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FACSIMILE TRANSMISSION COVER PAGE

DATE: 3/12/93 TIME: ________ DESTINATION FAX: 202-456-2557

FROM: Betsy Imholz ORIGIN FAX: 415-563-7859

TO: Shirley Sagawa

ATTN: ________

RE: Dept. of Ed. national promissory note

SPECIAL INSTRUCTIONS AND/OR MESSAGE:

Shirley - Attached is a note I faxed to Ellen V. and a letter from the National Consumer Law Center explaining the issues. The timing is so short that the coalition may not be able to act on this. We are approaching it from other angles as well, including the higher education community; we also seem to have a sympathetic and thoughtful ally in Maureen McLaughlin, Acting Secty of Postsecondary Ed.

Nevertheless, I thought you might be interested.

Take care!

Betsy

Number of Pages (Including this Cover Page): 7

March 12, 1993

Ellen-

I've been getting calls all morning and thus have not been able to compose a "sign-on" letter. I think the letter to Secty Riley should be brief, but also want to give coalition members enough background on which to make an informed decision whether to sign on. The attached letter from the National Consumer Law Center to Riley sums it up quite nicely. My suggestion would be to fax the NCLC letter to coalition members with your memo including a paragraph along these lines:

> On Tuesday, March 16, 1993, the Secretary of Education intends to finalize ~~approve~~ a standardized, national student loan application and promissory note for the 1993-94 school year, as required by the Higher Education Act amendments of 1992. The coalition would like to submit a letter to the Secretary advocating three issues of importance to low-income students raised by the proposed promissory note: (1) including in the promissory note the Federal Trade Commission "Holder Rule" notice, as required by federal law, to provide protection for trade school students whose school has a close relationship with the bank making the loan; (2) excluding a provision that would allow guaranty agencies to sue student borrowers in default on their loans in the city where the guaranty agency is located (which may mean a New York student having to defend a lawsuit in Indianapolis); and (3) excluding a provision that would, in the event of such a lawsuit, allow the guaranty agency's place of business to determine the body of law that applies.
>
> The enclosed letter to Secretary Riley from the National Consumer Law Center describes issues 1 and 2 above in greater detail. If you have questions about the three issues listed above, you may call Betsy Imholz, chair of our proprietary school subcommittee, at 415-563-7859 for further details. Please ~~let me know~~ call her to let her know by 5:00 EST p.m. Monday, March, 15 whether ~~I~~ she may add your organization's name to the list of signatories.

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(617) 523-8010

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March 4, 1993

The Honorable Richard W. Riley
Secretary of Education
U.S. Department of Education
ROB-3, Room 4181-A
400 Maryland Ave. SW
Washington D.C. 20202

Re: Pending Common FFEL Promissory Note Violates Federal Law and Fosters Trade School Fraud at Expense of Students and the U.S. Treasury

Dear Mr. Secretary,

I am writing on behalf of various low income clients around the country to bring to your immediate attention an action your Department is about to take that will not only foster trade school fraud and prove very costly to the U.S. Treasury, but is also in clear violation of federal law.

The Department is currently finalizing a common application and promissory note to be used for all FFEL's. Federal law requires that such a promissory note include the Federal Trade Commission "Holder Notice" where a student attends a for-profit school. (No such requirement exists when a student attends a for public or non-profit school.) This Holder Notice is a long-standing and essential consumer protection whenever consumers deal with any for-profit seller -- from car dealers to lawyers, - from trade schools to home improvement contractors. This notice is probably the most effective weapon the federal government has ever developed to counter fraud and compensate fraud victims.

The Department apparently is planning to violate this federal requirement because it is counter to the interests of for-profit schools, school lenders and guaranty agencies. Insufficient consideration is being given that compliance with this federal requirement is an essential safeguard for students attending trade schools and key to limiting the billions of dollars each year in trade school defaults. In fact, student representatives have not been included in the discussions concerning the common application and promissory note.

Department Action Would Violate Federal Law

The Higher Education Amendments of 1992 require that the Department enact a common FFEL application and promissory note. Federal law also requires that certain promissory notes contain the FTC "Holder Notice," a notice that states that the note holder is subject to all the student's school-related defenses.[1] I am concerned that the Department is considering a common application and promissory note that violates the FTC requirement.

There is no question that FFEL loans must comply with the Holder notice requirement. The enclosed February 11th letter from the FTC staff is about as clear a statement as you can find that the Holder Notice must be in the common promissory note whenever a student attends a <u>for-profit</u> school and that school <u>refers</u> the student to the lender or is <u>affiliated</u> with the lender by common control, contract, or any understanding, procedure, course of dealing, or arrangement, formal or informal.

The notice is thus not required for FFEL's involving public or non-profit schools, or even for-profit schools where the school has no special relationship with the lender. On the other hand, many FFEL promissory notes involving for-profit trade schools must contain the FTC Holder Notice.

Department Can Easily Accommodate FTC Holder Notice Requirement

Accommodating the FTC Holder Rule requirements can easily be accomplished in one of two ways. The Department either could approve two versions of the common form, one with the FTC Holder Notice and one without, or one common form that

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[1] The Federal Trade Commission Trade Regulation Rule Concerning Preservation of Consumers' Claims and Defenses, 16 Code of Federal Regulations 433, is commonly called the FTC Holder Rule. This Rule requires that promissory notes contain a specified notice stating that the note holder is subject to claims and defenses the borrower has against the seller (in the case of FFEL loans, this would be the school).

includes the notice with instructions to delete the notice where the FTC Rule does not apply.

I have been told the Department is considering rejecting both of these alternatives because they place too difficult a burden on financial aid administrators. This is an extraordinary conclusion. Non-profit and public schools would use one form without the notice for all their FFEL's. As for a for-profit school, it should know whether it is referring students to a lender or has a special business arrangement with a lender or not. The school uses one form if it does and another if it does not. It is hard to believe that all merchants in the country manage to comply with the FTC Rule, but that financial aid administrators at for-profit schools cannot. If that is the case, one wonders how they are allowed to administer other aspects of the FFEL program.

Compliance With FTC Holder Rule Will Limit Fraud and Default Losses

The federal requirement that certain FFEL's contain the Holder Notice is not a mere technical mandate. The FTC enacted the Holder Rule in 1976 to provide essential consumer protections for all consumers dealing with all kinds of for-profit sellers. For-profit schools are not so uniformly beyond reproach and so uniformly financially solvent as to merit special exclusion from the Rule. Compliance with the FTC Holder Rule will also lower FFEL default losses. Schools or closely related lenders will bear such losses instead of the U.S. Treasury. Lenders would also not pump money into clearly fraudulent and insolvent schools.

There is no merit to lender arguments that inclusion of the FTC notice will prevent students from obtaining loans to attend good for-profit schools. In effect, lenders are arguing that there are so many fraudulent and financially shaky for-profit schools participating in the program, that lenders would avoid loans to this whole sector of the program.

But the Holder Rule only applies to lenders who have special arrangements with for-profit schools. Who is better situated to handle this risk than these very lenders who are profiting from their special relationship with the school? If a lender is concerned that a school may engage in fraud or become insolvent, the Department should be delighted if the lender decides to end its special arrangement with that school. Moreover, if the lender has any suspicion about a school, and if it determines that existing surety protections are not sufficient, the lender, as a condition of its special relationship, can easily protect itself by requiring the school to establish a compensating balance account with the lender or an additional surety bond. That way the students, the lender, and the United States are all protected.

Proposed Venue Waiver Should Be Deleted From Promissory Note

While the failure to include the FTC Holder Notice is the major problem with the draft promissory note, there are other significant defects as well. For example, the draft promissory note includes a provision waiving the student's legal rights to a proper venue, allowing the guaranty agency to sue the student where the guaranty agency has its principal office. Consequently, a California resident could go to a California school, take out a loan from a California bank, and be sued on the loan in Indiana.

This provision conflicts with the federal Fair Debt Collection Practices Act, 15 U.S.C. 1692i, which requires that collection suits (at least by non-governmental collectors) be brought in the district where the note was signed or the student resides. The provision also violates fundamental notions of fair dealing in consumer transactions. See *Spiegel v. FTC*, 540 F. 2d 287 (7th Cir. 1976). The waiver may also be unconstitutional. See *Williams v. Illinois State Scholarship Commission*, 563 N.E. 2d 465 (Ill. 1990).

Choice of venue is not an academic matter. Students may have many valid defenses to a collection action -- that the student was entitled to a closed-school or a false certification write-off, that the school defrauded the student, that the loan documents were forged or altered, that the guaranty agency refused to enter into a reasonable and affordable payment plan, etc. A California student can hardly be expected to raise these issues in an Indiana court.

Concerns About Department's Process in Enacting a Common Form

There are serious questions about the process by which the Department is developing the common promissory note. The Higher Education Amendments of 1992 § 425(e) requires the Department to develop a common form in cooperation with "organizations involved with student financial assistance." The Department is apparently treating this language as grounds for *excluding* student representatives from the process. Ms. Elizabeth Imholz and Mr. Kenneth Babcock have devoted weeks of their time to participation as low income student representatives in the pending Department negotiated rulemaking on the 1992 Amendments, and they would be surprised to discover that they did not work for organizations involved with student financial assistance. Aren't student borrowers involved with student financial assistance?

I know that Ms. Imholz and Mr. Babcock have discussed the common application form with Mr. Bob Evans of your Department and provided him with detailed written comments. On behalf of various low income clients, I have also submitted several letters to the Department over the last several years about inclusion of the FTC Holder Notice in standard promissory notes. Nevertheless, the "negotiations" about the common FFEL application form have taken place solely with "the industry" -- banks, guarantors, and schools -- completely omitting student representatives.

Conclusion

In conclusion, the common application and promissory note will have an enormous impact -- on student rights, on the level of fraud among for-profit schools, and on default losses paid by the U.S. Treasury. The Department appears to be pressing ahead at great speed, without input from student representatives, toward a form that not only is bad public policy, but also that violates federal law.

It goes without saying that I would be delighted to provide any additional information that you need or meet with members of your staff. I would also appreciate receiving drafts of the common application and note that your Department circulates for comment.

Sincerely,

Jonathan Sheldon
Staff Attorney

cc. Ms. Madeleine Kunin
Mr. Michael Smith
Mr. Terry Peterson
Mr. Steven Winnick
Mr. James Thomas
Ms. Maureen McLaughlin
Ms. Elizabeth Imholz
Mr. Kenneth Babcock