Recently Commenced California Class Action May Impact Exposure Faced By Financial Institutions Involved With Federal Student Loans

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If your company is one of the many companies that participates in originating, guaranteeing or servicing student loans made under the Federal Family Education Loan Program ("FFELP") you should be aware of a recent putative class action filed in the United States District Court for the Northern District of California. In *Sharon Cheslow v. Wells Fargo Bank, N.A.*, 3:10-cv-593, defendant Wells Fargo Bank N.A. is alleged to have improperly capitalized interest on various types of FFELP loans in violation of numerous California consumer protection and false advertising laws. The putative class consists of residents and non-residents of California who borrowed FFELP loans from Wells Fargo.

According to U.S. Department of Education, approximately 95 million FFELP loans, including the Stafford Loan, the unsubsidized Stafford Loan, the PLUS Loan and the Consolidation Loan, were made from 2001-2009 for about $436 billion. (Click here for a listing of the top 100 originators of FFELP loans for FY09 AND FY08). The federal government serves as the ultimate guarantor of payment on FFELP loans. *See, e.g.*, 34 C.F.R. § 682.100. In certain instances, interest that accrues on FFELP loans can be capitalized. *See, e.g.*, 34 C.F.R. § 682.202(b).

To date, the exposure of companies participating in FFELP to lawsuits by loan borrowers has been limited by repeated holdings that the federal Higher Education Act ("HEA"), as amended, 20 U.S.C. §§ 1001-1155, of which FFELP is a part, does not provide borrowers with a private right of action. *See College Loan Corp. v. SLM Corp.*, 396 F.3d 588, 593 (4th Cir. 2005) (cataloging decisions). Second, it has recently been held that the HEA preempted a FFELP borrower's state breach of contract and statutory claims. *See Chae v. SLM Corp.,* 593 F.3d 936 (9th Cir. 2010). It is expected that both propositions will be tested in *Cheslow*.

It is also anticipated that Wells Fargo, relying on *Chae*, will contend that the HEA preempts the plaintiff's claims. The plaintiff may counter that *Chae* is inapplicable because her state law claims differ from those in *Chae*. The plaintiffs in *Chae*, FFELP borrowers, asserted California state law claims against their loan servicer for allegedly improperly calculating interest, assessing late fees and setting their loan repayment start-date. While the Ninth Circuit in *Chae* distinguished the Fourth Circuit's decision in *College Loan Corp.,* the plaintiff in *Cheslow* may attempt to argue that *College Loan Corp*. should steer the outcome on the preemption issue, not *Chae*. In *College Loan Corp.*, 396 F.3d at 599, the Fourth Circuit held that the HEA and regulations promulgated thereunder regarding FFELP did not preempt the breach of contract and other state law claims brought by a FFELP loan originator against other FFELP loan originators and servicers and that the plaintiff could rely on

violations of the HEA and related regulations to establish its state law claims against the defendants.

Wells Fargo may also try to limit the scope of the class by arguing that non-California residents cannot sue Wells Fargo on California state law claims in light of the restriction imposed by the Due Process Clause on the extraterritorially reach of a state’s laws.

Wells Fargo has not yet responded to the complaint; its response is due May 10th. We intend to monitor the docket and report on any developments.