COHEAO

January 2010 Conference

Litigation Process

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Introduction

Why Litigate—
Litigation can be one of your most effective collection tools for all types of student debts. It enables you to recover funds which would not be paid voluntarily.—"found money". It can also help lower your default rate by showing your borrowers how serious you are about collecting delinquent loan accounts.

Perkins Loan Regulations Require Litigation Review—
If collection efforts fail, the school must determine at least once every 2 years whether all the conditions listed below are met. If so, the school must litigate. The conditions are:

- The Total amount owed (including outstanding principle, interest, collection cost, and late charges) on all the borrower's Federal Perkins Loan and NDSLs at the school is more than $500;
- The borrower can be located and served with process;
- The borrower either has enough assets attachable under State law to cover a major portion of the debt, or enough income that can be garnished under State law to satisfy a major portion of the debt over a reasonable period of time (defining "reasonable" is left to the school);

- The borrower does not have a defense that will bar judgment for the school (if the school determines that the borrower has a partial defense, it must weigh the costs of litigation against the cost of recovery, based on the amount of enforceable portion of the debt); and
- The expected cost of litigation (including attorneys' fees) does not exceed the amount that can be recovered from the borrower.

Even if all the above conditions are not met, the school may sue if it chooses. Section 484A(a) of Higher Education Amendments of 1992 (P.L. 102-325) permanently eliminated any Federal or State statute of limitations that would have applied formerly to enforcement actions to collect Federal Perkins Loans .

The school must attempt to recover from the borrower all litigation costs, including attorney's fee, court costs and other related costs, to the extent, permitted by applicable state law. The school is also required to attempt recovery of all costs previously incurred in the collection of overdue payments. If these collection costs have not been paid by the borrower; a percentage of these unrecoverable costs may be charged to the Fund.

If the school cannot collect a payment after following all collection procedures (including litigation, if required), it may, with the Secretary's approval, assign the account to the U.S. Department of Education for collection. A school may assign a loan to the U.S. Department of Education for collection if the amount outstanding is $25 or more, including principal, interest, collection costs, and late charges.

If the school has a COHORT default rate of more than 20 percent as of June 30 two years before the school submits an assignment request, the school must provide documentation to the U.S. Department of Education that it has complied with all of the due diligence requirements discussed in this chapter.

Litigating Other Student Debts—

Litigation of other student debts is also an important part of management of your debt portfolio. However, as will be discussed later, there are some differences which must be taken into consideration when deciding which accounts to litigate.

Where to File?

A court must have personal jurisdiction over the debtor before the court may render a judgment or in any way affect the debtor's rights or property. Failure to file where the property is located forces a transfer of the judgment. However, a Defendant must generally be sued where they live.

For this reason, using local or small claims courts typically do not present the best solution.

Litigation: Promissory Notes

The use of promissory notes creates a written contract between the creditor and the borrower. Accordingly, when the borrower fails or refuses to repay the loan under the terms and conditions of a promissory note, a breach of contract occurs. This, in turn, means that if the creditor resorts to judicial process to collect on the promissory note, the proper cause of action is one of breach of written contract. The creditor becomes a plaintiff and the borrower becomes a defendant.

Unsigned promissory notes do not necessarily lead to the conclusion that the account cannot be collected. If the creditor/lender is able to establish that the borrower received the funds, it may be possible to establish an "account stated" and pursue recovery of the disbursement. Can you demonstrate that the student attended classes or received others goods, services or funds are the questions to review

An account stated may be established when there have been transactions between parties creating a creditor-debtor relationship. Some states require the presence of the "original" promissory note before the court will grant judgment. Most states allow a certified copy of the note and some allow a photocopy.

Litigation: Lost Promissory Note

Occasionally, a Promissory Note may be lost. The following cases deal with the issue of lost Promissory Notes and whether the debt may be collected.

- *Union Saving Bank v. Cassing*, 691 S.W.2d 513 (1985)
  This case held that where cause of action is brought on the debt, rather than on the promissory note itself, the instrument is only one of several means to prove the agreement, the consideration, and the obligation, and presentment of note or satisfactory proof that it has been lost or destroyed is not necessary.

- *Aesoph v. Golden*, 367 N.W.2d 639 (1985)
  This case held that although promissory note was lost, a blank promissory note was introduced at trial and testimony as to terms of note were regarded as secondary evidence.

Student Loan Litigation

1. Litigation of Student Loans
   A. There are several phases of the litigation process.

   1) Before Complaint

   a) It sometimes produces payment to notify the borrower of the pending litigation filing.

   b) It is critical to verify contact information for the debtor. Note: It is extremely important to file a notice of appearance immediately. This will avoid hearing notices and other documents being sent to the wrong location.

2. After complaint, before judgment

   a) The complaint has been filed. Therefore, it will be necessary to obtain judgment through agreed entry, default entry, summary judgment, or trial.

   b) Often, student loan suits can be resolved by the parties filing an agreed entry. The typical suit does not involve a trial.

3. After Judgment

   a) After judgment is obtained, the account is ready for execution on the judgment. This can be attachment of real or personal property of the debtor.

   b) It is important to make certain the certificate of judgment is filed.

4. Garnishment

   a) On October 6, 1993, President Clinton signed into law P.L.103-94, which allows for wage garnishment of Federal employees. Please note that federal employees who work in states that do not allow wage garnishment (NC, SC, PA, TX) will remain exempt from garnishment. It is not yet clear which state law will control the percentage of wages, when an employee lives and works in one state, but is paid from the agency's payroll department in another state.

   b) On October 1, 1994 the U.S. Post office issued final rules for the garnishment of U.S. Postal Service employees.

c) On January 1, 1995, the U.S. Department of Defense began processing applications for the garnishment of the disposable pay of judgment debtors who are members of the military.

1) They include any member of the Regular Army, Air Force, Navy, Marine Corps, or Coast Guard, and any member of a Reserve component of the Army, Air Force, Navy, Marine Corps or Coast Guard (including the Army National Guard of the United States and the Air National Guard of the United States) on active duty pursuant to 10 U.S.C. 672 (m), for a period in excess of 180 days at the time of application for involuntary allotment.

2) They do not include: retired personal, including those placed on the Temporary or permanent disabled retired list; and personnel in a prisoner of war or missing in action status as determined by the appropriate Secretary of the Military service branch.

Common Defenses/Rebuttals

1. Deferment

a) A borrower is not entitled to a deferment after default. 34 CFR 682.210, 34 CFR 674.37. This involves federal debt.

b) The borrower must have requested the deferment and provided the lender with all documentation required to establish eligibility for the deferment. Therefore, unless the borrower has requested, prepared and sent the form to the lender prior to default, it is irrelevant that the borrower was otherwise eligible for deferment. 34 CFR 682.210(a)(4), 34 CFR 674.37(a)(1).

c) Deferments may still be granted after default on either Stafford or Perkins loans if specific conditions are met. These are the responsibilities of the borrower to pursue.

2. Statutes of Limitation

a) On nonfederal debts, a generally worded statute of limitation does not run against the state. See, e.g., Department of Transportation v. Sullivan, 38 Ohio St. 3d 137 (1988)

i. In addition, the decision contains language which suggests the defenses of laches, waiver, and estoppel may also not be available against the state.
ii. This approach can be used for non-federal accounts for a state school only.
iii. In most states, reaffirmation or payments start a new time period.
iv. Under some state laws, the statute is tolled or suspended if the debtor is unavailable.

b) Section 1091a of Higher Education Act (P.L. 103-26) was amended to eliminate any statue of limitation that applied to enforcement actions to collect federal student loans.

i. Effective Date: April 9, 1991.
ii. Sunset Provision: November 15, 1992. However, it was extended before the expiration date.
iii. The Sunset Provision was rescinded in the 1992 Reauthorization

iv. In a federal court decision handed down June 23, 1992, elimination of the statue of limitation was held to be retroactive for all federal student loans, even if they would have been time barred when the amendments became effective.
The only federal loan now affected by the Statue of Limitation defense would be a loan where a judge denied judgment because of a statue of limitation defense prior to April 9, 1991.

3.Discharge in Bankruptcy

a) Many borrowers and some attorneys fail to realize that student loans are generally non-dischargeable in bankruptcy. Therefore, many student loans have not been discharged despite a prior discharge order issued in the bankruptcy court. These orders specifically state that all “dischargeable” debts are discharged.

b) Occasionally a debtor will file bankruptcy but will fail to list the promissory notes in the bankruptcy schedules. If this occurs the debtor will not be discharged.

4. Hold harmless provisions in divorce decree

   a. The agreement is between the former spouses and has no effect on the borrower's obligation to pay their loan. The remedy of the former spouse who was to be held harmless is an action for contempt in Domestic Court.

5. Infancy

   a) The federal government has formalized in 20 USC 1091(A)(b)(2), the concept that being a minor at the time of a loan agreement was made, is not a defense to repaying a federal student loan.

      i. On non-Federal loans, an approach to take is that the student ratified the contract when they become of age by continuing to accept the benefits of the loan and/or attend school.
      ii. An additional approach that has had some success, is to argue that parents are liable for "necessary" expenses of their minor children

1) **Federal Student Assistance—Collection Costs**

   a) Where debts are based on federal funds being received, collections cost are most clearly due from the debtor.

   b) The effect of Section 674.47(b) of the Federal Regulations and the federal statues is to supersede state consumer and other laws which would otherwise restrict collection cost being awarded.

   c) The federal law as part of the Higher Education Amendments of 1986, provide that "reasonable" collection costs be assessed by the institution against defaulted borrowers, even if no provision was contained in the promissory note.

d) What is “reasonable” for federal debts has been mandated by the Secretary in new regulations implemented in July, 2008. The regulations now limit collection costs on first placements to 30% and for second placements or legal accounts, 40%.

e) These limits are not applicable to nonfederal accounts but would obviously be considered by a court reviewing collection costs on nonfederal debts.

f) State courts sometimes restrict even federal student aid debt collection costs:

   i. Courts attempt to limit to a flat percentage, often 15 percent.
   ii. Many courts require that the request for collection costs be accompanied by an expense and time log to justify the request.
   iii. In a case decided in Dec. ‘09, the court held that collection costs on federal student debts could be set on a statutory rate, no matter the amount of time spent.

g) It is a constant education process between collection attorneys and the Judges of the state.

h) There have been interesting developments in the area of assessing collection costs against student borrowers. In the Wisc. case, Mariann Patzka v. Viterbo College 1996 WL 88520 (W.D. WIS.), the court held that the school’s policy of assessing collection costs on nonfederal student aid receivables violated the debtor’s rights because state law prohibited such costs. Other Wisc. decisions have held that the state law does not apply to state schools. The court decisions, contract language requirements and enforceability of these provisions vary from state to state. While addition of collection costs on federal student debt, such as Perkins or FFEL, would technically not be prevented by state law because of federal law preemption, it is typically extremely difficult to keep these differences clear before the court. When your institution places non-federal student receivable accounts for collection costs, because of potential liability for your institution, consultation with your legal counsel is recommended.

2. NonFederal Student Assistance

a) Collection costs are available in the state courts on these accounts in some states under certain circumstances.

i. Courts will not award these costs if the state consumer law prohibits them.
ii. Attempts to collect these costs can subject the creditor to penalties for violation of consumer protection laws.

b) The prerequisite generally required in states which do allow collection costs is a contract with specific language whereby the debtor agrees to pay charges defined as collection costs.

i. Courts in various states have taken the position that this contract language cannot be overly vague.

Thank You for Your Participation.

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