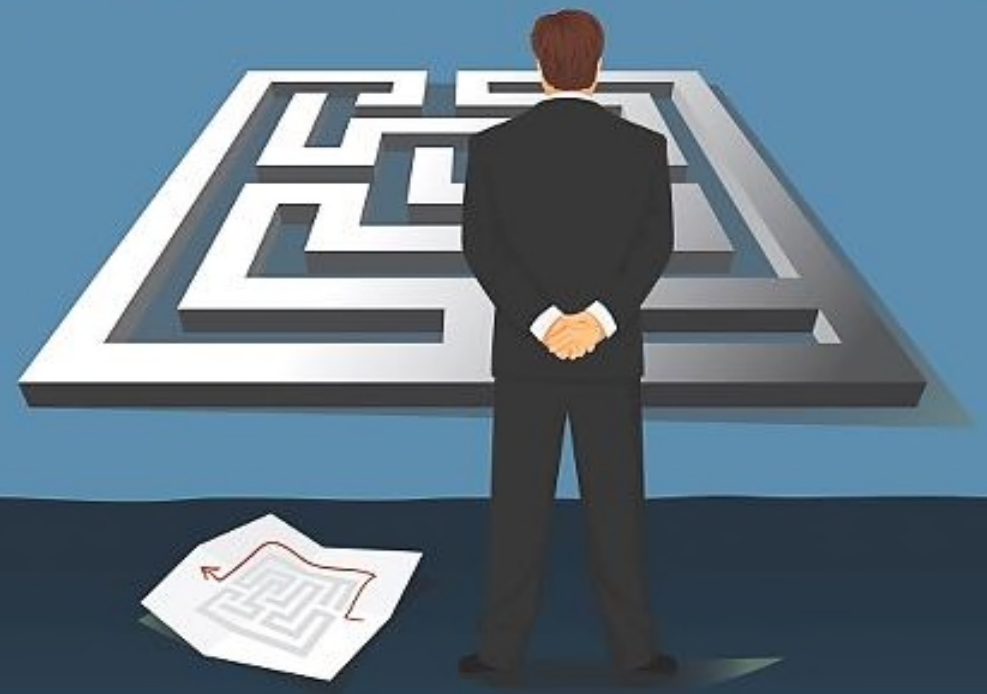
Decoding the Final Borrower Defense Rule

A Webinar Series from the Thompson Coburn Higher Education Team



Borrower Defense Webinar Series

- Webinar series schedule:
  - The New Borrower Defense Framework (November 29, 2016)
  - The Revised Financial Responsibility Standards (December 1, 2016)
  - Changes to Closed School and False Certification Discharge (December 6, 2016)
  - The Elimination of Pre-Dispute Arbitration Clauses and the New Repayment Rates for Proprietary Schools (December 8, 2016)

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Welcome & Introduction

- Aaron D. Lacey
  - Partner, Higher Education Practice, Thompson Coburn LLP.
- Higher Education Practice
  - Provide regulatory counsel on federal, state, and accrediting agency laws and standards (*e.g.*, Title IV, Title IX, Clery, consumer information).
  - Assist with postsecondary transactions, contract drafting and negotiation, policy creation, and compliance systems design.
  - Represent institutions in student and employee litigation, government investigations, administrative proceedings, audits, and reviews.

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WELCOME & INTRODUCTION

- Jeffrey R. Fink
  - Partner, Litigation Practice, Thompson Coburn LLP.
- Postsecondary Litigation Practice
  - Defend lawsuits and arbitrations brought by state attorneys general and former students in several states, including claims of fraud and violation of state consumer protection statutes and False Claims Act over representations about employment opportunities, transferability of credits, financial aid, accreditation, and educational quality.
  - Challenge government suspensions in financial aid programs, including veterans' benefits.
  - Defend employee-related litigation.

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Presentation Outline

- Politics & Prognostications
- The New Rule from 40,000 Feet
- Class Action and Arbitration Provisions
  - The Question of Legal Authority
  - In the Meantime…Arbitration Best Practices
- The “New” Repayment Rate
- TC Resources

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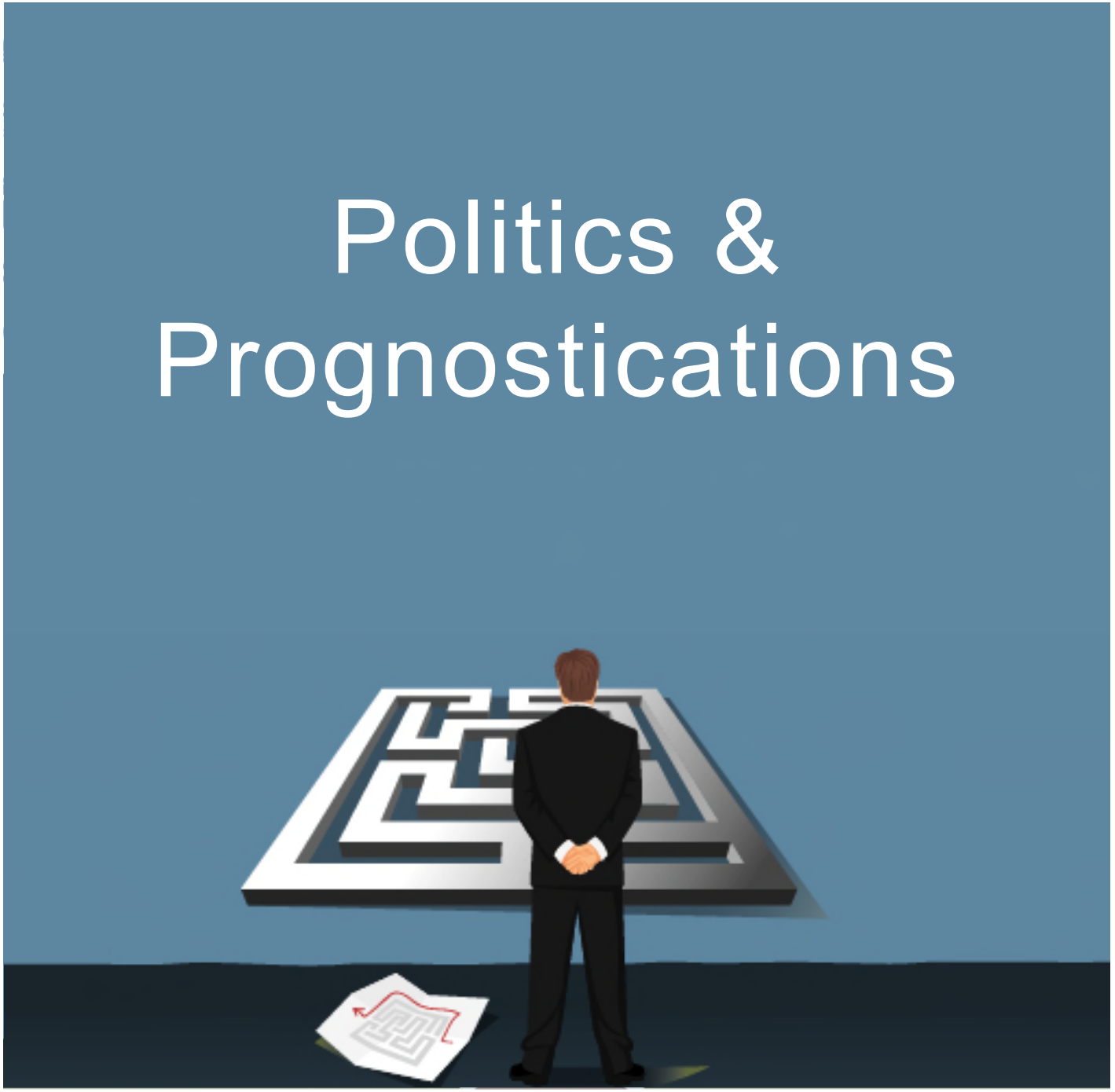
Politics & Prognostications



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Look Into My Crystal Ball…

Will this rule ever go into effect?

- The Congressional Review Act
  - Permits Congress to enact a "resolution of disapproval," which if passed by both houses of Congress and signed by the President overturns any rule promulgated by a federal administrative agency.
  - Congress must act within 60 legislative days of a rule's introduction.

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Look Into My Crystal Ball…

- Sets an expedited legislative path, requires only a simple majority rather than the usual 60 votes needed to block a filibuster.

- Removal through rulemaking
  - ED can modify or remove the rule through the rulemaking process
- Suspension of enforcement
  - ED can simply determine not to enforce the rule
- Legal challenge
  - If rule remains in place, legal challenge is likely, and possible ED would not defend all or some portion of the rule.

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Look Into My Crystal Ball…

- Congress will not act, nor will the White House, if the borrower defense rule is not a priority.
- The borrower defense statute and existing rule are already on the books, and will remain even if the new rule is struck down.
- Thousands of claims are being submitted, and will have to be dealt with through some process.

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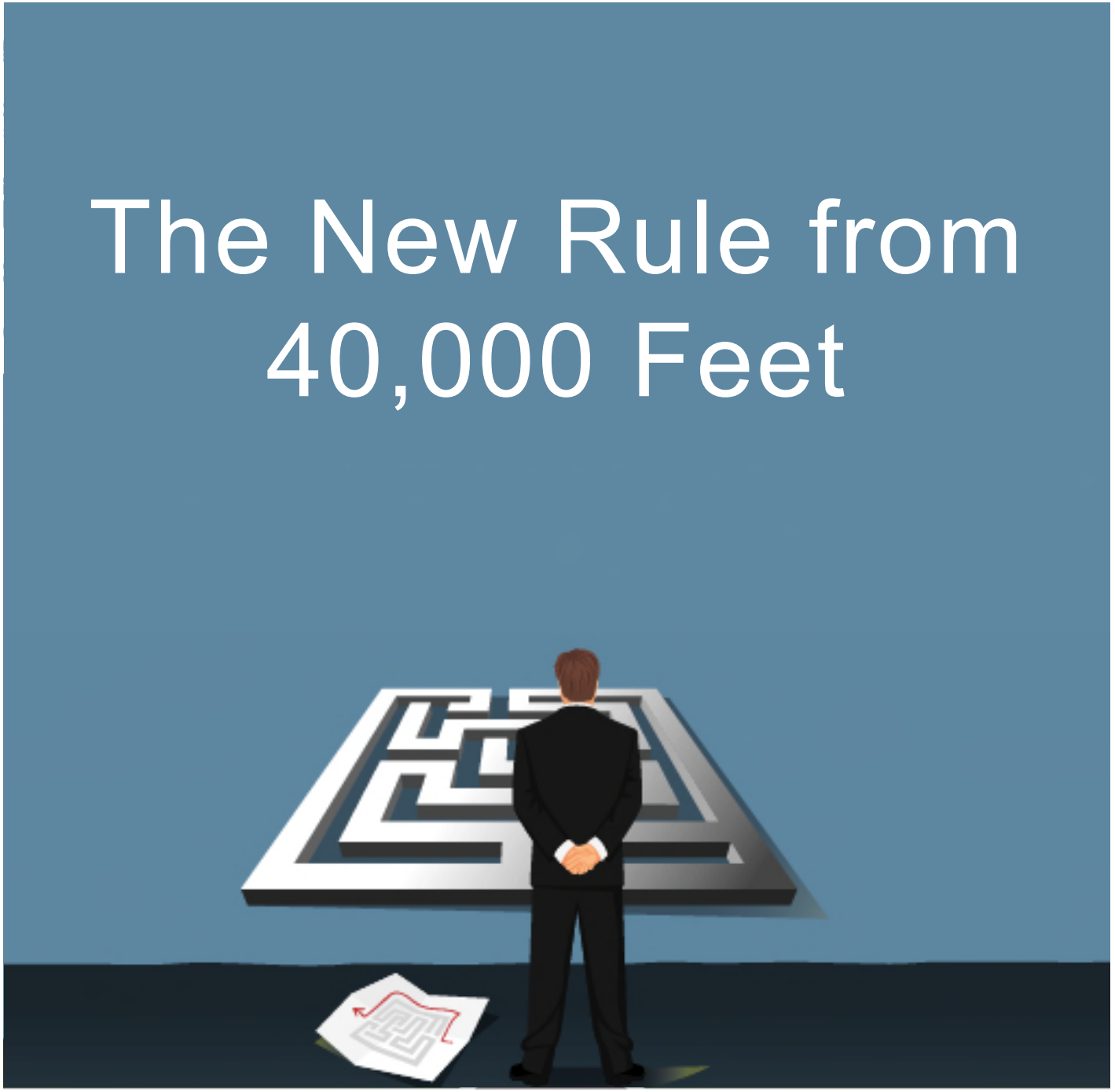
The New Rule from 40,000 Feet



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Elements of the New Rule

Borrower Defense Framework

- Financial Responsibility Triggers
- Arbitration Agreements
- Closed School Discharge
- False Certification Discharge
- Misrep-resentation
- Repayment Rates for Prop. Schools

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Implementation Timeline

Date	2016 Rulemaking Events
Jan. – Mar.	• Negotiated rulemaking committee meets
June 16	• New rules published
August 1	• Comment period closes
Nov. 1	• Publication of final rule in Federal Register*
July 1, 2017	• Effective date of new rule^

*Pursuant to Section 482(c) of the HEA, ED must publish final regulations before November 1 of a given year in order for them to take effect on July of the following year.

^Also pursuant to Section 482(c) of the HEA, ED has designated certain regulations for voluntary, early implementation by the regulated community, and elected to implement early certain requirements that are entirely the responsibility of ED.

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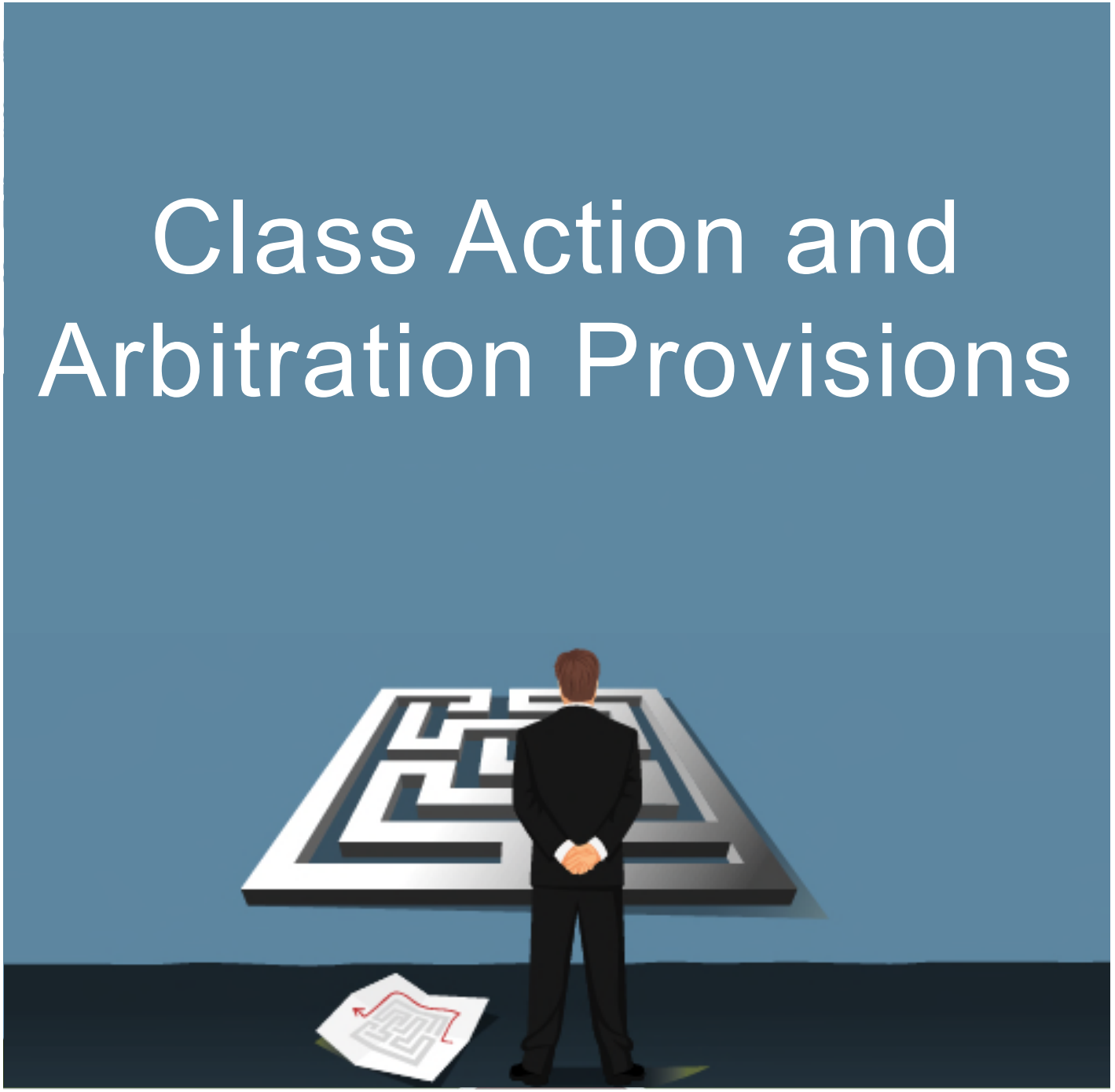
Class Action and Arbitration Provisions



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The DL Participation Agreement

The HEA directs ED to enter into agreements with institutions to participate in the Direct Loan Program.

- Section 685.300 of the regulations requires institutions wishing to participate in the DL Program to "[e]nter into a written program participation agreement with [ED]," and details terms of participation.

20 U.S.C. § 1087c(a); 34 C.F.R. § 685.300.

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The DL Participation Agreement

This "Direct Loan Program" agreement is part of each institution's Program Participation Agreement, which provides in the section titled Scope of Coverage:

> This Agreement covers the Institution's eligibility to participate in each of the following listed Title IV, HEA programs, and incorporates by reference the regulations cited… **FEDERAL DIRECT STUDENT LOAN PROGRAM**, 20 U.S.C. §§ 1087a *et seq.*; 34 C.F.R. Part 685.

Program Participation Agreement boilerplate.

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The DL Participation Agreement

Pursuant to the HEA, ED is directed to include in the agreement, among other things:

> Such other provisions as the Secretary determines are necessary to protect the interests of the United States and to promote the purposes of this part.

20 U.S.C. § 1087d(a)(6).

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The DL Participation Agreement

ED has inserted the new arbitration and class action requirements into 685.300 (terms of DL participation).

- They are a condition of participation and appear in a school's PPA.
- ED contends these new requirements are necessary to "protect the interests of the United States."

81 Fed. Reg. 76022 (Nov. 1, 2016).

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Qualifying Claims

New requirements would only relate to student claims or complaints that are or could be asserted as a borrower defense claim.

- This means claims or complaints based on acts or omissions of the school that (1) relate to the making of a federal loan or the provision of educational services for which the loan was provided; and (2) could be asserted as a defense to repayment under 685.222.

For purposes of this presentation, we will refer to these as qualifying claims.

New 34 C.F.R. § 685.300(i).

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New Restrictions for Qualifying Claims

Internal Remedies	• Schools prohibited from compelling exhaustion of internal remedies (685.300(d)).
Class Action Waivers	• Schools prohibited from enforcing class action waivers (685.300(e)(1)-(2)).
Mandatory Language Class Actions	• Schools must include language permitting participation in class actions (668.300(e)(3)).
Pre-Dispute Arbitration Agreements	• Schools prohibited from enforcing pre-dispute arbitration agreements (685.300(f)(1)-(2)).
Mandatory Language Pre-Dispute Arbitration	• Schools must include language permitting lawsuits (668.300(f)(3)).
Notification of Qualifying Claims	• Schools must notify ED of any qualifying claims filed in arbitration or court (668.300(g)-(h)).

New 34 C.F.R. § 685.300(d)-(i).

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Exhaustion of Internal Remedies

Institutions are prohibited from requiring students to first seek resolution of qualifying claims through an internal process.

- Students must be permitted to go directly to an accreditor or appropriate government agency.

New 34 C.F.R. § 685.300(d).

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Class Action Prohibition

Schools are prohibited from relying on a class action waiver in a pre-dispute agreement:

- With a student who received or benefitted from a Direct Loan; and
- With respect to any aspect of a class action that relates to a qualifying claim.

Does not have to be in an enrollment agreement or in an arbitration agreement.

New 34 C.F.R. § 685.300(e)(1)-(2).

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Mandatory Class Action Language

Any future agreement with a student who received or benefitted from a DL that includes a class action waiver must state:

> "We agree that neither we nor anyone else will use this agreement to stop you from being part of a class action lawsuit in court. You may file a class action lawsuit in court or you may be a member of a class action lawsuit even if you do not file it. This provision applies only to class action claims concerning our acts or omissions regarding the making of the Direct Loan or the provision by us of educational services for which the Direct Loan was obtained. We agree that only the court is to decide whether a claim asserted in the lawsuit is a claim regarding the making of the Federal Direct Loan or the provision of educational services for which the loan was obtained."

New 34 C.F.R. § 685.300(e)(3)(i).

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Mandatory Class Action Language

- Any existing pre-dispute agreement with a student addressing class actions must be amended to include language specifying that the school will not seek to prevent a class action.
  - Alternatively, a school may distribute a written notice to each student specifying that the school will not seek to prevent a class action.
- In both cases, the school must use specific language set out in the regulation.

New 34 C.F.R. § 685.300(e)(3)(ii)-(iii).

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Pre-Dispute Arbitration Prohibition

Schools are prohibited from:

- Entering into a pre-dispute agreement to arbitrate a qualifying claim; or
- Relying in any way on a pre-dispute arbitration agreement.

A "Pre-dispute arbitration agreement" means any agreement, regardless of its form or structure, between a school or a party acting on behalf of a school and a student providing for arbitration of any future dispute between the parties.

New 34 C.F.R. § 685.300(f)(1)-(2).

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Mandatory Arbitration Language

Any future pre-dispute arbitration agreement with a student who received or benefitted from a DL must include the following clause:

> "We agree that neither we nor anyone else will use this agreement to stop you from bringing a lawsuit concerning our acts or omissions regarding the making of the Federal Direct Loan or the provision by us of educational services for which the Federal Direct Loan was obtained. You may file a lawsuit for such a claim or you may be a member of a class action lawsuit for such a claim even if you do not file it. This provision does not apply to lawsuits concerning other claims. We agree that only the court is to decide whether a claim asserted in the lawsuit is a claim regarding the making of the Federal Direct Loan or the provision of educational services for which the loan was obtained."

New 34 C.F.R. § 685.300(f)(3).

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Mandatory Arbitration Language

- Any existing pre-dispute agreement with a student must be amended to include language specifying that school will not seek to prevent a lawsuit.
  - Alternatively, a school may distribute a written notice to each student specifying that the school will not seek to prevent a lawsuit.
- In both cases, the school must use specific language set out in the regulation.

New 34 C.F.R. § 685.300(f)(3).

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Qualifying Claim Notification

Schools must notify and provide documentation to ED if a matter involving a qualifying claim is filed in arbitration or court.

- Requirement applies if claim is filed by or against school.
- Must notify ED within 30 days for lawsuit filings and 60 days for arbitration filings.

New 34 C.F.R. § 685.300(g)-(h).

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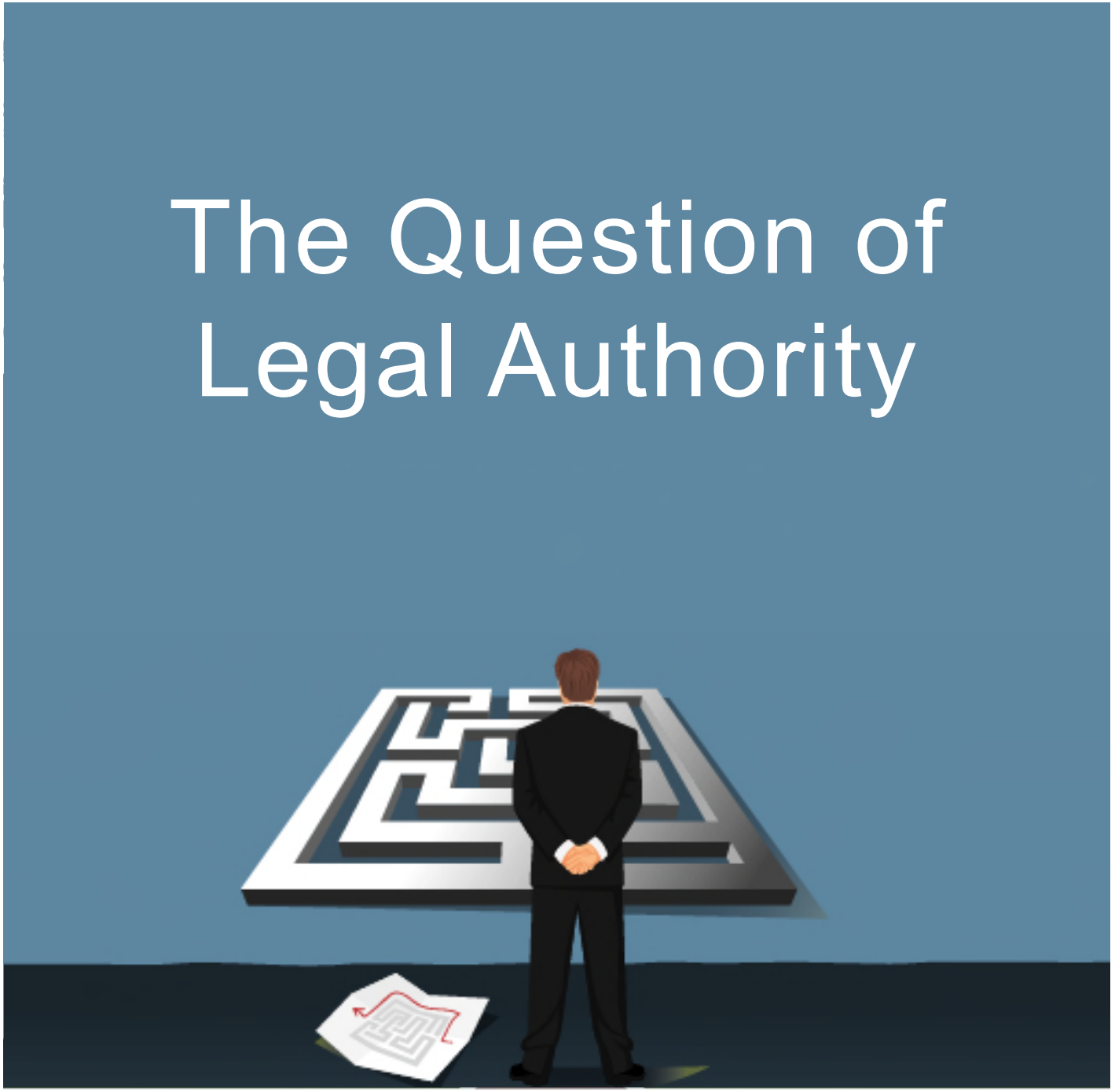
The Question of Legal Authority



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The Question of Legal Authority

It is unclear whether ED has authority to ban schools from using or enforcing pre-dispute arbitration agreements with students.

- The Federal Arbitration Act (FAA) says that pre-dispute arbitration agreements are generally valid and enforceable. The FAA implements a strong federal policy favoring arbitration of disputes.
- ED concedes that it "does not have the authority … to displace or diminish the effect of the FAA." Yet, ED claims that it can effectively – if not directly – bar pre-dispute arbitration agreements that would be enforceable under the FAA.

81 Fed. Reg. 76023 (Nov. 1, 2016).

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The Question of Legal Authority

ED has no express authority from Congress to regulate arbitration agreements.

- The Higher Education Act is silent about arbitration.
- Compare with the Dodd-Frank Act, which gives authority to the Consumer Financial Protection Board to regulate arbitration agreements in consumer financial agreements.

12 U.S.C. § 5518(b).

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The Question of Legal Authority

ED asserts that it has implicit authority under 28 U.S.C. § 1087d(a)(6).

- That statute provides that a program participation agreement shall include, among other things, “such other provisions as the Secretary determines are necessary to protect the interests of the United States and to promote the purposes of this part.”

The Question of Legal Authority

- ED then argues that both class action waivers and pre-dispute arbitration agreements "substantially harm the financial interest of the United States and thwart achievement of the purpose of the Direct Loan Program."
- ED argues that these arrangements permit institutions to insulate "themselves from direct and effective accountability for their misconduct, [to deter] publicity that would prompt government oversight agencies to react, and [to shift] the risk of loss for that misconduct to the taxpayer."

81 Fed. Reg. 76022 (Nov. 1, 2016).

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The Question of Legal Authority

However, ED's implicit authority under Section 1087 is limited by other federal statutes, including the Federal Arbitration Act. ED cannot issue rules that violate federal statutes.

- The interests of the United States are defined by federal statutes such as the FAA.
- Provisions in program participation agreements that conflict with federal statutes such as the FAA presumably are not "necessary to protect the interests of the United States."

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The Question of Legal Authority

An effective ban on pre-dispute arbitration agreements would seem to violate the FAA.

- This is a hot issue in the nursing home industry and with the National Labor Relations Board (NLRB).
- Recently, the Centers for Medicare & Medicaid Services (CMS) issued a rule prohibiting nursing homes that participate in Medicare or Medicaid from entering into new pre-dispute arbitration agreements with their residents.

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The Question of Legal Authority

- Nursing home groups challenged the rule.
- In November, a federal district court in Mississippi issued a preliminary injunction barring enforcement of the rule.
- While not issuing a final judgment, the court made a preliminary finding that CMS does not have the authority to ban nursing home arbitration.

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The Question of Legal Authority

- CMS argued that it had authority because Congress authorized the Secretary to impose "such other requirements relating to the health and safety [and the well-being] of residents … as [she] may find necessary" and to establish "other right[s]" to "protect and promote the rights of each resident."
- This is similar to ED's reliance on its authority to include in program participation agreements "such other provisions as the Secretary determines are necessary to protect the interests of the United States and to promote the purposes of this part."

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The Question of Legal Authority

- The court disagreed with CMS: "[S]eeking to ban nursing home arbitration agreements on the basis of extremely vague language such as this represents a breathtakingly broad assertion of authority by a federal agency."
- The court added that it saw "a serious danger that, if generalized language … were deemed sufficient to authorize a ban on arbitration agreements in nursing home cases, then many other agencies would choose to broadly exert power in a variety of contexts."

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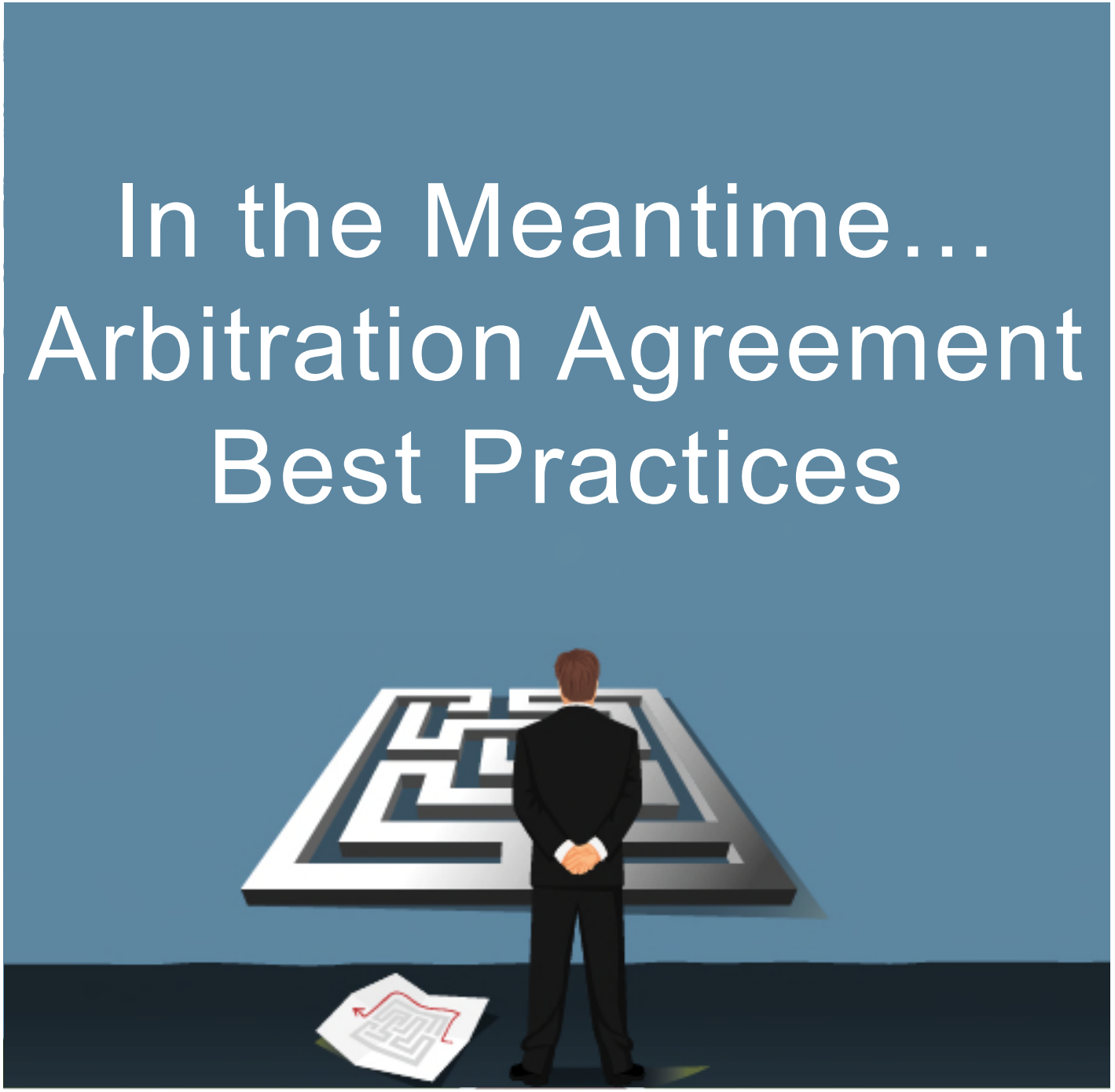
The Question of Legal Authority

- The court noted that Congress, using clear and direct language, has expressly granted certain federal agencies the authority to regulate or prohibit arbitration, but had not expressly granted such authority to CMS.
- The court rejected CMS's argument that the arbitration ban was valid because participation in Medicare and Medicaid is "voluntary," noting that nursing homes are heavily dependent on Medicare and Medicaid funds.
- CMS's argument is essentially the same argument that ED raises in defense of its arbitration ban.

The Question of Legal Authority

- The NLRB has been deciding that employers can't have arbitration agreements with their employees that ban class action claims in arbitration.
- The Fifth Circuit has struck down the NLRB's decisions because the National Labor Relations Act (NLRA) is silent about arbitration and doesn't override the FAA.
- Other courts—the Seventh and Ninth Circuits—have upheld the NLRB's decisions on the basis that the NLRA prohibits employers from interfering with collective action by employees.
- There are several requests for review pending before the US Supreme Court.

In the Meantime… Arbitration Agreement Best Practices



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In the Meantime…

- Schools with class action waivers or pre-dispute arbitration agreements should monitor CRA and agency activity closely.
- In addition, keep in mind that the new rule does not ban all arbitration agreements. Even if the rule sticks, schools may determine to keep limited arbitration agreements in place.

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In the Meantime…

"The regulations do not bar the school from seeking to persuade students to agree to arbitrate, so long as the attempt is made after the dispute arises. The regulations, moreover, extend only to pre-dispute agreements to arbitrate borrower defense-type grievances. They do not prohibit a school from requiring the student, as a condition of enrollment or continuing in a program, to agree to arbitrate claims that are not borrower defense-related grievances."

81 Fed. Reg. 76029 (Nov. 1, 2016).

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Arb. Agreements (Best Practices)

With regard to existing arbitration agreements, or any agreements you may design in the future, follow best practices.

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Arb. Agreements (Best Practices)

Arbitration agreements require the student's assent.

- Schools should avoid disputes about whether a student agreed to arbitration.
- Wet-ink signatures are best.
- Electronic signatures are more likely to be disputed.

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Arb. Agreements (Best Practices)

Arbitration agreements should be mutual.

- The student and the school should both be required to arbitrate any claims between them.
- Courts may not enforce the arbitration agreement if the school reserves the right to sue a student.

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Arb. Agreements (Best Practices)

Schools can't retain unilateral right to change the arbitration agreement.

- Schools should be careful if their enrollment agreements incorporate school catalogs or other documents.

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Arb. Agreements (Best Practices)

- Courts are more likely to enforce arbitration agreements if students are not required to pay significant expenses to arbitrate (*i.e.*, arbitration filing fees and arbitrator compensation).
- Schools should be sure their arbitration agreements clearly prohibit class action claims in arbitration.

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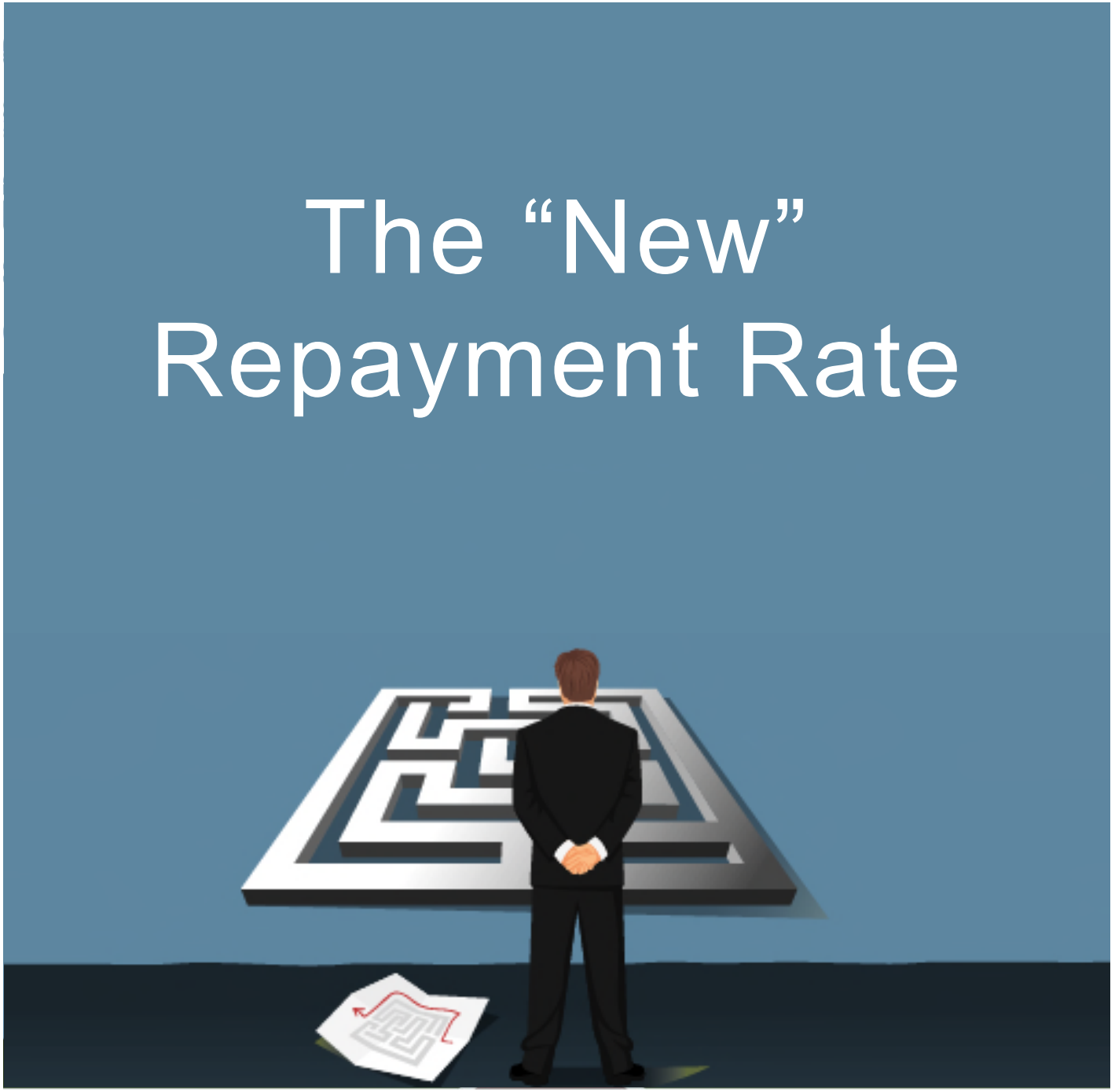
The “New” Repayment Rate



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The New Repayment Rate

ED scrapped the repayment rate formula from the proposed regulation. Instead, ED will calculate an institutional repayment rate using the repayment rate formula and data used for individual GE programs.

> "To avoid any confusion resulting from a new repayment rate calculation, as well as to limit burden on institutions, we are revising the repayment rate provision. Under this revised provision, the repayment rate data that proprietary institutions report at the program level will be used to calculate a comparable repayment rate at the institution level."

81 Fed. Reg. 76015 (Nov. 1, 2016).

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The Calculation

$$\frac{\text{Number of borrowers paid in full plus number of borrowers in active repayment}}{\text{Number of borrowers entering repayment}}$$

New 34 CFR § 668.413(b)(3).

The Numerator

- Number of borrowers paid in full. Of the number of borrowers entering repayment, the number who have fully repaid all FFEL or Direct Loans received for enrollment in the program.
- Number of borrowers in active repayment. Of the number of borrowers entering repayment, the number who, during the most recently completed award year, made loan payments sufficient to reduce by at least one dollar the outstanding balance of each of the borrower's FFEL or Direct Loans received for enrollment in the program, including consolidation loans that include a FFEL or Direct Loan received for enrollment in the program, by comparing the outstanding balance of each loan at the beginning and end of the award year.

New 34 CFR § 668.413(b).

The Denominator

Number of borrowers entering repayment. The total number of borrowers who entered repayment during the two-year cohort period on FFEL or Direct Loans received for enrollment in the program.

New 34 CFR § 668.413(b).

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The Warnings Trigger

The school must make the warnings if its institutional repayment rate is less than 50%.

- Warnings must be made for any award year in which the institution's loan repayment rate shows that the median borrower has not either fully repaid, or made loan payments sufficient to reduce by at least one dollar the outstanding balance of, each of the borrower's FFEL or Direct Loans received for enrollment in the institution.

New 34 CFR § 668.41(h)(3); 81 Fed. Reg. 76015 (Nov. 1, 2016).

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The Warnings Distribution

Schools must include the warning in all promotional materials that are made available to prospective or enrolled students by or on behalf of the institution.

- Promotional materials include, but are not limited to, an institution's Web site, catalogs, invitations, flyers, billboards, and advertising on or through radio, television, video, print media, social media, or the Internet.
- ED dropped the requirement for direct distribution to current and prospective students.

New 34 CFR § 668.41(h)(3).

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The Warnings Content

The warning language must read:

> "U.S. Department of Education Warning: A majority of recent student loan borrowers at this school are not paying down their loans."

- ED indicates that it may conduct consumer testing to determine whether the warning language should be revised. Any updates would be published in the Federal Register.

New 34 CFR § 668.41(h)(3).

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Singling Out the Proprietary Sector

ED's response to objections regarding the singling out of the proprietary sector was largely predictable. A couple of comments worth note…

> "[ED] believes that, because of the changes [to the repayment rate], it would be inappropriate to apply an institutional warning to sectors other than the proprietary sector, because public and private nonprofit institutions are not typically comprised solely of GE programs and the repayment rate warning may not be representative of all borrowers at the school."

81 Fed. Reg. 76015 (Nov. 1, 2016).

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Singling Out the Proprietary Sector

Federal student loan borrowers also typically represent a relatively small proportion of the student population in the public sector, whereas borrowing rates are much higher, on average, at proprietary institutions (for instance, among full-time undergraduates enrolled in 2011-12, 19.7 percent borrowed Stafford loans at public less-than-two-year institutions, compared with 82.9 percent at for-profit less-than-two-year institutions and 83.3 percent at for-profit two-year-and-above institutions)."

81 Fed. Reg. 76015 (Nov. 1, 2016).

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Singling Out the Proprietary Sector

"Federal student loan borrowers also typically represent a relatively small proportion of the student population in the public sector, whereas borrowing rates are much higher, on average, at proprietary institutions..."

81 Fed. Reg. 76015 (Nov. 1, 2016).

Full-time, full-year students	% Borrowing Stafford	Number of Undergraduates
Public	**47.1**	**5,997,000**
4-year doctoral	60.0	2,893,000
Other 4-year	54.0	969,000
2-year	26.5	2,104,000
Less-than-2-year	19.7	31,000
Private nonprofit	**66.0**	**1,875,000**
4-year doctoral	64.4	990,000
Other 4-year	68.2	849,000
Less-than-4-year	59.0	36,000
Private for-profit	**83.2**	**992,000**
2-year and above	83.3	859,000
Less-than-2-year	82.9	133,000

U.S. Department of Education, National Center for Education Statistics, 2007-08 and 2011-12 National Postsecondary Student Aid Study (NPSAS:08 and NPSAS:12). (This table was prepared July 2014.)

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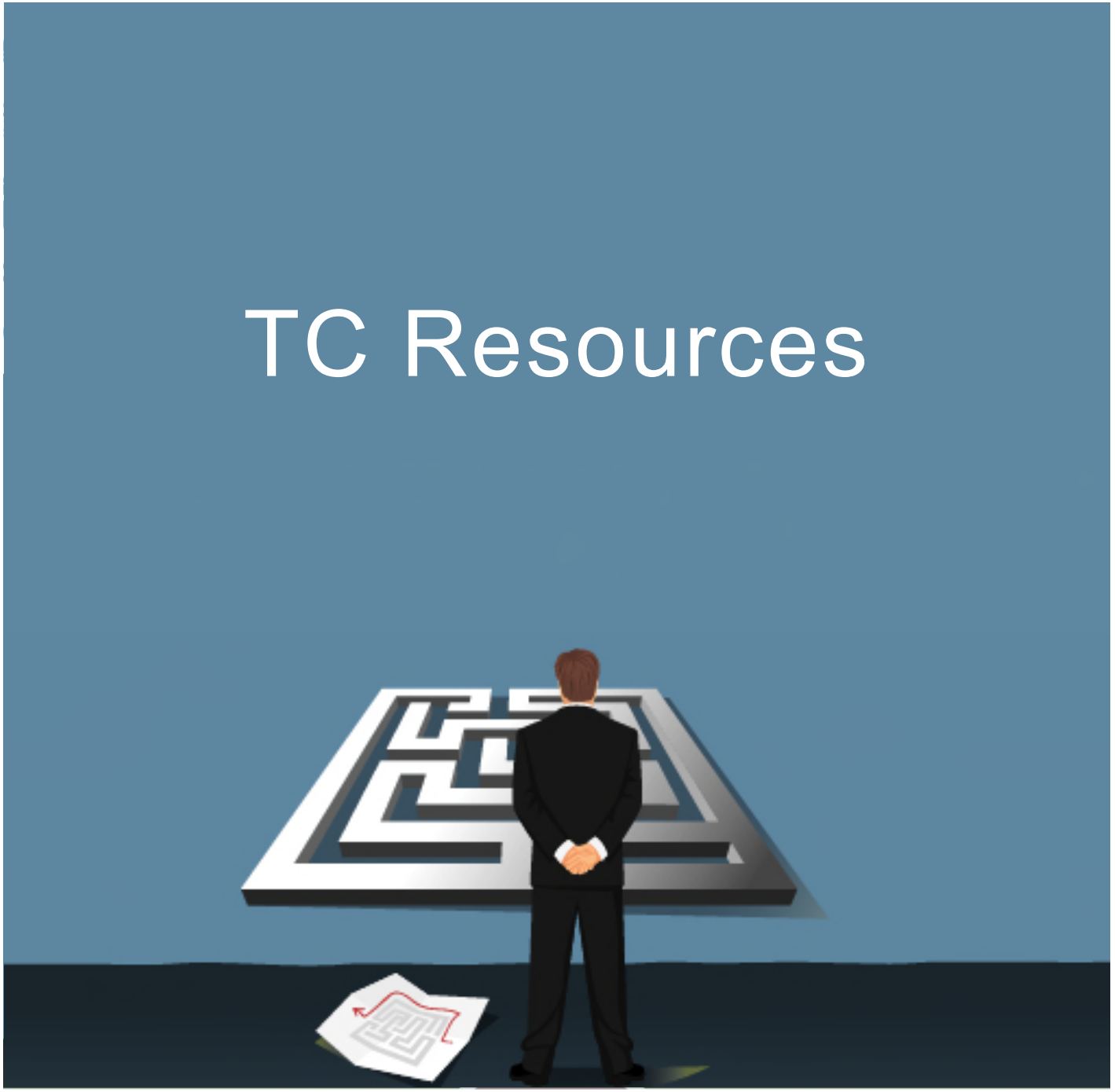
TC Resources



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TC Resources

Our higher education law blog, REGucation.

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Title IX and due process: ED tells Wesley that accused student not treated fairly

Paul Stoehr Aaron Lacey November 2, 2016

In a rare move, the Department of Education announced on October 12, 2016, its determination that Wesley College in Delaware had violated Title IX by failing to provide appropriate procedural protections to a student accused of sexual misconduct. READ MORE

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Contact Information

Jeffrey R. Fink, Esq.
Partner, Litigation Practice
Thompson Coburn LLP
jfink@thompsoncoburn.com
314-552-6145

Aaron D. Lacey, Esq.
Partner, Higher Education Practice
Thompson Coburn LLP
alacey@thompsoncoburn.com
314-552-6405

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