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Where are they now?

The Borrower Defense to Repayment and Gainful Employment Story

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BORROWER DEFENSE TO REPAYMENT

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A short BDTR history lesson

- Borrower Defense to Repayment (BDTR)
  - Originally added to the HEA in 1993 and regulations were issued in 1994
  - After Corinthian closure, ED invited impacted students to file claims under the existing rule, resulting in tens of thousands of claims
  - The 1994 version of the rule was insufficient (and inefficient) for handling the volume and bases for the claims
  - In 2015, ED announced a plan to form a negotiated rulemaking committee to update the rule

The history lesson continues…

- ED initiated negotiated rulemaking which was completed in 2016
- New rule published in October 2016 for July 1, 2017 effective date
- CAPPS sues ED over the BDR rule
- In June 2017, ED issues a delay on implementation of BDTR to July 2018, followed by a NPRM to rewrite the rule, with another delay to July 2019
- AGs sue ED over its delay of the BDTR Rule
- ED initiates a new negotiated rulemaking on BDTR which takes place in late 2017/early 2018
- ED publishes an amended proposed BDTR rule for comment in July 2018

The history lesson continues…

- September 2018, the District Court in DC finds that the delay by ED was in violation of the Administrative Procedures Act and orders that the 2016 rule must be implemented
- The court provides a 30 day stay on the ruling to allow ED to remedy any APA deficiencies (deadline is October 12)
- It is possible that the Court will order the 2016 rule be implemented, regardless of the status of a new rule, until a new rule could become effective on July 1, 2019 BUT…

BREAKING NEWS ALERT

- On October 3, 2018, ED reported that it will NOT have a final rule on BDTR published by November 1, 2018.
  - Under Master Calendar requirements, that pushes implementation date out to July 2020
  - Assuming court orders 2016 rule to be implemented, that rule would be in effect until 2020

…So, now we ***<u>have to</u>*** talk about the 2016 BDTR Rule

Because it is probably going to go into effect by the end of 2018, and will remain in effect until 2020.

2016 BDTR Rule - federal standard for “acts or omissions”

- Claim must be that the act or omission related to the making of a Direct Loan or the educational services for which the loan paid.
- In order to establish a defense, the borrower must show one of following by a preponderance of the evidence:
  - **Breach of contract between school and student**
    - if institution failed to perform its obligations under a contract with the borrower, s/he may assert this claim at any time
    - likely also includes other documents such a program brochures and catalogs that make up the entire contract with a student
    - for claims to recover amounts previously paid to ED, no later than six years after the breach
    - for claims against unpaid debt, no time limit

2016 BDTR Rule - federal standard for "acts or omissions"

- **"Contested judgement" against the school**
  - a decision of a court or administrative tribunal in favor of the student (whether as a plaintiff, member of a class, or covered party in a proceeding brought by a government agency against the school)
  - no statute of limitations on this type of claim
- **Substantial misrepresentation**
  - amends existing regulations on misrepresentation (§ 668.71):
    - removing any element of intent ("to deceive") and shifts to "misleading under the circumstances"
    - adds "any statement that omits information in such a way as to make the statement false, erroneous, or misleading."
  - includes institutional tactics that ED will consider as evidence of reasonable reliance by borrower
  - borrower may claim this at any time, and may assert a claim under this section to recover funds previously paid to ED not later than six years after the borrower discovers, or reasonably could have discovered, the substantial misrepresentation
  - for claims against unpaid debt, no time limit

2016 BDTR Rule – borrower claim processes

- Role of institution and ED
  - Borrower files a claim for discharge with ED, including basis for claim and documentary evidence
  - ED will determine whether a group claim exists, and will represent that group, in front of an ED hearing officer
  - ED can create its own group based on information it has, even if students have not filed BDTR claims
  - ED will determine the amount of relief for the student/group
  - ED will attribute any loan debts it forgives back to the institution as a liability
  - Either party may appeal ED's decision within 30 days
  - Borrowers can request reconsideration at any time
- 2016 rule was vague on the process by which institutions are notified and given the chance to respond to BDTR claims filed against them in "fact finding process" so ED issued procedural guidance on January 19, 2017.
  - Updated federal regs on LS&T proceedings
  - Provides notice to school of BDTR claim and allows schools to provide evidence in defense of the claim
  - Provides notice to the school of ED's intent to recover BDTR discharge amounts and opportunity to respond and/or request a hearing

2016 BDTR Rule – financial responsibility

- Triggers and Composite Score
  - ED will recalculate the school's most recently submitted composite score to determine the potential financial impact of certain reported triggering events
  - Depending on the trigger, ED uses varying methods of calculating the potential loss or liability
  - If the expected impact of the event results in a liability that lowers the composite score from the most recently completed year below 1.0, then the institution is not considered financially responsible

2016 BDTR Rule – financial responsibility

- The following triggers result in a composite score recalculation:
  - any debt or liability arising from a final judgment in a judicial or administrative proceeding
  - a lawsuit brought on or after July 1, 2017 by a State or Federal authority on claims related Direct Loan or the provision of educational services, where the lawsuit has been pending for 120 days
  - a lawsuit brought on or after July 1, 2017 related to claims of any kind, where the school either lost on MSJ or did not file a MSJ within the timeframe set by the court
    - Note that for these three, the assumed loss is based on the amount of the claim or stated liability, but ED does allow for institutions to counter that assumption.

2016 BDTR Rule – financial responsibility

- The following triggers result in a composite score recalculation (cont.):
  - accrediting body requires the school to submit a teach-out plan for a reason described in 34 C.F.R. § 602.24(c)(1) that covers the closing of the institution or any of its branches or additional locations
  - GE programs that could become ineligible based on their final D/E rates for the next award year
  - Withdrawal of equity from a school – including issuing a dividend – where the school's composite score is less than 1.5

2016 BDTR Rule – financial responsibility

- Triggers without composite score recalculation (automatic indications that the institution is not financially responsible):
  - failure of 90/10 ratio for one year
  - two most recent official CDRs are 30% or greater
  - for publically traded schools if the SEC warns the school that it may suspend trading the school's stock; the school failed to file a timely quarterly or annual report; or, the exchange notifies the school that the school is not in compliance with exchange requirements

2016 BDTR Rule – financial responsibility

- Discretionary Triggers - ED reserved the discretion to determine ANY event will have a materially adverse effect on the institution's continuing operations (some examples):
  - significant fluctuation in Title IV funds received in consecutive award years or over a period of award years
  - cited by a State licensing or authorizing agency for failing their requirements
  - failure of a financial stress test developed by ED
  - being placed on probation or show cause for failing to meet accrediting standards
  - violations of a credit agreement that enables the creditor to impose sanctions or penalties on the school pursuant to the credit agreement
  - pending BDTR claims or ED expects to receive a significant number of such claims
  - high annual drop-out rates as calculated by ED

2016 BDTR Rule – financial responsibility

- Schools will be required to provide notice to ED of the occurrence of any of the triggers, generally within 10 days of occurrence or notice
- In its notice to ED, the institution can argue that the trigger is non-material, no longer exists, or that the institution has insurance sufficient to cover all or part of the liabilities that could arise from the event
- ED has also made explicit that an institution may challenge the amount of the LOC required using existing procedures established to allow institution’s to contest an ED action as inappropriate (Subpart G process)

2016 BDTR Rule – financial responsibility

- Schools that are not financially responsible can meet alternative standards in order to remain in the T4 program:
  - post a 50% letter of credit; or
  - become provisionally certified, become subject to the zone alternative requirements and post a letter of credit of at least 10%, with the potential for more based on ED’s determination of the potential loss that the surety is meant to cover
- If additional triggers are met, or the institution has already posted a letter of credit, ED will evaluate the impact of the new events in light of the current posted surety and determine what additional amounts would be required to cover estimated losses

2016 BDTR Rule – financial responsibility

- ED may release the LOC for institutions where it is based on the recalculated composite score if in the next annual submittal of audited financials, the losses associated with the triggering event have been fully realized, and the composite score is above 1.0
  - In the interim, if the triggering event ceases to exist, and a recalculation of the composite score results in a rate over 1.0, ED *may* also release the letter of credit
- Institutions will be required to provide disclosures to students regarding the trigger event for 12 months following the notice to ED of the trigger, using essentially the same process as required for delivery of Gainful Employment disclosures

2016 BDTR Rule – other important elements

- Prohibition on obtaining or attempting to enforce a waiver of or ban on class action lawsuits regarding borrower defense-type claims
- Prohibition on compelling the borrower to enter into a pre-dispute agreement to arbitrate a borrower defense-type claim, or attempt to compel a borrower to arbitrate such a claim by virtue of an existing a pre-dispute arbitration agreement
  - Both of these bans are retroactively applied
  - Both of these provisions are also the subject of legal action by CAPPS to enjoin ED from enforcement
- Disclosure of “failing” repayment rates (applies to for-profit schools only) – but will now use the GE rule repayment calculation (which ED has not actually done to date)

2018 Notice of Proposed Rulemaking (NPRM): Rewriting the BDTR Rule

- The 2018 proposed rule on BDTR would:
  - Removes two of the 2016 standards:
    - Breach of contract between school and student
    - “Contested judgement” against the school
  - Retains substantial misrepresentation standard, but with higher bar for a claim
  - In order to be considered, the school’s statement must 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;
    - (iii) directly and clearly related to the making of the loan or the provision of educational services

2018 BDTR proposed rule rewrite of “substantial misrepresentation”

- The 2016 version of the BDTR Rule included a strict liability interpretation 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.

- In the 2018 version, a borrower now has 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.

- 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.

2018 BDTR proposed rule changes to the claim process

- Each borrower must make an individual application for BDTR relief to be reviewed on a case-by-case basis

- This provision reverses the 2016 rule that allowed ED to grant BDTR relief to groups based on common characteristics, as well as to borrowers who never applied

- 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

2018 BDTR proposed rule – financial responsibility triggers

- The mandatory triggers for a recalculation of a school's composite score 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
  (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.

2018 BDTR proposed rule –financial responsibility triggers

- The discretionary triggers for a recalculation of a school's composite score (which would be done at ED's discretion) include 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
  (5) has a cohort default rate over 30% for two consecutive years

- In both the automatic and discretionary triggers, ED would determine whether the event is likely to have a material adverse effect on the financial condition of the institution, and would then demand an LOC or other form of surety accordingly. Schools have an opportunity to challenge ED's findings.

Other important changes to the 2016 rule in the 2018 proposed rule

- Removes the prohibition on obtaining or attempting to enforce a waiver of or ban on class action lawsuits regarding borrower defense-type claims
- Removes the prohibition on compelling the borrower to enter into a pre-dispute agreement to arbitration of a borrower defense-type claim, or attempt to compel a borrower to arbitrate such a claim by virtue of an existing a pre-dispute arbitration agreement
- Removes the disclosure of “failing” repayment rates (applied to for-profit schools only)

2018 BDTR proposed rule - changes to composite score calculation of long-term debt

- The original definition of “long term debt” hasn’t changed – it is still “all debt obtained for long-term purposes, not to exceed total net property, plant and equipment includes lease liabilities for lease right-of-use assets and the short term portion of the debt, up to the amount of net property, plant and equipment.”

2018 BDTR proposed rule - changes to composite score calculation of long-term debt

- ED is making changes to how that debt can be used in a school's calculation of its Primary Reserve Ratio:
  - it "must include a disclosure in the financial statements that the debt, including lines of credit exceeds twelve months and was used to fund capitalized assets (i.e. property, plant and equipment or capitalized expenditures per Generally Accepted Accounting Principles (GAAP)). The disclosures that must be presented for any debt to be used in adjusted equity include the issue date, term, nature of capitalized amounts and amounts capitalized."
  - The debt obtained for long-term purposes will be limited to only those amounts disclosed in the financial statements that were used to fund capitalized assets.
- The new definition states that "any debt amount including long-term lines of credit used to fund operations must be excluded from debt obtained for long-term purposes."

2016 BDTR Rule – implementation plan

- Court ruling imminent
- Time needed to implement the 2016 Rule
- ED staffing issues
- Period of effectiveness
- ED approach to enforcement

GAINFUL EMPLOYMENT

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A little history lesson on Gainful Employment…

- First GE Rule was published in 2011, but was challenged by APSCU (now CECU) in court, and invalidated
- Second GE Rule was published in 2014 and became effective in July 2015
- First data reporting conducted in 2015 and has been required every year since
- First round of debt-to-earnings rates were published in January 2017
- ED has delayed implementation of numerous provisions of the rule, including extending the time period for appeals (from April 2017 to February 2018), and delaying the personal delivery, and publication in all promotional materials, provisions until July 2019

A little more history on Gainful Employment…

- The first round of debt-to-earnings rates indicated the following:
  - Over 800 programs serving hundreds of thousands students failed the Department's accountability thresholds
  - Ninety-eight percent of these failing GE programs were offered by for-profit institutions
  - An additional 1,239 programs received a "zone" rate

A little more history on Gainful Employment…

- ED was sued in 2017 by the American Association of Cosmetology Schools based on concerns regarding earnings data. The Court finds for AACS and orders ED to adjust the earnings appeal process for the plaintiffs.
- Instead, ED amends the process for all schools and delays implementation of the appeal process.

A little more history on Gainful Employment…

- The majority of failing programs filed an intent to appeal, which delayed the required student warnings until an appeal could be submitted and reviewed by ED.
- Because ED delayed the deadline for reviewing earnings appeals, there are still appeals that have not been completed and for which final rates have still not been issued.

A little more history on Gainful Employment…

- ED was sued by the Attorneys General of 17 states, and D.C. over its delay in implementing certain aspects of the GE Rule
- The AG suit uses the same legal theory in the GE case as it used in the BDTR case. It is possible that the Court could also take the same action in the GE case, requiring that ED implement the delays elements of the rule, regardless of the status of the new rule. That case is currently still in the motion and briefing stage.
- It is unclear what impact, if any, the AG lawsuit will have on the existing GE rule.

What has ED done with GE lately?

- ED issued the student completer lists necessary to calculate a second round of debt-to-earnings rates in April 2018, with a June deadline for challenges.
- No draft GE debt measures reports have been issued by ED.
- Note that in 2016, the student completer lists were issued in May with a July challenge deadline, and the debt data was issued in October with a December challenge deadline.

MORE BREAKING NEWS…

- In August 2018, ED issued an NPRM for a new version of the GE rule with the following Federal Register language:

  As discussed in more detail later in this notice of proposed rulemaking (NPRM), the proposed regulations would rescind the GE regulations and remove them from subpart Q of the Student Assistance and General Provisions in 34 CFR part 668.

- HOWEVER – On October 3, 2018, ED reported that it will not be ready to publish the final rule by November 1, 2018 for a July 1, 2019 implementation – meaning the existing rule is likely to remain effective until July 2020.

GE - now what?

- ED is indicating it believes it will publish the new GE rule before the end of 2018. ED may be considering whether they can use the “early implementation” option in the HEA, but that that provision is rarely ever used. Unclear if that will pass internal review.
- ED has indicated that its agreement with SSA has lapsed, so it cannot currently publish the second round of debt-to-earnings (D/E) rates; however, the delay may result in that agreement being made a priority.
- If ED and SSA reach a new agreement, it is likely that a new set of D/E rates could be published before 2020.
- It is assumed that the same group of AGs will again sue ED (or perhaps amend their existing suit) over the rescission of the GE Rule. There has already been much written in the press indicating the AG’s likely position that ED’s reasoning for the proposed rule is not supported by data (which, ironically, is the same basis under which CECU won its original GE challenges, and the reason ED is giving for its delay.)

What do you do now?

Prepare.

And then wait.

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Questions?

Further information:

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