

By David Stocker and Chad Echols

New Focus on Student Loans

Recent lawsuits question the practice of adding collection costs to nonfederal student debts

In August 2008, class-action lawsuits alleging improper addition of collection costs to nonfederal student debts were filed in Ohio and Connecticut. These lawsuits, filed less than three weeks apart in different states by different consumer law firms, as well as the July 2008 changes in the federal rules controlling the addition of these costs to federal loans, mandate a reexamination of this old problem.

The history of schools adding the cost of recovering defaulted federal student loans to the borrower's account, otherwise known as collection costs, had its beginnings with the federal law and regulations governing federal student loan programs. The theory behind adding collection costs was to shift the financial burden of recovering defaulted federal loans, supported with taxpayer funds, to the uncooperative borrower. The federal statutory authority for the addition of collection costs by schools to

federal student loans is found for the Federal Family Education Loan Program at 34 C.F.R. Section 682.202 and Perkins, 34 C.F.R. Section 674.45.

Under the federal rules controlling federal student loan recovery, schools were required to add costs they imposed. While there was some guidance in terms of assessing these costs, the language was broad enough, especially in the regulations governing schools' administration of the federal Perkins loan program, that schools often added collection costs in excess of the actual expense they incurred in recovery of the debt. This practice may have been part of the motivation for the changes to the rules controlling federal addition of collection costs implemented in July 2008.

Over time, the practice of schools adding collection costs to federal loan accounts migrated to other debts the defaulted student loan borrower owed to the school. These nonfederal debt types typically included tuition, room and board, as well as other institutional receivables. This is where problems associated with recovery of collection costs, especially for third-party agencies, began.

Unlike with federal student loans, there is no federal statutory or regulatory authority for schools to assess these collection costs to nonfederal student debts. As a result, the legality of adding such costs reverts to state contract law. This makes it difficult to pursue collection costs on nonfederal debt.

The frequent lack of contract between the defaulted borrower and the school can create problems. Without a written agreement wherein the student has agreed to pay collection costs,

adding these costs violates Section 807(2)(A) of the Fair Debt Collection Practices Act (FDCPA) and potentially the state laws where the debt is being collected.

Even if the school has entered into a written agreement with the former student, the language of the contract may not be sufficient in the state where the student lives and collection is being attempted. In some states, such as Connecticut, the state statute limits the addition of costs to 15 percent of the debt, even if there is a contract that permits a higher rate.

Adding a "choice of laws" clause would help solve these problems in future agreements between schools and their student borrowers by permitting the school's contract to be reviewed using the law of the state where the contract was signed, even if the borrower was in a different state.

The FDCPA language in Section 808(1) states that it is a violation to collect any amount incidental to the principal obligation unless that amount is *expressly* authorized by the agreement or permitted by law (emphasis added).

The "unless permitted by law" language has been construed in decisions such as *Johnson v. Riddle*, 305 F.3d 1107 (10th Cir. 2002), to mean that the charge or additional fee must be specifically established in the state's law or court decisions. Examples of these additional fees, which are specifically enumerated, include bad check charges or condo fees. With few exceptions, states have not created specific statutory authority to add collection costs to nonfederal student debts. Florida, for example, has created such a state law authority pursuant to Florida Statutes, Title XLVIII, Section 1010.03 (13)(i).

The alarming factor in the potential litigation of these cases under state law is that most state statutes do not have a damage limit similar to the FDCPA. In fact, most permit punitive as well as actual damages, and judgment awards could potentially be large.

The current environment in the arena of defaulted student debt recovery is sympathetic to the student consumer. There is widespread concern among student and consumer groups that college is too expensive and students already have too much debt when they leave school. Many consumer advocates point out that the addition of collection costs is not typical in the credit industry and believe they are burdensome and unfair.

These consumer groups were very active in lobbying the federal government to limit the addition of collection costs to federal debts. As a result, new regulations went into effect on July 1, 2008, which set limits on collection costs that may be assessed by schools on defaulted federal student debts. When combined with the already negative public reaction to adding collection costs to any student debt, these new federal limits add further support for anyone bringing suit on the nonfederal debts where there were already problems.

Without a contractual or statutory authorization for schools to add, or their agents to collect, collection costs on nonfederal debts, attempts to collect these debts puts the school and their collection agents at risk of violating state and federal consumer law. Unlike the FDCPA, which does not apply to schools' collection actions, some state laws include creditors in their coverage. Schools may also risk injury to their

reputation if they collect additional charges from former students without sufficient legal support.

It's important to be aware of the risks to collection agencies and their business partners, colleges and universities. This is a complex issue with many different state and federal laws involved. Agencies that collect student accounts should make sure they receive contractual documentation from their school clients, which will support the attempt to collect the charges added by the school on nonfederal debt. Further, they must be

aware of the application of the law in the state where they are collecting to the contract the school has provided.

Finally, both schools and collectors are urged to seek direction from their legal counsel. [cm](#)

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