Cooley

October 26, 2015

The US Department of Education (ED) is preparing for a new rulemaking that is intended to clarify—and very likely expand—the ability of student borrowers to be relieved of the obligation to repay their Federal Direct Loans. ED, which in August issued a **notice** of its intention to proceed with the rulemaking and announcing two public hearings on the subject, **announced last week** that it is accepting nominations for negotiators, and will soon outline plans and agenda items for the negotiated rulemaking. The first session of the negotiated rulemaking process will be January 14-16, 2016, with additional sessions in February and March 2016, to allow ED to issue a final regulation by the November 2016 deadline for compliance with ED's rulemaking calendar.

The regulation would interpret the venerable but, until very recently, little-used **"Borrower Defense to Repayment" provision** in the Higher Education Act and the minimal **ED regulations** that have long been on the books. While in the past only a handful of borrowers ever sought relief under this provision, the collapse of Corinthian Colleges coupled with the aggressive efforts of advocacy groups have encouraged a rapidly increasing number of former Corinthian students to seek relief from repayment of many millions—possibly billions—of dollars of loans. Responding to this deluge, the revised rules could become the vehicle to offer loan relief to a potentially enormous population of borrowers—including those who successfully completed their programs—who can claim the harm to be specified in the new regulations. Notably, the statutory provision makes the relief available without regard to the nature of the institution—for-profit, non-profit, or public.

The current statutory language is a model of brevity:

> *Borrower defenses*
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> *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.*

The current regulatory language reads, in pertinent part:

> *(c) Borrower defenses. (1) In any proceeding to collect on a Direct Loan, the borrower may assert as a defense against repayment, any act or omission of the school attended by the student that would give rise to a cause of action against the school under applicable State law. These proceedings include, but are not limited to, the following:*
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> > *(i) Tax refund offset proceedings under 34 CFR 30.33.*
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> > *(ii) Wage garnishment proceedings under section 488A of the Act.*
> >
> > *(iii) Salary offset proceedings for Federal employees under 34 CFR part 31.*
> >
> > *(iv) Credit bureau reporting proceedings under 31 U.S.C. 3711(f).*
>
> *[…]*

> *(c)(3) The Secretary may initiate an appropriate proceeding to require the school whose act or omission resulted in the borrower's successful defense against repayment of a Direct Loan to pay to the Secretary the amount of the loan to which the defense applies. However, the Secretary does not initiate such a proceeding after the period for the retention of records described in § 685.309(c) unless the school received actual notice of the claim during that period.*

The heart of the concept of the "Borrower Defense to Repayment" is that students can be relieved of the obligation to repay all or a portion of their federal loans if they can show that the institution in which they were enrolled committed certain undefined "acts or omissions" that impacted the educational services they received, or would otherwise affect their obligation to repay an educational loan. Historically, the scope of those violations has never been closely defined, primarily because there was no need: until early 2015, ED had only received five such claims over the course of 20 years. However, it has quickly become apparent that an absence of a clear regulatory standard and—equally important—procedures for evaluating and granting relief, cannot survive in the post-Corinthian era where many thousands of students are already seeking relief.

The key to the upcoming rulemaking will be how violations that could trigger relief are defined and the standards that borrowers would be required to meet to benefit. Simply put, what constitutes the vague statutory standard of an "act or omission" necessary to invoke this relief? And what law must be violated? The Higher Education Act is silent on this matter, while the current regulations curiously limit a claim to violations of *state* law. The statutory language itself is so broad that it is almost certain that ED will exercise considerable discretion in rewriting the new regulations. Indeed, the fifteen words constituting the entire statutory basis for requiring a program to lead to "Gainful Employment" exploded into many thousands in the GE rulemaking.

The other potentially explosive issue revolves around whether and how ED could seek to require an institution—or potentially those owning or in control of an institution—to reimburse the government for the value of the forgiven loans, as well as how ED could use the assessment of loss as a way to evaluate "institutional capability," which directly affects eligibility to participate in the Title IV programs. While the current regulations simply refer to "an appropriate process" for ED to recoup funds from an institution, ED has never fleshed out those terms and the statute is entirely silent on this point. In announcing the rulemaking, ED has specifically raised these issues for consideration.

Most of the witnesses at the two public hearings preceding the current process were representatives of state attorneys general, consumer advocates and students or student organizations, all of whom were united in advocating for an expansive rule that would provide the broadest relief. Indeed, some witnesses advocated blanket relief intended to eliminate the need for an aggrieved student to file any form of application or show any particular violation or harm beyond simply being—or having been—enrolled in an institution that has committed a sufficient "act or omission." To our knowledge, no representatives of any institutions spoke at the hearings. While the ED panelists offered very little insight into the Department's perspective, the actions of the Special Master appointed by Deputy Secretary Ted Mitchell to process borrower relief claims from former Corinthian students may signal the agency's intentions in the rulemaking. In his **first report** issued on September 3rd, the Special Master said that ED had already received over 4,100 borrower defense claims and has had to hire additional staff to process pending claims, streamline the process itself and publicize the availability of this relief.

Every indication is that ED has an ambitious agenda for this rulemaking. In fact, the October 20th Notice indicated an expanded agenda, even from that which was noted in the August Notice, including establishing a federal standard for qualifying "acts or omissions" (perhaps eliminating the underlying state law requirement completely) and expanding the rulemaking to include "other loan discharges," which might open the door for ED to address the separate topic of closed school loan discharges or the applicability of the regulations beyond the Direct Loan program. These topics are in addition to the already-noted plans to determine the standards and procedures that ED will use to pursue recourse from the institution, and the impact of these claims on the institution's "capability."

Although at the end of the process, except in the exceptionally unlikely event of consensus among the negotiators, the Secretary will

issue whatever rules he considers appropriate, the composition of the panel will be important so that critical issues are at least discussed and become a part of the record; certainly ensuring that there is adequate representation of the full range of potentially affected institutions, whether public, non-profit or for-profit institutions, is essential. The list of "constituencies" noted in the October Notice is particularly broad—including students, consumer advocates and Attorneys General, with a single representative from each of the non-profit sector, for-profit sector and minority-serving institutions, and two representatives from the public sector of higher education. We will be closely tracking this process and we encourage you to consider how this new rule might affect your institution and what involvement may be appropriate, either directly or through the associations in which you participate.

Cooley filed comments during the public hearing phase that highlight these and other issues. Those comments are available **here**. All 217 comments filed in this proceeding are available **here**.

If you are interested in further background information and analysis of the statutory and regulatory language and history of the Borrower Defense to Repayment, please contact **Kate Lee Carey** to request Cooley's background memo on this topic.

Key Contacts

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