The Department of Education (ED) and even state guaranty agencies hire private servicers to process student loan payments, keep track of the amount due, communicate with student loan borrowers, and work with the borrowers concerning repayment plans, deferments, deferrals, and discharges. Widespread reports allege servicers engage in deceptive, unfair, and grossly negligent practices, causing serious injury to student loan borrowers. When the borrowers seek to remedy these abuses, servicers with ED’s support argue the Higher Education Act (HEA) preempts borrowers’ state law claims.

Within the last few months the Seventh Circuit and a New York federal court have rejected these arguments and have allowed consumers to pursue state law claims against servicers for their abusive practices. See Nelson v. Great Lakes Educational Loan Services, Inc. [1], 928 F.3d 639 (7th Cir. June 27, 2019); Hyland v. Navient Corp. [2], 2019 WL 2918238 (S.D.N.Y. July 8, 2019).

Considering the millions of student loan borrowers and the widespread servicing abuses, this opens up an important avenue for borrower relief. Of special note, borrower claims cannot be forced into arbitration. Federal student loan agreements do not include arbitration clauses and servicers have no other way of obtaining a borrower’s assent to an arbitration agreement.

Federal Student Loan Servicer Abuses

Consumer Financial Protection Bureau, state attorney general, and private actions against Navient and other servicers include claims regarding servicers:

• Providing erroneous information about amounts due to repay;
• Processing payments incorrectly;
• Failing to respond to borrower communications;
• Providing confusing responses to borrower’s application for a lowered payment plan;
• Failing to offer or process borrowers’ payment plans to which borrowers were entitled;
• Steering borrowers to less favorable payment plans or deterring borrowers from obtaining better payment options;
• Allocating payments among a borrower’s multiple loans to maximize late payment fees;
• Inadequate or misleading statements on how to avoid late fees;
• Adding interest and late fees to loan balances during deferment periods when interest and late fees should not have been assessed;
• Adding late fees when payments were made within the grace period;
• Charging excessive late fees;
• Failing to correct inaccurate information sent to consumer reporting agencies;
• Failing to protect active duty servicemembers as required by law.

See NCLC’s Student Loan Law § 5.3 [3].

Critical Importance Whether Federal Law Preempts Borrowers’ State Law Claims Against Student Loan Servicers

The HEA governs the federal student loan program, but provides no direct private right of action. See NCLC’s Student Loan Law § 5.6.4.1 [4]. As a result, federal law is rarely a viable avenue for student borrower’s private action.

Instead, borrowers’ best claims against servicers often are those based on state law, such as unfair and deceptive acts and practices statutes (UDAP) or tort law. As described below, servicers argue with support from the Department of Education that the HEA preempts many such state claims. Nelson and Hyland take on great significance in rejecting this approach.

Any preemption analysis must consider field, express, and conflict preemption. Nelson and Hyland and other courts consistently hold that the HEA does not preempt the field of student loan borrowing. See NCLC’s Student Loan Law § 13.6.3.4.2 [5]. The following sections explain why express and conflict preemption should not apply to state law claims against servicers.

Seventh Circuit: No HEA Express Preemption of Affirmative Misrepresentation
Claims

Arguments that the HEA expressly preempts UDAP and other state law claims against servicers are based upon HEA § 1098g (20 U.S.C. § 1098g) which expressly preempts state “disclosure requirements” relating to federal student loans. Relying on Chae v. SLM Corp. [6], 593 F.3d 936 (9th Cir. 2010), servicers argue that a misrepresentation claim is just a failure to disclose claim in another guise, and that failure to disclose claims are preempted “disclosure requirements.”

As the Seventh Circuit in Nelson explains, this is an overly broad interpretation of Chae’s ruling. The plaintiffs in Chae alleged that they were misled as to the loan terms because the servicer computed interest using the daily balance method instead of using pre-computed interest. Importantly, the billing statements were silent as to the servicer’s method of computing interest so there was no affirmative misrepresentation as to the nature of the interest calculation.

Chae does not rule, as servicers and ED argue, that misrepresentation claims must be recast as a preempted disclosure claim. Instead, Chae found that it was the plaintiffs who had recast what was in essence a failure to disclose claim as a misrepresentation claim. Chae thus holds that certain failure to disclose claims are expressly preempted and that the plaintiff’s attempt to evade this by recasting the claim as an affirmative misrepresentation claim is to no avail. But Chae itself explicitly holds that claims whose essence is affirmative misrepresentation are not preempted, holding that there is no express preemption for claims based on the “use of fraudulent and deceptive practices” other than the interest calculation non-disclosure on the billing statements.

Nelson and Hyland similarly distinguish between claims based on false and misleading statements made voluntarily, not required by federal law (no express preemption) and failure to disclose information not otherwise required by federal law (express preemption). There is no express preemption where a servicer could have remained silent and not violated federal law, but instead makes false or misleading representations.

Student Loan Servicing Alliance v. District of Columbia [7], 351 F. Supp. 3d 26 (D.D.C. 2018) (“SLSA v. D.C.”) adds another reason that deception claims are not expressly preempted. SLSA v. D.C. finds that the HEA’s express preemption of state law disclosure requirements does not even apply to communications between borrowers and servicers, but only between borrowers and the owner of the student loan.

Conflict Preemption

State law claims can also be subject to conflict preemption if the state claim would create an obstacle to achieving the HEA’s congressional purposes. Nelson and Hyland reject conflict preemption as applied to UDAP claims against servicers. Nelson points out that the HEA contains five express preemption provisions—Congress considered what state law should be preempted and decided only on these five provisions. Moreover, there is no value for federal conformity as to claims involving deception. (In fact, there is a great amount of uniformity among states and the FTC Act as to what representations are deceptive.)

The earlier Ninth Circuit decision in Chae did find conflict preemption as to the borrower’s state law claims. But Nelson distinguishes Chae because Chae focused on the value of uniformity as to the method of setting late fees, repayment start dates, and interest calculations. This value of uniformity does not extend to affirmative misrepresentations not required by federal law.

The Department of Education (ED) in a March 2018 interpretation argues for broad conflict preemption of state servicer laws. 83 Fed. Reg. 10,619 [8] (Mar. 12, 2018). While that interpretation almost exclusively relates to state laws regulating and licensing servicers, servicers argue it applies also to state UDAP claims against servicers. Only one court, Lawson-Ross v. Great Lakes [9], 2018 WL 5621872, *3–4 (N.D. Fla. Sept. 20, 2018), has found the interpretation was entitled to any deference. Nelson, Hyland, and SLSA v. D.C. all declined to follow the interpretation. Specifically, Nelson finds ED’s interpretation “is not persuasive because it is not particularly thorough and it ‘represents a stark, unexplained change’ in the Department’s position.” Id. at note 2.

Winning State Law Claims

State UDAP claims are well designed to remedy student loan servicer abusive practices. Every state has a private right of action under its state UDAP statute that broadly prohibits deceptive and in most cases unfair or unconscionable practices. Attorney fees, actual damages, and either punitive, multiple, or minimum damages are typically available. See NCLC’s Unfair and Deceptive Acts and Practices Appendix A [10].
Nevertheless, some statutes exempt credit, debt collection or regulated companies, and, in these states, UDAP coverage to servicers may be an issue. See Hyland, where the court found that the New York UDAP statute applied to servicers, but not one of California’s two UDAP statutes.

UDAP statutes generally prohibit misrepresentations and material omissions. Nevertheless, as described above material omissions or failure to disclose claims are likely to run into express preemption concerns. This is a gray area which has not been fully resolved by the courts. On the other hand, Nelson and Hyland are persuasive precedent that a UDAP claim for affirmative misrepresentation is not preempted. To the extent possible, borrowers should provide factual details to demonstrate how their claims fall into the latter category.

The same distinction should be made with UDAP unfairness claims. An unfair practice claim will be preempted if federal law requires or permits the challenged practice and possibly if it is based on failure to disclose. Preemption should not be implicated if the unfairness relates to an abusive practice unrelated to disclosure.

For example, it should be an unfair practice for a servicer to refuse to grant a requested payment plan to which the borrower is entitled to by law. This does not conflict with a federal requirement, and it is not based on a failure to disclose. The servicer has clearly disclosed that it refuses to grant the payment plan.

Where a UDAP claim is unavailable because of scope issues with a particular state UDAP statute, then tort claims may provide an alternative. Examples might be fraud, misrepresentation, and negligence. Negligence claims though must show that the servicer owed the borrower a duty of care.

### State Law Claims That May Not Be As Successful

A number of states have enacted statutes regulating student loan servicers or requiring licensure of student loan servicers. Borrower claims can be brought under such a statute’s private right of action or by alleging that the servicer statute’s violation is a state UDAP violation.

Servicers are likely to argue these claims are subject to federal preemption. A federal district court in SLSA v. D.C. found the District of Columbia’s licensing scheme conflicted with ED’s delegated authority to contract with servicers. However, the SLSA court rejected most of the arguments raised by SLSA, finding only that D.C. licensure requirements might represent the District of Columbia “second-guessing” ED’s choice of contractors. The court’s decision should not be read to suggest that any state regulatory scheme is preempted.

Whether or not specific state regulation of servicers conflicts with the HEA or is expressly preempted should be a case-by-case determination. Importantly, courts generally have not been persuaded that the HEA reflects a congressional goal of “uniformity” that requires a broad preemption of state law. See SLSA v. D.C., Nelson and Hyland.

Breach of a fiduciary duty must show that the servicer has such a duty to the borrower. Creditors and servicers are often found not to have such a duty. To overcome this, the borrower will have to show that the servicer has undertaken a fiduciary duty to act or give advice for the benefit of its borrowers. See Hyland.

Unjust enrichment requires a showing that the servicer received something that does not belong to it and rightly belongs to the borrower. This may run into problems if the servicer passes on the payments to the federal government or to a guaranty agency. See Hyland.

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