Comment on Notice of Proposed Rulemaking,
Docket ID ED-2015-OPE-0103,
34 CFR Parts 30, 668, 674, 682, 685, and 686,
by Margaret Reiter, and

Comment Joined by the Following:

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August 1, 2016

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Introduction

The Department has taken some significant steps since the negotiated rulemaking to improve certain aspects of the proposed borrower defense and discharge provisions. I support those improvements, including the elimination of the statute of limitations on borrower defense to repayment, the longer statute of limitations on borrower defenses seeking recovery of amounts paid, and improvements to the arbitration provisions. Still these changes and other provisions need improvements.

Because of the length of the preamble and the numerous statements that needed to be addressed, and because others whose comments I support, including TICAS and the legal aid organizations, are commenting on other sections, these comments will relate only to the borrower defense standard, primarily to the proposed sections 34 CFR 685.206(c) and 685.222.

I base my comment on my experience as a consumer investigator for four years at the Los Angeles County Department of Consumer Affairs investigated for-profit schools; 20 years experience as a consumer law prosecutor with the California Attorney General's Office, during which time I was either the supervisor or the lead prosecutor on a number of for-profit school cases which resulted in millions of dollars of restitution being awarded, permanent injunctions entered, and a number of schools closing; nearly 8 years working voluntarily with non-profit groups who seek to insure students at for-profit schools are not cheated and left with debt for the rest of their lives.

A. Borrower Defense Standards – General Comments (§§ 685.206, 685.222, Appendix A)

Many of the comments relevant to these sections relate to all of these sections because they analyze the numerous shortcomings of the rationales offered in support of deleting the current borrower defense standard and adding the other. Generally, the rationales provided in the Preamble are not rational. Among their failings are these:

- They suffer from a lack of concrete, valid legal or factual examples to support them.
- They downplay the gravity of the radical diminution of consumer protection by failing to acknowledge either the long history or the centrality to consumer protection law of the existing rule they propose to eliminate.
- They fail to disclose that this is not the first attempt by the Department to diminish borrower defenses.
- They minimize the extent to which current borrower rights will be excised from the rules.

- They overstate the extent to which the rule will diminish the Department's burden, among other ways, by minimizing the extent to which the Department will need to rely on state law for all of the millions of outstanding loans, as well as to determine the defenses still left.
- They claim the rule will reduce the burden on borrowers, but they fail to mention, much less discuss the ways it will increase the cost and burden on borrowers.
- They selectively justify eliminating state and other federal law rights borrowers currently have, but justify the proposed rules by selectively embracing or relying on certain state and other federal laws.
- They fail to recognize or consider how the proposed rules will facilitate unscrupulous institutions' avoidance of borrower defenses while those institutions continue to cheat students and thereby, the Department and taxpayers.
- They demonstrate a lack of understanding of how unfair and deceptive business practice cases are brought and successfully resolved, but, nevertheless, show disregard for the advice of state attorneys general and other experienced litigators, such as those from legal aid organizations.

Given the Department's abysmal track record in preventing national scandal time and again because of its failure to adequately police the student loan and grant programs, the proposed rules changes, which will further reduce borrowers' and states' ability to do so, is shocking.

Although the preamble says the only consideration in deciding a borrower's defense is the merit of that defense, the proposed rules, supposedly intended to protect consumers, have such extraordinarily unusual and high barriers to borrower relief, that it appears that concerns about the "federal fisc," as Department officials often noted during the negotiated rulemaking, took a far higher priority in constructing the rules than did consumer protection and deterrence of unscrupulous schools.

Even in the midst of a continuing national scandal about the fraud, deception and other reprehensible conduct of for-profit schools, the multi-million, if not billions of taxpayer dollars wasted, and the young lives destroyed due to school misconduct and lack of enforcement by the Department, the proposed rules focus on protecting us all, not from that reality, but from the possibility that students might somehow wreak havoc on the Title IV programs.

This comment will focus on the inadequate justification for these rule changes. It will also note simple changes to the proposed rules that could better achieve all of the stated goals.

B. By Failing to Set Forth the True Genesis of Borrower Defense Rules, the NPRM Minimizes the Result: The Reinstatement of Contractual Terms the Federal Trade Commission Long Ago Found to Be Unfair and Deceptive

The current borrower defense regulation allows borrowers to raise as a defense against collection on their student loan anything they could raise in a state action against the school. 34 CFR 685.206(c). The Department states that the regulation has been in place only since 1995, which is technically true. NPRM p. 39330. That regulation, however did not spring out of nowhere in 1995. The principle on which it is based and from which it is derived stems from a long-standing bedrock principle of consumer law. Since the 1970's the Department has recognized that the principle applies to Title IV loans.

The principle is that a business should not be able to insulate itself or the creditor from liability for the business' unlawful conduct by using credit agreements that require payments to a creditor to which it refers its customers or with which it is "affiliated by common control, contract, or business arrangement," but which do not allow the consumer to defend against the creditor to the same extent the consumer could defend against the original business. See 16 CFR 433.1(d).[1]

1. As Early as 1972, the Department Acknowledged The Right of Student Loan Borrowers to Raise State (and Federal) Law Defenses to Repayment

As early as 1972, the predecessor to the Department of Education (the Department) recognized that generally under state law, lenders in the Title IV student loan programs were not holders-in-due course. In other words the Department recognized that the student loan holders might not be legally able to collect on the loan when a borrower had a claim against the original school or lender.

> "Loans made under the Guaranteed Student Loan Program are not, under the laws of most states, negotiable instruments of which a party may be a holder in due course."
>
> "Thus, any valid defenses on a note which a student borrower may have against a lender, including a lender school, could generally be asserted against any subsequent holder of that note. And since the Commissioner insures only enforceable obligations, no Federal insurance applies to a note as to which such valid defenses exist."[2]

2. The Failure to Allow All Borrower Claims and Defenses Against a Referred or Affiliated Creditor Is an Unfair or Deceptive Practice

In May 1976, the Federal Trade Commission (FTC) promulgated a rule to establish the principle in all consumer credit transactions. 36 FR 1211. It did so by requiring that businesses not take or accept any such credit agreement unless it contained a specific notice to the creditor (holder) to the effect that the consumer has the same right to defend against collection by the holder as the consumer could have asserted against the original business. 16 CFR 433.2.[3] It acted under its

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1. A credit contract that does not allow consumers to collect against subsequent holders of the contract is often referred to as a "negotiable instrument" and the entity holding such a contract is called a "holder-in-due-course."

2. Dear Colleague Type Letter, perhaps before DE called them that, "To Federally Insured Student Loan Officers, All Participating Lenders & Educational Institutions," December 20, 1972, from the Office of Education, Dept. of Health, Education , and Welfare, Regional Office, 50 Fulton Street, San Francisco, California 94102, announcing workshops to be held and the attached "Prospectus for the Guaranteed Student Loan Program," prepared by the Division of Insured Loans, U.S. Office of Education, Washington, D.C. (HEW), p. 11.

3. The FTC Holder Rule reads as follows:

authority to prescribe “rules which define with specificity acts or practices which are unfair or deceptive acts or practices in or affecting commerce . . . .” 15 U.S.C. 45(a)(1).

Accordingly, the FTC’s promulgation of the rule was its determination that not allowing consumers to assert against such holders’ claims or defenses they had against the original seller was an unfair or deceptive act or practice. The prescribed rule asserted that the unfairness or deception applied unless the notice provided that the holder of the contract was subject to all claims or defenses the consumer could raise against the original business. 16 CFR 433.2.

Because the FTC has jurisdiction over matters affecting commerce, its rule generally applied and still applies to for-profit schools, but does not to apply to public institutions or non-profit organizations.

The FTC specifically stated that school contracts were covered by the rule:

> “The rule expressly applies to credit contracts arising from sales of services, such as trade or vocational school agreements as well as sales of consumer tangibles.”
>
> 40 F.R. 535324.

In connection with any sale or lease of goods or services to consumers, in or affecting commerce as “commerce” is defined in the Federal Trade Commission Act, it is an unfair or deceptive act or practice within the meaning of section 5 of that Act for a seller, directly or indirectly, to:

(a) Take or receive a consumer credit contract which fails to contain the following provision in at least ten point, bold face, type:

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

or,

(b) Accept, as full or partial payment for such sale or lease, the proceeds of any purchase money loan (as purchase money loan is defined herein), unless any consumer credit contract made in connection with such purchase money loan contains the following provision in at least ten point, bold face, type:

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

16 CFR §433.2. Definitions are contained in 16 CFR §433.1.

3. The Department Recognized Borrowers' Right under the FTC Holder Rule to Raise All Claims and Defenses Against a Referred or an Affiliated Student Loan Lender/Holder

In June, 1976, the Department told schools and lenders that loan contracts to which the FTC Rule applied had to include the FTC Holder Notice:

> "It appears that all for-profit educational institutions fall within the Rule's definition of 'seller' and are covered."

The Department stated that for schools covered (ones which had referred consumers to lenders or which had the requisite affiliation by common control, contract, or business arrangement with the lender), student loan contracts had to include the FTC Holder notice.[4] Most affected schools did not begin to include the required notice, however, and apparently, neither the FTC nor the Department devoted effort to enforcing the rule for more than 17 years, from 1976 through 1993![5]

4. In April and May 1993, the Department Acknowledged that the FTC Holder Rule Notice Had to Be Included in all FFEL, Direct, and Other Guaranteed Student Loan Program Promissory Notes Beginning in 1994.

Despite the lack of prior enforcement efforts, when the Department prepared standard form promissory notes in 1993 to be used on all student loans, the Department recognized the law required including an FTC-like notice in the standard form promissory notes.[6]

The language the Department initially required for FFEL loan promissory notes fairly closely tracked the FTC Holder Rule language. It stated as follows:

> "If this loan is made by the school, or if the proceeds of this loan are used to pay tuition and charges of a for-profit school that refers loan applicants to the lender, or that is

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4. Office of Education of the Department of Health, Education and Welfare Bulletin #L16, S9 (June 28, 1976).

5. Even if the loan contract did not contain the required notice, under various state legal principles, borrowers may still be able to raise the claim or defense successfully. See, e.g., National Consumer Law Center, Student Loan Law, 5th Ed., 12.9; 13.8.5.3 (2015).

6. April 14, 1993 Letter from Robert W. Evans, Director of the Division of Policy Development, Policy, Training, and Analysis Services in the Office of Education of DE to Guarantee Agency Directors; with attached "Common Application Manual, p.7:

> [W]e have added a clause required by the Federal Trade Commission (FTC) Holder Rule that applies to for-profit institutions. This FTC Holder Rule specifies that a holder of the loan is subject to all claims and defenses that the borrower could assert against the for-profit institution that made the loan.

The Department also advised program participants that it had added the FTC Holder-type notice to Perkins Loan promissory notes, but that this would not create any new defenses for Perkins loans. Dear Colleague Letter CB-93-4, dated May 1993; see also Dear Colleague Letter GEN-92-21, October 1992.

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> affiliated with the lender by common control, contract or business arrangement, any holder of the note is **subject to all claims and defenses** which I could assert against the school. My recovery under this provision shall not exceed the amount I paid on the loan."[7]

> Emphasis added. The Department sent similar information on Direct loans:

> "[W]e have added a clause [to the common direct loan promissory note] required by the Federal Trade Commission (FTC) Holder Rule that applies to for-profit institutions. This FTC Holder Rule specifies that a holder of the loan is subject to **all claims and defenses** that the borrower could assert against the for-profit institution that made the loan."[8]

Emphasis added. The initial Direct Loan Borrower Defense Notice stated:

> "Any holder of this loan is subject to **all claims and defenses** that I could assert against the institution that made this loan; my recovery is limited to the amount I repaid on this loan."[9]

Emphasis added.[10]

5. Why the Department's Failure to Discuss the History of the Borrower Defense Regulation Is Important

The Department's failure to describe the true foundations of the current regulation, 34 CFR 685.206(c), suggests its removal of that provision for all future borrowers is of minimal importance. But that regulation is not just some rule the Department itself hatched that has no general significance. The Department proposes to eliminate from the student loan program a key consumer protection rule that has served consumers and tempered business conduct for at least 40 years. In promulgating that rule the FTC determined that not to allow borrowers to raise "all claims and defenses" against the lender that they have against the original business is an unfair or deceptive act or practice.

The student loan program has been and continues to be scandalously plagued by unfair or deceptive acts or practices, as demonstrated in the 1990's by the Nunn investigation and report, more recently by the Harkin investigation and report, and even more recently by the Corinthian debacle and numerous pending state and federal investigations of other of the large schools in the program. As discussed more fully below, the Department has wholly failed to demonstrate a solid rationale for its repudiation of the FTC's determination that not allowing consumers to raise all such claims and defenses is, in itself, an unfair or deceptive practice. The Department's disregard for the

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7. Application and Promissory Note, Federal Stafford Loans (Subsidized and Unsubsidized) and Federal Supplemental Loans for Students (SLS) 4/22/93. In accordance with the coverage of the FTC Holder Rule, the notice applied only to loans made for attendance at for-profit schools.

8. Dear Colleague Letter CB-93-4, p. 1, May 1993.

9. Common Direct Loan promissory note attached to Dear Colleague letter, CB-93-4, p. 1, May 1993.

10. Because the lender for direct loans is the Department, an affiliation by contract or business arrangement is present in all direct loans, so the direct loan notice did not need to discuss that limitation.

findings of its sister agency is just one of the many distressing and shocking features of the explanation for, and the proposal itself, to eliminate the Department's current analog of the FTC Holder Rule.

C. The Rationales for Severely Reducing Borrowers' State Law Defenses Fail to Justify Reinstating Contractual Terms Found to Be Unfair and Deceptive

The Preamble claims the proposed elimination of the existing standard is necessary, because due to the growth of distance education, the standard could burden the Department or students or could result in uneven treatment. The Preamble further claims that "much" of the bases for borrower defenses will be included in the substitute standard proposed. None of these rationales supports the drastic changes proposed.

1. The Preamble Claims the Growth of Distance Education Sparked this Move to Eliminate Most State Law Defenses; In Fact, this Proposed Rule Is but One More Example of the Department's Repeated Efforts, and the For-Profit Schools' Long-Existing Goal: to Reduce Borrower Defenses

a. The Preamble Overstates the Increase in Education Provided Remotely

The Preamble points to a great increase in distance education in the last 20 years as the primary reason for the need to eliminate state law defenses. It cites statistics to show a great increase since 1999. While there has been an increase in distance education, the preamble overstates this change because it fails to consider the correspondence course analog to distance education. Long before the 1995 regulation, correspondence programs participated in Title IV student loan programs. For example, as early as 1990, the California Attorney General filed suit against a large publicly traded for-profit school, United Education & Software (UES). One of the major programs UES offered was a correspondence program which purportedly trained students for employment as word processors. Complaint, People v. United Education & Software, L.A.S.C. No. 743121.

b. The Department Did Not Historically "Assume" the Current Rule Applied the Laws of the State Where the School Was Located

The Preamble contends, "Generally, the regulation was assumed to refer to the laws of the Statein which the institution was located." NPRM, p. 39336. The early history of the Direct Loan regulation does not support that claim. Congress authorized the Department to institute interim rules to cover the first year of the Direct Loan program. The Department's interim rule specified that the laws of the state where the school was located should apply to borrower defenses:

> "The act or omission gives rise to a cause of action against the school recognized **<u>under the law of the State in which the school attended by the student was located</u>**; . . . ."

59 FR 475 et. seq., January 4, 1994 (Emphasis added). Later that year, however, the Department changed that provision:

> "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**."

59 FR 61690, Dec. 1. 1994, as amended at 60 FR 33345, June 28, 1995 (Emphasis added). Had the Department believed that the applicable law was that of the school's location, it would not have needed to make this change. This change strongly suggests that even before the increase of distance education on which the Preamble relies, the Department recognized that which state law should be used could not be assumed to be the state law where the school was located.

c. Efforts to Reduce Student Loan Borrowers' Defenses under the FTC Holder Rule Began Well Before the Growth of Distance Education on which the Preamble Relies

In April and May 1993, the Department acknowledged that it was required to include the FTC Holder Rule in FFEL and Direct Loan promissory notes, and did so. See ante, Section A.4. Absent any statutory provision, the FTC Holder Rule would have continued to apply to the Direct Loan program, just as it continues to apply to the FFEL program.

(1) A Last Minute, One Sentence Amendment on Borrower Defenses Was Sneaked into the Direct Loan Program Statute

The final version of the law enacting the Direct Loan program included a one-sentence amendment. Apparently, that sentence had not been in either the House or Senate version of the bill. It changed everything:

> "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."

107 Stat. 351; Pub. L. 103-61, title IV, Subtitle A, section 4021 [Direct Loan Program], p. 40, August 10, 1993.

Although the genesis of this amendment cannot be tracked in the bills that came into the conference, it was no secret that the Career College Association (CCA), the predecessor to the current for-profit school trade and lobbying association, and the Consumer Bankers Association opposed inclusion of the FTC Holder Rule in the standard promissory note. CCA even contemplated suing to have the FTC Holder language removed. CBA Advisory, June 17, 1993.

At the same time, the Direct Loan bill was moving through Congress. In July 1993, CCA explored possible vehicles to amend the Direct Loan bill to remove the FTC Holder Rule. CCA Memo dated July 6, 1993 for fax tree distribution. Although CCA did not succeed in completely removing the FTC Holder Rule, it should be no surprise that a last minute amendment gave the Department authority broad enough to attack the Holder Rule in the Direct Loan program.

(2) The Department Immediately Reduced Borrower Defenses in the Direct Loan Program that Otherwise Would Have Been Protected by the Holder Rule.

The Holder Rule (and the standard promissory notes the Department had just published) stated that any holder of the student loan was "subject to **all claims and defenses**" that the borrower could assert against the institution. Suddenly, the final Direct Loan rule reduced the borrower defenses in these ways:

- It no longer allowed borrowers to raise **claims**. It restricted borrowers to asserting defenses only in proceedings begun against them. It precluded them from bringing affirmative claims against the holder.
- It no longer allowed borrowers' to raise "**all** claims and defenses." It precluded borrowers from directly bringing any claims or defenses under federal law, instead, limiting their rights to relief available under state law.

59 FR 61690 (December 1, 1994); 60 FR 37767 (July 21, 1995).

Although not contained in the rule itself, the Secretary also explained that although the rule still said borrowers could raise "all" defenses based on state law, in fact, the Department would not recognize as a defense against repayment of the loan, "a cause of action that is not directly related to the loan or the educational services." The Department offered examples of defenses borrowers could not raise: sexual or racial harassment or personal injury tort claims. 60 FR 37767, 37769 (July 21, 1995).

This narrowing of borrower rights took place during the same time frame in which scandalous for-profit school misconduct had risen to national attention. Nevertheless, while reducing borrower defenses, the Department broadened the scope of the rule to apply not just to for-profit schools, but to all schools. Although for-profit schools regularly attempt to have rules applicable only to them broadened to apply to other types of schools so as to weaken them, it is unclear whether they were the impetus for broadening the rule in this instance.

(3) The Department Again Attempted to Narrow Borrower Defenses in 2013

In 2013, the Department began a negotiated rulemaking, primarily to address the gainful employment rules. The negotiators agreed on the topics to be covered. Nevertheless, in the midst of the negotiating sessions, the Department attempted to add a new topic: narrowing borrower defenses by prohibiting defenses based on state law to rely on violations of the HEA.[11] Some non-federal negotiators objected to including a topic outside of those agreed to among the negotiators. The Department withdrew the proposal.

(4) The History of Prior Department Efforts to Narrow Borrowers Defenses Matters

The history shows the proposed change is but one more effort to narrow the defense borrowers may raise, nevertheless, a primary rationale offered for the elimination of the current borrowers' defense provision is the growth of distance education. Such a drastic uncoupling of borrower defenses from the Department's ability to collect, a practice long determined to be unfair and deceptive, cannot be supported by such a thin rationale.

2. The Limited "Burden" Associated with the Longstanding Right of Borrowers to Assert Defenses Based on State Laws Fails to Justify a Retreat to Unfair and Deceptive Contract Terms

The preamble asserts that a primary reason for eliminating the current borrower defenses available under state laws is because "of the difficulties in application and interpretation of the current State law standard . . . ." NPRM, p. 39336. The preamble claims that "an approach based on State law would present a significant burden" "for Department officials to determine the applicability and interpretation of States' laws . . . ." NPRM, p. 39339. The various explanations offered to support this rationale, however, are unpersuasive.

a. The Department Will Not Avoid Having to Apply State Laws

For several reasons, the Department will have to continue to apply state law defenses in many cases, despite the proposed rule.

(1) The Department Will Always Have to Apply State Laws to Borrower Defenses for Millions of Borrowers on Billions of Dollars of Existing Loans and Loans Yet to Be Made Before a Regulation Becomes Final

The preamble notes that the Department "is committed to ensuring that students harmed by Corinthian's fraudulent practices receive the relief to which they are entitled under current . . . borrower defense regulations" NPRM, p. 39335. But, in fact, the Department could not reduce defenses available to current borrowers because they are guaranteed by legally binding agreements – the student loan promissory notes, and by Department regulations and its interpretation of its

11. Department Draft for Discussion Purposes 11/08/2013, p. 72, 685.206(c)(2). A borrower may not assert as a defense to repayment of a Direct Loan a cause of action for which an element is that the school, a location of the school, or a program offered by the school did not or does not meet one or more requirements for the school, location, or program, as applicable, to be eligible to participate in a title IV, HEA program.

prior regulations and promissory notes.[12] Additionally, the FTC Holder Rule applies explicitly to covered FFEL loans for for-profit schools, as discussed above.

There are nearly 42 million borrowers who have outstanding Direct, Perkins or FFEL loans on some $1.2549 trillion dollars of loans.[13] Presumably, the vast majority of those were made after the Department included the FTC-Holder-like language in its promissory notes. And even for those dating back to 1976, as noted above, borrowers might be able to assert state law defenses even if the note did not contain the required notice. See footnote 5.

Indeed, the preamble notes that the Department has received thousands of borrower defense claims from Corinthian students. NPRM, p. 39335. Surely the Department has already reviewed those claims in light of the applicable state laws. Yet the preamble makes no mention of the state law analysis the Department has already carried out to address those claims that presumably arose around the time Corinthian filed bankruptcy more than a year ago. How many state laws has the Department already analyzed in connection with that case? Is it possible that the Department has failed to undertake that analysis on claims that have been outstanding for months or a year or more?

(2) The "Burden" Is No Greater than that on the Servicers, Lenders, or Guarantee Agencies

Loan Servicers, Lenders, or Guarantee Agencies, too, will continue to have to apply state laws to determine borrower defenses on Direct, FFEL, and Perkins loans, existing, or made before the proposed regulation becomes effective. This regulation cannot retroactively change that. The Preamble asserts the state law defenses must be eliminated to unburden the Department. Yet these other entities, like the Department itself, will continue to be required to apply the existing standard.

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12. Although the FTC-Holder-type notice in the FFEL Master Promissory Note itself initially applied only to for-profit schools. In publishing those promissory notes, the Department stated that other provisions of the note did not cut off holder-type defenses to borrowers at other types of schools. The Department explained:

> "The comment [suggesting that it did not apply] reflects a misunderstanding of the language in the FFEL Program's common promissory note. That promissory note includes a provision that reflects the requirements of the Federal Trade Commission's ``Holder Rule''. The FTC only regulates ``for profit'' entities and the promissory note provision reflects that limitation. However, the promissory note also specifically provides that applicable State law may provide for certain borrower rights, remedies and defenses in addition to those stated in the note. Thus, contrary to the commenter's suggestion, the promissory note does not prohibit borrowers from asserting a defense against repayment of a loan received for attendance at a not-for-profit school."

59 FR 61690 et seq, re 34 CFR 685.206(c) (December 1, 1994). Thus, since at least 1995, the Department interpreted its standard FFEL promissory notes not preventing borrowers at any type of school, not just at for-profit schools, from subjecting lenders to some state law borrower defenses. This was also true for Direct loans under the explicit direct loan regulatory language, as well as under the Direct Loan promissory note Holder-type language.

13. Federal Student Aid Portfolio Summary as https://studentaid.ed.gov/sa/about/data-center/student/portfolio as of July 24, 2016.

The Preamble does not explain or justify reducing the "burden" on the Department, when that "burden" is the same for these entities.

Has the Department failed to provide these other entities guidance on how to apply state laws? Can the Department seriously contemplate that it will provide no guidance to these entities about how to respond to borrower defenses on loans existing before the proposed rule becomes effective?

(3) Even if the Number of Loans Subject to the Existing Standard Is Diminished by Consolidation, the "Burden" of Having to Apply State Laws Would Scarcely Be Affected

Because the Department proposes to allow existing borrowers to use the new regulation to assert a borrower defense if they consolidate their existing loans into a direct loan, the Department may assume it will be able to eliminate many of those existing loans and the accompanying borrower defenses. Even if the Department is correct that over time many will consolidate their loans, because the proposed rule will be disadvantageous for some borrowers depending on their particular circumstances, the Department cannot hope to eliminate all existing defenses raised on outstanding loans.

As the Department has acknowledged, under the laws of most states, a borrower may defend against a loan as long as the loan is outstanding. That rule is applicable to the outstanding loans and those made before the effective date of the proposed rule. As we know, student loans may be outstanding for 20, 25, or more years after a borrower is scheduled to begin repayment. Some loans may be outstanding even after borrowers reach retirement age and collection efforts are made against their social security payments. In short, the Department will have to undertake the same analysis of state laws it seeks to avoid, even if the substitute standard becomes effective. The only question is whether it will undertake that effort and use that standard for all loans, or if it will persist in establishing a substitute standard which will cause it to have to determine how to apply two different standards for decades to come.

Rather than decrease its burden, establishing a different standard for new loans will make the Department's and borrowers' tasks more complicated and burdensome. Some students will have loans subject to more than one standard. For example, a student who has outstanding loans who then takes out another loan after the new regulation goes into effect will have to assert and have their borrower defenses decided under two different standards.

(4) The Proposed Substitute Standard Proposed Necessarily Requires Interpretation and Reliance on State Laws

(a) The Breach of Contract Standard Depends on State Law

This topic is addressed below.

(b) The Substantial Misrepresentation Standard Relies in Part on Interpretation of State Law

As noted elsewhere below, the Substantial Misrepresentation Standard the Department itself relies on was drafted with input, based on state UDAP laws, particularly that of California, as well as aspects which were drawn from the Federal Trade Commission Vocational School Rule. Interpretation and application of the standard will necessarily involve an analysis of state law.

b. Determining Which State's Laws Apply Will Not Place a Major Burden on the Department

The Preamble notes that the current regulation does not identify which state law applies, instead stating that the "applicable" state law applies. NPRM, p. 39336. The Preamble claims it would be a "burden" for the Department to have to continue to figure out which state law is applicable. NPRM, pp. 39336, 39339. The Preamble says this is because some states' laws don't apply to out-of-state schools offering distance education within the state. Others do. NPRM, p. 39336. Apparently, the Preamble refers to specific laws states have enacted to address postsecondary education. Generally, which state's law applies depends on specific rules, which can easily be sorted out.

(1) Which State's Specific Postsecondary School Laws Apply to Postsecondary Schools Is Not Difficult to Determine

To participate in Title IV programs, schools must demonstrate they have state authorization to operate. 34 CFR 600.4-600.6. The Department has determined that that state authorization must be more than mere approval to operate a business. 34 CFR 600.9. Consequently, every state has specific provisions that apply/authorize schools to operate. Typically these provisions make clear whether they apply only to schools with a physical presence in the state or also to out-of-state schools that offer distance education in the state. See, e.g., Ca. Ed. Code § 94858.

Indeed, the very framework of Title IV depends on a triad to insure program integrity, the Department of Education approval, accreditation by recognized accrediting agencies, and state authorization. 34 CFR 600.4, 600.5, 600.6. In recent years, the Department has again recognized the importance of the third part of the triad – state authorization. Given two rulemaking procedures on the topic of state authorization over the last several years, it is difficult to believe that the Department has not carefully considered which states already apply their laws to out-of-state schools offering distance education in their state and which do not. Surely, this is information the Department has already analyzed and should have no trouble applying.

In any event, even if the Department has not done this analysis in connection with considering regulations that should govern state authorization over out-of-state schools, most of the work has been done for them. The National Consumer Law Center's (NCLC) *Student Loan Law* treatise provides a state by state analysis of which states' laws specifically apply to private colleges that offer distance education from out of state. NCLC, *Student Loan Law, Fifth Ed.,*App. E, p. 547 (2015). These treatises are updated regularly. If a non-profit organization has been able to figure it out, and update the information regularly, surely the task would not be too burdensome for the Department.

(2) Which State's General Laws Apply to Postsecondary Schools Is Not a Major Burden to Determine

The Preamble claims the spread of distance education has made the determination of which law applies more difficult. A state's general laws, however, including especially its unfair and deceptive acts and practices (UDAP) laws, generally apply to conduct in the state, so long as there are sufficient contacts with the state to meet constitutional due process considerations of minimum contacts. Businesses offering products or services in a state are generally subject to that state's laws, regardless of where the business is physically located. The Preamble points to no instances in which the Department has had difficulty determining which state's laws apply, even to the tens of thousands of defenses raised in connection with Corinthian schools.

To the extent a situation might be subject to more than one state's general or UDAP laws, there is a standard choice of law mechanism for determining which state's law to apply. Generally, state laws, and UDAP laws in particular, apply to all unlawful conduct directed against a state's consumers. Again, the Preamble points to no instances in which such a difficulty has arisen.

c. Strong Resources Available to the Department Insure any "Burden" from Application of Borrower Defenses Based on State Law Rights Is Minor

The Preamble complains that the Department could not apply state laws. It rejects having to maintain the longstanding borrower defenses based on state law, as well as including UDAP provisions under the proposed federal standard. The Preamble claims these state laws "have not been subject to a degree of judicial development sufficient to make their application to the borrower defense context clear;" that state UDAP laws are meant for enforcement by state agencies, not individual borrowers; that the Department could not engage in "nuanced application of complex legal doctrines. NPRM 39339-40. These rationales do not withstand scrutiny.

(1) Existing State Consumer Protection Laws Are Older and Generally More Developed than the New Misrepresentation Standard Proposed

The most important state laws borrowers can assert are those known generally as unfair and deceptive practice (UDAP) laws. All states have such laws. Most either spurred changes to the FTC Act, or were initially patterned after the FTC Act's prohibition on unfair and deceptive acts and practices. The original California unfair competition law (Civil Code § 3369, moved in 1977 to Bus. & Prof. Code §17200) was interpreted to apply to consumer transactions and allow consumers relief beginning in 1935. *American Philetelic Soc. V. Claibourne*, 3 Cal. 2d. 689 (1935). The FTC Act was amended to protect consumers against on unfair and deceptive acts and practices in 1938. *FTC* v. *Colgate Palmolive Co.* 85 S.Ct. 1035 (1965).

Unlike the new, unique and untested substantial misrepresentation standard proposed to apply only to borrower defenses, state UDAP laws, which typically prohibit unfair, fraudulent, and unlawful business acts, as well as misrepresentation, have been refined by judicial decisions over 50 to 80 years or more.14 Additionally, the attorneys generals of many states have joined together to investigate multiple for-profit schools. They have provided the Department with extensive information about the states' UDAP laws.

Contrary to the implication in the Preamble, these state laws generally allow private individuals, as well as state agencies, to bring actions based on business' unfair and deceptive conduct. See, e.g., NCLC, *Unfair and Deceptive Acts & Practices,* 8th Ed., pp. 1-2. (2012).

d. NCLC Has Already Gathered UDAP Knowledge & Summarized All State UDAP Laws

The non-profit NCLC regularly publishes and updates a treatise that summarizes all of the states' UDAP laws and discusses the major aspects of UDAP law. NCLC, *Unfair and Deceptive Acts and Practices*, 8th Ed.; and Appendix A (2012); online version (2015).

(1) The Substantial Misrepresentation Standard Is Not Simply Based on the FTC Rules

I participated in the recent negotiation of the substantial misrepresentation rule. I offered a number of aspects of California's UDAP laws, which were accepted and incorporated into the rule. And as noted elsewhere, the unique, higher threshold requiring actual reliance does not reflect either state UDAP laws or the FTC rule.

(2) The Proposed Breach of Contract Standard Will Require Continued Use of State Laws

As discussed elsewhere, those laws are not uniform and will require the Department to apply state laws.

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14. See, e.g., *Barquis v*. **Error! Main Document Only.***Merchants Collection Assn.* 7 Cal.3d 94, 112 (1972) (An "unlawful" business practice is "anything that can properly be called a business practice and that at the same time is forbidden by law."); accord *Stop Youth Addiction v Lucky Stores*, 17 Cal.4th 553, 560 (1998)). But, "[t]he language of section 3369 . . . does not limit its coverage to . . . 'deceptive' practices, but instead explicitly extends to any 'unlawful, unfair *or* deceptive business practice'; . . . [T]he section was intentionally framed in its broad, sweeping language, precisely to . . . deal with the innumerable 'new schemes which the fertility of man's invention would contrive.'" (Citations omitted.)); see also, *Kwikset Corp. v. Super. Ct*., 51 Cal. 4th 310, 320 (2011); *;*Pulaski & Middleman, LLC v. Google, Inc.*, 802 F. 3d 979 (9th Cir. 2015, cert. den. June 6, 2016) ("To state a claim under the [Unfair Competition Law or False Advertising Law] 'based on false advertising or promotional practices, it is necessary only to show that members of the public are likely to be deceived.' *In re Tobacco II Cases*, 46 Cal. 4th 298, 312 (2009); see also *Stearns v. Ticketmaster Corp.*, 655 F.3d 1013, 1020 (9th Cir. 2011) (holding that a district court erred in denying class certification by requiring individualized proof of reliance and causation, and remanding in light of In re Tobacco II Cases), cert. denied, 132 S. Ct. 1970 (2012). This inquiry does not require 'individualized proof of deception, reliance and injury.' *In re Tobacco II Cases*, 46 Cal. 4th at 320; Stearns, 655 F.3d at 1020. '[I]n effect, California has created what amounts to a conclusive presumption that when a defendant puts out tainted bait and a person sees it and bites, the defendant has caused an injury; restitution is the remedy.' *Stearns*, 655 F.3d at 1021 n. 13."

3. The Preamble's Justification of a "Longstanding" Department Position for Removing Violations of the HEA from Borrower Defenses on Existing Loans Is Contrary to the Department's Prior Statements

Proposed section 685.222(a)(3) applies to both the existing regulation 685.206(c) which is applicable to all loans before the effective date of the proposed regulation, as well as to section 685.222, which applies to those made after that date. The inappropriate justification for retroactive application to existing loans is discussed here. The reasons why this change is altogether inappropriate is discussed in depth post, in Section D.5.

Because all loans made before new regulations become effective are subject to the rights and remedies contained in loan agreements subject to the prior regulation, the Department would not be able to apply this new restriction to loans under 685.206(c) unless, perhaps, by showing that the new limitation is merely making explicit an existing interpretation of current law. Hence, the application to existing loans depends on the Preamble claim that it is merely a "longstanding" interpretation of existing law.

> "The proposed regulation would prohibit the use of a violation of the HEA, whether alleged 'directly or indirectly based on state law,' unless it also constituted a substantial misrepresentation or breach of contract."

NPRM, p. 39339. The Preamble claims that this limitation, contained in proposed § 685.222(a)(3), sets forth

> "The Department's longstanding position that an act or omission by the school that violates an eligibility or compliance requirement in the HEA or its implementing regulations does not necessarily affect the enforceability of a Federal student loan obtained to attend the school, and is not, therefore, automatically a basis for a borrower defense."

NPRM, p. 39338. While that statement is true in part, it does not provide a legal basis to have the proposed regulation apply retroactively.

When the Department promulgated the current borrower defense regulation for FFEL loans in 2007, which, like the Direct loan regulation, allows borrowers to raise state causes of action as a defense, it supported allowing borrowers to raise state actions by explaining:

> "[T]his change is consistent with a long line of court decisions that found that the HEA does not preempt State laws that allow borrowers to raise State law claims as a defense against collection of a FFEL Program loan unless particular State laws actually conflict with the objectives of the HEA. *Armstrong* v. *Accrediting Council for Continuing Educ. & Training, Inc.*, 168 F.3d 1362 (D.C. Cir. 1999), *cert. denied*,528 U.S. 1173 (2000). Courts have also concluded that the lack of a private right of action does not preclude the use of violations of the HEA as evidence of the violation of State laws. [Citations omitted.]"

72 Fed.Reg. 61977-78 (November 1, 2007). The case it relied on there to support allowing borrowers to assert federal violations, and to do so in state cases, is the very case it now claims precludes such defenses. NPRM, p. 39338, fn. 7. In fact, that case merely stands for the very

ordinary proposition that while a federal law, such as the HEA, does not generally preempt state law, a state law that directly conflicts with the HEA is preempted, as was the case with the particular provision at issue in that case. 168 F.3d at 1369. There is no longstanding position of the Department to suggest that borrowers cannot raise a violation of the HEA as a predicate for a state law violation.

State UDAP laws often prohibit unlawful conduct as well as unfair or fraudulent conduct, as well as untrue and misleading advertising. See, e.g., Ca. Bus.& Prof. Code §17200 (includes prohibition on unlawful conduct). Section 17200 "prohibits any practices forbidden by law, be it civil or criminal, federal, state, or municipal, statutory, regulatory, or court-made." Saunders v. Superior Ct. 27, Cal.App.4th 832, 838-39 (1994); see e.g., Roskind v. Morgan Stanley Dean Witter & Co., 880 Cal.App.4th 345, 352 (2000) (violation of federal law may be a predicate for section 17200.).

Under the current regulation, 34 CFR 685.222(a), borrowers would be able to raise as a defense "a cause of action under applicable state law," including violations of the HEA, which constitute violations under state UDAP law. The Department's attempt to retroactively change the rules applicable to loans made before a new regulation is promulgated, is entirely inappropriate and contrary to legal principles. The claim that such a position is based on a claimed longstanding interpretation is not borne out by the Department's own statements.

4. The Department Can Reduce Its "Burden," Provide More Even Treatment of Borrowers, and Protect Taxpayers without Diminishing the Borrower Defense Standard Established to Prohibit Unfair and Deceptive Credit Arrangements

a. Federal Consumer Protection Laws Generally Do Not Preempt or Reduce Consumers' Rights under State Laws, but Serve as a Floor

Generally, when a federal law or regulation intends to provide broad consumer protections, it does not preempt all state laws. It only preempts those that are less protective of consumers than the new federal standard. Although the proposed substitute standard here does not state it is preempting state law, that is the effect, given the two extremely limited bases that purport to rely on state law. It is extraordinary to have a federal agency use its regulatory power to eliminate state law consumer rights, as the proposed standard does, especially when it purports to be intended to improve consumer rights. It is particularly unusual when, as here, there is no explicit Congressional intent to preempt state consumer protection laws.

Typically, a federal statute or regulation intending to protect consumers contains a limited preemption provision along the following lines:

> "This subchapter does not annul, alter, or affect, or exempt any person subject to the provisions of this subchapter from complying with the laws of any State with respect to debt collection practices, except to the extent that those laws are inconsistent with any provision of this subchapter, and then only to the extent of the inconsistency. For purposes

> of this section, a State law is not inconsistent with this subchapter if the protection such law affords any consumer is greater than the protection provided by this subchapter."

Fair Debt Collection Practices, 15 USC 1692n; see also, Real Estate Settlement Procedures, 12 USC 2616; Limitations on Consumer Credit Extended to Service Members and Dependants, 10 USC 987(d)(1); Utility Slamming and Cramming, 42 USC 16471(e) ("If the Federal Trade Commission determines that a State's regulations provide equivalent or greater protection than the provisions of this section, such State regulations shall apply in that State in lieu of the regulations issued by the Commission under this section."); Equal Credit Opportunity, 12 CFR 202.11; Privacy of Consumer Financial Information, 12 CFR 322.17

b. A Federal Standard that is a Robust Floor Would Eliminate Most of the Use of State Laws

Establishing a substitute standard as a floor would honor the Department's sister agency's determination, manifest in the FTC Holder Rule, that credit agreements that prevent borrowers from raising "all claims and defenses" against an affiliated or referred holder, such as the Department, is an unfair and deceptive practice. This step is a minimum necessity if the Department is not to become complicit in reinvigorating the very unfair and deceptive practice that was eliminated from consumer credit transactions 40 years ago. If the substitute standard were a more robust floor, requiring only reasonable reliance to prove substantial misrepresentation and covering all forms of UDAP violations and contract causes of action, for example, borrowers from most states would benefit more from it more than from their state law defenses. Consequently the Department would likely need to apply fewer states' laws.

c. The Department Could Specify which State's Laws Apply

As discussed above, under the current borrower defense standard, there appears to be little difficulty in determining which state's laws apply. However, if more than one state's laws apply, the Department could specify in its rules how it would decide which state's general or UDAP laws to apply. For example, the Department could always apply the laws of the state where the student resides. Alternatively, it could always apply whichever law is more protective of the borrowers. That is the expected result from a choice of law analysis.

D. The Preamble Fails to Demonstrate Either that the Current Standard Has Resulted in Uneven Treatment of Borrowers, or that Elimination of the Existing Right to Raise State Law as a Defense Would Ensure Even Treatment

The Preamble states:

> "The current borrower defense standard in § 685.206(c) is wholly dependent upon State law and, as a result, may provide uneven relief to students affected by the same bad practices but who attended schools in different States."

NPRM, p. 39339. The Preamble does not support the major elimination of the borrower defense standard on this basis.

1. The Preamble Fails to Identify a Single Instance in Which the Department's Handling of Borrowers Defenses Resulted in Substantially Different Treatment

Although the Preamble raises uneven treatment as a primary reason for the proposed substitute standard that would reinstate loan provisions the FTC found to be unfair and deceptive, the Preamble identifies not a single instance in which such uneven treatment has occurred. It is difficult to see the problem, or its extent, when there is no evidence of the circumstances this drastic proposal claims occur.

2. The Alternative Defenses Proposed Do Not Provide the Even Results the Preamble Claims is a Primary Goal for the Drastic Reduction of Borrower Defenses

As discussed above, if the Department truly wanted to insure even relief, other solutions are available. In the proposal, however, in every which way, the proposed replacement does not insure any less uneven treatment. Among those ways are the following:

- The "judgment" standard (685.222(b)) necessarily relies on the state laws that were the basis of the judgment.[15] As discussed below, this purported defense is extremely problematic for other reasons. But, to the extent it were a useful defense, it would provide no more, and likely less uniformity than the current standard.
- The "breach of contract" standard (685.222(c)), like the judgment standard, necessarily relies on state law. While there are similarities in breach of contract law among the states, just as there are similarities among the states in UDAP laws, the breach of contract laws are not identical. Indeed, the case on which the preamble relies to demonstrate use of a breach of contract defense itself notes the differences among state laws, e.g., in what they count as part of a school contract. See NPRM, p. 39341, citing Vurimindi v. Fuqua Sch. Of Business 435 F. App'x 129 (3d Cir 2011) (per curiam; not reported; IOP 5.7: not citable by 3rd Circuit as considered non precedential). This and other problematic aspects of that standard are discussed more fully below.
- Borrowers who are more easily taken advantage of are also less likely to be able to explain their situation so as to prove to the Department, by a preponderance of the evidence, that they personally received a statement that is substantially misleading, on which they relied to their detriment, entitling them to full restitution. Borrowers would likely achieve more even results if they had to prove either that a person could reasonably rely on the misrepresentation or the person actually relied, but not both.
- Most borrowers will not be able to bring legal actions themselves. Borrowers in states with less aggressive Attorneys General or less available legal aid services, even though equally harmed as borrowers in other states will be less likely to be included in a breach of contract or other state

15 Although it also allows defenses based on federal law, section 685.222(a), as discussed below, disallows use of the most relevant federal law.

law case. And they will be less likely to find someone with sufficient expertise to guide them as to what information they have that they need to use to present the complex information needed for a borrower defense to the Department.

- Attorneys General may become less interested in spending their limited resources on these kinds of cases if the majority of their state law causes of action will no longer be sufficient to request borrower relief from the Department, and the borrowers affected by the unfair, unlawful, abusive, or fraudulent conduct or misrepresentations will, consequently, be so unlikely to have their loans discharged.
- The proposal (Appendix A) allows different standards for showing detriment. The borrower defenses will be heard by different hearing officers who may choose whichever standard they please, including standards not included in Appendix A. Different borrowers will necessarily be subject to different standards. This is especially true for borrowers the Department deems in its sole discretion are not entitled to group relief. A presumption of full restitution, at least in connection with allegations of misrepresentation would reduce the uneven nature of relief.
- The Department's current "substantial misrepresentation" standard is new. The current version, which had extensive revisions as a result of a negotiated rulemaking in 2009 and 2010, became final (with a few changes since then) in 2010. 75 Fed.Reg. 66832 (October 29, 2010. Its proposed requirement for individual, actual and reasonable reliance is virtually unprecedented in modern consumer protection law. Nor does the Preamble explain the legal source, if any, for that requirement. Consequently, there is little to no precedent or development of case law to guide those who will attempt to apply this rule. As this unique rule will apply only in the context of borrower defenses, there will not be the development of a precedential body of law uniformly interpreting it. Even those aspects of substantial misrepresentation that apply to Department actions as well, will have little to no body of law in support as those few Department actions based on substantial misrepresentation would not generally be the result of nondefault, contested determinations. It cannot be expected to provide uniformity of results comparable to, for example, state UDAP laws that have been in place, in most cases, for 40 to 70 or more years and which often have a well-developed body of case law interpreting them. As discussed above, proving a federal floor, based on all prongs of UDAP law would be far more likely to reduce uneven results.

In short, the facts do not support a concern for uneven treatment as a basis strong enough to bear the weight of eliminating most consumer protection rights under state law; for reinstating credit contractual provisions that are unfair and deceptive.

E. The Preamble Statement that the "Proposed Standard [685.222]. . . Will Address Much of the Behavior Arising in the Borrower Defense Context" Does Not Stand Up to Scrutiny or Address the Problems Cited as Inherent in Relying on State Laws

The current standard allows borrowers to raise as borrower defenses "all" state causes of action they may have, without regard to the type of state action or whether the matter has been tried. The

Preamble claim that the "proposed standard . . . will address much of the behavior arising in the borrower defense context" lacks a sound legal, factual, or practical foundation. For those unfamiliar with consumer protection law, consumer protection litigation or prosecution, the words of the preamble may sound reasonable. But they hide unpleasant truths about the real impact of the proposed standard. The proposed standard amounts to a defacto preemption of most state laws that can be raised in all other consumer credit transactions, including in the FFEL program. It amounts to a repudiation of the FTC's careful investigation and long-standing determination that to prevent consumers from being able to raise against the holder of a credit agreement "all claims and defenses" the borrower could raise against the original business is an unfair and deceptive practice. As discussed in the following sections devoted to each of the three aspects of the standard, the Preamble's claim is woefully inadequate to bear the weight of the proposed decimation of one of the primary foundations of consumer protection law.

1. The Court Judgment Remedy (34 CFR 685.222(b)) Is Illusory

At the last of the three negotiated rulemaking meetings the Department proposed a standard that would allow borrower defenses based on judgments that were "claim preclusive." Whether a judgment is claim preclusive is a matter of law. However, in the NPRM, the proposed regulation substitutes the Department's judgment as to what judgments should be respected. It denies a borrower defense based even on judgments that are claim preclusive unless the borrower can show "by the preponderance of evidence" (NPRM, p. 39417, proposed 685.222(a)(2)) that a "nondefault, favorable contested judgment" has been obtained against the school. NPRM, p. 3917, proposed 685.222(b). The Department knows full well that such judgments are about as common as unicorns.

a. The Preamble Offers No Evidence of Any Actual Past Judgment that Would Qualify as a Borrower Defense

The preamble offers no examples of any judgment that has been obtained that would qualify. Despite the extraordinary efforts of numerous state attorneys general to rein in the widespread fraud in the for-profit school industry, a comprehensive list of recent investigations and resolutions of cases shows over and over that almost all, if not all such cases do not end in "contested" judgments. *Public Report*, at http://www.republicreport.org/2014/law-enforcement-for-profit-colleges/ as of July 25, 2016.

b. By Their Nature, Almost All Cases Against For-Profit Schools Will Not Result in a Favorable "Contested" Judgment

Based on my experience having spent nearly 25 years as a consumer investigator or prosecutor, I can say that the vast majority of consumer protection cases never reach contested judgments. This is especially true of cases brought against for-profit colleges. Often prosecutors will seek temporary restraining orders or preliminary injunctions to stop the unlawful conduct while the case proceeds. Fraudulent schools often cannot attract sufficient new students to continue operation once they are constrained by such orders to act lawfully. Although they may initially put up a vigorous legal defense, over time, they often stop defending or file bankruptcy. Although some relief the prosecutor seeks is not stayed by a bankruptcy, other aspects of the case may be stayed. Ultimately, there is no practical, and usually, no legal basis to proceed with the case. The school must settle or default. Much as a prosecutor might want to secure a "contested" judgment, there is no reasonable basis to do so.

Alternatively, attorneys generals' investigations may trigger the Department to control disbursements of federal student aid funds. Most schools have little in the way of resources other than the revenue from Title IV loans and grants to tide them over, so they are quite likely to close, file bankruptcy, and/or no longer defend against a lawsuit. Indeed, the Department could effectively further limit which cases could reach a contested judgment by such actions.

Even a school that is robust and might be able to defend against a prosecution has much more incentive to offer a substantial settlement. A judgment would present many obstacles to continued operation, including possible loss of accreditation or regulatory approval. A school that wants to continue to operate will, at some point before trial, necessarily offer a sufficient amount to settle a prosecution. Similarly, an attorney general in a litigation battle with a multimillion or multibillion dollar corporation has strong incentives to reach a reasonable settlement, rather than spend time and resources further litigating any single case.

Cases brought by students are similarly unlikely to reach contested judgments. Unless the Department's proposed rule on forced arbitration is strengthened, in the future as now, most students will be precluded from bringing legal actions. And arbitration rules thwart discovery essential to showing the unlawful practice.

Even if the proposed arbitration rules are strengthened, many of the reasons discussed in relation to prosecutions are also true for private actions. There are additional obstacles for private lawsuits. The cost of such a suit would virtually preclude individuals bringing such actions. Class actions depend on a law firm having sufficient resources to maintain an action over several years of litigation. Moreover, the incentives to settle private class actions are even greater than the incentives to settle a public prosecution. Because most class action attorneys are paid from the proceeds, a reasonable settlement is far more beneficial to both the consumers and the attorneys than a later judgment, which a school might not be able to pay.

Requiring a contested court judgment effectively eliminates most state causes of action from borrower defenses, and forces borrowers to couch all defenses as misrepresentations. As discussed below, trying to squeeze all nefarious conduct into the definition of substantial misrepresentation will greatly narrow the range of successful defenses.

c. Contrary to Claims in the Preamble, Requiring "Favorable Nondefault, Contested Judgments" Will Greatly Increase the Cost and Burden on Borrowers

The Preamble claims that "the reliance upon State law presents a significant burden for borrowers who are making a threshold determination as to whether they may have a claim."

NPRM, p. 39339. This claim ignores the substantially greater burden on borrowers of not only having to reach that threshold, but to have to find an attorney, usually one who is willing to take on an extremely resource intensive case, without pay, to wait through years of investigations, litigation and appeals before being able to present a borrower defense. Meanwhile, the borrower is left with the obligation to continue to pay on the student loans or wind up in default, with all the detriments that brings. Or, if the company files bankruptcy or closes, they are likely not to receive any compensation from the state case and prohibited from asserting the action as a borrower defense.

Perhaps the Preamble intends to say that it would be less burdensome because a student could base a claim on substantial misrepresentation, because then one does not need a state court judgment. But if that is the argument, its essence is that the Department doesn't believe the judgment basis will provide any substantial benefit to borrowers, but offers it as window dressing. State court law does provide needed additional bases for borrower relief as discussed below, but the crabbed limitation to only "favorable contested judgments" effectively narrows that avenue of relief to a sliver.

2. The Breach of Contract Remedy (685.222(c)) Is Illusory

The Preamble asserts that the Department recognizes that breach of contract claims "may not necessarily fall within the scope of the substantial misrepresentation component of the federal standard." NPRM, p. 39340. Of course, the same can be said for many of the other state law claims the proposed rule eliminates unless they are contained in a successful, nondefault contested judgment. Why then allow a breach of contract defense, but no others? The rationale for reducing state defenses to this narrow scope apparently hinges solely on the statement that the Department recognizes that students enter into contracts with schools, and that borrowers have, "over the years, asserted claims for relief against schools for losses arising from a breach of those contracts." NPRM, p. 39340. The thinness of the rationale and the facts and law strongly suggest that this portion of the standard, once again, serves as window dressing, but cannot be considered a rational basis for eliminating all other state causes of action.

a. The Preamble Fails to Demonstrate any Breach of Contract Claim Used Successfully Against any For-Profit School

The Preamble statement that borrowers have, "over the years, asserted claims for relief against schools for losses arising from a breach of those contracts," NPRM, p. 39340, is supported by a single case citation. That case is an unreported per curiam decision by the Third Circuit. Vurimindi v. Fuqua Sch. Of Business 435 F. App'x 129 (3d Cir 2011) (per curiam; not reported; IOP 5.7: not citable by the Third Circuit itself as considered non precedential).

In his 119 page third amended complaint, the plaintiff had sued Duke University, his fellow students, and companies that hired those students, among other bases, for breach of contract. The court granted defendants' motions to dismiss, then denied his motion for reconsideration and the right to file a fourth amended complaint. He appealed. Among other things, he alleged Duke breached his contract by failing to advance his entrepreneurial activity, to facilitate new relationships for him, to prepare him to lead others and manage resources, and by allowing and encouraging his fellow students and professors to pick on and otherwise harass him, and by characterizing him as a threat on campus. Id.

Clearly, this case bears no resemblance to the kinds of abuse that the state attorneys general, the Department itself, and other federal agencies have alleged has occurred at numerous for-profit colleges.

Why then, does the proposed rule offer a breach of contract remedy, but delete the numerous other state law remedies?

b. Most For-Profit School Contracts Obligate the Student, but Promise Virtually Nothing, so There is Virtually Nothing the School Could Breach

Attached are several for-profit school enrollment agreements. Some of the contracts seem to bind the student to the terms of a catalog or other document, but do not bind the school. Some contracts purport to state disclosures or documents the student admits to having received and understood, or identify all manner of changes the school can make in its own discretion, despite the words of the agreement. But as can be seen, about the only thing the schools promise in these agreements is to provide a certain number of hours of class. Even as to that commitment, however, some contracts appear to grant the school the right to change them. See Attachments of samples of various for-profit schools: Le Cordon Bleu Enrollment Agreement; Argosy University California Enrollment Agreement; DeVry University Passport2College Application/Enrollment Agreement. One is hard pressed to determine how one would make a breach of contract claim given the dearth of commitments by the school.

c. Breach of Contract Claims May or May Not Include Other Documents Beyond the Enrollment Agreement Itself

In the one contract case example cited in the Preamble, the court allowed the plaintiff's assertion that the contract included various other documents defendant Duke University published. The court noted, however, that states vary on whether such extraneous documents are considered part of the contract. Vurimindi v. Fuqua Sch. Of Business 435 F. App'x 129 (3d Cir 2011) (per curiam; not reported; IOP 5.7: not citable by 3rd Circuit as considered non precedential). Of course, as noted above, the differences in state law on this point, and in the ability of borrowers to present their defenses could result in uneven results, were a contract actually susceptible to a claim of breach.

d. The Preamble Does Not Justify Excluding Defenses Based on Other Contract-Related Claims

The Preamble offers no explanation for excluding other contact-related causes of action that might be more relevant to the circumstances in which most borrower defenses would arise. Potentially relevant contract-related remedies include lack of formation of a contract due to lack of capacity, lack of definite terms, or lack of consideration; contract contrary to public policy; mistake; mutual mistake; breach of covenant of good faith and fair dealing; undue influence; and economic duress. See, e.g., Ca Civil Jury Instructions Series 300.

Additionally, if a school includes in its form contract numerous provisions purporting to state that the borrower has read, received or understood certain things when the school regularly fails to provide such statements to the borrower, the conduct might constitute an unfair act or practice under state UDAP law. It might not, however, satisfy the requirements to show a substantial misrepresentation because, the defense could argue, based on the contract statements, that the student did not rely on those false statements when enrolling. See discussion below of the need to maintain borrowers' rights to assert defenses based on unfair or deceptive conduct.

e. The Preamble Contains an Unfortunate Phrase that May Be Interpreted to Narrow This Claimed Defense Even Further

To the extent the final standard for the borrower defense rule is not substantially improved, at least language needs to be removed from the Preamble so as not to add ambiguity to a breach of contract defense. The Preamble describes the breach of contract defense as applying only when "specific obligations" have been breached. NPRM, p. 39338. Breach of contract claims have a long history of court interpretation of what constitutes a breach. This phrase in the Preamble, however, seems to add a gloss that will add ambiguity, potentially another layer to be decided, to a determination of a breach of contract claim. Breach of contract law itself determines whether a promise is sufficiently specific to constitute a breach when not provided as promised. See, e.g., California Civil Jury Instructions, 302, citing Weddington Productions, Inc. v. Flick, 60 Cal.App.4th 793, 811 (1998) ("In order for acceptance of a proposal to result in the formation of a contract, the proposal 'must be sufficiently definite, or must call for such definite terms in the acceptance, that the performance promised is reasonably certain.' [Citation.].") The Preamble could be corrected either by removing the phrase or by adding to it "as determined under the applicable contract law."

3. The Substantial Misrepresentation Standard Fails to Encompass Much of Current Consumer Defenses, Increases the Burden on Students and the Department, Would Result in Uneven Treatment of Borrowers, Shows Unscrupulous Schools How to Avoid the Consequences of Their Conduct, and Would Reduce the Effectiveness of Borrower Defenses in Reducing the Unethical, Exploitative and Predatory Conduct that Plague the For-Profit Sector of the Title IV Program and Taxpayer Costs

a. Misrepresentation Is Only One of the Standard Legs of Consumer Protection Law

The Preamble claims the substitute standard will "address much of the behavior arising in the borrower defense context." NPRM, p. 39340. As discussed above, the other two bases allowed in the substitute standard realistically provide little on which borrower defenses can be based. Consequently, if the substitute standard is to "address much of the behavior arising in the borrower defense context," the substantial misrepresentation" basis will have to carry that weight.

The Preamble points to no consumer protection laws that require consumers to rely solely on misrepresentations to address unfair and deceptive acts or practices. Neither the FTC, nor any of the state UDAP laws relies solely on allegations of misrepresentation. The essence of consumer protection laws is that they are designed not just to address known ways by which consumers are bilked. From their earliest incarnations, they have been

> "intentionally framed in . . . broad, sweeping language, precisely to . . . deal with the innumerable 'new schemes which the fertility of man's invention would contrive.'"

Barquis v. Merchants Collection Assn. 7 Cal.3d 94, 112 (1972). As one of the earliest unfair competition cases involving consumers explained,

> "It may be granted that this case is a novel one and that it may be doubtful whether other cases [like this] may soon arise, but the fact that a scheme is original in its conception is not a good argument against its circumvention. It has been said in the case of *Weinstock, Lubin & Co. v. Marks,* 109 **Cal**. 529, 539, one of the leading cases on unfair competition in this state: 'The fact that the question comes to us in an entirely new guise and that the schemer has concocted a kind of deception heretofore unheard of in legal jurisprudence, is no reason why equity is either unable or unwilling to deal with him. It has been said by some judge or law-writer that, "no fixed rules can be established upon which to deal with fraud, for, were courts of equity to once declare rules prescribing the limitation of their power in dealing with it, the jurisdiction would be perpetually cramped and eluded by new schemes which the fertility of man's invention would contrive".'"

American Philetelic Soc. V. Claibourne, 3 Cal. 2d. 689 (1935).

State UDAP laws, as well as the FTC Act and the Consumer Financial Protection Bureau provisions also prohibit other types of unfair or deceptive conduct, including unfair, abusive, fraudulent and unlawful business acts or practices. Generally, the proscriptions are in the disjunctive and you only need to prove that the conduct was either, an unlawful, an unfair, or a fraudulent act or practice. See, e.g., Stop Youth Addiction, Inc. v. Lucky Stores, Inc., 17 Cal.4th 553, 570 (1998); Schnall v. Hertz Corp., 78 Cal.App.4th 1144, 446 (2000); Podolsky v. First Healthcare Corp., 50 Cal.App.4th 632, 647 (1966).

b. Experienced Prosecutors and Other Litigators Almost Always Never Allege Only Misrepresentation

The Preamble asserts that these other attributes of consumer protection law – unfair, abusive, fraudulent or unlawful business acts or practices "are often alleged in combination with misrepresentations and are not often addressed on their own by the courts." NPRM, p. 39340. Of course. No experienced prosecutor would forego use of all appropriate allegations. Precisely because the strength of evidence, witnesses, documents or other aspects of allegations or a court's view of the various allegations cannot be certainly known in advance, a prosecutor or any other experienced litigator would be a fool not to include all major allegations. Similarly, a borrower would be ill-advised not to set forth all bases for a defense. Nevertheless, there is a long history of the courts separately identifying and analyzing the different types of UDAP violations.

(1) Some Cases Turn on the Unlawful Acts or Practices Prohibition

Under California law, for example, unlawful conduct under the state's UDAP laws is "anything that can properly be called a business practice and that at the same time is forbidden by law." *Stop Youth Addiction, Inc. v. Lucky Stores, Inc*., 17 Cal.4th 553 (1998) (citations omitted). Often, reliance on unlawful business conduct is a less resource intensive, less burdensome way to prove a consumer claim or defense than by trying to prove a misrepresentation. Proving a violation of a law requires only proof of what the law requires and that the business (the school) did not comply. By comparison, showing a substantial misrepresentation under the proposed regulation requires a showing that a particular statement was made, that you personally heard or saw that misrepresentation, that it was misleading, that it was substantially misleading, that you relied on it, and that the reliance was to your detriment. Each one of those elements could thwart proving a borrower defense, even though the student was, in fact, the victim of a substantial misrepresentation.

Prosecutors and private litigators often base actions on unlawful business conduct, separate and apart from any allegation of misrepresentation. See, e.g., *Barquis v. Merchants Collection Assn.*, 7 Cal.3d 94, 112 (1972) (repeated violation of filing requirements for collection actions constituted unlawful business practice; *Diaz* v. *Kay-Dix Ranch*, 9 **Cal**. App.**3d** 588 (1970) (hiring of undocumented workers constituted unlawful business practice (but no injunction due to considerations of federalism); *Aron v. Uhaul Co. of California*, 143 Cal.App.4th 796 (alleged violation of statutory fuel gauge requirements sufficiently alleges unlawful business conduct); *Stop Youth Addiction, Inc. v. Lucky Stores, Inc*., 17 Cal.4th 553 (1998) (alleged sale of cigarettes to minors sufficiently alleges unlawful business conduct); Roskind v. Morgan Stanley Dean Witter & Co., 80 Cal.App.4th 345 (2000) (violation of federal law prohibiting "trading ahead" can be alleged as unlawful business conduct under California law).

In the for-profit school context, a number of California Attorney General prosecutions specifically allege unlawful conduct separate and apart from allegations of misrepresentations or unfair conduct. Cases have alleged and/or obtained stipulated or default judgments that required restitution based in part on unlawful conduct allegations based on the state's UDAP law. See, e.g.,

> People v. Corinthian Schools Inc., L.A.S.C. No. BC 374999, Complaint filed July 31, 2007, alleged specific unlawful conduct, including the following: failure to provide required disclosures about transferability of credits, failure to provide required disclosures or provided required disclosures that were inaccurate about job placement or salaries, offering programs that did not meet the required performance standards, falsifying required

completion and job placement records, and failure to provide students, as required by law, a reasonable amount of time to review disclosures;

People v. Wilshire Computer College, L.A.S.C. No. BC018391, Judgment by Default (for failure to provide discovery) filed November 29, 1993, included the finding that the school failed to properly test students who did not have high school diplomas for their ability to benefit, then falsely certified to the Department of Education that those students were eligible for federal financial aid, and a prohibition on the school accepting money on loan agreements that did not contain the FTC Holder Notice;

People v. National Technical College, L.A.S.C. No. C727570, Complaint filed June 14, 1989, allegations included the defendants engaged in unlawful conduct including placing advertisements for the college in help-wanted columns in violation of California law, advertising without disclosing the name of the school in violation of California law, violating the provisions of the federal law and rules on testing students who do not have high school diploma to determine if they have the ability to benefit from the program, applying for Pell grants for students in programs too short to qualify for the grants, and failing to provide the school's refund policy to students in the language in which the enrollment agreements were negotiated.

c. The State Law Unfair Conduct Prohibition Is an Essential Element of Consumer Protection Law and Borrower Defense

The essence of consumer protection law, including borrower defenses is that the law is sufficiently broad to encompass, as discussed above, "new schemes which the fertility of man's invention would contrive." *Barquis v. Merchants Collection Assn.* 7 Cal.3d 94, 112 (1972).

(1) Some Cases Turn on the Unfair Conduct Prohibition

Conduct that does not violate a specific law and which may not be deceptive may be an unfair business act or practice. See, e.g., *Bondanza v. Penninsula Hospital & Medical Ctr.*, 23 Cal.3d 260 (1979) (unfair practice of having no agreement as to the amount of collection charges that could be added to a medical bill, adding collection charges equal to one-third of the bill being collected, even though the cost to collect the bill was much less); *People v. Casa Blanca Convalescent Homes, Inc.* (1984) 159 Cal.App.3d 509 (1984) (failure to provide adequate nursing, filth, and other intolerable conditions in a nursing home) (standard in *Bondanza* and *Casa Blanca* for finding unfair conduct later disapproved for use in competitor cases in *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.*, 20 Cal.4th 163, 184-185 (1999).

(2) The Substitute Standard's Use of Unfair Conduct Is No More Certain than State Law Unfair Conduct

The Preamble rejects continued use of state law violations based on unfair acts or practices as a basis for a borrower defense. It also rejects including a standalone federal standard on those bases. The Preamble contends it would be too difficult to determine what kinds of conduct warrant relief.

NPRM, p. 39339. But it then ably identifies several kinds of conduct that it views as unfair or abusive practices. NPRM, p. 39343. The list is not exhaustive. Consequently, the Department's own list, like any description of unfair or abusive conduct would have to be, is not specific. The only difference is that borrowers may not rely on these types of unfair or abusive conduct as a defense, unless coupled with a misrepresentation.

(3) Subsuming Unfair Conduct into an Analysis of Misrepresentation Provides a Guide to Unscrupulous Schools on How to Continue to Defraud Students without Consequences

The proposed rule gives a nod to unfair and abusive conduct, but in a way that does not always fit the situation. Unfair or abusive conduct is unfair or abusive, whether or not accompanied by misrepresentations. If under the proposed rule, such conduct cannot stand alone, it will not address new schemes – a primary purpose of making such unfair or abusive conduct illegal.

As Department staff commented at various times during the Negotiated Rulemaking, both in the sessions and informally, many of the statements students who spoke at the sessions identified as misrepresentations might be characterized not as misrepresentations, but as puffery. Indeed, the emotional tools identified are precisely the type of statement that may be hard to show as a misrepresentation. With the use of such, arguably non-misrepresentations and abusive or unfair practices, clever scammers can accomplish the same misconduct as they have done in the past with misrepresentations. Even now, the cleverer schools do not represent their job placement possibilities or discuss transferability of courses.

For example, a school might say:

> "Being a radiologist is a great career." "There are many openings for radiologists." "What's keeping you back?" "Are you ready to commit today?" "Do you want to just be sitting on the couch the rest of your life?" "Are you really serious about having a better life?" "If you got a job earning $50,000 a year, what is the first thing you would buy?" "Your children will be so proud of you when they see you getting your degree." "You don't have to pay anything out of pocket."

Arguably, these statements are not misrepresentations. Yet these kinds of emotionally loaded statements are very persuasive at getting students to enroll. But, when they are accompanied with pressure to enroll right away or efforts to prevent the student from consulting with an advisor or family, they are as, if not more effective at inducing a student to enroll than if the school used specific misrepresentations. And if the school then does not have, for example, the equipment on which a person would need to train for the career program, does not have instructors, uses other students as teachers or in numerous other ways does not provide an education, the student is as much victimized as if the school used misrepresentations.

Because the proposed standard eliminates state causes of action, such as unfair, unlawful or deceptive conduct, and because the substitute standard does not include them as stand-alone baes either, the proposed standard is a roadmap to schools that want to continue to cheat students and rake in the Title IV funds, but not spend much on providing students an education.

This problem will also be exacerbated unless the preamble to the final rule better differentiates between what the Preamble refers to as educational malpractice and a school's failure to provide equipment, laboratories, internships, instructors, and the other necessary aspects of an education. The cases cited involved public schools. NPRM, p. 39337, fn. 5. Unlike for-profit businesses, there apparently were no misrepresentations or other unfair, abusive, unlawful or deceptive tactics used to induce the students to part with money for the education being offered. The very broad and vague description of educational malpractice in the Preamble, however, could be used to thwart borrower defenses, even when a school has wholly failed to provide the program paid for.

The Preamble states that a borrower need not allege any of the plus circumstances to successfully allege a misrepresentation. Even so, over time, triers of fact may begin to expect to see at least one of the plus factors, which will make it even more difficult for borrowers who are genuine victims of misrepresentations to prove their defense. If the final rule persists with this mixed standard, the preamble to the final rule needs to be even clearer, if possible.

d. Some Cases Turn on the Fraudulent and Deceptive Conduct Prohibition

An act, or the failure to act, itself, may be fraudulent or deceptive even in the absence of any misleading statement. The proposed substantial misrepresentation standard ignores this kind of conduct. For examples of fraudulent business acts or practices, see, e.g., *Daniel v. Ford Motor Co.*, 806 F.3d 1217 (9^{th} Cir. 2015) (omission of information about tire failure problem on a new vehicle may constitute a fraudulent business practice by omission actionable under California's unfair competition law; the consumers relied on no statements made before the purchase.); *People v. Dollar Rent-a-Car Systems, Inc.*, 211 Cal.app.3d 219 (1989) (use of contract charging consumers a retail repair rate on damaged rental cars, without disclosing the company paid only a lesser wholesale rate was a deceptive business practice); *Poldolsky v. Healthcare Corp.*, 50 Cal.App.4^{th} 632 (1996) (summary judgment for defendants reversed; agreement with a family member caregiver to be responsible to pay for a relative on admission to a nursing home was deceptive because the agreement did not disclose the minimal value of the consideration being provided in exchange for their agreement to pay substantial sums, and because the associated conduct plaintiffs alleged (having to sign a stack of documents under pressure at admission of relative to nursing home), which caused them to believe they had no choice if they wanted to have their relative admitted, might separately constitute deceptive conduct, to be proven at trial.).

In the for-profit school context, similar types of fraudulent conduct not used to induce a student to enroll or continue in the school, and not predicated on either a misleading statement or an omission that makes a statement made misleading, can easily be envisioned. In some cases, the conduct can occur with no relevant statements being made. In other cases, the only statements made could be argued to be mere puffery. To suggest just a few examples:

- Receiving students' oral statements that they are withdrawing, failing to disclose that the school only accepts written withdrawals, then failing to return Title IV funds or refund money the students had prepaid for the portion of the course left after the school was advised of the withdrawal.
- Enrolling students in programs that require internships for state licensure, but neither arranging adequate internships nor telling students that the school will not provide the internships.
- Having students sign enrollment agreements that require only de minimus consideration from the school.
- Without testing them, enrolling students who have only a high school diploma in programs that require advanced college level math skills.

Obviously, a school intent on profiting by any means could devise numerous other schemes based on fraudulent conduct to part borrowers from their money.

4. The Proposed Standard Requires a Greater Showing to Discharge One Loan Than the Department Must Show to Terminate an Entire School's Participation

The Department may suspend or terminate a school's participation in Title IV programs or impose a civil penalty of up to $25,000 for each substantial misrepresentation. 20 USC 1094(c)(3)(A) and (B)(ii). The Department need not show actual reliance by anyone on a misrepresentation, but only that someone "could reasonably be expected to rely," on the statement. 34 CFR 688.71(c). Typically, consumer protection laws, as is true with this standard, do not need to show actual reliance, but only that a person could reasonably be expected to rely on the misrepresentation. *Day v. AT&T*, 63 Cal.App.4th 325, ("Actual deception or confusion caused by misleading statements is not required." (Citation omitted.)); see also *FTC v. Tashman*, 318 F. 3d 1273, 1977 (11th Cir. 2003).

Yet, under the proposed substitute standard, a borrower must meet a higher burden. To defend against a single student loan, the borrower must prove not just reasonable reliance, but that the borrower actually and reasonably relied on the misrepresentation.

a. The Department's Rationale that It Needs a Weaker Standard to Stop Misrepresentations Before Anyone Is Actually Misled Is Pure Fantasy

The Preamble claims the Department needs a lower standard than an individual borrower so the Department can "stop misrepresentations even before any persons are misled, so it needs to be able to act on representations that "could have been reasonably relied" on. NPRM, p. 39343. This is an extraordinary claim. The Preamble provides no evidence that the Department has ever suspended, terminated or sought a civil penalty against a school <u>**before**</u> anyone has been misled. It would be highly unusual for any law enforcement or regulatory agency to take such extreme measures based on seeing a misleading advertisement or other statement before it could have misled anyone. Agencies can and do take action to stop a misleading advertisement without having evidence of anyone who was misled. But that the agency would even be able to act before anyone could be misled would be highly unusual.

In fact, the reason consumer protection laws allow actions if a person could reasonably be misled is because the statement itself can be viewed and the trier of fact can judge whether it would be likely to mislead. Requiring actual reliance merely increases the burden on both the borrower and the trier of fact, in this case, the Department, without necessarily adding any benefit. For an individual, proving that they saw any particular ad, when they were not making copies of the ads, when the institution used a number of slightly differing ads, when the individual was subject to a variety of contacts and statements, similarly, imposes a burden without purpose.

b. Application of the "Reasonable Reliance" Standard Rather Than Requiring Actual Reliance Will Better Protect the Student Loan System

The Preamble claims the Department needs this lower standard because it is acting in the public interest, compared to a borrower, who is acting in his/her own interest. The Preamble also states that the requirement for actual reliance "will protect the Federal Government, taxpayers, and institutions from unsubstantiated claims.

The Preamble misapprehends the dual purposes of the Holder Rule or its current Department analog. A main purpose of tieing the duty of the seller (the school) to the borrower's requirement to pay is to police the system. A lender who faces risk by providing credit to dishonest schools will be more likely to better monitor and enforce the rules and regulations that govern schools in the program than if the lender can lessen the risk by making it harder for borrowers to defend against the improper conduct. Federal Trade Commission Preservation of Consumers' Claims and Defenses, Final Regulations, Proposed Amendment and Statement of Basis and Purpose, 40 Fed.Reg. 53506, 53509 (1975); accord Mansfield, Cathy Lesser, "The Federal Trade Commission Holder Rule and It's Applicbility to Student Loans – Reallocating the Risk of Proprietary School Failure," *Wake Forest Law Review*, 635, 663-666 (1991). Indeed, because of the long history of inadequate supervision of schools by the Department, making it more difficult for a borrower to defend is contrary to the incentives the Holder Rule provides and the Student Loan Program needs.

We are awash in evidence of corrupt schools being investigated by multiple state and federal agencies. The Preamble provides no evidence, but implies that a reasonable reliance, rather than an actual reliance would be used by unscrupulous students to cheat the system. This is contrary to the Department's view when it established the borrower defense rule under the Direct Loan Program:

> The Secretary believes that the proposed regulations provide an adequate system for adjudicating claims by borrowers that have a defense against repayment of a loan based on the acts or omissions of the school. The Secretary notes that the regulations identify formal proceedings in which borrowers may raise the acts or omissions of the school as a defense against collection of the loan. The Secretary does not believe that these proceedings will be used by borrowers to raise frivolous appeals. Moreover, schools are further protected from

> frivolous claims by the requirement that the Secretary initiate a second proceeding to enforce a liability against the school.

59 Fed.Reg. 61690 et. seq. (December 1, 1994) (electronic version, specific page numbers not available). The Department has stated that, until the recent implosion of some of the largest for-profit schools, very few borrowers have asserted defenses. The rumination in the Preamble that requiring actual reliance would protect against unsubstantiated claims is both without any factual or legal support, and is contradicted by the FTC's own investigation of the likely favorable consequences of its much more robust borrower defense.

5. The Purported State Court Judgment Standard in a Case Proving Unlawful Conduct Is Even Narrower Than It Seems Because Section 685.222(a)(3) Preempts State UDAP Laws that Rely on Underlying Violations of the Higher Education Act

Read in combination with section 685.222(a)(5), section 685.222(b) seems to say that any state court judgment related to the student's education or loan would qualify for a borrower defense. Section 685.222(a)(3), however, asserts that the judgment cannot be based on a violation of the Higher Education Act (HEA) unless the conduct would also constitute either a misrepresentation or a breach of contract.

As discussed above, state UDAP laws often rely on the violations of other laws, state or federal as underlying bases for finding an unlawful act or practice under the state UDAP law. The proposed substitute standard requires a judgment for a defense based on unlawful business acts or practices. But it goes even further and rejects judgments grounded on unlawful conduct if that unlawful conduct is a violation of any provision of the Higher Education Act. That means, failure to provide accurate disclosures of salaries, job placement, completion rates and other fundamental requirements of the HEA cannot be used as predicates for proving unlawful conduct under state UDAP laws. Notably, the Preamble never mentions the word preemption, as if by not saying the word, we will not notice that is the effect of section 685.222(a)(3).

6. The Preamble Brazenly Dismisses the Loss of Borrower Defenses Long Held by the Federal Trade Commission to Be Essential to Avoid Unfair and Deceptive Credit Transactions By Saying that Borrowers Have Other Relief Available Elsewhere (NPRM, p. 39340)

In declining to either maintain the current standard that would allow borrowers to assert state law claims based on unfair, unlawful or fraudulent acts or practices or to include such bases in the proposed substitute federal standard, the Preamble remarks that borrowers may bring actions against the institutions and have other avenues of relief outside of the Department under other federal or state laws based on abusive or unfair conduct. The Preamble notes that such actions may result in judgments. NPRM, p. 39340.

In essence the Preamble means that the only avenue for raising a borrower defense based on these other forms of unfair and deceptive conduct is to obtain a judgment. The discussion of the judgment basis above explains why that avenue of relief, for most borrowers, is illusory.

The Preamble also seems to be suggesting that even if these kinds of unfair and deceptive practices cannot result in a borrower defense (absent a judgment), borrowers may still be able to obtain relief by bringing cases against the schools. NPRM, p. 39340. Of course, that dodges the whole point. The purpose of the Holder Rule and its current Department analog is that those claims that could be brought against the school can also be raised in defense against collection by the loan holder, the department. Being able to sue the school is not the point. For reasons discussed above, in most instances, the school will have closed, gone into default in a lawsuit, or filed bankruptcy and the student will be able to recover little, if any money from the defunct school. But the student will still have to pay the student loan to the Department. The claim that other avenues exist to raise unfair, unlawful, abusive, or deceptive conduct does not justify removing borrower defenses, which the FTC considered essential to prevent unfair and deceptive acts and practices.

Conclusion

The Department can address the concerns and dangers described here by reinstating borrowers' rights to raise all defenses[16] and by changing the proposed federal standard to a robust floor.

16. As noted above, however, removal of the rights of borrowers to raise all claims is also contrary to the FTC Holder Rule and the FTC's determination that disallowing borrowers the right to raise against the holder any of these claims they have against the original seller (the school) is an unfair and deceptive practice. Nevertheless, this proposed rule and this comment addressing it may be confined to addressing the changes proposed, and redressing prior changes is beyond the scope of the proposal and comments addressing it.