MEMORANDUM

To: **Borrower Defense Negotiated Rulemaking Committee, U.S. Department of Education**

From: **Ashley Harrington and Suzanne Martindale, Negotiators for Consumer Advocacy Organizations; Abby Shafroth and Juliana Fredman, Negotiators for Legal Assistance Organizations Representing Students; Stevaughn Bush, Negotiator for Students; Walter Ochinko, Negotiator for Servicemember and Veteran Borrowers**

Date: **December 8, 2017**

Re: **Issue 1 – Borrower Defense Standard**

The Department has asked the Borrower Defense Committee to provide input on whether there should be a federal standard for determining if a borrower can establish a defense to repayment of a loan based on an act or omission of a school. The Department has also asked what the federal standard should be if one is established, what burden of persuasion borrowers should be required to meet in order to assert a defense to repayment, and how relief should be determined.

This memorandum identifies important principles that we believe should guide the answers to these questions, and provides proposals consistent with those principles for the Department and the Committee's consideration.

I. Guiding Principles for a Fair Borrower Defense Standard

1. Borrower protections based in state consumer law should not be diminished.
2. A federal standard should be available as a floor to ensure that all federal student loan borrowers, regardless of state of residence, have reasonable access to relief.
3. A federal standard should protect and provide relief to student borrowers from harmful school conduct relating to the student's decision to enroll or stay enrolled and/or take out loans, should be clear to both students and schools (while still being flexible enough to ensure predatory schools cannot easily get around the rules), and should be readily administrable by the Department.
4. Borrowers harmed by an institution's deceptive or otherwise unlawful conduct should be eligible for relief regardless of whether there is proof of the institution's bad intent. Concerns that harmless mistakes by schools should not entitle borrowers to get out of their loans are better addressed by considering whether the mistake was reasonably likely to harm borrowers rather than whether it was intentional.
5. If the evidence shows that it is more likely than not that a borrower was victim of an institution's conduct that provides a borrower defense, the borrower should get relief.

6. Borrowers with valid borrower defenses should receive full relief on the federal student loans tied to the borrower defense, and should not be denied relief based on when the misconduct occurred.

II. Proposals Stemming from the Guiding Principles for a Fair Borrower Defense Standard

1. Borrower protections based on state consumer protections should not be diminished.

Under the 1994 regulations and the longstanding terms of the Master Promissory Notes, borrowers can assert state consumer protection law claim or defense against their school as a borrower defense to their federal student loans. The Department should not use this process to eliminate these longstanding rights for new borrowers. For example, California has the biggest state population and among the strongest state consumer protection laws; these students' rights should not be diminished. Preserving the availability of state law defenses also respects the important interests of states in protecting students and borrowers, and enables the Department to work more efficiently with state law enforcement when investigating borrower defenses, particularly those that may be supported by state findings. We therefore propose preserving the right to assert a borrower defense based on state law.

Eliminating the rights of new borrowers to raise state-law based defenses to repayment will not reduce the Department's need to know and apply state law. As the Department has stated, the millions of current federal student loan borrowers with loans issued since 1994 have a right to raise state-law based defenses based in the 1994 regulations and their Master Promissory Notes. The Department will therefore have to continue analyzing state law defenses for existing borrowers.

- **Proposal: We propose preserving the right to assert a borrower defense based on state law.**

2. A federal standard should be available as a floor to ensure that all federal student loan borrowers, regardless of state of residence, have reasonable access to relief.

While borrowers should continue to be able to assert a borrower defense based on conduct that violates their own state law protections, the regulations should also ensure that all federal student loan borrowers, regardless of their state of residence, have reasonable access to borrower defense relief. We therefore propose that all borrowers should also be able to assert a borrower defense based on conduct that violates a federal standard. Establishing a "federal floor" for when borrowers should receive relief ensures that all borrowers have reasonable access to relief, while preserving access to the stronger student protections that exist in some states and respecting the authority of states to continue to develop and enforce laws to protect their residents.

- **Proposal: We propose that all borrowers should be able to assert a borrower defense based on conduct that violates a federal standard, in addition to being able to assert a defense based on a school's violation of the laws of their state.**

3. A federal standard should protect and provide relief to student borrowers from harmful school conduct relating to the student's decision to enroll or stay enrolled and/or take out loans, should be clear to both students and schools (while still being flexible enough to ensure predatory schools cannot easily get around the rules), and should be readily administrable by the Department.

A federal borrower defense standard should protect and provide relief to student borrowers from harmful conduct, should be clear to both students and schools (while still being flexible enough to ensure predatory schools cannot easily get around the rules), and should be readily administrable by the Department. The best way to satisfy this principle is to look to existing laws designed to protect consumers. A sensible federal standard should closely align to established federal and state consumer protection and contract laws, including in particular laws and regulations prohibiting unfair, deceptive, and abusive acts and practices. These laws have already been carefully developed to protect consumers from harmful conduct, have been well-defined by legislatures, courts, and law enforcement agencies, and most schools are already accustomed to complying with them.

- **Proposal: We propose that a federal borrower defense standard should mirror well-defined concepts already used in federal and state consumer protection and contract law, including:**
  - **Unfair acts or omissions;**
  - **Deceptive acts or omissions, including but not limited to misrepresentations;**
  - **Abusive acts or omissions;**
  - **Unlawful acts or omissions; and**
  - **Breach of contract and violation of duty of good faith and fair dealing.**

The school activities subject to this standard could be reasonably limited to those relating to the student borrower's decision to enroll, take out loans, and use those loans to pay for educational and career services sought to complete a program.

The types of misconduct that predatory schools have committed in recent years bear the character of these types of classic consumer protection violations, including but not limited to: deceptive representations about job placement rates; abusive marketing tactics, including recruiting soldiers, even those suffering cognitive impairments, at wounded warrior barracks;

and other examples of unlawful conduct that have been investigated by state and federal agencies.[1]

Notably, the vast majority of borrower defense claims to date have pertained only to a modest number of schools that engaged in widespread and well-documented misconduct. According to Department records, three-fourths of pending claims are from students who attended Corinthian Colleges, and virtually all of them are from students who attended large, publicly-traded for-profit institutions, many of which have since closed.[2] Therefore, a federal standard that mirrors consumer protection law will provide a balanced approach that targets the worst actors—those engaged in conduct that lawmakers and regulators have already determined should be prohibited—and protects students and taxpayers, without significantly impacting the vast majority of schools that provide competent instruction and services to their students.

A federal borrower defense standard rooted in consumer protection principles would be consistent with laws and regulations that have a history of helping to protect consumers from unscrupulous business conduct, including conduct that results in the origination or facilitation of loan obligations.

Examples of existing federal consumer protection statutes that the borrower defense standard could mirror are included below:

- *Unfair Conduct:* The Federal Trade Commission (FTC) has long enforced prohibitions against unfair or deceptive acts or practices. 15 U.S.C. § 45. Under the FTC Act and its accompanying guidance, an act or practice is "unfair" if it (1) causes or is likely to cause substantial injury to consumers; (2) cannot be reasonably avoided by consumers; and (3) is not outweighed by countervailing benefits to consumers or competition. 15 U.S.C. § 45(n).

- *Deceptive Conduct*: An act or practice is "deceptive" under the FTC Act if (1) it is a representation, omission or practice misleads or is likely to mislead a consumer; (2) the consumer's interpretation is reasonable under the circumstances; and (3) the misleading representation, omission or practice is material. *See FTC Policy Statement on Deception* (Oct. 14, 1983) (appended to *Cliffdale & Assocs., Inc.*, 103 F.T.C. 110, 174 (1984)). The FTC used this authority to pursue action against DeVry University last year after uncovering evidence that DeVry had made unsubstantiated claims to students in its marketing materials for many years about job placement rates and expected income levels

[1] *See* S. COMM. ON HEALTH, EDUC., LABOR AND PENSIONS, FOR PROFIT HIGHER EDUCATION: THE FAILURE TO SAFEGUARD THE FEDERAL INVESTMENT AND ENSURE STUDENT SUCCESS, S. REP. NO. 112-37, pt. 1 (2012), *available at* https://www.help.senate.gov/imo/media/for_profit_report/PartI.pdf.

[2] THE CENTURY FDN., COLLEGE COMPLAINTS UNMASKED 1 (2017), *available at* https://tcf.org/content/report/college-complaints-unmasked/ (analyzing data obtained from Dep't of Educ. via FOIA request).

associated with its job training programs. The agency alleged that DeVry's advertisements were deceptive, and that as a result the school had been unjustly enriched through their unlawful conduct. *See* Complaint at ¶59, *FTC v. DeVry Educ. Grp., Inc.*, Case No. 16-cv-579 (filed Jan. 27, 2016). The action was resolved through a $100 million settlement, the proceeds of which are being used to provide refunds to students. Stipulated Final Order at 10, *FTC v. DeVry Educ. Grp., Inc.*, Case No. 16-cv-579 (filed Dec. 15, 2016).

- *Abusive Conduct*: The Dodd-Frank Act provides similar definitions of unfair and deceptive acts or practices, and also provides a clear definition of "abusive" acts or practices related to financial products and services that should be incorporated in the borrower defense standard. 12 U.S.C. § 5531. An act or practice is "abusive" if it:

  (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.

  12 U.S.C. § 5531(d). Both the CFPB and the State of Illinois have recently applied this abusive practices standard to protect student loan borrowers from predatory school conduct, in cases against ITT and Alta Colleges. *See Consumer Fin. Protection Bureau v. ITT Educ. Servs., Inc.*, Case No. 14-cv-292 (filed S.D. Ind. Feb. 26, 2014); *Illinois v. Alta Colleges, Inc.*, Case No. 14-cv-3786 (filed N.D. Ill. May 22, 2014).

In addition to these federal laws, all 50 states have unfair and deceptive acts and practices laws ("UDAP" laws), most of which are modeled at least in part on the FTC Act. Under the 1994 regulations and existing loan promissory notes, borrowers can assert borrower defenses based on such unfair or deceptive acts by their schools.

Issue paper 1 asks whether a new borrower defense standard should be based on common law fraud, instead of on such consumer protection laws. The answer is no. There is simply no rationale for sharply deviating from a consumer protection-oriented standard for borrower defense and applying a much less protective standard, such as common law fraud. Indeed, the state unfair and deceptive practices acts that borrowers may rely on under the 1994 borrower defense regulations were designed to increase consumer protections from the limited protections provided by common law fraud. Basing a new borrower defense standard on

common law fraud would drastically limit access to relief for victims of school misconduct as compared to either the 1994 or 2016 borrower defense rules.

Such a drastic, student-unfriendly change would be particularly indefensible now given the Department's determination just last year that requiring a borrower to prove an institution's intent to deceive "would render borrower defense claims implausible for most borrowers" because accessing such evidence would be "nearly impossible for borrowers." 81 Fed. Reg. 75,937. A common law fraud standard would do just that, as it requires proof of intent.

4. Borrowers harmed by an institution's deceptive or otherwise unlawful conduct should be eligible for relief regardless of whether there is proof of the institution's bad intent. Concerns that harmless mistakes by schools should not entitle borrowers to get out of their loans are better addressed by considering whether the mistake was reasonably likely to harm borrowers or actually harmed borrowers, rather than whether it was intentional.

We agree with the Department's 2016 statement of principle that it "is more reasonable and fair" for an institution to be held responsible for harm it causes borrowers by misrepresentations or other misconduct than to leave borrowers to bear such costs, regardless of what the institution's intent was. *See* 81 Fed. Reg. 75,947. A borrower harmed by a school recruiter's false statement should be eligible for relief even if the recruiter did not know the statement was false. 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 caused it and could have better prevented it. For this reason, as well as the important practical point that "[g]athering evidence of intent would likely be nearly impossible for borrowers," 81 Fed. Reg. 75,937, we propose that a federal borrower defense standard should not require borrowers to prove the school's intent or knowledge to be eligible for relief.

We agree that borrowers should not be entitled to discharge of their loans based on trivial, harmless mistakes by a school. But rather than focusing on whether a school intentionally or mistakenly provided misinformation or engaged in other misconduct, the better approach is to focus on whether such conduct was reasonably likely to harm students (or actually harmed the applicant seeking relief). Mistakes that are reasonably likely to harm students (e.g., advertising 90% job placement rates instead of 9%) are appropriate bases for borrower defenses, whereas mistakes that are not reasonably likely to be harmful (e.g., advertising that the faculty includes 20 Nobel Laureates instead of 19) are not.

- **Proposal: We propose that a federal borrower defense standard should <u>not</u> require borrowers to prove the school's intent or knowledge to be eligible for relief.**

5. If the evidence shows that it is more likely than not that a borrower was victim of an institution's conduct that provides a borrower defense, the borrower should get relief.

The Department requested input on the burden of persuasion that the borrower should have to meet to get relief. We believe that if the evidence shows that it is more likely than not that a borrower was victim of an institution's misconduct that provides a borrower defense, the borrower should get relief. In other words, the Department should not have to tell borrowers: "The government believes, based on the evidence, that you were a victim of school misconduct but the government will nonetheless continue collecting from you anyway."

We therefore propose that whether applying a federal or a state standard, the Department should require that borrowers meet a preponderance of the evidence standard to demonstrate their entitlement to relief. A preponderance of the evidence standard is the default standard for civil actions, including consumer protection claims. *See, e.g.*, CAL. EVID. CODE § 115 ("Except as otherwise provided by law, the burden of proof requires proof by a preponderance of the evidence"). It is also the standard that the Department uses in other proceedings regarding federal education loans. *See* 34 C.F.R. § 34.14(b), (c) (administrative wage garnishment); 34 C.F.R. § 31.7(e) (federal salary offset).

By contrast, there is no reason to limit relief only to borrowers able to satisfy a higher burden of proof, such as "clear and convincing" evidence standard. These higher burdens of proof are the exception to the rule in civil cases, and are typically reserved for claims where fundamental rights are at stake, such as habeas corpus rights in capital cases. *See, e.g.*, *Calderon v. Thompson*, 523 U.S. 538 (1998). A higher evidentiary burden would result in denials of relief to many borrowers with credible evidence that they were scammed into taking out loans simply due to the difficulty of gathering overwhelming evidence. A heightened standard of proof is particularly inappropriate to an administrative proceeding that does not include evidence discovery rights for the plaintiff that would be available in court, and in which the vast majority of borrowers will not be represented by lawyers.

The Department considered arguments in favor of higher standards of proof, including the clear-and-convincing standard, during the 2016 rulemaking and found that the "preponderance of the evidence" standard "is appropriate" for borrower defense claims and "strikes a balance between ensuring borrowers who have been harmed are not subject to an overly burdensome evidentiary standard and protecting the Federal Government, taxpayers, and institutions from unsubstantiated claims." 81 Fed. Reg. 75,936.

- **Proposal: We propose that whether applying a federal or a state standard, the Department should require that borrowers meet a preponderance of the evidence standard to demonstrate their entitlement to relief.**

7. *Borrowers with valid borrower defenses should receive full relief on the federal student loans tied to the borrower defense, and should not be denied relief based on when the misconduct occurred.*

The Department requests input on how the Department should determine the amount of relief a borrower with a valid borrower defense should receive. We believe that the simplest approach is the best approach here: borrowers with valid defenses should receive full relief from the federal student loans related to their borrower defense, including refunds of amounts already paid and discharge of outstanding balances. This is the approach to relief that the Department takes with respect to other loan discharge programs, including discharges based on school closure and false certification of eligibility for loans. We see no reason to complicate the discharge determination for borrowers and the Department alike, or to limit relief to borrowers who were victims of school misconduct under the borrower defense provision.

Providing full relief from the relevant loans also makes sense given that most borrowers with successful defenses would not have enrolled or taken out loans to attend the school at all if not for the deceptive, abusive, or unfair way the school recruited them or signed them up for aid.

Additionally, even full relief from federal student loans is an insufficient remedy for the many students lured by false promises into attending predatory schools. These students also are often saddled with private loan debt and out of pocket costs; they lose out on thousands of dollars in critical Pell grants that they can't get back to use for a second chance at a better education; they often suffer financial hardship due to their loans and worthless degrees that can lead to evictions, ruined credit, and reliance on expensive payday loans; they suffer stress and embarrassment at being duped and being unable to get a job in their field; and they can never get back the time they wasted at a school they would not have attended if the school had been straight with them—time they could have spent earning money at a job or attending a quality school. Given that even full relief from the relevant federal loans is insufficient to get harmed borrowers back to where they would have been absent the school misconduct, the Department should not look for ways to reduce relief still further.

Finally, borrowers' eligibility for refunds of amounts already paid or collected, and for cancellation of outstanding balances, should not be time limited based on when they seek relief. Borrowers may take years to assert a defense simply because they were not previously aware of their rights or how to pursue them, or because the facts of their school misconduct had been hidden. A borrower may have a harder time proving their eligibility for a borrower defense many years after the misconduct occurred, but if they can then the Department should not arbitrarily limit loan relief simply because of when the claim was submitted.

- **Proposal: We propose that borrowers with valid defenses should receive full relief from the federal student loans related to their borrower defense, including refunds of amounts already paid and discharge of outstanding balance, and that eligibility for full relief should not be time limited.**