Overview

After much controversy, significant changes to U.S. Department of Education regulations went into effect July 1, 2020, concerning the rights of student loan borrowers, including the right to obtain “borrower defense” and closed school discharges of student loans and students’ right to bring claims in court against their school. Issued September 23, 2019, the rules became effective on July 1, 2020. See 84 Fed. Reg. 49,788 (Sept. 23, 2019).

Pursuant to the Congressional Review Act, both Houses of Congress voted to rescind the rule changes, but the House failed to override the President’s veto [1]. A challenge by the New York Legal Assistance Group to the rule changes is pending. Case No. 1:20-cv-01414-LGS (S.D.N.Y.).


This article explains the significant student rights that change with the 2019 rule amendments—the borrower defense discharge, the closed school discharge, and the limits on school mandatory arbitration agreements. The article also explains which borrowers are and are not affected by these changes. Rights of students for loans taken out before July 1, 2020 are examined in detail in the new 2019 Sixth Edition of NCLC’s Student Loan Law [4]. All the changes enacted by the new rules will soon be added to that treatise’s digital version.

The Rule Changes Affect Three of Eight Rights to Cancel or Discharge Student Loan Indebtedness

The rule changes affect three of the eight current methods students have to cancel or discharge their student loans under current regulations. As detailed in NCLC’s Student Loan Law [4] the eight rights are:

- The closed-school discharge: school’s closure while the student borrower was still enrolled (§ 10.3 [5]);
- The false certification discharge: the school’s false certification of the student borrower’s eligibility for federal loans—including false certification due to forgery or identity theft (§ 10.4 [6]);
- The borrower defense discharge: the borrower’s defense to repayment based on certain types of school misconduct relating to the borrower’s recruitment, enrollment, or taking on of federal student loans (§ 10.6 [7]);
- The unpaid refund discharge: the school’s failure to pay a refund owed to a student borrower (§ 10.5 [8]);
- The borrower’s permanent and total disability (§ 10.8 [9]);
- The death of the borrower, or of the student for parent PLUS loans (§ 10.9 [10]);
- The borrower’s profession, such as teaching or military service in limited circumstances and public service jobs (§§ 10.10 [11], 10.11 [12], and 10.12 [13]); and
- Compromise and settlement (§ 7.6 [14]).

The Department’s new regulations change student rights under the first three of these: the closed school, false certification, and borrower defense discharges. Significantly, these changes only apply to loans issued after July 1, 2020, while largely leaving the prior regulatory scheme intact for loans issued before July 1, 2020.

Student Rights to Discharge a Loan Based on School Misconduct Depend on a Loan’s Issue Date

The Higher Education Act (HEA) specifies that, notwithstanding any other provision of state or federal law, the Secretary of the Department of Education shall specify in regulations when school misconduct may be asserted as a defense to Direct Loan repayment. 20 U.S.C. § 1087e(h). The Department issued rules in 1994, amended them in 2016, and amended them yet again with the new rule changes.

Each amendment changed the substantive eligibility standard that would apply to loans in the future. As a result, a student’s...
right to raise school misconduct as a defense to a student loan’s repayment depends on when the loan was issued. Loans issued before July 1, 2017 are governed by 1994 rule standards, 34 C.F.R. § 685.206(c). The 2016 rules added process provisions for all loans, 34 C.F.R. §§ 685.222(e–k), and added a new substantive eligibility standard for loans issued from July 1, 2017 until July 1, 2020. The most recent rules’ addition, 34 C.F.R. § 685.206(e), applies a new eligibility standard and application process for loans issued after July 1, 2020.

1994 Borrower Defense Standards and 2016 Procedures Applicable to Direct Loans Issued Before July 1, 2017

The 1994 Direct Loan borrower defense regulations provide that in regard to Direct Loans “the borrower may assert as a defense against repayment any act or omission of the school that would give rise to a cause of action against the school under applicable State law.” See 34 C.F.R. § 685.206(c); 59 Fed. Reg. 61,664 (Dec. 1, 1994). The 2016 rules also provided procedures to obtain relief where such defenses apply, 34 C.F.R. §§ 685.206(c)(2), 685.222(e–k), described below. It is unclear whether that process can apply retroactively if it restricts the relief the borrower would otherwise be eligible for under the standard.

2016 Borrower Defense Standards Applicable to Loans Issued Between July 1, 2017 and June 30, 2020

In 2016, the Department promulgated new borrower defense rules, not effective until October 16, 2018, and examined in detail in NCLC’s Student Loan Law § 10.6.2.3 [15]. Starting for loans issued after July 1, 2017 through June 30, 2020, the 2016 rules applied a new relief eligibility standard. 34 C.F.R. §§ 685.222(a–d). That standard is:

(1) The school made a substantial misrepresentation that the borrower reasonably relied on to his or her detriment in deciding to attend, or to continue attending the school, or in deciding to take out a federal loan; or
(2) The school breached a contractual promise; or
(3) There is a non-default, contested court judgment against the school in the borrower’s favor.

Under this standard, the relevant underlying school “act or omission” must “relate[] to the making of a Direct Loan for enrollment at the school or the provision of educational services for which the loan was provided.” See generally 34 C.F.R § 685.222(a). See also 81 Fed. Reg. 75,926 (Nov. 1, 2016). However, advocates should be aware that borrowers’ Master Promissory Notes may incorporate reference to the 1994 regulations’ state law standard, and advocates may be able to argue the state law standard governs if it provides greater access to relief.

2016 Borrower Defense Procedures Applicable to All Direct Loans Issued Prior to July 1, 2020

The 2016 rules established a process to resolve all pending borrower defense applications and to determine how much relief those applications are entitled to, including for loans issued prior to October 16, 2018. See 34 C.F.R. § 685.222(e–k). The 2016 rules allow the Department to issue borrower defense discharges via individual application or via a Department-initiated group discharge. While the Department requested that students supplement their application with additional evidence, the Department issued discharges based solely on a borrower’s written testimony. The 2016 rules also proscribed how the Department would determine how much of a borrower’s loan would be discharged if their borrower defense application was granted. It is unclear whether that process can apply retroactively if it restricts the relief the borrower would otherwise be eligible for under the standard or if the borrowers’ Master Promissory Note references the 1994 state law standard.

2019 Borrower Defense Amendments Applicable to Direct Loans Issued After July 1, 2020

The 2019 rules establish a new eligibility standard and claims adjudication process for Direct Loans issued on or after July 1, 2020. The new rule leaves the prior substantive standards and processes set out in the prior rules in place for Direct Loans issued prior to July 1, 2020.
For Direct Loans issued on or after July 1, 2020, borrowers are eligible for relief if they substantiate through a sworn statement and other written evidence that:

1. The borrower submitted their claim within three years of leaving their school;
2. The borrower relied upon a “statement, act, or omission by an eligible school to a borrower that is false, misleading, or deceptive” that “directly and clearly relates to enrollment or continuing enrollment at the institution or the provision of educational services for which the loan was made”;
3. The borrower demonstrated that the school made the misrepresentation with “knowledge of its false, misleading, or deceptive nature or with a reckless disregard for the truth”; and
4. The borrower demonstrated that they suffered “financial harm” in the form of “monetary loss” as a result of the school’s misrepresentation, beyond the loss of incurring a borrowing a federal student loan obligation.

See generally 34 C.F.R. § 685.206(e). The new rule offers a non-exhaustive list of what may constitute a borrower defense, such as where a school’s marketing materials are “materially different” from the school’s reality or where the school misrepresents endorsement from third parties or approval by accreditors.

The new rule requires that borrowers provide written evidence beyond their own testimony to establish that the school made a misrepresentation. See 84 Fed. Reg. 49,817–49,818 (Sept. 23, 2019). Claims based on verbal misrepresentations will be looked at with skepticism. See 84 Fed. Reg. 49,807 (Sept. 23, 2019). Sources of evidence of school misconduct are suggested at NCLC’s Student Loan Law § 10.4.2.6, [16]

The 2019 rules also list what cannot establish a borrower defense:

- A violation of the other borrower defense standards unless the claim otherwise fulfills the 2019 standard;
- A claim that fails to “directly and clearly relate to enrollment or continuing enrollment at the institution or the provision of educational services for which the loan was made”;
- A claim relating to the “general quality of the student’s education”;
- Academic disputes or disciplinary matters, personal injury, sexual harassment, a violation of civil rights, slander or defamation, property damage, or informal communications from other students; or
- A breach of contract, unless the school’s conduct would otherwise violate the 2019 federal standard.

See 34 C.F.R. § 685.206(e)(5).

Unlike the prior rules which do not require demonstration of individual harm as a prerequisite, the 2019 rules require that borrowers show they were financially harmed by their school and troublingly that taking out a loan without anything more does not establish financial harm. Furthermore, unemployment only counts as financial harm if it is not “predominantly due to intervening … economic or labor market conditions” and the borrower has shown that their unemployment is involuntary. Personal injury, inconvenience, aggravation, emotional distress, pain and suffering, punitive damages, or opportunity costs do not count as financial harm. See 34 C.F.R. § 685.206(e)(3), (4).

The 2019 rules also eliminate the ability to bring claims as a group or for the Department to initiate claims for a group; applications must be from and for an individual only. The 2019 rules also make the Department’s consideration of agency-held school-related evidence discretionary instead of mandatory. Compare 34 C.F.R. § 685.206(e)(9)(ii), with 34 C.F.R. § 685.222(e)(3)(i).

Complicated Picture Concerning School Use of Mandatory Arbitration Agreements

Prior to the new rules going into effect on July 1, 2020, the Department of Education’s rules strictly limited schools’ use of mandatory arbitration terms. The 2016 rule made a school’s receipt of Title IV Direct Loans contingent on the school’s abandonment of arbitration agreements and class action waivers, at least insofar as legal claims concerning the school’s acts or omissions regarding the educational services for which the Direct Loan was obtained or the school’s actions in making the loan itself. 81 Fed. Reg. 75,926 (Nov. 1, 2016) (adding 34 C.F.R. § 685.300(d)–(i)).

Although that rule was not effective until October 16, 2018, significantly, it applies to arbitration requirements found in enrollment agreements entered into even before that date. On October 16, 2018, the arbitration regulations went into effect
and schools were required to notify current students subject to arbitration agreements with the school that the school would not compel arbitration of claims that could be raised as a borrower defense, and would not enter into a pre-dispute arbitration agreement with students pertaining to claims that could be raised as borrower defenses.

Consequently, schools complying with Department rules should have informed any student who either was accepted for admission or was currently enrolled during the period October 16, 2018 to June 30, 2020, that any arbitration agreement the student had with the school was not binding and the school could not enter into new arbitration agreements with any student during that time frame. See generally NCLC’s Student Loan Law § 14.4.6 [18].

Nevertheless, it is unclear the extent of school compliance and Department enforcement of these requirements. Also unclear is whether schools’ standard program participation agreements with the Department reflected the rule requirements.

The Department’s 2019 regulations, effective July 1, 2020, rescind these protections against mandatory arbitration and instead require only that schools provide a notice to prospective students of its use of arbitration agreements and class action waivers. See 84 Fed. Reg. 49,788, 49,933 (Sept. 23, 2019) (removing paragraphs 34 C.F.R. § 685.300(d)–(i)). The new rule just requires a written description of the arbitration process the student is to follow, and an explanation of how and when an arbitration requirement or class action waiver applies. 34 C.F.R. § 685.304(a)(6)(xiii)–(xv).

The new rule also limits a school’s right to require a student to resort to arbitration or any form of informal dispute resolution prior to the student filing a borrow defense application with the Department. The school also cannot, in any way, require students to limit, relinquish, or waive their ability to file a borrower defense claim. 34 C.F.R. § 668.41(h)(1)(i).

Practical Implications of Varying Rules on School Arbitration Requirements

The varying rules on mandatory arbitration create a confusing situation. This section only discusses the implication of Department rules. The regulations create the following practical considerations for advocates and students:

(1) Students who were no longer enrolled in school as of October 16, 2018—when the Department was ordered to put the arbitration regulations into effect—may be subject to a mandatory arbitration agreement, but only if the school can produce an agreement and show that the student consented to the agreement.
(2) Students who attended school at any time during the October 16, 2018 to June 30, 2020 period should have received a statement that any arbitration agreement was not effective. If they did receive this notice, then no arbitration agreement is effective unless after July 1, 2020, the student entered into a new agreement to arbitrate. Schools may have difficulty doing so if the student is no longer in attendance because the school cannot unilaterally impose such a requirement without the now former student’s consent, though advocates should still carefully review enrollment agreements as the extent of school compliance is unclear.
(3) Schools should not have included arbitration agreements limiting students’ right to litigate borrower defense claims in court in the period between October 16, 2018 and June 30, 2020. Thus, students who only attended the school during this period should not be subject to arbitration.
(4) Any arbitration agreement entered into after July 1, 2020 may be enforceable, but the school must also comply with the new rule requirements discussed above.

However, advocates should also consider other grounds to challenge an arbitration agreement as examined in detail in NCLC’s Consumer Arbitration Agreements [19] (e.g., the contract was unconscionable, never validly consummated, or waived).

The Closed School Discharge for Student Loans Issued Prior to July 1, 2020

Student loan borrowers have a statutory right to a full loan discharge if the student could not complete their educational program because of school closure (defined as ceasing to provide instruction in all programs). The closed school discharge is of particular import for students who attended for-profit schools. For example, from 2014 to 2018 over 450,000 students were in attendance at for-profit schools that closed. However, regulations have narrowed who is eligible to exercise their right to a closed school discharge. The closed school discharge applies to FFEL, Direct, and Perkins loans and also to Parent PLUS loan if the student on whose behalf the loan was taken out qualifies.

The discharge right applies where the branch of the school the student attended closes, even if other school locations remain open.
A student who has completed or is in the process of completing their program, via teach-out, or by transferring one or more credits to the same or comparable program at another school is ineligible for a discharge. For more detail about all aspects of the closed school discharge, see NCLC’s Student Loan Law § 10.3 [5].

Three Changes to the Closed School Discharge Rules for Loans Issued After July 1, 2020

The new rules make three changes to the closed school discharge for loans issued after July 1, 2020. The most significant is that the new rules eliminate an automatic closed school discharge for all schools that close after July 1, 2020. See 34 C.F.R. § 685.214(c)(3)(ii). Instead, students will have to apply individually for the discharge.

For loans issued before July 1, 2020, the Department could automatically discharge student loans if the school closed after November 1, 2013 and certain other conditions were met. See U.S. Dep’t of Educ., Electronic Announcement, Closed School Discharge Changes (Dec. 13, 2018) [20]. Between when the Department began implementing automatic closed school discharges in December 2018 and January 2020, the Department processed over 30,000 automatic closed school discharges.

Second, under the old rules, if a student opted-in but later dropped out of a teach-out program at the closed or other school before completing his or her program, the student would still be eligible for a closed school discharge. This right for loans issued after July 1, 2020 only applies if the teach-out does not “materially meet the requirements of the approved teach-out plan.” See 34 C.F.R. §§ 214(c)(2)(i), (ii), 84 Fed. Reg. 49789, 49852-53, 49,898 (Sept. 23, 2019).

The third change is more generous for loans disbursed after July 1, 2020. Under the prior rules, borrowers were eligible for a closed school discharge if they withdrew from their school not more than 120 days from the school’s closure date. Under the new rule, borrowers are eligible for a closed school discharge if they withdrew from their school not more than 180 days before the school’s closure date. Both the old 120-day and the new 180-day periods can be extended in exceptional circumstances, but the rules differ as to their definition of exceptional circumstances. Compare 34 C.F.R. § 685.214(c)(1)(i)(B), with § 685.214(c)(2)(i)(B).

Changes to the False Certification Discharges For Loans Issued After July 1, 2020

Borrowers are entitled to a loan discharge if they received at least part of an FFEL Program loan or Direct Loan after January 1, 1986, and if their eligibility to borrow was falsely certified by the school. 20 U.S.C. § 1087(c). The Department of Education recognizes that a school falsely certified a borrower’s eligibility to borrow loans in a variety of ways, including (1) non-compliance with eligibility requirements for students who do not have a high school diploma or equivalent; (2) the student was ineligible for employment in their state based on a disqualifying condition; or (3) the borrower’s signature was forged or the borrower’s identity was stolen. 34 C.F.R. § 685.215 (Direct Loans). See also 34 C.F.R. § 682.402(e) (grounds for FFEL loans false certification discharges). The 2019 rules rescinded some of the ways borrowers with loans issued after July 1, 2020 could show they are eligible for discharge. See 34 C.F.R. § 685.215(e).

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