**Issue Paper 1**

**Session 1: November 13-15, 2017**

**Issue:** Whether to establish a Federal standard for the purpose of determining if a borrower can establish a defense to the repayment of a loan based on an act or omission of an institution.

**Statutory cite:** §455(h) of the Higher Education Act of 1965, as amended

**Regulatory cite:** 34 CFR685.206(c)

**Summary of issue:**

Beginning with the Direct Loan program regulations issued in 1994, and as clarified in a Notice of Interpretation issued in 1995, the current borrower defense (BD) standard requires a Direct Loan borrower to establish the existence of an “act or omission” by the institution attended by the student that would give rise to a cause of action against the school under “applicable State law” to demonstrate a defense to repayment. In its 1995 Notice of Interpretation,[[1]](#footnote-2) the Department clarified that a BD claim would be recognized only if it was directly related to the loan at issue or the educational services for which the loan was provided. The regulation reads, in relevant part:

*In any proceeding to collect on a Direct Loan, the borrower may assert as a defense against repayment, any act or omission of the school attended by the student that would give rise to a cause of action against the school under applicable State law* [34 CFR 685.206(c)(1)].

The Department currently evaluates claims under this State law-based standard.

The HEA directs the Secretary to issue regulations in this area. The relevant section of the statute reads, in full:

*Notwithstanding any other provision of State or Federal law, the Secretary shall specify in regulations which acts or omissions of an institution of higher education a borrower may assert as a defense to repayment of a loan made under this part, except that in no event may a borrower recover from the Secretary, in any action arising from or relating to a loan made under this part, an amount in excess of the amount such borrower has repaid on such loan* [HEA § 455(h), 20 U.S.C. § 1087e(h)].

Questions for consideration by the committee include:

* Whether and how should the Department establish a uniform (“Federal”) standard, as opposed to a standard based on applicable State law, for evaluating BD claims?
* If we establish a Federal standard, what should serve as the basis for a BD claim?  Should the definition of misrepresentation that governs a borrower’s defense to repayment correspond to the definition that governs the Department’s own enforcement actions in 34 CFR 668.71?

* Should such a Federal standard be based on common law fraud as its definition? The Restatement (Second) of Torts defines fraudulent misrepresentation as: “One who fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation.” Restatement (Second) of Torts § 525 (1977).
* Should this Federal standard require a borrower to demonstrate a reasonable reliance on the act or omission causing injury to the borrower? Are there other definitions or requirements that could be considered?
* What should be the burden of persuasion for a borrower’s claim? In fraud cases, a majority of courts apply the clear-and-convincing standard of proof to the elements of a claim for fraud. Restatement (Third) of Torts: Liab. for Econ. Harm § 9 (tentative draft no. 2, 2014). However, for causes of action based on consumer protection law, some states have concluded that only a preponderance of the evidence is required. *See, e.g.*, Malooley v. Alice, 621 N.E.2d 265, 268 (Ill. App. 1993).
* What factors should the Department consider when determining the amount of relief a borrower should receive? Should the Department consider the borrower’s actions or circumstances when determining the amount of relief? Should the Department consider whether the borrower could have ascertained the truth without difficulty, inconvenience, or special skill?

1. <https://www.gpo.gov/fdsys/pkg/FR-1995-07-21/html/95-17988.htm> [↑](#footnote-ref-2)