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Higher Education Alert

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With borrower defense claims on the rise, how should schools respond?

By Amy Spencer and Matthew Netti

Schools across the country are facing a steep increase in borrower defense to repayment claims—with little practical guidance from the Department of Education.

What's the impact?

- The Department of Education is processing borrower defense to repayment applications at an expedited rate—schools may challenge these claims in a number of ways.
- The Fifth Circuit has scheduled oral argument on the borrower-friendly 2022 BDR Rules on November 6, 2023.

As part of a settlement agreement approved in the Northern District of California in *Sweet v. Cardona*,[1] the Department of Education (ED) has been processing a backlog of student loan borrower defense to repayment (BDR) applications and sending notice to educational institutions of the claims against them. Although largely dormant until recently, BDR has existed as a creature of regulatory creation since the mid-90s when it was enacted as a guardrail to allow

[1] *Sweet v. Cardona*, No. C 19-03674 WHA (N.D. Cal.).

borrowers subject to identified institutional misconduct to seek forgiveness of their federal student loans.[2] Students seeking loan forgiveness apply for a BDR discharge through Federal Student Aid by filling out an application that asks for information about the borrower, the institution, and the borrower's allegations against their educational institution.

Per the regulations, institutions are not required to respond to a BDR application notification, but for the school, responding may go a long way in contesting the merits of the claim. Under the current rules, adopted in 2022 but currently stayed by a nationwide injunction issued in the Fifth Circuit,[3] institutions have 90 days to respond following notification of a BDR claim. If an institution fails to respond timely, ED presumes the institution does not contest the claim. However, if ED rules in the claimant's favor, in a separate proceeding, ED may seek recoupment of damages from the institution.

Schools across the country that have never seen BDR applications before, suddenly confronted with allegations of misconduct, are left to decide whether to respond to the applications and, if so, how, with little help or guidance from ED.

The 1994 Rule

The borrower defense program was created in 1994 as a way for students to attempt to discharge and recoup loans when schools violated the law but was rarely used. Under the 1994 Rule, to assert a BDR claim, a borrower must demonstrate by a preponderance of the evidence an

> act or omission of the school . . . that relates to the making of the loan for enrollment . . . or the provision of educational services for which the loan was provided that would give rise to a cause of action against the school under applicable State law . . . .[4]

The borrower may submit their claim at any time; however, the statute of limitations on a recoupment action is the latter of "(i) [t]hree years from the end of the last award year in which the student attended the institution; or (ii) The limitation period that State law would apply to an action by the borrower to recover on the cause of action on which the borrower defense is based."[5]

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[2] *See* 20 U.S.C. 1087e(h); 34 C.F.R. § 685.206(c)(1).

[3] See *Career Colls. & Schools of Texas v. Cardona*, No. 23-50491 (5th Cir. Aug. 7, 2023).

[4] 34 C.F.R. § 685.206(c)(1).

[5] *Id.* at § 685.206(c)(3), (4).

2022 *Sweet* Class Settlement

After the program's inception in 1994, applications picked up during the Obama administration, but many BDR applications remained unresolved by ED for years. In 2016, to address the growing concerns of educational institutional wrongdoing and student debt, the Obama administration enacted new regulations and created a Borrower Defense Unit to address the backlog of unresolved applications.[6] However, the process rate decelerated again under the Trump administration, eventually coming to a complete halt as ED worked to enact revised regulations.[7]

In 2018, in response to ED's inaction, students filed a purported class action against the Secretary of ED to fulfill the agency's duty to process BDR applications. "As of June 2019, borrowers had filed 272,721 total applications, 210,168 of which remained pending."[8]

In 2022, the parties reached a settlement agreement, approved by the federal court, which practically granted approximately 200,000 borrowers who attended 151 named educational institutions and filed applications before June 22, 2022, complete discharge of their loans. For borrowers who attended other schools but whose BDR applications were filed before June 22, 2022, the settlement provided a streamlined process based on the 2016 Rules for adjudicating these remaining claims. ED agreed to decide on outstanding borrower defense applications no later than July 28, 2025. And "If ED doesn't issue a decision within this time period, the borrowers will receive Full Settlement Relief."

Most schools are now receiving notice of BDR applications filed by what the settlement termed "post-settlement-class" applicants, having filed their applications between June 22, 2022, and November 15, 2022. Generally speaking, the settlement provided for these applications to be decided under the 2016 Rules as written but requiring a response within sixty (60) days. Like the settlement class applications, if ED fails to act on these applications by January 28, 2026, the borrowers receive full, automatic relief. However, for both sets of applicants, full relief in this context does not constitute a finding of misconduct against the school and does not authorize ED to initiate a recoupment proceeding.[9] As ED attempts to adjudicate outstanding borrower defense applications pursuant to the *Sweet* settlement, schools across the country are being notified of applications against them at an increased rate, with one school having reported receiving 80 ED notifications in a day.

As the *Sweet* settlement provided, ED will process post-settlement-class applications under the 2016 BDR Regulation. To state a claim under the 2016 Rules, a borrower must show, by a preponderance of the evidence, one of the following:

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[6] 81 Fed. Reg. 75,926 (Nov. 1, 2016).

[7] 34 C.F.R. § 685.206(e).

[8] *Sweet v. Cardona*, No. C 19-03674 WHA, 2023 WL 2213610, at *1 (N.D. Cal. Feb. 24, 2023).

[9] *See Sweet v. Cardona*, No. 19-cv-03674 (N.D. Cal.), Decl. of Benjamin Miller at 5, ¶ 9.

- A claim under the 1994 Rule;
- A judgment against the school;
- A breach of contract by the school; or
- A substantial misrepresentation by the school.

After formally granting a BDR application under the 2016 Rules, ED may initiate recoupment proceedings against the institution:

- Within the six-year period applicable to the breach of contract or substantial misrepresentation sections;
- At any time if the borrower obtained a judgment against the school; and
- At any time if the school received notice of the claim during the six-year period.[10]

2022 Rule Change

In 2022, the Biden administration enacted a more borrower-friendly standard for granting BDR applications—rendering poorly defined "[a]ggressive or deceptive recruitment conduct or tactics" as an "actionable act or omission" by an institution and setting a "totality of the circumstances" standard used by ED when considering circumstances that warrant relief.[11] After a trade association in Texas sued the Biden administration arguing that the rule changes exceeded the agency's authority and were unconstitutional, the Fifth Circuit enjoined the 2022 Rules pending oral argument scheduled for November 6, 2023.[12]

Additionally, since Republicans regained the majority in the U.S. House of Representatives, the House Committee on Education and the Workforce has been actively pursuing documents and data regarding borrower defense repayment claims, reportedly primarily pertaining to the settlement in *Sweet v. Cardona*, including issuing a subpoena "for documents and information on borrower defense to repayment of student loans," on October 31, 2023, calling for production "no later than November 14, 2023."

What's next?

The Supreme Court set the stage for what schools are now experiencing when it issued its decision striking down the Biden administration's student loan forgiveness plan.[13] The Biden administration's attention has now shifted to BDR applications as a means to achieve forgiveness

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[10] *See* 34 C.F.R. §§ 685.222(a)-(e); 668.71; 668.75.

[11] *See* 34 C.F.R. §§ 685.401, 403, 407, 409; 668.50.

[12] *See Career Colls. & Schools of Texas v. Cardona*, No. 23-50491 (5th Cir. Aug. 7, 2023); Douglas-Gabriel, Danielle, "Appeals court halts new Biden rules on debt relief for defrauded students," *The Washington Post* (Aug. 7, 2023).

[13] *Biden v. Nebraska*, 143 S. Ct. 2355 (2023).

of student loans post *Biden v. Nebraska*, with ED beginning to process applications at an expedited rate to comply with the *Sweet* settlement. However, arguably, if the Fifth Circuit lifts its injunction, the 2022 Rules may subsume all the pending BDR applications.[14] This increased agency action under an uncertain regulatory framework has left educational institutions puzzled as to next steps. In response, schools may be able to challenge these applications facially, as barred by the applicable statute of limitations, and on the merits. We will continue to monitor and report on ED's approach to BDR applications and are happy to assist schools in considering possible responses to ED.

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[14] *See* 34 C.F.R. §§ 685.400, 401, 403, 407, 409; 668.501.