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Federal Vs. State: The Fight To Regulate Student Loans

By **Joseph Cioffi and James Serritella** (April 10, 2018, 10:58 AM EDT)

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Is the federal government acting like an absentee landlord? When it comes to enforcement of student loans, several states seem to think so. Questions surrounding the effect of certain servicing practices on student loan borrowers and consumer-driven lawsuits against servicers selected by the federal government are motivating states to step up activity, in the absence, they say, of appropriate federal action.

States Seek to Take the Lead

State action in the area is not new. Since 2015, states have pushed forward consumer protection laws regarding student loans, including passing student loan bills of rights. Some jurisdictions, such as Connecticut and the District of Columbia, have called for a state ombudsman to manage loan repayment complaints and taken other actions to prohibit unfair or deceptive practices. Others have tried to address servicer conduct through new licensing requirements. Massachusetts, in particular, provides a recent example of aggressive action that is catching the attention of the U.S. Department of Education — the state commenced an action against a student loan servicer under state and federal consumer protection laws.[1]

But now, the Department of Education is fighting back, including through a notice (that has no legal force) published in the Federal Register that relates to the Higher Education Act (or HEA), the Direct Loan Program and the Federal Family Education Loan (or FFEL) Program. The Department of Education argues that the states have overreached and that federal preemption precludes state interference in the servicing of federal programs.

There Are Several Paths to Preemption

Preemption derives from the supremacy clause of the Constitution, which provides that the laws of the United States "shall be the supreme law of the Land."[2] Under U.S. Supreme Court precedent, there are three types of preemption: (1) field preemption, (2) express preemption and (3) conflict preemption. In the past, courts have not found sweeping preemption of state student loan regulation, but according to the Department of Education, the new state regulations present different considerations.

Field Preemption

To determine if federal preemption exists, courts will generally first determine whether there is "field preemption." This is found when the relevant federal regulation is so pervasive in a field as to create an inference that Congress left no room for supplemental state regulation. In the context of student loan servicing, however, the resolute language of prior decisions makes it unlikely courts would be willing to upend existing precedent.[3]

Express Preemption

If field preemption is not found, then courts will seek to determine if there is "express preemption" by examining whether the language of the federal statute expressly provides that state law is preempted. Here, the HEA provides that "[l]oans made, insured, or guaranteed pursuant to a program authorized by title IV of the [HEA] shall not be subject to any disclosure requirements of any State law."[4] However, in recent consumer lawsuits against servicers, judicial analysis of express preemption has yielded mixed results. For example, in Nelson v. Great Lakes Education Loan Services, a recent consumer lawsuit based in part on the servicer's alleged failure to disclose repayment options to consumers over telephone, one court held that the plaintiffs' claims were preempted by the HEA.[5] Yet, in another recent case involving similar claims, Davis v. Navient Corp., the court reached the opposite conclusion.[6]

In its notice, the Department of Education, relying on Chae v SLM Corp.[7] and Nelson, argues that state regulation of both written and nonwritten communications between servicers and borrowers should be preempted under the HEA. However, the department does not address or even mention Davis, which was decided on the same day the department's notice was published. Further, although the Department of Education argues for express preemption where state servicing laws attempt to regulate activity related to collection practices, there is little precedent on these issues.

Conflict Preemption

If a court does not find there is field or express preemption, then finally, it will look for what is known as "conflict preemption." Conflict preemption arises when "it is impossible to comply with both state and federal law" or when "state law stands as an obstacle to achieving the objectives of the federal law."[8]

Although conflict preemption has not been a major issue to date, the Department of Education seems poised to try to forge new ground by suggesting that certain recently enacted or proposed state servicing laws may conflict with federal law "or impede the uniform administration of" loan programs. The department's concern is that fees for state licensing and additional costs associated with complying with multiple state regimes will get tacked onto the cost of student loans, unnecessarily burdening borrowers and, ultimately, taxpayers.

In fact, the federal government expressed similar concerns in the recent statement of interest it filed in a case involving the Pennsylvania Higher Education Assistance Agency, which concerned PHEAA's alleged failure to count forbearance periods as qualifying payments for federal loan forgiveness programs. There, the court determined that the government did not actually argue that the claims were preempted but instead "cautions that some of the injunctive relief that the Commonwealth asks for in its complaint may conflict with the requirements of regulations promulgated by the [Department of Education] or the requirements of PHEAA's loan servicing contract with the Department."[9] Nonetheless, Massachusetts brought the claims under consumer protection laws, as opposed to specific laws targeted at servicers, which a court would more likely view as conflicting with federal law.

Where Will the Battle Be Fought?

In cases commenced by states, defendants have limited avenues available to remove the action to federal court. Diversity of citizenship would likely not be an option given that the suits would not involve private citizens. The other basis for removal, the existence of a federal question, would also be unlikely where state law is at issue.

If the federal government determines to go on the offensive, it could file a statement of interest in a state-commenced action, but if PHEAA is any indication, the statement may not necessarily impact the forum for the dispute. Alternatively, the federal government could directly commence an action against a state, but to date, it has reserved such action for disputes involving major public policy issues, such as environmental protection, immigration and voting rights.

Conclusion

As the student loan debt burden grows, it is possible that servicing issues will rise in importance to be on par with such matters of national importance, leading to more federal action. So far, states have generally enjoyed the home-field advantage, but that could change. The present skirmish is just a prelude to the real battle. Preemption in the context of student loan servicing laws is an issue for the courts to decide — maybe the highest one, at that.

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[1] See Commonwealth v. Pennsylvania Higher Education Assistance Agency, 2018 Mass. Super. LEXIS 14, No. 1784-cv-02682 (Mass. Super. Ct. Feb. 28, 2018) (PHEAA).

[2] U.S. Const. art. VI, cl. 2.

[3] See Armstrong v. Accrediting Council for Continuing Education & Training Inc., 168 F. 3d 1362, 1369 (D.C. Cir 1999).

[4] 20 U.S.C. 1098g.

[5] Nelson v. Great Lakes Education Loan Services, 2017 U.S. Dist. LEXIS 208331, No. 17-cv-00183 (S.D. Ill. Dec. 19, 2017).

[6] Davis v. Navient Corp., 2018 U.S. Dist. LEXIS 41365, No.17-CV-00992 (W.D.N.Y. March 12, 2018).

[7] Chae v SLM Corp., 593 F3d 936, 942 (9th Cir. 2010)

[8] Wisconsin Public Intervenor v. Mortier, 501 U.S. 597, 604-05 (1991).

[9] 2018 Mass. Super. LEXIS 14, at *24.