Cooley

New Student Debt Standards Could Allow Massive Loan Forgiveness

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This memo discusses the new federal standards for students to have their federal loans forgiven under the Final Draft of the BDTR Rule. Future Cooley memos will discuss the BDTR process for both students and institutions, the proposed financial responsibility and letter of credit triggers, and the other forms of loan discharge that were addressed during the recent negotiations.

While the Negotiated Rulemaking has concluded, the issues embedded in the Borrower Defense to Repayment regulation (BDTR Rule) remain under active discussion within the US Department of Education and promise to change the legal landscape for institutions and student borrowers as the Department moves forward with its rulemaking. This is the first of several client alerts that we are preparing to discuss these simmering issues. The Department is expected to issue its Proposed Rule this summer for an expanded regulation that should be published by November 1, 2016 in order to take effect on July 1, 2017.[1]

The Negotiated Rulemaking on this subject was notable for the way in which this seemingly modest rule was expanded to touch on a wide range of compliance issues that prompted intense debate and will surely lead to additional discussion as the rule advances through the public comment process.

We encourage you to keep this rulemaking on your agenda and plan to submit comments when the Department issues the NPRM this summer. Since the Negotiated Rulemaking ended without consensus, the Department has a free hand to draft the proposed rule. Nevertheless, we believe the Department's Final Draft submitted to the negotiating committee (the Final Draft) will be the starting point for the upcoming proposal and therefore it is important that institutions understand the scope and potential impact of that Final Draft.

Establishing a new federal standard while preserving state-based claims

Since the BDTR Rule[2] was enacted in 1994, it has provided a mechanism for student borrowers to claim that the government cannot collect on their federal loans due to the "acts and omissions" of the institution they attended as evaluated under state law without any specific standards.

The new rule is expected to provide more specific standards to clarify students' rights and expand the types of acts or omissions that could serve as the basis for a BDTR claim.

The proposed language would establish a new, three-part federal standard, while preserving the students' right to use a state claim judgment as the basis to seek loan forgiveness.

1. **Judgment against the school.** A borrower could make a claim if s/he obtains a favorable contested judgment against the school based on state or federal law in a court of competent jurisdiction. A contested judgement in this context means the institution presented a defense and lost (as opposed to a default judgement, where one party does not respond to a claim and the judge orders in favor of the other party). A borrower may assert this as a basis for a claim at any time without regard to any statute of limitations. In a fascinating twist that will require future discussion, the new rule is expected to extend this right to students who bring claims as individuals or as members of a class, and even students who are represented in some sense by a government agency that brings a case.
2. **Breach of contract by the school.** A borrower could make a claim if the school s/he attended failed to

perform its obligations under the terms of a contract with the student. There are two timeframes under this section: if students make a claim based on a debt they still owe to ED, there is no time limit – they can assert that claim at any time after the alleged breach. For claims to recover amounts previously collected by ED, the student must make the claim not later than four years after the breach.

3. **Substantial misrepresentation by the school**. A borrower could make a claim if the school or any of its representatives or third party agents that provide marketing, advertising, recruiting, or admissions services, made a substantial misrepresentation that the borrower reasonably relied on when the borrower decided to attend, or to continue attending, the school. Again, this provision has two proposed timelines: if students make a claim based on a debt they still owe to ED, there is no time limit – they can assert that claim at any time after the alleged misrepresentation. For claims to recover amounts previously collected by ED, the student must make the claim not later than four years after the student discovers, or reasonably could have discovered, the information constituting the substantial misrepresentation.

The new meaning of "substantial misrepresentation"

It is important to note that the Final Draft also included a new definition of "substantial misrepresentation," which creates at least some expectation that the person making the claim was harmed. ED defined it as "any misrepresentation to a person on which that person could reasonably be expected to rely, or has reasonably relied, to that person's detriment."

The focus on ensuring the claimant actually suffered damage under this type of claim resulted in a heated debate during the Negotiated Rulemaking, specifically relating to ED's insistence that it be provided the discretion to determine the amount of the debt that it might discharge based on such a claim. ED outlined what factors it could consider in deciding the "amount of injury" suffered by the student borrower. The list included the difference in tuition between the program attended by the student and the average tuition for comparable programs; the difference between the financial charges the student could have reasonably believed the school was charging, and the actual amount charged by the school; the difference between the student's earnings and the amount of expected earnings that was presented, or available for the student to research (through Bureau of Labor Statistics data); the total amount of the student's economic loss as reduced by the value of the benefit (if any) of the education; and other factors as determined by ED. The consumer advocates were furious about this provision, repeatedly saying that a substantial misrepresentation is, by definition, enough for a full discharge but ED defended its need for discretion in this area.

Additionally, the Final Draft attempted to clarify what actions by an institution might be considered "substantial misrepresentation." These included: the institution made insistent demands that the borrower make enrollment- or loan-related decisions immediately; there was an unreasonable emphasis on unfavorable consequences of delay; the institution used multiple school employees or any of the other parties, at the same time, "against a single borrower"; and the institution made statements discouraging the borrower from consulting an adviser, a family member, or other resources.

These issues involving the new standards for BDTR claims raise a host of related issues such as:

- The process to adjudicate claims filed under the Department's administrative systems.
- The level of evidence ED will expect before granting a claim.
- ED's willingness to accept mere allegations of wrongdoing by agencies as the basis for relief.

Stay tuned for additional alerts from Cooley on the other important aspects of the Final Draft and updates when ED issues its Proposed Rule.

Notes

1. This is the second in a series with respect to current rulemaking by the US Department of Education to revise the BDTR regulation. Read our prior alert that discussed the Negotiated Rulemaking itself, and check back here for our future alerts on this subject.
2. The Rule is currently codified at 34 CFR 685.206 (c), and is based on 20 USC 1087e(h).

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