No. 99-540

In the Supreme Court of the United States

EDDIE BARTELS, ET AL., PETITIONERS

v.

RICHARD RILEY, SECRETARY OF EDUCATION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether a federal student loan program, which has since been modified, but which, at the time pertinent here, provided that a borrower could use school misconduct as a defense against a lender only if the lender had an "origination relationship" with the school, preempts a state law allowing a borrower to use the school's misconduct as a defense against the lender under a broader set of circumstances.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-13a) is unpublished, but the judgment is noted at 189 F.3d 483 (Table). The opinion of the district court (Pet. App. 14a-29a) is reported at 918 F. Supp. 1565.

JURISDICTION

The judgment of the court of appeals was entered on June 29, 1999. The petition for a writ of certiorari was filed on September 27, 1999. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Guaranteed Student Loan Program (GSLP) was established by Congress as part of the Higher

Education Act of 1965 (HEA), 20 U.S.C. 1071 *et seq.*[1] The GSLP encourages private lending to students who would otherwise be unable to finance their educations by offering private lenders federal subsidies and a loan guarantee backed by federal reinsurance. The GSLP also encourages student loans by facilitating the purchase of the loans in the secondary market. Those purchases provide primary lenders with cash to make additional loans.

During the 1980s, the Department of Education encouraged lenders to make GSLP loans, in part by limiting lender exposure to defenses against collection efforts based on school misconduct. The Department considered a lender to be subject to such state-law, school-based defenses only if it had an "origination" relationship with the school (and in certain other limited circumstances not relevant here). See 34 C.F.R. 682.200, 682.206(a)(2) (1988); Letter from Acting Assistant Secretary Kenneth D. Whitehead to Hon. Stephen J. Solarz (May 19, 1988) (stating that "a student who borrows under the GSL program from a third party lender remains responsible for repaying the loan even if the school closes" unless an "origination relationship" exists between the lender and the school); 55 Fed. Reg. 48,327 (1990) (describing Secretary's "longstanding view" that, absent an "origination relationship" between the lender and the school, "a student who borrows under the GSL program from a third-party lender remains legally responsible for repaying the loan, even if the school fails to provide the

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[1] In 1992, the GSLP was renamed the "Federal Family Education Loan Program." We follow the court of appeals' practice of using the name of the program as it existed between 1988 and 1991 in our discussion. Pet. 3 n.1; Pet. App. 3a.

student with the services purchased by the student"); 34 C.F.R. 682.604(f)(2)(iii) (1989) (providing that students should be counseled that they cannot raise school-related defenses on a loan "other than a loan made or originated by the school"); Letter from General Counsel Jeffrey C. Martin to Hon. Edward M. Kennedy, (Oct. 4, 1991) (explaining Department's view that "banks should be afforded protection from potential liability under state law for school misconduct" except in "a few narrow circumstances"); 57 Fed. Reg. 60,304 (1992).

The Department's regulations defined origination as a "special relationship" arising where the lender delegated to the school "substantial functions or responsibilities normally performed by lenders before making loans." 34 C.F.R. 682.200(b) (1988); 51 Fed. Reg. 40,890 (1986). Not every relationship between a lender and a school constituted such a special origination relationship. To the contrary, a close relationship between lender and school was *mandated* by the HEA and regulations and practices implementing the GSLP. Pet. App. 21a. For example, at the time that the loans at issue in this case were made (1988-1991), the regulations specified that the student had to submit the loan application to the school (rather than the lender). 34 C.F.R. 682.102(a) (1988). With minor exceptions, the loan proceeds had to be disbursed directly to the school. 20 U.S.C. 1078(b)(1)(N) (1988). The school determined the period for which the loan was made, which affected the loan's interest rate, 20 U.S.C. 1077a(g)(2) (1988). The school was required to provide the lender with information regarding the student's eligibility for the loan, the student's enrollment, the estimated cost of the student's attendance, the student's estimated financial assistance, and a statement evidencing the school's

determination of the student's need for the loan under federal guidelines. 20 U.S.C. 1078(a)(2) (1988); 34 C.F.R. 682.603(b) (1988).[2]

Congress significantly amended the HEA in 1992. Of particular relevance here, Congress directed the Secretary to develop a uniform loan application form and promissory note for the program. Pet. App. 20a n.3; 20 U.S.C. 1082(m)(1). The uniform promissory note developed by the Secretary contained a clause that allowed a borrower to assert against a lender any claim or defense that the borrower would have against a for-profit school, if the school had "referred" the borrower to, or was "affiliated with," the lender, as defined in applicable regulations. Pet. App. 5a n.2, 20a n.3. Congress also authorized specific relief for students who had taken out loans for education after January 1, 1986, and suffered specific problems, such as inability to receive the anticipated education due to school closure. 20 U.S.C. 1087(c).

2. This case concerns loans made to petitioners between 1988 and 1991 to attend courses at the Riley Institute, a Georgia vocational school. Pet. App. 3a. Petitioners allege that the school made misrepresentations to induce them to take out GSLP loans and to enroll in its educational programs and then failed to provide the promised educational and job placement services. Petitioners sued the school as well as the Secretary of the United States Department of Education and three guarantee agencies which held petitioners' promissory notes after petitioners defaulted on their loans: the Higher Education Assistance Founda-

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[2] An additional requirement, that the school provide the lender with the loan's distribution schedule, was added in 1989. See 20 U.S.C. 1078(a)(2)(A)(i)(III) (Supp. II 1990).

tion (HEAF), the Georgia Higher Education Assistance Corporation (GHEAC), and the Student Loan Marketing Association (Sallie Mae). Petitioners asserted claims for fraud, breach of contract, ex delicto contract breach, negligence per se, and unfair trade practices. *Id.* at 2a-4a. Petitioners sought rescission of their loan contracts, declaratory and injunctive relief, actual and punitive damages, attorneys' fees and costs. *Id.* at 15a. The only claim relevant to this petition is petitioners' claim for a declaratory judgment that, because Riley Institute acted as an agent for the original lenders under Georgia law, the loans are subject to defenses arising from Riley Institute's misrepresentations. Pet. i, 3.[3]

The district court dismissed all of petitioners' claims. Pet. App. 28a-31a. With respect to the claim based on Georgia agency law, the district court found that the HEA *mandated* the close relationship between school and lender that formed the basis of petitioners' agency claims under Georgia law. Pet. App. 21a. For that reason, the court concluded that petitioners' claims based on that broad theory conflicted with the purposes and procedures of the HEA and were therefore preempted by federal law. Pet. App. 21a-22a.

In an unpublished opinion, the Eleventh Circuit Court of Appeals affirmed. The court reasoned that petitioners' claims under Georgia agency law "would penalize lenders for participating in the GSLP program

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[3] The Secretary was not a defendant with respect to that claim, which was count one of petitioners' complaint. See Pet. App. 15a. Throughout this brief, we use the word "respondents" to refer to the defendants with respect to that claim—namely HEAF, GHEAC, and Sallie Mae—even though the Secretary is technically a respondent to the petition for a writ of certiorari as well.

according to its express terms." Pet. App. 8a. Because that result would "stand[] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," the court of appeals held that petitioners' claims were preempted by federal law. *Ibid.* (quoting *California Fed. Sav. & Loan Ass'n* v. *Guerra*, 479 U.S. 272, 281 (1987)).

Petitioners now seek this Court's review of only the question whether federal law preempts application of a state law allowing a borrower to assert school fraud as a defense to loan collection based on an "agency" relationship between the lender and the school. Pet. i, 3.[4]

ARGUMENT

The decision of the court of appeals is unpublished and does not conflict with any decision of this Court or any other court of appeals. In addition, the question presented by the petition lacks substantial prospective importance because of intervening statutory and regulatory changes. This Court's review is therefore not warranted.

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[4] Petitioners specifically abandoned all other claims in their petition:

> Petitioners sought a declaratory judgment that, because of the school's role in arranging these loans, the loans are subject to defenses arising from the school's misrepresentations. The common law of Georgia, like that of other states, provides that, where a seller acts as agent for a lender in arranging financing to pay for the seller's goods or services, the lender may be held responsible for misrepresentations made by the seller. *Petitioners also presented alternative theories for raising these defenses, but these alternative theories are not included in this petition.*

Pet. 3 (emphasis added) (citations omitted).

1. During the time period in which the loans at issue in this case were made, the Department of Education considered a lender under the Guaranteed Student Loan Program (GLSP) to be subject to state-law defenses based on school misconduct only in a limited set of circumstances, such as when the school performed so many loan-related functions that it "originated" the loan. See pp. 2-4, *supra*. Acting pursuant to its authority to implement the Higher Education Act of 1965 (HEA), 20 U.S. 1071 *et seq.*, the Department weighed the relative importance of (1) protecting borrowers from liability for GSLP loans used to attend schools that did not deliver promised training to their students, and (2) encouraging private lenders to make GSLP loans by protecting them from defenses based on the schools' actions. The Department determined that to protect students, state-law school-based defenses should be available where a lender had a particularly close relationship (an "origination" relationship) with the school; but, to encourage lending, state-law school-based defenses should not be available in other circumstances. As we explain more fully in our brief in opposition to the petition for a writ of certiorari in *Armstrong* v. *Accrediting Council for Continuing Education and Training, Inc.*, No. 99-395, state laws that recognize defenses based on school misconduct in a broader set of circumstances are preempted because they stand as an obstacle to those federal objectives. That conclusion is fully consistent with this Court's precedents concerning conflict preemption. See, *e.g.*, *Hines* v. *Davidowitz*, 312 U.S. 52 (1941).[5]

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[5] As petitioners note (Pet. 1-2), the petition in *Armstrong* presents essentially the same question as the petition in this case. Petitioners have incorporated by reference (Pet. 5) the arguments

Petitioners argue (Pet. 3) that they are entitled to assert school-based defenses because an agency relationship (as defined by Georgia law) existed between the school and the lenders. According to petitioners, "agency" under Georgia law occurs whenever "a seller arranges a loan with a third party lender to pay for the seller's goods or services." C.A. Br. for Plaintiffs-Appellants 5; Pet. 3. Specifically, petitioners state that an agency relationship exists when a school procures a loan and obtains the student's signatures on all student loan documents. C.A. Br. for Plaintiffs-Appellants 5. If school-based defenses could be asserted whenever a school performed those activities, however, those defenses could always be asserted against GSLP lenders because the GSLP *required* a school participating in the program to undertake those activities.[6] That result would undermine the federal policy that school-based defenses should be available only in specified, limited circumstances. The court of appeals thus correctly rejected petitioners' contention that they could assert the Riley Institute's misconduct as a defense to repay-

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in support of the petition for a writ of certiorari in *Armstrong*. We likewise incorporate into our response in this case our arguments in response to the *Armstrong* petition.

[6] As noted in more detail at pages 3-4, *supra*, the statute required schools to provide information to students about loan availability and to lenders about a student's estimated cost of attendance, estimated financial assistance and loan disbursement schedule. 20 U.S.C. 1078(a)(2), 1092 (1988). Loan proceeds had to be paid directly to the school. 20 U.S.C. 1078(b)(1)(N) (1988). In addition, regulations required the student to submit the loan application to the school, not the lender. 34 C.F.R. 682.102(a) (1988). Regulations also provided for the school to complete forms and provide information to the lender as part of the loan process and prohibited the school from assessing fees for those services. 34 C.F.R. 668.12(b)(2)(iii), 682.603(b) (1988).

ment of their loans merely because an agency relationship existed under Georgia law between the Riley Institute and the lenders.

Petitioners are correct (Pet. 6, 7) that the court of appeals' reasoning is erroneous to the extent that it implies that the regulations permitting an origination relationship are the sole source of preemption (see Pet. App. 8a) or suggests that state-law defenses are preempted even if there was an origination relationship as defined by the regulations (see *id.* at 9a n.6). There is no need, however, for this Court to grant certiorari in order to correct any error that the court of appeals may have made, because the court of appeals' opinion is unpublished and thus "not considered binding precedent" under Eleventh Circuit Rule 36-2, and, as we explain below, there is no conflict or question of substantial continuing importance.

2. The decision of the court of appeals does not conflict with any decision of this Court. Petitioners incorrectly suggest (Pet. 6) that the decision conflicts with *Freightliner Corp.* v. *Myrick*, 514 U.S. 280 (1995), and *California Federal Savings & Loan Ass'n* v. *Guerra*, 479 U.S. 272 (1987). In *Freightliner*, the Court held that state tort law imposing liability for failure to install anti-lock braking systems (ABS) in tractor-trailers was not preempted, because there was no federal regulation in effect either requiring or prohibiting ABS systems in those vehicles and no evidence that the federal regulatory agency decided that the vehicles should be free from state regulation on the subject. 514 U.S. at 286-287, 289-290. The Court concluded that "[a] finding of liability against petitioners [automobile manufacturers] would undermine no federal objectives or purposes with respect to ABS devices, since none exist." *Id.* at 289-290. Similarly, in *Guerra*, the Court deter-

mined that the purposes of the federal Pregnancy Discrimination Act would not be frustrated if States provided employees with greater protection than the federal law. 479 U.S. at 292.

Here, in contrast, federal objectives would be thwarted by the application of Georgia law as proposed by petitioners. The Department of Education determined during the period at issue that lenders should be subject to defenses based on school misconduct only in limited circumstances, such as when the school had so significant a role in the lending relationship that it "originated" the loan. See pp. 2-4, *supra*. The objective of that federal policy was to promote widespread access to student loans. Application of Georgia agency law, which (according to petitioners) would apply in many situations where an origination relationship did not exist, would undermine the federal objective by creating much greater lender liability, thus discouraging GSLP lending.

There is also no basis for petitioners' assertion (Pet. 7-8) that preemption of Georgia law lacks a sufficient statutory or regulatory basis or conflicts with this Court's decisions in *Puerto Rico Department of Consumer Affairs* v. *Isla Petroleum Corp.*, 485 U.S. 495 (1988), and *Ray* v. *Atlantic Richfield Co.*, 435 U.S. 151 (1978). Those cases refused to find preemption from congressional and agency decisions not to regulate. Here, in contrast, preemption arises because application of Georgia agency law would undermine the objectives of the HEA as reflected in the roles of the school and the lender under regulations governing the GSLP.

3. There is also no conflict among the courts of appeals. Petitioners purport to identify only one such conflict, with *Veal* v. *First American Savings Bank*,

914 F.2d 909 (7th Cir. 1990). They contend (Pet. 2) that *Veal* "stated that state law defenses were not preempted by the Higher Education Act." Petitioners misread *Veal*. The district court in *Veal* had held that the state-law remedy of rescission *was* preempted by federal law. See 914 F.2d at 911; *Graham* v. *Security Sav. & Loan*, 125 F.R.D. 687, 692-693 (N.D. Ind. 1989). The district court had also held that plaintiffs failed to state a claim and that the HEA does not create a private right of action. *Id.* at 693. The court of appeals *affirmed* solely on the ground of failure to state a claim. 914 F.2d at 911. As a result, that court never addressed preemption.[7]

The other courts that have addressed similar questions have uniformly held that similar state-law, school-based defenses are preempted. *Armstrong* v. *Accrediting Council for Continuing Educ. & Training, Inc.*, 168 F.3d 1362, as amended, 177 F.3d 1036 (D.C. Cir. 1999), petition for cert. pending, No. 99-395; *Bogart* v. *Nebraska Student Loan Program*, 858 S.W.2d 78, 81 (Ark. 1993); *Morgan* v. *Markerdowne Corp.*, 976 F. Supp. 301 (D.N.J. 1997); *Crawford* v. *American Inst. of Prof'l*

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[7] The footnote from *Veal* on which petitioners apparently rely (see Pet. 22, *Armstrong*, *supra* (No. 99-385)), simply states that, "if sued by a Lender in state court for collection of one of these loans, each of these plaintiff students would be entitled to assert any defenses *available* under state law *that are applicable to his or her particular loan*." 914 F.2d at 915 n.7 (emphasis added). That footnote reflects the fact that the HEA does not preempt *the entire field* of loan defenses. Therefore, state-law defenses may be "available" to student debtors and "applicable" to the students' loans to the extent those defenses do not actually conflict with federal law. Thus, apart from the fact that the footnote was not part of the holding in *Veal*, it is consistent with the decision in this case.

Careers, 934 F. Supp. 335 (D. Ariz. 1996); *Tipton* v. *Secretary of Educ.*, 768 F. Supp. 540 (S.D. W.Va. 1991); see also *Williams* v. *National Sch. of Health Tech., Inc.*, 836 F. Supp. 273, 282 (E.D. Pa. 1993) (state law arguably allowing school-based defenses for certain forms of contracts inapplicable to student loan because federal statute governs form of student loan transaction), aff'd, 37 F.3d 1491 (3d Cir. 1994) (Table).

4. Finally, the question presented lacks substantial prospective importance because statutory and regulatory changes made in 1992 and later years eliminate the issue from more recent loans and provide alternative relief for many earlier loans. As a result of the 1992 amendments to the HEA, all GSLP loans issued during or after 1994 contain a clause allowing students to assert against the lender any defense that would have been available against the school if the school was "affiliated with" the lender or "referred" the student to the lender, as defined in applicable regulations. Pet. App. 5a n.2, 20a n.3. In addition, 20 U.S.C. 1087(c), enacted in 1992 and amended thereafter, provides for the discharge of a GSLP loan made in or after 1986 if the student is unable to complete a program due to school closure, the school falsely certified the student's eligibility, or the school failed to make a refund owed to the lender. Thus, the question decided by the court below is relevant only to the small number of cases in which a student asserts a state-law, school-based defense against the lender, the loan was made before 1994, and none of the bases for discharge listed in 20 U.S.C. 1087(c) is present. Because those circumstances are so narrow, further review is not warranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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