

Borrower Defense to Repayment: The Saga Continues

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Comments on the proposed new rule due August 30, 2018

Two years ago, [we wrote about](#) the Obama Administration's proposed rules governing "Borrower Defense to Repayment," based on [one](#) sentence in the Higher Education Act intended to protect federal student loan borrowers. Those rules were intended to go into effect July 1, 2017. For those who may have lost track, after Secretary DeVos delayed the effective date of the updated BDTR Rule, ED conducted a new round of negotiated rulemaking. To no one's surprise, the negotiations did not lead to consensus, giving ED the freedom to propose an entirely new version. For more background, [read our series of BDTR posts](#).

While much of the debate over borrower defense has focused on the tens of thousands of former students of now-closed for-profit schools, such as ITT and those operated by Corinthian, the BDTR law (and therefore regulations) applies to every student borrower, regardless of whether he or she attended a for-profit, nonprofit or public institution.

With the official publication of the department's [notice of proposed rulemaking](#), the 30-day clock for public comment is now ticking. The new NPRM proposes very significant changes to what the previous administration sought to implement. While most of the changes attempt to clarify and balance student and institutional rights with respect to borrower defense claims, like the Obama Administration version, the NPRM branches out to proposed changes in other areas, including the department's system to measure the financial responsibility of institutions that participate in the federal student aid programs, closed school and false certification discharges. It is important to note – as discussed below – that the department is inviting comments not only on the entirety of the new rule, as required by law, but also on specific elements.

Below is our initial high-level overview of the primary components of the proposed rule. We will be issuing additional posts on this subject – particularly the very important financial responsibility issues embedded in this NPRM.

Status of Current Rule and Effective Date

Assuming that ED publishes a final rule by November 1, 2018, the earliest effective date would be for loans made *after* July 1, 2019. In the interim, and for all loans made in earlier periods, the very sparse [1994 version of the rule](#) will continue to apply. Tens of thousands of previously submitted BDTR claims remain under review with the department.

Limited Basis for BDTR Claims

In a major change from the original rule, the NPRM would establish a federal standard for review of BDTR claims, replacing the current system, which requires ED to try to adjudicate these claims under the particular state law applicable to that student.

In contrast with the never fully implemented 2016 rule that set three categories of evidence borrowers could use to support a BDTR claim – a broad definition of misrepresentation, a judgement against the school or a breach of contract claim – the NPRM would limit the borrower basis to make a claim to only misrepresentation by the school. Such misrepresentation would have to be (i) false, misleading or deceptive; (ii) made with knowledge of its false, misleading or deceptive nature or with a reckless disregard for the truth; and (iii) directly and clearly related to the making of the loan or the provision of educational services. This is a major shift from the 2016 version, which included a strict-liability definition under which any misleading statement could be grounds for a claim, regardless of whether there was evidence that the institution *intended* to provide false information, misrepresent or deceive.

Further, in another very important change, in addition to providing evidence of a knowing and intentional misrepresentation, a borrower would have to establish that he or she "reasonably relied" on the misrepresentation "under the circumstances" and that he or she suffered financial harm *as a result* of that misrepresentation. ED's commentary makes clear that the harm must focus on monetary loss, rather than opportunity costs (that is, spending time enrolled in a program) or a borrower's disappointment in the outcome of his or her program.

The proposed rule also requires that borrower claims must be related to the issuance of a federal student loan and, unlike the 2016 version, specifically provides that a claim cannot be based on other matters such as the quality of education or academic disputes and disciplinary matters.

In yet another significant departure from the 2016 rule, the NPRM would require each borrower to make an individual application for BDTR relief to be reviewed on a case-by-case basis. This would reverse the provision in the 2016 rule, designed particularly for students who were affected by the Corinthian, ITT and other major closures that allowed ED to grant BDTR relief to groups based on common characteristics, as well as to borrowers who never applied.

Finally, and again unlike the earlier version, the proposed rule would establish a formal process, with procedures and timelines, to enable an institution to have an opportunity to present evidence to defend itself against a claim.

“Defensive” Claims vs. “Affirmative” Claims – ED Requesting Comment

An important change is whether claims must be “defensive” – that is, protection against a collection action for a defaulted loan, which was the standard under the rarely invoked 1994 regulation, or “affirmative” – where the student has continued to make payments – as provided under the 2016 proposal. The proposed rule specifically invites input on whether ED should limit claims to borrowers who have defaulted on their loans or also allow affirmative claims. ED notes that a defensive-only path might incentivize borrowers to go into default in order to make a BDTR claim with no assurance that the claim would be granted, but allowing affirmative claims may open the door to frivolous claims, which may then require additional regulatory protections and procedures.

Standard of Proof – ED Requesting Comment

ED has proposed that a borrower must establish his or her claim “by a preponderance of the evidence,” meaning that the underlying conduct by the school was more likely than not to have occurred, which is consistent with the 2016 rule. However, ED also pointedly invites comment on whether it should require that claims be supported by the higher standard of clear and convincing evidence, meaning that the claim is substantially more likely than not, or has a high probability, of being true.

Additional Provisions Unrelated to Student Loans

Like the 2016 BDTR Rule, the NPRM has a number of provisions unrelated to the BDTR statute but triggered by the high-profile school closures that immediately preceded the earlier version.

Arbitration and Class Action Lawsuits

An area of hot debate in this category is whether schools may use pre-dispute arbitration provisions in enrollment agreements or similar documents that require students to waive their rights to participate in class actions and agree to resolve all disputes through arbitration rather than the courts. While the 2016 rule reflected ED’s position that it could prohibit such provisions under the terms of the school’s program participation agreement, the proposed rule looks to recent Supreme Court precedent and the Federal Arbitration Act to conclude that ED cannot impose such a prohibition. However, the proposed rule does require additional plain language disclosures regarding any internal grievance procedures and alternative dispute resolution conditions.

Financial Responsibility and Letter of Credit or Surety Triggers

The NPRM has continued the concept embedded in the 2016 rule, which identified certain triggering events that would require a recalculation of the school’s financial responsibility composite score and require a school to post a potentially substantial letter of credit. While the proposed rule is considerably less aggressive in its attempt to identify at-risk institutions for purposes of evaluating their ongoing financial responsibility, the methodology and impact of that recalculation bears very close review in this comment period. As was the case with the 2016 rule, there are two categories of triggers, one mandatory and one at the discretion of ED.

The mandatory triggers for such a recalculation include (1) a liability for BDTR loan discharges or a judicial or administrative action against the institution, (2) for a proprietary institution whose composite score is less than 1.5, an owner’s withdrawal of equity from the institution by any means, including by declaring a dividend, or (3) for a publicly traded institution, the SEC suspends or revokes its registration, suspends trading of their stock or delists the institution or the institution fails to make a required report.

ED also has identified a number of discretionary triggers that would allow ED to perform a recalculation of the composite score and consider requiring a letter of credit. These are if a school (1) is issued an accreditor show-cause action, (2) violates a credit agreement, (3) is threatened with the loss of state authorization, (4) violates the 90/10 rule for one year or (4) has a cohort default rate over 30% for two consecutive years. In each of these cases, ED would determine whether the event is likely to have a material adverse effect on the financial condition of the institution.

In another interesting back-to-the-future twist, ED proposes to return to a policy discarded 25 years ago, allowing a school to satisfy any “letter of credit” requirements with a surety bond, which is typically far less costly. In most cases, a letter of credit must be cash collateralized and, in any event, tends to bear high fees compared to typically far less costly surety bonds. Additional proposed options include the deposit of cash or an arrangement for ED to offset future Title IV funds over time in order to create an ED-controlled account that would function as a form of surety.

It Ain't Over 'til It's Over: State Lawsuits

In 2017, the attorneys general of 18 states and the District of Columbia sued the department over its delay in implementing the 2016 rule, as well as its handling of the current backlog of student BDTR claims. We fully expect that the proposed changes to the rule will spur additional legal challenges from states and others concerned over the potentially more stringent review process for student relief.

Public Comment Period

ED will accept public comment on the proposed rule until August 30, 2018. All comments must be filed through the [ED portal](#). If you are interested in more information on the proposed rule or would like assistance in developing comments, please contact [us](#) for assistance. In the meantime, keep an eye on [our blog](#) for additional posts regarding the financial responsibility and related provisions in this proposed rule package.

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