UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE GENERAL COUNSEL

THE GENERAL COUNSEL

October 4, 1991

Senator Edward M. Kennedy
United States Senate
Washington, DC 20510-2101

Dear Senator Kennedy:

Secretary Alexander has asked me to answer your letter concerning the general legal question of whether, and if so when, students can avoid repaying their guaranteed loans owed to lenders on the ground that their school failed to deliver the promised educational services or otherwise defrauded the student. As you will recall, this issue was raised earlier this year by a West Virginia federal district court ruling in Tipton v. Secretary of Education.

I apologize for the delay in answering your letter. During this period, the Department has been giving this matter very careful review, and we have refined our position.

Briefly stated, it is the Department's conclusion that banks should be afforded protection from potential liability under state law for school misconduct in most situations, but that there are a few narrow circumstances where it is consistent with federal policy for banks to bear the financial consequences of school misconduct.

In our view, where the bank's relationship with the school in question is no more than one of receiving referrals or cooperating in the paperwork processing, the bank should not be held responsible for student misconduct, and contrary state laws that would let students refuse to repay their loans should be deemed preempted. That will cover standard lending practices in the student loan program, and addresses the principal contrary ruling in Tipton that gave rise to lender concerns.

On the other hand, we think that it is consistent with federal policy for a bank to be held accountable for school misconduct where (1) the bank had notice of prior serious student complaints which were not responsibly addressed by the school, (2) the bank and school are corporate affiliates, (3) the bank had delegated substantial pre-loan functions to the school, thus making the school its agent, or (4) the bank paid finders' fees to the school. Banks may avoid these situations, and potential risks, through their own prudent conduct; yet where they fail to do so, fairness to student borrowers and to taxpayers counsels that banks be held accountable for serious school misconduct.

We are setting forth the Department's position in more detail in a legal brief that we are filing today in the United States District Court for the District of Columbia, and I have enclosed a copy for your information. I have also enclosed answers to the three specific questions accompanying your letter.

If you have any further questions on this subject, we would be happy to meet with you or your staff.

Sincerely,

Jeffrey C. Martin

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