UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF THE UNDER SECRETARY

January 14, 2016

Stephanie Rosenthal
Chief of Staff, Division of Financial Practices
Federal Trade Commission
Bureau of Consumer Protection
600 Pennsylvania Avenue, NW
Washington, DC 20580

Dear Ms. Rosenthal:

This letter follows up on your phone discussion on December 2, 2015 with the Department of Education's Office of General Counsel regarding the application of the Federal Trade Commission (FTC)'s Holder Rule to claims brought by student and parent borrowers in the Federal Family Education Loan (FFEL) program. Borrower defenses to repayment of FFEL loans that rest on claims against the school attended with the proceeds of the loan will almost always be based on the FTC Holder Rule "preservation of defenses" clause, 16 CFR § 433, included in the FFEL student and parent loan promissory notes. We seek a determination from your office about the effect of applicable statutes of limitation on claims and defenses that might be raised by a borrower, relying on the Holder Rule clause in the FFEL loan agreement, as a set-off to a demand for repayment on a FFEL loan.

We understand that the FTC's 1976 Guidelines on the Holder Rule discuss the impact of statutes of limitations on claims and defenses raised by a borrower by stating that: "[t]he words "Claims and Defenses" which must appear in the Notice are not given any special definition by the Commission...Appropriate statutes, decisions, and rules in each jurisdiction will control, and the pertinent rules of law and equity, including rules of evidence, procedure, and statutes of limitations, will continue to apply." FTC, *Guidelines on Trade Regulation Rule Concerning Preservation of Consumers' Claims and Defenses*, 41 FR 20022, 20023 – 20024 (May 14, 1976) (emphasis added). The Guidelines state, as an example, "Where a local jurisdiction has a two-year statute of limitations on contract claims, such claims and defenses would be extinguished after two years." *Id.* at 20024 (emphasis added).

Our question arises in the context of claims against a merchant – here, the school - that are time-barred under applicable state law. We ask if it is the Commission's view that where a borrower's claim against a school would be time-barred under state law, the borrower could assert that time-barred claim in an action by a lender seeking repayment of the loan, as a defense that would set off the amount of the claim against the unpaid balance on a loan. If the Commission considers a borrower to be able to assert the time-barred claim as a defense, we also ask whether the

Commission views the Rule as enabling the borrower to assert the time-barred claim affirmatively in an action to recover amounts already paid to the lender.

The language of the FTC Guidelines seems to suggest that under the Rule, time-barred claims, for example, for breach of contract, are "extinguished" for all purposes. *Id.* We understand, however, that courts commonly allow a party to use a time-barred claim defensively if that claim arises from the same transaction as the opponent's timely claim, and treat these claims as claims for common law recoupment. The FTC Guidelines do not use the term recoupment but appear to contemplate that concept when referring to what the Guidelines describe as a "set-off:"

> "[t]he Rule does apply to all claims or defenses connected with the transaction, whether in tort or contract....It is also possible for a consumer to have a claim or defense against a seller because of a separate transaction. The provision required by the Rule would not allow him to assert such a claim or defense against the holder. The holder's obligations are limited to those arising from the transaction which he finances. <u>The vast majority of cases, in the staff's opinion, will involve a limited right of set-off against the unpaid balance</u>."

(emphasis added).

The key similarity between common law recoupment and the set-off described in the Guidelines appears to be that the Holder Rule clause allows the consumer to assert only those claims connected to the same transaction as that financed with the loan. We understand that that the term "setoff" is commonly used to describe a counterclaim that arises out of a transaction unrelated to a plaintiff's cause of action against the defendant. Based in these considerations and the explanation of the scope of the Rule provided in the Guidelines, we question the meaning of the statement in the Guidelines that time-barred claims are "extinguished." We ask for clarification whether the Commission intends the Rule to enable the consumer to assert either affirmatively or as a defense to the loan only those claims that are within the otherwise applicable statute of limitations, or to assert time-barred claims as viable defenses, regardless of the applicable statutes of limitations that would bar affirmative recovery on such claims.

We appreciate your consideration of our request. In order to assist us in a current rulemaking in this area, we ask that you provide your response as expeditiously as practicable. Please do not hesitate to contact us if you have any questions about our request.

Sincerely,

Jeff Appel

Jeff Appel
Deputy Under Secretary
U.S. Department of Education