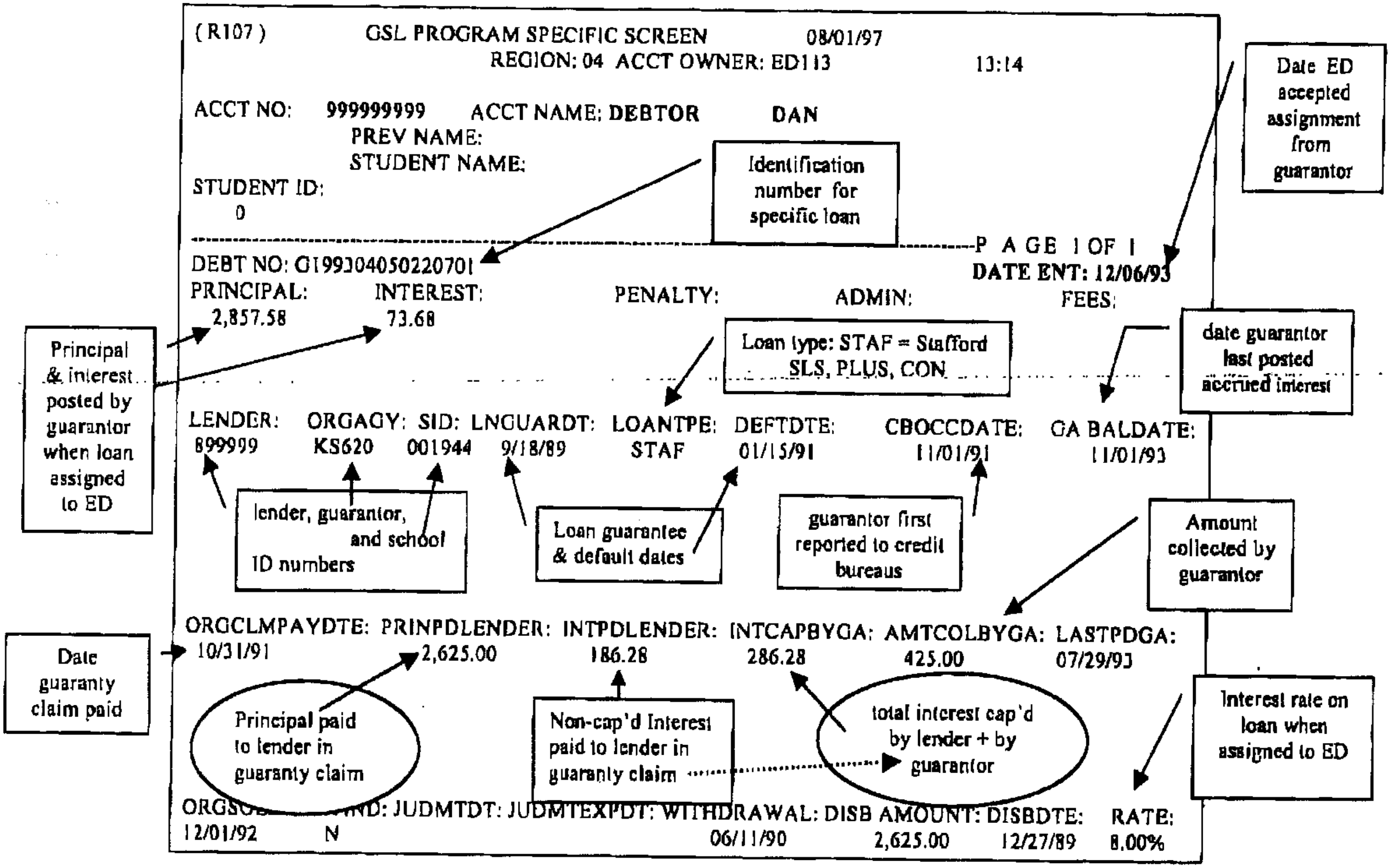

R 107 screen displays information regarding history of Guaranteed Student Loan/Federal Family Education Loan

(L102) COLLECTOR NOTE PAD ED0701 03/12/02
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ACCT NO: Redacted
ACCT NAME: BARNES , DAVID A
ED BALANCE: 0.00 PROJ/ACT CA: 0.00 CA BALANCE: 0.00
SOURCE
DATE CODE NARRATIVE

11/08/99 EA 9999 T/R LMVM JCHAPMAN
11/15/99 EA 9999 T/R TT BRS WIFE GVMM SD FILED BKCY GV AT TYS NM # JCHAPMAN T ATTY LMTC JCHAPMAN
11/30/99 EA43632 CH13 BK FILED 11/15/99,CS#Redacted,SO DIST OF IN,D OCS FWD TO ECMC,AFOSTER
*****BK FILED AFTER 10/7/98*****AFOSTER
EA 9999 *****AWG STOPPED*****AFOSTER
12/07/99 ED4213 ***BNK EFT APPRVD. MCUMMINGS/CM4
12/17/99 GDFLM502 Redacted TRANSFERRED TO TGA
Redacted TRANSFERRED TO TGA
10/30/01 ED9396 DOJ INT 396 DONE SDAVIS
03/12/02 ED0701

PF13-L101 14-L102 15-L103 16-L104 17-L105 18-L106 19-L107 20-L108 21-L109

EXHIBIT
2

ORIGINAL

UNITED STATES DISTRICT COURT

FOR THE SOUTHERN DISTRICT OF INDIANA

NEW ALBANY DIVISION

EDUCATIONAL CREDIT MANAGEMENT CORPORATION, Plaintiff, v. DAVID A. BARNES and NANCY A. BARNES, Defendants.	Case No. NA 00-0241-C-D\S

Washington, D.C.

Wednesday, July 11, 2001

Deposition of:

GARY HOPKINS

called for examination by counsel for the Chapter 13 Trustee, pursuant to notice, at Room 6-E100, 400 Maryland Avenue, S.W., Washington, D.C., at 4:00 p.m., when were present on behalf of the respective parties:

EXHIBIT

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A No, I sure don't.

Q Okay. The Secretary of Education has indicated to us, once again, that the collection charges include charges that are called direct cost and indirect cost. Can you draw a distinction between those two items for me?

A No. Direct and indirect? No, sir.

Q And it's also my understanding that at the current time the only charges the Department is assessing defaulted student loan borrowers are the contingency fees due to the guarantee agencies and the Treasury offset fees; is that correct?

A One correction. Contingency fees due to the private collection agencies that we use.

Q Okay. Draw the distinction for me, if you would, between a private collection agency used by the Department of Education and the guarantor.

A From my perspective the distinction is contractual. We have a contract with a private collection agency that spells out the agreement for collecting on our debt. There is a guarantee agency agreement that spells out the terms of what the programs better than I do.

A With FFEL program there is no set time period because guarantors are allowed to attempt collection on the loans after they initially go into default. And there are guidelines that spell out when they assign them to us, but they are based in large part on the level of success or lack of success that the guarantors have.

So they could come to us in four year. If a guarantor has not been successful in getting any payments, or if they're getting intermittent payments, it could be as much as eight, nine, ten, eleven years before we get the loans. And they also have an option to send them even sooner than four years if, for whatever reason, they decide that the loan is not one that they'll likely be able to collect.

With respect to direct loans, there is no guarantor present. So the loans would be transferred to us as soon as the Direct Loan Division reached that default stage with them. They would assign them to us. There's no in between.

Q I hate to interrupt you, but on your

based on the cost of collection that they determine or what the borrower would have been charged if the Department of Education held the loans, whichever is the least.

Q Okay. Now, there was some testimony earlier about what you do when you refer loans to collection agencies. Can you speak, either generally or specifically, about the range of collection costs that you see from the collection agencies to which loans are approved by the DOE?

A On our current contracts, through our bid process, we actually came up with one fee for regular collections.

Q And what -- is that a percentage?

A Yes.

Q What is the percentage?

A Twenty.

Q Twenty percent.

A Right.

Q How long has that been in effect?

A Since October 1 of 2000.

Q Was there one fee before then or a range assessed against all borrowers with defaulted loans held by that agency.

Q To your knowledge, is the current DOE policy on assessment of collection costs consistent with the language that's in that commentary?

A On accounts that transfer -- assigned to our collection agencies, yes.

Q And would you also -- when you say "assigned to collection agencies," would you include it within that the accounts which would be assigned to ECMC in a bankruptcy?

A Yes.

Q If I told you that ECMC in its practice regularly includes collection costs based on a percentage when they have received a loan, which is in default and is in bankruptcy, but that they regularly do not include collection costs if they have to file a proof of claim for a loan which is not in default, would you consider that to be consistent with what's in the regulation there?

A Yes.

(Pause in proceedings.)

Q Were those rates, the percentage rates that were discussed, were those net rates or gross rates?

A The 20 percent translates to a 25 percent collection cost, if that's what you're asking.

Q Okay. That's all I had.

Okay And that's 25 percent of? How is that 25 percent determined?

A Twenty-five percent of the borrower payment.

Q So, well, let's do a hypothetical. If the borrower was paying 125 dollars --

A Right.

Q -- how would that --

A Oh, I see what you're asking.

Q How would that work out?

A Twenty percent of it would go to the collection agency.

Q I think that clarifies what we wanted to clarify.

A It can get confusing, but I see what you're asking.

UNITED STATES DISTRICT COURT

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SOUTHERN DISTRICT OF INDIANA

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NEW ALBANY DIVISION

IN THE MATTER OF: EDUCATIONAL CREDIT MANAGEMENT CORPORATION Plaintiff, v. DAVID A. BARNES and NANCY K. BARNES, Defendants.	CASE NO. NA 00-0241-C-D/S

Wednesday,
July 12, 2001

Washington, D.C.

DEPOSITION OF

PAMELA MORAN

was called for examination by counsel for Chapter 13 Trustee, pursuant to notice, at 1:00 p.m., at 400 Maryland, S.W., Room 6-E100, where were present on behalf of the respective parties:

ORIGINAL

EXHIBIT 4

collection cost of defaulted student loans throughout the country, at least on the individual guarantee agencies, and you're telling those agencies that you do not have to breakdown your costs on a per case basis.

A We are not requiring the agency to individually document every activity that they undertake with every single individual.

And consistent with 30.60 that we point people to, and the listing of costs that's in 30.60, if you look at some of those costs, salaries of all the staff involved say at the guarantee agency that might be involved in collection activity.

Some of those things can only be dealt with if you're going to pass them along to a defaulted individual on an averaging kind of basis.

The make whole approach to the use of contingency fee collectors, especially if you're using multiple contingency fee collectors like the Department does and like many guarantee agencies do, it lends itself to an averaging process that just in an administratively realistic -- from a realistic standpoint administratively and also from a cost effective standpoint for the federal program, because the guarantee agencies primarily using federal money to do collections on behalf of the taxpayers on these defaulted accounts.

Q Doesn't 34 C.F.R. 682.410(b)(6), which refers to collection efforts on defaulted loans, require a guarantee agency to document all its collection activities on the loan?

A The agency would need to support whatever it said its costs related to collection were, in a sense to support -- there has to be support for whatever percentage they are using in an assessment of collection costs.

410(b)(6) which requires certain activities in due diligence in the post-default collection arena for the individual borrower, that would have to be documented.

That's separate from documenting the costs of the overall operation of the agency in collecting those debts including using contingency fee-based collectors.

these costs that you are incurring for all of these activities, including passing the loans off to a private collector under a contingency fee-based contract.

And you can use all of those costs, direct and indirect, in determining what your flat rate percentage that you'll be assessing in terms of collection costs.

Q Okay, and in the Secretary's amicus brief, I think there is a reference made to direct and indirect costs that are included in this contingency fee.

A Yes.

Q What's the distinction between those costs?

A Well an indirect cost could be lighting and heating and air conditioning in the area, computer time that you might share with the rest of the guarantee agency operation.

Maybe even some portion of the salaries of staff that are working in the collection area.

That would be, in my mind, examples of

primarily federal money.

They, as I mentioned before, are required to notify the borrower that they have paid a default claim to the lender, that they are to send a notice, I think that's covered in 410(b)(5), delineating what information they must provide the borrower in the notice.

A lot of it has to do with what activities might come to play if the borrower does not honor the debt or contact them and make repayment arrangements.

It does provide the borrower with the hearing possibility to challenge the debt, challenge the status of the debt.

And then after that period of time where that opportunity is given, if the borrower doesn't contact the agency and either satisfactorily prove the case relative to its being non-enforceable or not a correct amount or not in default.

They have an opportunity to make satisfactory repayment arrangements also as part of that process and if they don't make satisfactory repayment arrangements, then you move into the phase of post-default collection activity where the agency would then start doing a series of letter and phone calls.

And take the other steps that I described like possible litigation, administrative wage garnishment, IRS offset, assessment of collection charges, turning them over to a contingency fee-based contractor at some point.

Q Now you mentioned the fact that the default of the student loan is a federal claim, controlled by the Federal Claims Collection Standards. Is that correct?

A I don't think I meant that quite as literally as that. I mean, it's a federal claim in the sense that it's a federal asset. And federal money is basically being used by the agency in an attempt to try to return money back on that defaulted loan that we have had to pay in federal reinsurance.

The Federal Claims Collection Standards, which we're under, are the model that we've used in promulgating the regulations for the agencies.

Q Okay, could you pull Mr. Hunter's brief.

Q And in the bankruptcy scenario as in this case, where the only action taken by ECMC was the ministerial act of filing a Proof of Claim form, they're entitled to the same amount of collection charge that a non-bankruptcy defaulted student loan guarantee agency would be entitled?

A Non-defaulted bankruptcy account was your last phrase?

Q A defaulted non-bankruptcy account.

A A default? Yes. The defaulted non-bankrupt borrower would incur the same collection costs with ECMC as the defaulted borrower who then files the bankruptcy petition.

Q Then what is the meaning in 4 C.F.R. 102.13(d) of the language similar stages of delinquency. Explain the stages of delinquency.

A Stages of delinquency, in this case we're talking about a borrower who's in default.

Q So the bottom line for the Department is there are no different stages of delinquency, you are either not in default or you are in default.

A As it relates to collection costs, it's being at a certain stage of default. Having gone through that initial period of the hearing before and you've gotten beyond that and the borrower has not made satisfactory arrangements.

So we're really talking about all accounts across the nation, as well as the ones held by the Department, that reach that certain stage of default.

That's what I interpret to be similar stages of delinquency.

Q And, in the eyes of the Department, there's only one stage. Is that correct?

A Basically all borrowers who are in default, past that initial phase are subject to costs of collection. And those costs of collection are being handled on a make whole basis.

Q Okay, now Mr. Hopkins indicated that normally the Department does not assign accounts to guarantee agencies. I think he talked about two possibilities. One would be when the guarantee agency made a mistake and turned the account over to the Department. The Department, under certain circumstances, may assign that account back.

Q By Great Lakes is what --

A Well, no. Because if the loan was assigned to the Secretary, the Secretary would then begin activities itself also. Or, if it went to another agency, that agency would take whatever action that was necessary in an attempt to collect the loan.

Now a bankruptcy filing, of course, would interupt the ability of the agency to take steps to collect the loan.

Q So, aren't we really talking about two entirely different scenarios between the defaulted student loan in a non-bankruptcy situation as far as what a guarantee agency can do.

And the defaulted student loan in a bankruptcy situation where the activity of the guarantee agency is limited by the Bankruptcy Code.

A No, because the assessment of the collection costs on a defaulted account are not directly tied back to the individual activities on that individual borrower.

Q Under the make whole theory.

A Under the make whole, under the use of the averaging, under the recognition in coming up with that through a cost analysis and the use of the averaging, the use of direct and indirect costs, that's not, as was previously stated, tied directly into the individual activities of the agency on that individual borrower's account.

Q But it's your testimony that you don't think there's ever been a cost analysis done on a defaulted student loan in a bankruptcy situation on that separate scenario.

A I don't believe I testified to that effect.

Q Okay.

A I don't believe I said that.

Q Then tell me.

A I said that bankruptcy is not handled separately. That the cost analysis that's done to establish the make whole, the average, the flat rate percentage that will be applied by that particular agency, there is not a separate analysis that is done for bankrupt accounts.

There's not a separate treatment for

documented discharge potential for that individual. Death, total and permanent disability, possibly bankruptcy if the debt was effectively totally discharged.

And under the make whole approach, from a national standpoint of having the defaulted borrower bear the costs of collection on that defaulted account, if Great Lakes is not going to collect it, actively collect it through payments and payment application, then the Secretary will do it or if the Secretary doesn't do it, another guarantee agency will do it.

In this case, ECMC. But --

Q As far as actual work that may be required to collect this account in the Chapter 13, that may be very limited. It may be limited to filing a Proof of Claim on the Account.

A As I stated previously, the activities done on the individual account are not dictating the percentage of collection costs that are being assessed the borrower by the guarantee agency or, in the case of the Secretary, by the Secretary.

Q So essentially under the make whole account, there is not necessarily any relationship whatsoever regarding the amount of work done to collect the account and the fee received by the guarantee agency.

A There is a relationship for that guarantee agency to the costs that they are incurring in their overall collection activities as an agency with their defaulted portfolio.

There is a relationship of that to the percentage that they are assessing defaulted borrowers who reach a certain level of default.

That is the relationship. The relationship is not tied to the individual activity undertaken for that particular individual borrower's account.

Q Now, under the make whole account, the Secretary's argument is that this is a reasonable thing to do because what we do is we bid these accounts out and we use the market to establish a reasonable value for the account or for collection of the account. Is that your understanding of the

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Secretary's position?

A That's my understanding of the Secretary's position in terms of the contingency fee-based collectors that, in fact, that's what's going on.

Q Okay. Now, once again, according to Mr. Hopkins, the Department deals with one and only one guarantee agency in bankruptcy cases and that's ECMC. Does ECMC have to bid in order to get the Department's bankruptcy business? Is that based on competitive bidding that establishes the reasonableness of the make whole process?

A I think, I'm sorry, could you repeat the question again?

Q Okay, I think we're in agreement that the Secretary's position is that the assessment of the fees under this make whole concept is reasonable because of the competitive bidding that establishes a market rate for collection charges. And I guess my question to you is is there competitive bidding from ECMC and other guarantee agencies to do the Department of Education's bankruptcy work on defaulted student loans?

A No, to do its collection work. If the Department wanted collection work done, we would do competitive bidding on collection work through contingency fee-based collectors.

Guarantee agencies also in using contingency fee-based collectors, would use the competitive bidding, generally, especially if they are State agencies. But even our not-for-profit non-state agencies in the use of contingency fee-based contractors.

But that process, and setting the market rate, I think was we made the point, was that that effectively provides a realistic ceiling for assessment of collection costs in our regulations under 410(b)(2).

That, in fact, by us at the Department because if you remember the way the reg sets forth, where we're saying the collection costs that will be passed along by the guarantee agencies are the lesser of the result of the formula in 30.60 or what the Secretary would assess.

And since the Secretary is using several

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF INDIANA
NEW ALBANY DIVISION

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Educational Credit
Management Corporation,

Plaintiff,

vs. Case No. NA00-0241-C-D/S

David A. Barnes and
Nancy A. Barnés,

Defendants.

- - - - - - - - - - - - - - - - -

DEPOSITION OF

KATHLEEN KING

OCTOBER 16, 2001

8:30 A.M.

COPY

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EXHIBIT
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St. Cloud State University Minnesota.
Q. Now, what are your duties and responsibilities in your current position with ECMC?
A. I am responsible for all of the financial transactions of ECMC, all the accounting functions, the financial reporting, payroll, planning. All the traditional accounting functions.
Q. And does that include the financial aspects of monies collected on defaulted guaranteed student loans by ECMC?
A. Yes, it does. It involves reporting on those collections.
Q. Tell me exactly what ECMC does.
A. We are a nonprofit guarantor under the Higher Education Act as appointed by the Secretary of Education. ECMC has two lines of business within -- under that designation. One is the Federal Service Bureau or the FSB which primarily collects on bankrupt student loans, and the other is the traditional guarantor function which we refer to as the ECMC the guarantor which acts as any other guarantor does within the country.
Q. You said FSB primarily collects on student

A. Yes, he is.
Q. And what's his title?
A. I believe he is manager of merge and transfer.
Q. Is the FSB Division of ECMC the exclusive representative of the Department of Education on defaulted guaranteed student loans in bankruptcy?
A. No.
Q. Explain that. Who else is?
A. Other guaranty agencies have bankruptcy student loans. They have loans that they hold that where they pay a claim, a bankruptcy claim or defaulted claim then it becomes a bankruptcy. They hold those loans or they service those loans. Some of those agencies choose to send their loans to us for servicing. The department I believe does service some of their own bankruptcy loans and sends some to us.
Q. Okay. Now, in regard to the defaulted guaranteed student loans held by the Department of Education, does the Department of Education assign those loans, or once they go into bankruptcy to any other entity other than ECMC to your knowledge?
A. Not that I'm aware of.

starting up, and at that time it was thought that the direct lending program would cause many guarantors to go out of business, that the direct lending program would basically replace the FFELP Program. And the proposal was that we have a core group of people here who have been through a wind-down process, it appears that you will need that knowledge going forward, so what we'd like to do is create a transitional guaranty agency to help the department transition from the FFELP Program to the direct lending program and assist in winding-down other guaranty agencies if necessary.

Q. Okay. And did the change of name from Transitional Guaranty Agency to ECMC, did that signal the fact that the transitional period had past and now the ECMC was transitioning into a new phase of --

A. When we -- in 1996 the State of Virginia decided they no longer wanted to have a state guaranty agency and they asked the Department of Education if TGA could become the designated guarantor in the State of Virginia. And the name change was tied to that, that we were no

Education on defaulted guaranteed student loans in bankruptcy?

A. I believe it was in May of 1994.

Q. In these agreements which the Department of Education entered into, not only with ECMC, TGA, but all the other guaranty agencies throughout the country, it was my understanding that there was some type of process of competitive bidding. Do you have any knowledge of that?

A. No, I do not.

Q. When ECMC began servicing these defaulted student loans for the Department of Education in bankruptcy proceedings, was there any type of request for a proposal sent to ECMC or TGA?

A. That I do not recall.

Q. Are you aware of the physical process by which the Department of Education actually assigns a defaulted guaranteed student loan to ECMC in a Chapter 13 bankruptcy proceeding?

A. Not -- I'm not very familiar with that process.

Q. Are you familiar with the formula that ECMC uses to calculate its collection cost to be assessed in a 13 and to be applied and added to the proofs of claim filed in a Chapter 13 whole rate.

Q. January 1st, 2002 could there possibly be a new rate?

A. Yes. We will calculate the rate. Because we have to have the rate on January 1st we calculate the rate from October through September 30th, October 1st through September 30th on the federal fiscal year. That gives us time to calculate it based on actual numbers, and then that is then used for the next calendar year.

Q. Under the make whole formula is there necessarily any direct correlation on an individual case-by-case basis regarding the amount of work done on a particular case to collect a defaulted student loan and the amount of collection cost assessed to that individual?

A. We do not track the costs on a loan-by-loan basis. We aggregate all the costs and come up with one rate.

Q. So I guess once again my question is, under the make whole formula is there necessarily a correlation between the actual cost expended on an individual, collecting an individual loan and the collection cost assessed to that

Q. Okay. And ECMC has no control over that reserve account?
A. We do have control over that reserve account but we -- but it is a reserve account for the U.S. Government. So we do have a fiduciary responsibility associated with that reserve account.
Q. So let's say from a particular case we have a thousand dollars that goes into the reserve account, what does ECMC do with those funds?
A. Those funds go into the reserve account and out of that reserve account we are allowed to pay our costs associated with the bankruptcy.
Q. And when you refer to cost, you refer to the make whole cost that you apply?
A. No. When I refer to cost in this situation it is our actual cost incurred. It would be our personnel cost incurred with servicing the bankruptcy loans, the legal fees incurred in association with the -- with the bankruptcies, and our overhead costs associated with the bankruptcies. So it is our actual cost.
Q. So for each Chapter 13 bankruptcy you have the ability or you know the actual cost involved?
A. No, not on each individual account.

rate.

A. We only take our costs associated with the default portfolio, collecting on default loans, and spread that over our collections on the default portfolio. We exclude bankruptcy from both our revenue and our expenses pieces for the calculation.

Q. Okay. That's what I misunderstood then. Thank you. And these costs you have set out are the costs that are excluded when you calculate your default?

A. Correct. The bankruptcy costs are excluded.

Q. Okay.

MR. EGAN: Joe, could just clarify the question? You said so your costs are excluded when you calculate your default?

BY MR. BLACK:

Q. Okay. The costs listed in what you've handed me, are those costs that are not included in the ECMC cost calculation for the recovery on default portfolios?

A. Correct.

Q. Do you have any cost categories that would differentiate between a Chapter 13 and a Chapter 7 for legal fees?

A. Yes.
Q. So ECMC is not out any money. ECMC as a unit is not subsidizing these, but it's just not making income off of them?
A. Exactly.
MR. BLACK: Okay.
BY MR. OLLIS:
Q. On the particular analysis that you've done between 10/98 and 9/99 it's my understanding you are losing money in the bankruptcy area, is that correct?
A. We are not losing money in the sense of a revenue and expense item. We are performing the service for the department and we are charging our expenses against the revenues on the bankruptcies.
Q. Obviously I'm not accountant, but what I'm saying is that to me your rate is 18.06, is that correct?
MR. EGAN: Dave, could you clarify which rate?
BY MR. OLLIS:
Q. The collection cost rate that you receive is 18.06 for the year 2001, correct?
A. That is the make whole rate.

analysis of collection costs that you've prepared for the same period. And, first of all, if you could describe the percentage that is in this litigation study that you prepared.
A. In this study we looked at the costs, the costs and the collections associated with our bankruptcies. The bankruptcy collections were approximately $13 million. And then we looked at the costs of the bankruptcies which were 2.5 million excluding overhead. For purposes of this projection I did not include overhead. It was just an internal analysis. And dividing the bankruptcy costs by the bankruptcy collections the resultant percentage is 19.02 percent.
Q. That number does not take into account overhead, does it?
A. No, it does not.
Q. I believe you testified earlier that you estimated that the overhead might have been in the 400 to $500,000 range, is that correct?
A. Yes.
Q. Would you be able to calculate an approximate percentage if you plugged in that estimate of overhead into this worksheet?

A. Yes, you could. I don't have a calculator.

MR. EGAN: Off the record.

(Discussion off the record.)

BY MR. EGAN:

Q. Were you able to perform a calculation on what we're calling the litigation worksheet taking the percentage and adding in an overhead component?

A. Yes. Assuming overhead is approximately $400,000 the percentage with the overhead would be 22.06 percent.

Q. And if you were to apply that to the formula that is in 34 CFR 30.60, what percentage would you get for including proofs of claim and other purposes?

A. It would be 28.30 percent.

Q. In a given year is there typically a difference between the -- let me rephrase that. At least with respect to the year in which you've done a litigation study, the period from October 1, 1998 through September 30, 1999, is there a difference between the percentage that is obtained through the analysis of collection costs and the percentage that was obtained through this litigation study?

A. Yes. The litigation study was higher than the default collection study.
Q. Which of the two is the document that is used by ECMC to determine percentage for collection costs included in proof of claim?
A. It is the analysis of collection costs, the costs associated with the defaulted loans.
Q. And at least with respect to this period of time is it fair to say that's a lower percentage than the resultant in the litigation study?
A. Yes, it is.
Q. There was some question and testimony earlier about how you're paid, how ECMC is paid for its bankruptcy activities. Could you go ahead and just recharacterize that for me.
A. We do not receive a fee for our bankruptcy activity. We are allowed to charge the costs of our bankruptcy activity against the reserve fund into which the bankruptcy collections are deposited.
Q. So going back again to this year, because this is the only year which we have this kind of a study, the period from September 1, 1998 through -- excuse me, October 1, 1998 through

September 30, 1999, would this reflect the amount which would have been taken out of the reserve to pay ECMC for its bankruptcy activities?

A. It represents the amount that would have been charged to the reserve associated with the bankruptcy activity.

Q. And so what is the net effect on the reserve to make those withdrawals?

A. It's a decrease in the reserve.

Q. And is the Department of Education familiar with that procedure?

A. Yes, they are.

Q. And are they in agreement with that procedure?

A. Yes, they are.

Q. Do you have any information on collection cost percentages that are charged by other guarantors?

A. A little over a year ago when an employee asked other guaranty agencies what their collection costs were and we did get back some information on those. USA Education their collection costs were 20 percent.

Q. And what period of time are we talking about?

A. This was -- the question was asked during the year 2000, so I'm assuming these are their percentages for 2000. PHEAA which is the Pennsylvania guarantor is 20.5 percent. Texas was 19.39 percent. And these three guarantors are three of the top five guarantors in the country as far as volume goes. Great Lakes was 20 percent and Great Lakes is within the top 10. And Louisiana was 19.16. And the reason that we queried other guaranty agencies was to basically validate our percentages and we did by doing this.

Q. And can you relate those numbers to the percentage that ECMC had in effect for 2000?

A. I am not sure if these are their make whole percentages or the CR equivalent. However, --

Q. It would make a big difference?

A. It would, but in either case we were lower than all the others.

Q. Are you aware of any requirement in the materials that you've seen, federal regulations or internal materials, that mandates that ECMC perform a separate analysis of its legal costs in relation to other costs?

A. No, I am not.

(Discussion off the record.)

A. It would end up increasing our costs if we had to track, each track the cost associated with processing each single transaction associated with each account.

Q. Are you familiar with voluntary flexible agreements?

A. I am somewhat familiar with them, yes.

Q. Could you just explain briefly what they are?

A. With the reauthorization in 1998 part of reauthorization allowed for voluntary flexible agreements. And what those are is guarantors, either by themselves or in conjunction with other guarantors, could make a proposal to the Department of Education to process something differently than what is currently being done, so they could in essence say we will process collections in this manner and receive this fee for it in lieu of what's allowed in the regulations. However, the result of the voluntary flexible agreement could not cost the government anymore than what the current regulations do.

Q. And is the agreement that you currently have with the DOE a voluntary flexible agreement?

A. No, it is not. However, some people consider

A. In essence, yes, we do not receive anything. We are allowed to charge our costs against there, but we have not received anything above our costs for that service.
Q. Then why would ECMC bother with doing bankruptcy work if you were a break even point?
A. It is a service that we are providing for the department. They have asked us to provide this service for them and to use the reserve funds to cover our costs for those services. It's my understanding that these loans were sitting at the department and there was very little activity on them. So it is in the federal interest for us to collect on those because, you know, basically 81 percent of a hundred dollar trustee payment is better than nothing if these loans are not being actively worked.
Q. I understand that. But you are in charge of a very important part of a rather large business entity. And my question, you know, are you telling me that on your Chapter 13 work for the Department of Education you do nothing more than break even?
A. Yes. I'd like to remind you we are a nonprofit organization.

payment. And then their collection costs are then -- that goes into their operating fund and then their collection costs are charged against their operating fund. So the 24 percent is in the regulations on default payments and it's up to 18 and a half percent on consolidations is the fee that we are allowed to retain.

Q. Okay. So how does the 24 percent that you're allowed to retain, does that apply in the bankruptcy cases also?

A. For most guaranty agencies every dollar they receive in a bankruptcy is sent back to the Department of Education and they need to -- any costs that they had associated with that bankruptcy come out of their operating fund. With our situation any bankruptcy money that we collect gets deposited into the FSB reserve fund and our costs associated with that come out of the FSB reserve fund. And in this new setup more guarantors are transferring their bankruptcies to us because it's not profitable for them in their operating fund to have those costs come out when they have no revenue associated with those going into their operating fund. But it benefits the Department

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
NEW ALBANY DIVISION

EDUCATIONAL CREDIT MANAGEMENT CORPORATION,	)	
Plaintiff,	)	
vs.	)	CASE NO: NA-00-0241-C-D/S
DAVID A. BARNES and NANCY K. BARNES,	)	
Defendants.	)	

ECMC'S AMENDED RESPONSES TO THE TRUSTEE'S FIRST SET OF INTERROGATORIES ADDRESSED TO EDUCATIONAL CREDIT MANAGEMENT CORPORATION

Educational Credit Management Corporation ("ECMC") hereby provide its Amended Responses to the First Set of Interrogatories (the "Interrogatories") propounded by the Chapter 13 Trustee, Joseph M. Black Jr. (the "Trustee"). ECMC reserves the right to supplement its responses set forth herein. These responses replace and supercede ECMC's responses dated October 11, 2001.

DEFINITIONS

Terms not otherwise defined herein shall have the meaning set forth in the Interrogatories.

PRELIMINARY STATEMENT

ECMC makes these objections and responses subject to and without waiver of (1) all questions as to the admissibility into evidence of ECMC's responses, any documents to which reference may be made, or the subject matter of any of such documents; (2) the right to object to other discovery directed to the subject matter of the Interrogatories; (3) the right to make additional objections or seek protective orders in the event additional review of files and pretrial

EXHIBIT
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INTERROGATORY NO. 11:

Are the collection costs recovered by ECMC through a Chapter 13 proceeding retained in their entirety by ECMC?

RESPONSE: Under its current arrangements with the DOE, ECMC collects payments from defaulted student loan borrowers in bankruptcy that consist of principal, interest and collection costs (the "Bankruptcy Payments"). All Bankruptcy Payments are retained in a reserve fund for the benefit of the United States Government and are owned entirely by the Government. ECMC does not maintain an operating fund for the funds recovered through a Chapter 13 proceeding, nor does ECMC hold a legal interest in the reserve fund. ECMC is permitted to recover expenses for operating the bankruptcy processing unit from the reserve fund as specified in the documents to be produced in response to the Trustee's Request for Production #1.

INTERROGATORY NO. 12:

If the answer to the preceding Interrogatory is in the negative, set forth in detail any and all entities which receive any portion of the collection costs recovered by ECMC in the Chapter 13 proceeding, and the percentage of the collection costs recovered by ECMC that is distributed to said entity or entities.

RESPONSE: The recovery of all funds regardless of whether collection cost, interest, or principal in a Chapter 13 proceeding are retained in the reserve fund as described above and are owned by the United States Government. A portion of the reserve fund is used to pay ECMC's expenses for processing the bankruptcy cases.

INTERROGATORY NO. 13:

What steps does ECMC take to monitor or determine whether a Chapter 13 Trustee has paid twelve (12) consecutive monthly student loan payments to ECMC on a debtor's defaulted student loan through the Chapter 13 proceeding?

RESPONSE: ECMC monitors payments of student loans on individual payment records for each student loan and, as such, maintains a loan history that shows loan payments. ECMC takes no further steps to monitor or determine (a) whether a Chapter 13 Trustee has paid 12 consecutive monthly student loan payments to ECMC, (b) whether these payments are reasonable under the circumstances, whether the payments are on time, and (c) whether the debtor is willing to sign a new promissory note during the Chapter 13 proceeding, each of which is a condition precedent to rehabilitating a student loan under 34 C.F.R. § 682.405.

INTERROGATORY NO. 14:

List all Federal Regulations that apply to ECMC or to which ECMC is subject in its collection of defaulted student loans?

RESPONSE: ECMC objects to this Interrogatory because (i) it is overly broad and unduly burdensome and (ii) it seeks information that is neither relevant nor likely to lead to the discovery of relevant and admissible information. This having been said, and without waiving its objections, ECMC responds that it is aware of the following federal regulations that are directly related to a collection of defaulted student loans: 34 C.F.R. § 682.100 *et seq.* and 34 C.F.R. § 30.60. ECMC is also subject to OMB Circular A-122 entitled "Cost Principles for non-profit organizations" last updated June 1, 1998.

DANIEL S. FISHER, Associate Attorney, ECMC

STATE OF MINNESOTA)
) ss:
COUNTY OF RAMSEY)

The foregoing was subscribed and sworn before me on ~~November~~ December 10, 2001, by Daniel S. Fisher, Associate Attorney of ECMC, a Minnesota corporation on behalf of the corporation.

AMY JW SCHREINER
NOTARY PUBLIC - MINNESOTA
My Commission Expires Jan. 31, 2005

Amy JW Schreiner
Notary Public
My commission expires: 1/31/05

Respectfully submitted,

FROST BROWN TODD LLC
John S. Egan
Edward M. King

John S. Egan By EMK
400 West Market Street, 32nd Floor
Louisville, Kentucky 40202
(502) 589-5400
Counsel for Educational Credit Management Corporation Signing as to Objections Pursuant to FRCP 33

CERTIFICATE OF SERVICE

I hereby certify that on December 11, 2001, a true copy of the foregoing pleading was served on David C. Ollis, Attorney for Joseph M. Black, Jr., Chapter 13 Trustee, P.O. Box 846, Seymour, IN 47274, and on Jeffrey Hunter, Assistant United States Attorney, 10 W. Market Street, Ste. 2100, Indianapolis, IN 46204-3048; and the United States Trustee, 101 W. Ohio Street, Ste. 1000, Indianapolis, IN 46204, via first class mail, postage prepaid.

Edward R. K.

COUNSEL FOR EDUCATIONAL CREDIT
MANAGEMENT CORPORATION

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