UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

TINA CARR and YVETTE COLON, Plaintiffs, v. ELISABETH DEVOS, in her official capacity as Secretary of the U.S. Department of Education; NAVIENT CORPORATION; NAVIENT SOLUTIONS LLC; NAVIENT CREDIT FINANCE CORPORATION; SALLIE MAE BANK; EDUCATIONAL CREDIT MANAGEMENT CORPORATION; JOHN DOE TRUST #1, f/k/a "Sallie Mae Education Trust"; JOHN DOE TRUST #2, a/k/a "Navient Federal Loan Trust"; JOHN DOE TRUST #3, a/k/a "Deutsche Bank ELT Navient & SLM Trusts," a/k/a "Deutsche Bank ELT SLM Trusts"; JOHN DOE TRUST #4, a/k/a "Bank of NY ELT SLMA Trusts"; and JOHN DOE INC. a/k/a "Navient," Defendants.	Case No.: 17-cv-8790 (KPF)

MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANT DEVOS'S MOTION TO DISMISS

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PRELIMINARY STATEMENT

Plaintiffs Tina Carr and Yvette Colon sought an education from Sanford-Brown Institute ("SBI") to advance their careers, but because they were cheated by the school and got no meaningful education, they were left with nothing but the crushing burden of student loan debts. These unpaid debts have caused them years of harm, continuing to the present day. Each month, their credit is further damaged and the balances on their loans mount as a result of accruing interest.

Ms. Carr's and Ms. Colon's student loan contracts, and federal statute and regulations, give them a defense to repayment of their federal loans where the school violated state law. SBI's misrepresentations to Ms. Colon, Ms. Carr, and many others did exactly that, as the New York State Office of the Attorney General ("OAG") concluded after an investigation and enforcement action. Three years ago, Ms. Carr and Ms. Colon each applied to the Secretary of the United States Department of Education (the "Department"), asking the Department to recognize their defenses. But even though Ms. Carr and Ms. Colon were among the first five of over one hundred thousand student loan borrowers to submit such requests, the Department has not ruled on their requests. Instead, it has continued to add interest to their balances and report negative information to credit bureaus.

Faced with no other options, Ms. Carr and Ms. Colon brought this action. They seek a textbook form of declaratory relief: an immediate adjudication of the validity of their contractual defenses, without having to await the Department's decision to initiate collection proceedings against them "at [its] leisure—or never." *City of Rome v. Verizon Commc'ns, Inc.*, 362 F.3d 168, 175 n.3 (2d Cir. 2004) (citation omitted).

The Department now asks the Court to dismiss these claims on three grounds, each of

which is flawed. First, the Department asserts that the Secretary is immune from this suit, but the Higher Education Act ("HEA") waives immunity for a declaratory judgment action like this one. Second, the Department argues that neither Plaintiff has stated a claim against the Secretary, but this ignores the nature of the declaratory remedy, which is based on the cause of action of the hypothetical future plaintiff—here, the Department itself. This argument is also inconsistent with applicable law and with the Department's own past conduct. Finally, the Department seeks dismissal for Plaintiffs' failure to meet an exhaustion requirement that simply does not exist and should not be invented.

Plaintiffs respectfully request that this Court deny the motion, giving Plaintiffs access to the judicial forum to which they are entitled, and which they desperately need.

BACKGROUND

I. Factual Background

A. Plaintiffs Colon and Carr Were Defrauded by SBI.

In 2006, Plaintiff Yvette Colon, who had worked for many years as a medical assistant and receptionist, decided to advance her career by becoming a cardiac sonographer. Am. Compl. ¶¶ 120−21. She met with an SBI representative at SBI's New York, New York campus, who falsely told Ms. Colon that SBI's cardiac sonography program was accredited and that if she attended SBI she would definitely get a job as a sonographer and would earn $50,000 to $60,000 per year. *Id.* ¶¶ 122−25. A different representative later told her that her SBI credits would be transferable. *Id.* ¶ 128. On the basis of these and other false representations, Ms. Colon enrolled at SBI and borrowed four Federal Family Education Loan program (FFEL) loans, totaling $14,838, and two private loans, totaling $21,095, to finance her attendance. *Id.* ¶¶ 126, 128−30, 137−39. Ms. Colon graduated from SBI in 2008 with a certificate in Non-Invasive

Cardiovascular Technology (Sonography). *Id.* ¶ 131. However, because SBI's program was not accredited, she could not sit for the licensing test that is a de facto requirement for employment in the field of sonography, and she could not transfer her credits. *Id.* ¶¶ 125, 129, 132−33, 136. Ms. Colon nonetheless diligently searched for a job as a cardiac sonographer, but was unable to find work in the field and eventually returned to a job in medical billing. *Id.* ¶ 135. Although Ms. Colon has paid thousands of dollars on her federal and private loans, she has been unable to meet her full debt burden, and her private loans have gone into default. *Id.* ¶¶ 149−50. As a result of carrying debt she cannot repay, Ms. Colon's dreams of owning a home have been dashed; she was only able to obtain a car loan at a very high interest rate; and her credit was severely damaged by adverse credit reporting. *Id.* ¶ 151.

After taking care of her mother during her cancer treatment, Plaintiff Tina Carr decided to pursue a medical career. *Id.* ¶ 87−88. She planned to become credentialed in medical assisting, then gain additional hands-on work experience and eventually become a registered nurse. *Id.* ¶ 90. In 2011, she met with an SBI representative at SBI's Melville, New York campus, who falsely told her that SBI had an 80% job placement rate (the actual rate was 26.1%), that if she attended SBI she would secure a job as a medical assistant, and that once she did, her future employer would likely pay for her further education, including a registered nursing program. *Id.* ¶¶ 93, 96−100, 107−08. The representative also misled Ms. Carr into believing that her credits would be transferable to a registered nursing program. *Id.* ¶¶ 101−02. On the basis of these and other false representations, Ms. Carr enrolled at SBI and borrowed six federal Direct student loans, totaling $14,576, to finance her attendance. *Id.* ¶¶ 103, 109−11. Ms. Carr graduated from SBI in 2012 with an associate degree in Medical Assisting. *Id.* ¶ 112. Despite graduating with a 4.0 grade point average, Ms. Carr was unable to find any job in the medical field. *Id.* ¶¶ 113−15.

Ms. Carr became homeless and took a job as a cashier at J.C. Penney in order to have a steady source of income. *Id.* ¶ 116. Ms. Carr's federal loans have gone into default because she has been unable to afford payments. *Id.* ¶ 118. As a result of carrying debt she cannot repay, Ms. Carr had her car repossessed and her credit severely damaged by adverse credit reporting. *Id.* ¶ 119.

Ms. Carr and Ms. Colon were not the only students SBI defrauded. The OAG found that SBI systematically made the same false and deceptive representations to numerous prospective and enrolled students—including inflated job placement rates, failure to disclose that many of its health services programs were not accredited, and misrepresentations about transferability of credits—and that these practices violated New York's consumer protection statute, General Business Law § 349. *Id*. ¶¶ 152−64.

B. Defendants Ignored Plaintiffs' Assertions of Their Defenses to Repayment.

Under the terms of Ms. Carr's and Ms. Colon's student loan contracts, SBI's violations of state law provide a defense to repayment of their loans that can be asserted against the entities that hold the loans. To assert their defenses under these provisions, in March 2015, Ms. Colon and Ms. Carr each wrote a letter to the Department of Education asking that the Department recognize SBI's misconduct as a defense to repayment of her federal student loans; Ms. Colon also wrote to "Navient" (which is, on information and belief, Navient Solutions, LLC). *Id.* ¶¶ 183, 186−87. Each of their submissions included a sworn affidavit setting forth the misconduct described above and voluminous exhibits, including OAG evidence documenting SBI's misconduct. *Id.* The Department has never responded to the substance of Ms. Colon's letter, and its response to Ms. Carr wrongly stated that a school's misrepresentations could not provide a legal basis for a borrower to be relieved of the obligation to repay her federal loans. *Id.* ¶ 184. Both Ms. Carr's and Ms. Colon's applications are currently "pending" with the Department. Dep't Mem. Supp. Mot. to Dismiss ("Dep't Mem."), ECF No. 60, at 2.

C. Plaintiffs Have Suffered, and Continue to Suffer, Harm.

Meanwhile, even as the Department has failed to resolve Ms. Carr's and Ms. Colon's applications, it has repeatedly harmed Ms. Carr and Ms. Colon by taking actions premised on their loans' validity. The Department incorrectly states that "there has been no attempt to collect against [Plaintiffs'] loans since their applications were filed." Dep't Mem. at 1. To the contrary, in the more than three years since they wrote to the Department to assert their defenses, both Ms. Colon and Ms. Carr have been subject to collection activity on their federal student loans. For two years after Ms. Colon filed her application, payments continued to become due on her federal loans each month; the Department accepted her payments in some of those months, and in months when she was unable to pay the full amount due, the Department added late fees to her total loan balance. *See* Declaration of Jessica Ranucci ("Ranucci Decl.") ¶ 4. In July 2015, Ms. Carr received a notice that the Department intended to collect on her loans through tax offset. Ranucci Decl. Ex. D.

Ms. Colon's loans are currently in forbearance, and Ms. Carr's loans are in stopped collections status, Am. Compl. ¶¶ 185, 188, but Defendants continue actively to harm both Plaintiffs in other ways. Critically, interest has been accruing, and continues to accrue today, on both Ms. Carr's and Ms. Colon's loans. The total balance of Ms. Colon's federal loans, for example, has increased by *nearly $4,000* since she first asserted her defense in March 2015, counting both late fees and interest. *See* Ranucci Decl. ¶¶ 4−5. And every month, Defendants report negative information on these loans to credit reporting agencies, further damaging Plaintiffs' credit. Am. Compl. ¶¶ 185, 188, 194−98.

II. Statutory and Regulatory Background

A. Borrowers Can Assert State Law Claims as Defenses to Repayment.

All FFEL and Direct loan promissory notes issued since 1994 contain provisions explicitly allowing the borrower to assert her school's violations of state law as a defense to repayment of her student loans (called a "defense to repayment" or "borrower defense"). *See* 81 Fed. Reg. 75926, 75938 n.6 (Nov. 1, 2016). FFEL master promissory notes—including Ms. Colon's—state:

> If a particular loan under this MPN is made by the school, or if the proceeds of a particular loan made under this MPN are used to pay tuition and charges of a for-profit school that refers loan applicants to the lender or that is affiliated with the lender by common control, contract or business arrangement, any lender holding such loan is subject to all claims and defenses that I could assert against the school.[1]

Direct Loan master promissory notes—including Ms. Carr's—state:

> In some cases, you may assert, as a defense against collection of your loan, that the school did something wrong or failed to do something that it should have done. You can make such a defense against repayment only if the school's act or omission directly relates to your loan or to the educational services that the loan was intended to pay for, and if what the school did or did not do would give rise to a legal cause of action against the school under applicable state law.

Federal regulations contain substantially similar provisions. *See* 34 C.F.R. § 682.209(g) (FFEL); 34 C.F.R. § 685.206(c)(1) (Direct).

It is well-settled that the same substantive standard governs borrowers' rights to assert defenses to repayment under the FFEL and Direct Loan programs, notwithstanding minor differences in the relevant language: A borrower may assert such a defense if her school violated state law. *See, e.g.*, 20 U.S.C. § 1087e(a)(1) (articulating a principle of parity between the two

[1] On April 18, 2018, after Plaintiffs filed their Amended Complaint, Plaintiffs' counsel received a response to their Privacy Act request seeking documents regarding Plaintiffs' loans. The master promissory note included therein contains slightly different language than that quoted in the Amended Complaint. *Compare* Ranucci Decl. Ex. A ("any lender holding such loan") *with* Am. Compl. ¶ 173 ("any holder of this Note").

programs); 60 Fed. Reg. 37768, 37769–70 (July 21, 1995) (no "significant[] differen[ces]" between legal standard of Direct and FFEL borrower defense provisions because both are based on state law).

The purpose of the defense to repayment provision is to prevent a creditor from profiting from a seller's illegal practices while insulating itself from the consumer's claims and defenses. It is based on the Federal Trade Commission's long-standing Holder Rule, 16 C.F.R. § 433.2, which requires a similar provision in certain consumer credit contracts because "the financier is in a better position" than "an innocent consumer" "both to protect itself and to assume the risk of a seller's reliability." 40 Fed. Reg. 53506, 53509 (Nov. 18, 1975); *accord* 41 Fed. Reg. 4496, 4499 (Jan. 29, 1976) (recognizing that preserving student claims and defenses against holders of federal student loan notes encourages those actors to "exercise a professional judgment about the school's capability of meeting its commitments to its student borrowers"). This rule has always been applicable to students who borrow federal student loans to attend for-profit schools. *See* Dep't Mem. at 6. It is the reason that Plaintiffs' loan notes, and the Departments' regulations, allow for defenses based on school misconduct. *See* 81 Fed. Reg. at 75956 & n.25 ("the Department's borrower defense regulation . . . was based upon the right of FFEL borrowers to bring claims and defenses, which in turn was adopted from the FTC's Holder Rule Provision"); Dep't Mem. at 5.

B. The Department Has Struggled to Implement Any Process for Resolving Borrower Defense Applications.

When Plaintiffs asserted their defenses in March 2015, they were among the first five borrowers to do so. *See* Dep't Mem. at 7. Since then, as major for-profit college chains have folded, more than 135,000 borrowers have submitted such applications to the Department. U.S. Dep't of Educ., Office of Postsecondary Educ., *Borrower Defense Claims: Data Analysis* at 3,

Ranucci Decl. Ex. G. Nearly three years ago, the Department recognized that "borrowers have a right to assert a defense to repayment claim," that "thousands of more claims" were likely to be submitted, and that "a clearer process for potential claimants" was needed. *See* Letter from James W. Runcie to Office of Management and Budget (June 4, 2015), Ranucci Decl. Ex. F. Nonetheless, the Department has made little progress in addressing these applications.

In fact, the Department has processed claims *only* from students who attended three specific schools: American Career Institute's Massachusetts campuses, ITT Technical Institute, and Corinthian Colleges. *See* U.S. Dep't of Educ., Office of Inspector Gen., *Federal Student Aid's Borrower Defense to Repayment Loan Discharge Process* (Dec. 8, 2017), at 10, 13, 16, *available at* https://perma.cc/9MVW-XR9W ("OIG Report"). There is no indication that the Department has begun to adjudicate, or even developed a process for adjudicating, any other claims. *See id.* at 13 (Department has "not implement[ed] policies and procedures for reviewing and making determinations on unique claims that do not fit into one of the . . . established categories"); U.S. Dep't of Educ., Press Release, *Improved Borrower Defense Discharge Process Will Aid Defrauded Borrowers, Protect Taxpayers* (Dec. 20, 2017), *available at* http://perma.cc/US2M-7Y4J ("USED Press Release").

The Department's minimal progress is due, at least in part, to its decision to stop processing claims for nearly a year pending a review of "borrower defense policies." OIG Report at 3. From January 20 to December 20, 2017, the Department "did not complete or begin" to analyze "additional categories of borrower defense claims qualified for discharge." *Id*. at 10. On December 20, 2017, the Department announced that it would resume processing applications pursuant to a purportedly "improved process," which amounts to keeping in place existing "approval" criteria that apply to former Corinthian students. *See* USED Press Release. As of

October 30, 2017, the Department had received 135,050 borrower defense claims from students who attended over 1,500 schools, and had resolved only 31,140 of those claims, all from students who attended the three institutions listed above. *See* USED Data Analysis at 4, 6.

Meanwhile, the Department has stymied regulations that would create a process accessible to borrowers. In 2015, the Department held public hearings and convened a negotiated rulemaking committee, published a notice of proposed rulemaking, and issued a final rule for borrower defense. *See* 80 Fed. Reg. 50588 (Aug. 20, 2015); 81 Fed. Reg. 39330 (June 16, 2016); 81 Fed. Reg. 75926 (Nov. 1, 2016). The rule established a new standard for borrower defense claims applicable only to loans issued after the regulation's effective date and established an administrative process for the adjudication of individual and group borrower defense claims, as well as proceedings for recoupment against schools for liabilities on borrower defenses. 81 Fed. Reg. at 76083-86. However, the Department has repeatedly delayed implementation of this regulation, which now is not slated to take effect until July 1, 2019. *See* 82 Fed. Reg. 27621 (June 16, 2017) (staying regulation); 82 Fed. Reg. 49114 (Oct. 24, 2017) (delaying effective date to July 1, 2018); 83 Fed. Reg. 6458 (Feb. 14, 2018) (delaying effective date to July 1, 2019); Am. Compl. ¶ 189. In the interim, it has changed course on its regulatory agenda, including by convening a new negotiated rulemaking committee to develop a new borrower defense regulation from scratch—suggesting that the existing delayed rule will never become effective in any event. *See* 82 Fed. Reg. 27640 (June 16, 2017). Of course, no regulatory change would affect the terms of any borrower's existing promissory note.

C. The Department Oversees, and Has a Duty to Collect, Federal Student Loans.

The Department oversees and maintains ultimate control over the FFEL and Direct Loan programs. In addition to issuing Direct Loans, the Department has the authority to set the terms of federal student loan Master Promissory Notes, approve FFEL lenders (when the program was

issuing new loans), and determine schools' eligibility to receive federal student loan proceeds, among other responsibilities.

The Department has the power to discharge, cancel, settle, compromise, or suspend collection on any Direct or FFEL loan. 20 U.S.C. § 1087; *id.* § 1087e; 31 U.S.C. § 3711(a)(2)-(3). Unless the Department has taken one of these steps, it has a mandatory duty to collect federal student loans. 31 U.S.C. § 3711(a)(1); *see also* Brief for Def.-Appellee Sec'y of Educ. at 11, *Salazar v. King*, No. 15-832 (2d Cir. 2016) ("The Secretary is required to seek collection of all federally guaranteed student loans."). To fulfill this duty, the Department has an obligation to report to credit agencies, and has an array of extraordinary collection powers: It can garnish borrowers' wages, seize their tax refunds, and bring collection lawsuits against them in federal district court. *See* 20 U.S.C. § 1080a (requiring reporting to credit agencies); 34 C.F.R. § 30.1(a)(3) (litigation); *id.* § 34.1 *et seq.* (wage garnishment); *id.* § 30.33 (tax offset).

III. Procedural Background

On November 12, 2017, Plaintiffs filed the instant declaratory judgment action, and on March 2, 2018, filed an Amended Complaint adding a number of private entities alleged to be the holders of Ms. Colon's loans. *See* Am. Compl. ¶¶ 20−86. The Amended Complaint brings three counts, each of which seeks a declaratory judgment that Plaintiffs' loans are not enforceable: Count I is asserted against the Department regarding Ms. Carr's federal loans; Count II is asserted against the Department and private defendants regarding Ms. Colon's federal loans; and Count III is asserted against only private defendants regarding Ms. Colon's private loans. *Id.* On April 6, 2018, the Department moved to dismiss Counts I and II, the counts to which it is a party. *See* Dep't Mem.[2] For the reasons set forth below, Plaintiffs respectfully

[2] On the same day, three of the private defendants filed a joint motion to compel Ms. Colon to arbitrate Count III based on an arbitration clause in her private loan contracts. Defs.' Mot. to

request that the motion be denied.

LEGAL STANDARD

A. Motion to Dismiss

"A Rule 12(b)(1) motion challenging subject matter jurisdiction may be either facial or fact-based." *Carter v. HealthPort Techs., LLC*, 822 F.3d 47, 56 (2d Cir. 2016). Where, as here, the 12(b)(1) motion is facial, the "plaintiff opposing such a motion bears no evidentiary burden. Instead, to resolve a facial Rule 12(b)(1) motion, a district court must determine whether the complaint and its exhibits allege facts that establish subject-matter jurisdiction." *Chakraborty v. Soto*, No. 16 Civ. 9128, 2017 WL 5157616, at *6 (S.D.N.Y. Nov. 6, 2017) (internal quotation marks, alterations, and citations omitted).

When reviewing a motion to dismiss under Rule 12(b)(6), a court must "accept[] all factual allegations in the complaint as true and draw[] all reasonable inferences in the plaintiff's favor." *Fait v. Regions Fin. Corp.*, 655 F.3d 105, 109 (2d Cir. 2011). Where there is no statute mandating exhaustion, a motion to dismiss for failure to exhaust administrative remedies is considered under Rule 12(b)(6). *See Zhong v. U.S. Dep't of Justice*, 480 F.3d 104, 122 (2d Cir. 2007) (where no statute requires exhaustion, subject matter jurisdiction is not at issue).

B. Declaratory Judgment Act

Under the Declaratory Judgment Act, 28 U.S.C. §§ 2201-02, a court may adjudicate "a substantial controversy, between parties having adverse legal interests," that is real and immediate. *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 127 (2007) (citation omitted). "[T]he Declaratory Judgment Act should be liberally construed to accomplish its purpose of

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Compel Arb. of Count III, ECF No. 62. As explained further in a separate letter to the Court, ECF No. 69, Ms. Colon is not opposing this motion.

providing a speedy and inexpensive method of adjudicating legal disputes without invoking coercive remedies." *Garanti Finansal Kiralama A.S. v. Aqua Marine & Trading Inc*., 697 F.3d 59, 70 (2d Cir. 2012) (citation omitted).

The Declaratory Judgment Act allows a potential defendant to have her legal rights "resolved by a Court promptly rather than waiting for the opposing party . . . to choose to exercise its rights to judicial intervention, particularly where the delay in seeking judicial intervention will cause substantial prejudice to the declaratory judgment plaintiff." *Great Am. Ins. Co. v. Houston Gen. Ins. Co*., 735 F. Supp. 581, 585 (S.D.N.Y. 1990). In other words, "[t]he intent is to allow a party to be free from the whim of its opponent in deciding when to resolve the legal dispute between them." *Id*. Such relief is especially suitable where, as here, a party seeks adjudication of the merits of a contractual defense, and so "courts regularly consider the merits of affirmative defenses raised by declaratory plaintiffs." *BASF Corp. v. Symington*, 50 F.3d 555, 558 (8th Cir. 1995) (collecting cases).

ARGUMENT

I. The HEA Waives Sovereign Immunity for This Declaratory Judgment Action.

The Higher Education Act's sovereign immunity waiver permits the Secretary of Education to "sue and be sued" on any matter, provided that "no attachment, injunction, garnishment, or other similar process, mesne or final, shall be issued against the Secretary or property under the Secretary's control." 20 U.S.C. § 1082(a)(2). Plaintiffs' prototypical declaratory judgment claims—seeking a declaration of the parties' contractual rights—do not seek an injunction or "similar process," and the Department's argument that Plaintiffs' claims are nonetheless barred rests on a manufactured test with no basis in case law or logic. The Secretary thus enjoys no immunity from this suit.

A. There Is No Immunity Because Plaintiffs Seek a Declaratory Judgment, Not an Injunction.

The HEA's "sue and be sued" clause does not carve out declaratory judgment claims from those on which the Secretary may be sued, and there is no basis on which to read in such an exception. "[S]ue-and-be-sued waivers are to be 'liberally construed.'" *F.D.I.C. v. Meyer*, 510 U.S. 471, 480 (1994). A court reviewing a "sue and be sued" clause must give effect to Congress's decision to permit the government actor to be subject to suit, and should not ordinarily infer any exceptions not expressly enumerated by Congress. *See U.S. Postal Serv. v. Flamingo Indus. (USA) Ltd.*, 540 U.S. 736, 741 (2004); *Fed. Hous. Admin. v. Burr*, 309 U.S. 242, 245 (1940).

The Department asserts that the declaration sought here is "sufficiently injunctive" as to erase the distinction between the two forms of relief. Dep't Mem. at 10. But this argument ignores black letter legal principles. Courts have long recognized that "declaratory relief . . . is *not* synonymous with an injunction." *Ulstein Mar., Ltd. v. United States*, 833 F.2d 1052, 1055 (1st Cir. 1987) (emphasis added); *see also Bank of Am. NT & SA v. Riley*, 940 F. Supp. 348, 351 (D.D.C. 1996) (noting "long recognized" "differences between" the two forms of relief). "An injunction is a coercive order by a court directing a party to do or refrain from doing something, and applies to future actions. A declaratory judgment states the existing legal rights in a controversy, but does not, in itself, coerce any party or enjoin any future action." *Ulstein Mar.*, 833 F.2d at 1055 (interpreting nearly identical sovereign immunity waiver in the Small Business Act and citing cases); *see also Steffel v. Thompson*, 415 U.S. 452, 471 (1974) (Declaratory judgment "is a much milder form of relief than an injunction. Though it may be persuasive, it is not ultimately coercive." (citation omitted)).

Plaintiffs' claims here illustrate the distinction. Plaintiffs seek a declaration to establish that, as they assert, SBI's misconduct is an affirmative defense to their student loan repayment obligations. This action achieves a primary purpose of the Declaratory Judgment Act: to "allow prospective defendants to sue to establish their nonliability," and thereby avoid the unfairness that arises from having to wait to be sued to assert one's legal rights. *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500, 508 (1959); *see also City of Rome*, 362 F.3d at 175 n.3 (describing one purpose of the Act as "releas[ing] 'potential defendants from the Damoclean threat of impending litigation which a harassing adversary might brandish, while initiating suit at his leisure—or never'" (citation omitted)); 10B Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure* § 2751 (4th ed. 2018) (declaratory judgment "provides a useful solution" where, for example, one party to a promissory note claims that it was procured by fraud and seeks an adjudication of "whether the note [i]s a binding obligation").

If Plaintiffs prevail in this action, they can present their declarations to credit reporting agencies, in order to have negative information about these loans removed from their credit reports. *See* 15 U.S.C. § 1681i (Fair Credit Reporting Act credit dispute procedure); *DiNello v. U.S. Dep't of Educ.*, No. 06 C 2763, 2006 WL 3783010, at *1 (N.D. Ill. Dec. 21, 2006) (declaratory judgment "is not simply an indirect means of prohibiting defendant from further collecting the loan" but "could be used by plaintiff to show credit agencies that reports of an existing debt are inaccurate"). In addition, although the Department would not be in contempt if it nonetheless sued Plaintiffs to collect the debts, Plaintiffs could use the "the force and effect of" the declaratory judgment to assert a complete bar to the suit. *Steffel*, 415 U.S. at 471.

Because declaratory judgments and injunctions are distinct remedies, courts considering the plain language of the HEA's sovereign immunity waiver have routinely denied the

Department's motions to dismiss declaratory judgment claims for lack of jurisdiction. *See Thomas v. Bennett*, 856 F.2d 1165, 1168 (8th Cir. 1988); *Bartels v. Riley*, No. 98-8885, slip op. at 10-13 (11th Cir. June 29, 1999), ECF. No. 62-1; *Jones v. U.S. Dep't of Educ.*, No. 08 Civ. 4404, 2010 WL 2710624, at *3 (E.D.N.Y. July 6, 2010); *DiNello*, 2006 WL3783010, at *4; *OneSimpleLoan v. U.S. Sec'y of Educ.*, No. 06 Civ. 2979, 2006 WL 1596768, at *5−6 (S.D.N.Y. June 9, 2006), *aff'd*, 496 F.3d 197 (2d Cir. 2007); *Bank of Am. NT*, 940 F. Supp. at 351, *aff'd*, 132 F.3d 1480 (D.C. Cir. 1997); *Student Loan Mktg. Ass'n v. Riley*, 907 F. Supp. 464, 474 (D.D.C. 1995), *aff'd*, 104 F.3d 397 (D.C. Cir. 1997). Indeed, some courts have proposed that plaintiffs seek declaratory relief rather than an injunction, because sovereign immunity bars only the latter. *See, e.g.*, *Calise Beauty Sch., Inc. v. Riley*, 941 F. Supp. 425, 430 (S.D.N.Y. 1996); *see also Pro Sch., Inc. v. Riley*, 824 F. Supp. 1314, 1315-16 (E.D. Wis. 1993) (following dismissal of plaintiff's claims for injunctive relief, plaintiff, "[w]ith the Court's permission, . . . filed an Amended Complaint seeking declaratory relief").

More specifically, courts routinely exercise jurisdiction over declaratory judgment claims brought by student loan borrowers regarding the status of their loans as enforceable or unenforceable obligations. In *De La Mota v. United States Department of Education*, the district court found that the HEA waived immunity from suit for the declaratory relief sought by federal student loan borrowers claiming loan cancellation under a federal statute. No. 02 Civ. 4276, 2003 WL 21919774, at *5 (S.D.N.Y. Aug. 12, 2003). Although the court later denied the declaratory claim on the merits, the Second Circuit vacated and remanded for entry of a declaratory judgment in plaintiffs' favor. *De La Mota v. U.S. Dep't of Educ.*, No. 02 CIV. 4276 (LAP), 2003 WL 22038741, at *4 (S.D.N.Y. Aug. 29, 2003); *De La Mota v. U.S. Dep't of Educ.*, 412 F.3d 71, 82 (2d Cir. 2005). Courts across the country have exercised jurisdiction over similar declaratory

judgment actions by federal student loan borrowers. *See Rice v. U.S. Dep't of Educ.*, No. 08 Civ. 0127, 2008 WL 2872202, at *2 n.1 (W.D. Mo. July 22, 2008) ("[T]he Court has jurisdiction to consider the debt's validity and issue appropriate declaratory relief."); *Burgess v. U.S. Dep't of Educ.*, No. 1:05-CV-98, 2006 WL 1047064, at *2 (D. Vt. Apr. 17, 2006) (exercising jurisdiction over student loan borrower's claim for a "declaratory judgment setting forth: (1) the status of [his] student loan debt; [and] (2) the defendants' rights to any further recovery on that debt"); *Perkins v. U.S. Dep't of Educ.*, No. 01 Civ. 867, 2002 WL 31370473, at *4 (S.D. Ohio Sept. 30, 2002) (exercising jurisdiction over borrower's claim for a declaratory judgment that he was never party to a federal loan and that his loan debt had been paid in full).

B. The Department Has Articulated No Convincing Reason to Extend Immunity to This Action.

The Department argues that this declaratory judgment action should be considered "sufficiently injunctive" to entitle the Secretary to immunity because the relief sought is purportedly "anticipatory" and because it does not target a "specific means of collection." Dep't Mem. at 10-11. This test is simply invented, having no basis in either case law or logic.

The Department bases its argument primarily on *American Association of Cosmetology Schools v. Riley* ("*Cosmetology Schools*"), in which a divided Ninth Circuit panel found the Secretary to be immune from a trade association's suit seeking a declaration that specific administrative appeal decisions barring schools from the FFEL program were "null and void." 170 F.3d 1250, 1253 (9th Cir. 1999). The Court explained that if the decisions were voided, statutes and regulations would require the Secretary to immediately reinstate the schools, which would have the effect of paying funds in the Secretary's control to those schools. *Id.* at 1254. The Court therefore reasoned that the declaratory relief was barred by the HEA's prohibition on issuing an "attachment, injunction, garnishment, or other similar process." *Id.* (emphasis

omitted). Judge Reinhardt dissented, stating that the decision was "simply incorrect," and relied on a "novel and unsupported theory" not based on "a single case, piece of legislative history, or any other authority." *Id.* at 1256 (Reinhardt, J., dissenting).

Whether incorrect or not, *Cosmetology Schools* is based on facts different than those here, and is a legal outlier that cannot bear the weight placed on it by the Department. Not a single case has applied the reasoning in *Cosmetology Schools* to find immunity from a claim for declaratory relief. On the contrary, the only case to have explicitly considered the application of *Cosmetology Schools* to circumstances comparable to those here found that the Secretary was not immune. *See DiNello*, 2006 WL 3783010, at *1, *4 (finding jurisdiction to issue declaration that federal student loan borrower's loans had been paid in full, because relief was not "coercive in nature or otherwise similar to injunctive relief").

All of the other cases on which the Department relies actually hold that the court *does* have jurisdiction over a declaratory judgment action. For example, the court in *Bank of America* found that it had jurisdiction over a declaratory judgment claim asserted against the Secretary, and noted that the majority of other courts reached the same conclusion. 940 F. Supp. at 350−51. The Department illogically suggests that because *Bank of America* allowed a claim for relief that purportedly was *not* "anticipatory," the inverse rule should apply—that is, courts should *not* allow claims for relief that *is* anticipatory. But *Bank of America* holds no such thing. In any event, what Plaintiffs seek here is a declaration of their present rights. The Department also cites *Thomas*, in which the Eighth Circuit found that it *had* jurisdiction over a declaratory judgment claim asserted against the Secretary. 856 F.2d at 1166-67. The declaration the plaintiff obtained in that case concerned a particular method of collection, but that fact does not, as the Department claims, support a rule that declarations *not* targeting a discrete avenue of collection *are* barred by

sovereign immunity. And courts have repeatedly issued declarations regarding the underlying validity of borrowers' obligations on their loans—which are not limited to a particular method of collection. *See supra* pages 15-16.

II. Both Ms. Carr and Ms. Colon Have Stated Claims Against the Department.

The Department argues that neither Ms. Carr nor Ms. Colon has stated a claim against the Secretary, "albeit for different reasons," Dep't Mem. at 16, but the opposite is true: Both Ms. Carr and Ms. Colon *have* stated claims, for essentially the same reason. Both Plaintiffs are subject to collection actions in which the Secretary sues them to collect on their student loans, and Plaintiffs have brought this declaratory judgment action to obtain an immediate adjudication of whether the defense to repayment they would assert in such proceedings is valid. In other words, the relevant cause of action here is the *Department's*. *Cf. City of Rome*, 362 F.3d at 175 n.3 (key inquiry in declaratory judgment action is "the character of the threatened action" that the declaratory plaintiff is seeking to "forestall," when determining federal question jurisdiction); *Franchise Tax Bd. v. Constr. Laborers Vacation Tr. for S. Cal.*, 463 U.S. 1, 19 (1983) (similar); 10B Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure* § 2767 (4th ed. 2018) (courts look to the "claim on the face of the complaint that would have been presented" in the hypothetical coercive action). The purpose of the Declaratory Judgment Act is to allow plaintiffs like Ms. Carr and Ms. Colon to assert their defense in a timely fashion, rather than face "the Damoclean threat of impending litigation" which an adversary might initiate "at his leisure—or never." *City of Rome*, 362 F.3d at 175 n.3 (citation omitted); *see supra* pages 11-12. Where, as here, Plaintiffs are suffering ongoing harm—and thus there is an "immedia[te]" controversy—they may get into court to obtain an advance adjudication of the Department's cause of action. *Ray Legal Consulting Grp. v. Gray*, 37 F. Supp. 3d 689, 700 (S.D.N.Y. 2014) (Failla, J.) (quoting *In re Prudential Lines Inc.*, 158 F.3d 65, 70 (2d Cir. 1998)).

Moreover, the Department's argument that it is not a proper party to either Plaintiff's claim is belied by the Department's own conduct. As the Department describes at length, it has accepted, and is purporting to process, over one hundred thousand borrower defense applications from both Direct Loan and FFEL borrowers, including Ms. Colon and Ms. Carr. Dep't Mem. at 6−7, 20−21. The Department has shown both by its words and its actions that it has the authority to adjudicate assertions of such defenses for all federal loan borrowers, and that assertion of such defenses is not limited to collection actions. Its argument to the contrary in this case is "nothing more than a convenient litigating position." *Christopher v. SmithKline Beecham Corp.*, 567 U.S. 142, 155 (2012).

A. Ms. Carr Can Bring This Declaratory Suit to Assert Her Defense Against the Department.

The Department contends that the regulation providing the substantive standard for Direct Loan borrower defenses allows such defenses *only* in a post-default collection proceeding. Dep't Mem. at 17. As described above, this argument ignores the structure of declaratory judgment claims, since this action seeks an advance adjudication of precisely such a collection proceeding. But the Department's reading of the regulation itself is also incorrect. In creating the Direct Loan program, Congress instructed the Secretary of Education to "specify in regulations *which* acts or omissions of an institution of higher education a borrower may assert as a defense to repayment" of a Direct Loan. 20 U.S.C. § 1087e(h) (emphasis added). It was to fulfill this mandate that the Department promulgated 34 C.F.R. § 685.206(c), which sets the applicable standard for a borrower defense: "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." This regulation codifies the Holder Rule, *see supra* pages 6-7. It also includes an explicitly non-exhaustive list of proceedings in which the borrower's defense can be asserted. The

Department's position that the regulation *limits* a borrower's ability to assert defenses outside of those specified proceedings thus misunderstands the purpose of the regulation and the statute it effectuates.

Moreover, the Department's own statements and behavior flatly contradict the reading of the regulation that it advances here. The Department has made clear that "a borrower who is not in default," and thus not subject to *any* of the "proceedings to collect" identified in § 685.206(c), "can also assert a claim that the loan is not legally enforceable on the basis of a claim against the school." Letter from Arne Duncan, Secretary, U.S. Dep't. of Educ., to Sen. Elizabeth Warren, at 4 (Aug. 14, 2014), Ranucci Decl. Ex. E; *see also* 81 Fed. Reg. at 75956 ("the Direct Loan borrower defense regulations . . . allow[] borrowers to assert both claims *and* defenses to repayment, without regard as to whether such claims or defenses could only be brought in the context of debt collection proceedings"). And the Department has not rejected Ms. Carr's borrower defense claim because her loans are not in any collection proceeding—to the contrary, the Department insists that Ms. Carr must allow the Department to resolve her claim.

Because there is no basis to limit Ms. Carr's assertion of her defense to collection proceedings—and this declaratory judgment is premised on such a proceeding in any event—her claim should proceed.

B. The Department is a Proper Defendant for Ms. Colon's Claim.

Like its position with respect to Ms. Carr, the Department's position that Ms. Colon cannot assert her defense against it is inconsistent with the applicable regulatory framework and the Department's own conduct.

The FFEL program was structured to ensure that the Department of Education maintained complete control over FFEL loans. *See supra* pages 9-10. A private lender could originate a FFEL loan only on terms set by the Department. 20 U.S.C. §§ 1077, 1085(d). The lender

received a subsidy from the Department for making the loan, 34 C.F.R. § 682.302, and faced minimal risk because the Department is the "final insurer of the FFEL program," *Salazar v. King*, 822 F.3d 61, 66 (2d Cir. 2016). As the party that bears the risk of loss, the Department—not the private lender or holder—maintains total control over loan repayment terms. *See, e.g.*, 34 C.F.R. § 682.209 (repayment); *id.* § 682.215 (income-based repayment); *id.* § 682.407 (discharge). There are sound policy reasons for holding the Department accountable when a school such as SBI has committed misconduct, because it is the Department that allowed the school to participate in the federal student aid program in the first place. *See* 20 U.S.C. §§ 1094, 1087c(a); 34 C.F.R. §§ 668.14, 685.300 (Department decides schools' eligibility, enters contracts with participating schools, and can suspend or terminate schools).

Critically, FFEL program rules provide that the Department would be the plaintiff in the hypothetical collection action forming the basis of Ms. Colon's declaratory judgment claim. When a FFEL borrower defaults, the loan is transferred to the guaranty agency and, eventually, to the Department. 20 U.S.C. § 1080(a); *see also* 34 C.F.R. § 682.409. The Department must reimburse the guaranty agency for its loss, and once it has done so, the United States is "subrogated for all of the rights of the holder" and "entitled to an assignment of the note." 20 U.S.C. § 1080(b). The Department is then entitled to sue a FFEL borrower to collect on a defaulted FFEL loan—and it routinely does so. *See, e.g.*, *United States v. Williams*, No. 09 Civ. 3465, 2013 WL 3187050, at *2 (E.D.N.Y. June 20, 2013). In Count II, Ms. Colon asserts her defense now, so she does not have to "expose h[er]self to liability" by defaulting on her loans—the "very purpose of the Declaratory Judgment Act." *MedImmune*, 549 U.S. at 128–29.

The Department may also be liable on Count II because of the Department's contractual and regulatory relationship with the holder of Ms. Colon's FFEL loans. *See, e.g.*, 34 C.F.R.

§ 682.400. Because such liability hinges on the terms of that relationship, which are set forth in contracts and other documents, the Count should not be dismissed before Ms. Colon has been able to take relevant discovery. In *Jackson v. Culinary School of Washington*, for example, the court denied the Secretary's motion to dismiss a defrauded federal student loan borrower's declaratory judgment claim because the Secretary's liability under agency principles turned on questions of fact that could not be resolved on a motion to dismiss. 788 F. Supp. 1233, 1242 (D.D.C. 1992). This Court should likewise deny the Department's motion to dismiss here.

III. There Is No Exhaustion Requirement Here, and the Court Should Not Create One.

There is no statutory or regulatory requirement that Ms. Carr or Ms. Colon exhaust administrative remedies before seeking declaratory relief in federal court. Although the Department acknowledges this, it argues that this Court should nonetheless create an exhaustion requirement and apply it to Ms. Carr and Ms. Colon. Dep't Mem. at 19. But there is no reason to impose such a requirement here, where every day that passes without an adjudication of their defenses causes additional harm to Ms. Carr and Ms. Colon.

Because exhaustion of Plaintiffs' claims is not mandated by statute, the Court may only require exhaustion after undertaking an "intensely practical" inquiry that takes into account "both the nature of the claim presented and the characteristics of the particular administrative procedure provided." *McCarthy v. Madigan*, 503 U.S. 140, 146 (1992) (citation omitted). The Court should *not* demand exhaustion where, as here, plaintiffs' "interests in immediate judicial review outweigh the government's interests in . . . efficiency or administrative autonomy." *Id.* Ms. Carr and Ms. Colon require "immediate judicial review" to address the Department's adverse credit reporting and the ongoing accrual of interest on their loans.

In addition, this is not a circumstance where exhaustion would "protect[] administrative

agency authority" by "allow[ing] the agency to apply its special expertise." *Id.* at 145. In this declaratory judgment action, Ms. Carr and Ms. Colon seek an adjudication of their contractual rights, which turn on the application of state law—as to which the Department has no "special expertise." Indeed, the Department has *disclaimed* expertise in interpreting state law as it pertains to borrower defense claims. According to the Department, the fact that borrower defense claims are predicated "upon State law presents a significant burden" for its "officials[,] who must determine the applicability and interpretation of laws that may vary from one State to another." 81 Fed. Reg. at 39330. By its own account, the Department has struggled with "the inherent uncertainties in interpreting another authorities' [sic] laws." *Id.* at 75938.

By contrast, this Court is highly competent to construe and apply state law. *See DiBella v. Hopkins*, 403 F.3d 102, 111 (2d Cir. 2005) (federal courts' "job" includes deciding state law issues, including novel ones). And federal courts in this district, including this very Court, have repeatedly applied the state law provision at issue here, New York's General Business Law § 349. *See, e.g.*, *A.V.E.L.A., Inc. v. Estate of Marilyn Monroe, LLC*, 131 F. Supp. 3d 196, 200 (S.D.N.Y. 2018) (Failla, J.); *Braynina v. TJX Cos., Inc.*, No. 15 CIV. 5897, 2016 WL 5374134, at *4 (S.D.N.Y. Sept. 26, 2016) (Failla, J.); *Forgione v. Gaglio*, No. 13 CIV. 9061, 2015 WL 718270, at *14-16 (S.D.N.Y. Feb. 13, 2015) (Failla, J.).

Nor would exhaustion "promot[e] judicial efficiency" by, for example, "produc[ing] a useful record for subsequent judicial consideration, especially in a complex or technical factual context." *McCarthy*, 503 U.S. at 145. The New York State OAG—the chief enforcer of state law, specially charged with enforcing General Business Law § 349, *see* N.Y. Gen. Bus. Law § 349(b) (authorizing OAG to enjoin violations of law and seek restitution)—has already compiled such a record and made its findings. Am. Compl. ¶¶ 152−66. And in the few instances in which

the Department has rendered decisions on borrower defense applications, it has not developed its own record, but has instead relied on findings by state attorneys general—precisely the same evidence already available here. *See, e.g.*, U.S. Dep't of Educ., *Third Report of the Special Master for Borrower Defense to the Under Secretary* (Mar. 25, 2016) at 4, *available at* https://perma.cc/NY2R-MYS9 (borrower defense relief authorized for some Corinthian College borrowers based on California Attorney General's findings).

The Department's reliance on *Krebs v. Charlotte School of Law, LLC*, No. 17 Civ. 190, 2017 WL 3880667 (W.D.N.C. Sept. 5, 2017), to support imposing a judicially-created exhaustion requirement here, is misplaced. *Krebs* held that plaintiffs who sought to bypass the administrative process entirely could not "complain[] about having to wait for a decision from the DOE." *Id.* at *12. The plaintiffs in *Krebs* "ha[d] not even filed borrower defense to repayment claims," and therefore could not trace any injury to the Department. *Id.* By contrast, Ms. Carr and Ms. Colon submitted their borrower defense claims to the Department over three years ago. During that time, rather than resolve Ms. Carr's and Ms. Colon's claims, the Department has only made things worse for them: It has collected on and regularly reported their loans as outstanding to national credit reporting agencies, and it has added thousands of dollars of interest to their balances. Ms. Carr and Ms. Colon's powerful interest "in retaining prompt access to a federal judicial forum" thus plainly outweighs any "countervailing institutional interests favoring exhaustion." *McCarthy*, 503 U.S. at 146.[3]

CONCLUSION

For the foregoing reasons, Plaintiffs respectfully request that the Department's motion to

[3] To the extent the Department is also arguing that Ms. Carr's and Ms. Colon's claims are "not ripe" because they have not satisfied a putative exhaustion requirement that the Department asks this Court to impose, Dep't Mem. at 2, that argument is wholly misplaced. For the reasons described *supra*, this controversy has sufficient immediacy to render Plaintiffs' declaratory judgment claims ripe for adjudication.

dismiss be denied.

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Respectfully submitted,

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