UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE SECRETARY

In the Matter of

AMERICAN EDUCATION SERVICES/PHEAA **Program Review Control No. 2006202513**

DECISION OF THE SECRETARY

This matter comes before the Secretary on appeal by American Education Services/Pennsylvania Higher Education Assistance Agency (AES/PHEAA) of an initial determination by Federal Student Aid (FSA). AES/PHEAA requests that the Secretary overturn the determination of FSA. Under the authority vested in the Secretary, the Secretary has delegated to me the authority to decide this appeal.

DISCUSSION

On March 28, 2006, Federal Student Aid issued findings of a review it conducted to determine whether student loan operations of AES/PHEAA comply with the requirements of the Taxpayer Teacher Protection Act of 2004 (TTPA) and its regulations at 34 CFR 682.302(e).

AES/PHEAA is a "public corporation and government instrumentality created by the Pennsylvania General Assembly" that provides a secondary market for Federal Family Education Loan Program (FFELP) loans, which it purchases from lenders. AES issued tax-exempt bonds to obtain funds to acquire loans. At the time of the review, some $858 million of such bonds issued prior to October 1, 1993, were outstanding. AES bills the U.S. Department of Education (Department) for special allowance payments (SAP) on the loans it holds. AES also services loans held by other lenders, and calculates SAP for those loans as well.

FSA's letter of March 28, 2006, found two violations of the TTPA by AES/PHEAA. AES/PHEAA appealed FSA's determination, submitting appeal letters on May 11, 2006, and August 18, 2006. FSA responded to AES/PHEAA in a letter dated July 20, 2006, and also submitted a formal appeal response brief to the Secretary's attention on April 10, 2007.

Nature of Appeal

PHEAA appeals FSA's findings that PHEAA, in violation of the TTPA:

(1) Inappropriately moved 9.5 percent floor eligible loans from a tax-exempt (floor eligible) issue to a taxable issue after October 1, 2004.
(2) Inappropriately moved 9.5 percent floor loans from one taxable issue to another taxable issue after October 1, 2004.

PHEAA challenges the first finding, arguing that the violation found by FSA was an isolated incident that has not been repeated. PHEAA challenges the second finding, arguing that such transfers from one taxable issue to another taxable issue are not, in fact, violations of the TTPA.

Violation #1: Discussion and Findings

As to violation #1, AES/PHEAA does not deny FSA's finding that a 2005 sale of approximately $9.645 million in loans transferred the loans from a tax-exempt issue to a taxable issue after October 1, 2004. Nor does AES/PHEAA deny that such a transfer violates the terms of the TTPA. AES/PHEAA merely argues that this particular transfer was an "isolated issue" and that its systems have not resulted in any other illegal transfers. AES/PHEAA argues that its system is 100 percent compliant, with the exception of this one isolated mistake.

Regardless of whether the violation was intentional, AES/PHEAA admits the particular transfer violated the TTPA. FSA was justified in finding a violation and insisting on corrective action, regardless of whether the violation was intentional.

Violation #2: Discussion and Findings

As to the second violation, AES/PHEAA denies that it violated the TTPA, asserting that FSA's interpretation that the TTPA prohibits taxable to taxable transfers is wrong. The appeal letters filed by AES/PHEAA include no legal analysis demonstrating why FSA's interpretation of the TTPA is wrong. The appeal merely asserts in a conclusory manner that "this scenario is not prohibited by TTPA." It further asserts: "We believe your reading of the TTPA concerning the loss of 9.5 percent treatment for loans transferred from taxable to taxable ... is not supported by either the plain language of the TTPA or your prior guidance." AES/PHEAA makes no attempt to analyze or explain why the text of the TTPA should be read not to exclude taxable to taxable transfers. Nor did AES/PHEAA attempt to explain why FSA's interpretation of the statute is not supported by the statute's text. In contrast, FSA submitted legal briefs that specifically interpreted the text's plain meaning.

As FSA explained in its briefing, the TTPA changed the previous SAP rules. The TTPA amended HEA 438(b)(2)(B) by adding new clause (v), which provides that SAP is payable at the usual rate, rather than the 9.5 percent minimum return rate–

> …for a holder of loans that–
>
> (I) were made or purchased with funds–
> (aa) obtained from the issuance of obligations the income from which is excluded from gross income under the Internal Revenue Code of 1986 and which obligations were originally issued before October 1, 1993; or
> (bb) obtained from collections or default reimbursements on, or interest or other income ... on the investment of such funds; and
>
> (II) are–
> (aa) financed by such an obligation that, after September 30, 2004, and before January 1, 2006, has matured or been retired or defeased;
> (bb) refinanced after September 30, 2004, and before January 1, 2006, with funds obtained from a source other than funds described in subclause (I) of this clause; or
> (cc) sold or transferred to any other holder after September 30, 2004, and before January 1, 2006.

Instead of offering any countervailing textual analysis to support its claim that taxable to taxable transfers remain lawful under the TTPA despite its plain text, AES/PHEAA's appeal merely asserts that it lacked sufficient notice of how FSA was interpreting the TTPA, and argues that there was confusion (including confusion by FSA officials) on this issue.

In January 2005, the Department's Office of Postsecondary Education issued a Dear Colleague letter, explaining the change in law. The letter specifically noted that the TTPA had altered the previous landscape, in which "loans that were financed with funds obtained by the holder from the issuance of tax-exempt obligations originally issued prior to October 1, 1993 received a special allowance at a rate that … would not be less than 9.5 percent… ." The letter explained that, after the TTPA, the rule was changing "on some loans that would have been subject to this treatment." The Dear Colleague letter then listed <u>three categories</u> of loans that would no longer receive the 9.5 floor treatment, specifically, loans that are:

(1) "Financed by a tax exempt obligation that, after September 30, 2004… has matured or been retired or defeased;"

(2) "Refinanced after September 30, 2004, … with funds obtained from a source other than funds described in section 438(b)(2)(B)(v)(I) of the HEA [i.e.—tax exempt sources]; or

(3) "Sold or transferred to any other holder after September 30, 2004… ."

Even granting for the sake of argument AES/PHEAA's claim that the TTPA's provisions were not abundantly clear and that confusion existed in the industry about the statute's meaning, AES/PHEAA was not justified in assuming that no change in the law had occurred, and that business should continue according to the status quo ante. The Department's January 2005 Dear Colleague Letter specifically invited stakeholders: "If you have questions concerning the recent statutory changes, please contact Pam Moran … or George Harris… ." Nothing in the record suggests that AES/PHEAA made any attempt to obtain clarification or further guidance from these individuals or any other Department officials. Faced with what AES/PHEAA claims was confusion about the statute's meaning, it was incumbent upon AES/PHEAA to obtain clarification regarding how FSA would be interpreting the statute's meaning. By failing to seek and obtain clarification, AES/PHEAA abdicated its responsibilities and cannot now be excused from the consequences.

AES/PHEAA's final argument, set out in bold text, notes that "**the movement of 9.5% floor loans from one taxable issue to another taxable issue resulted in no additional 9.5% floor loans or increased SAP payments from the Department.**" (emphasis in original). AES/PHEAA argues that, as a result, it is complying with the intent of Congress to "curb the growth of 9.5% floor loans." AES/PHEAA believes that the intent of the TTPA was merely to "curb the growth" of 9.5 percent floor loans, not to actually reduce the number of such loans. In AES/PHEAA's view, because taxable to taxable transfers only perpetuate existing floor-eligible loans, and do not create new floor eligible 9.5 percent loans not yet in existence, it is meeting Congressional intent to "curb the growth" of these loans. In light of the clear statutory language, I did not find the evidence submitted by AES/PHEAA to be indicia of clear Congressional intent that the TTPA was only intended to curb the growth in floor eligible loans, and was not intended to change the floor eligibility status of taxable to taxable transferred loans.

ORDER

Accordingly, I HEREBY AFFIRM the determination of FSA.

So ordered this 11th day of January 2008.

David L. Dunn
Chief of Staff
Office of the Secretary

Washington, D.C.

SERVICE LIST

Office of Hearings and Appeals
U.S. Department of Education
400 Maryland Avenue, S.W.
Washington, DC 20202

Fred J. Marinucci
Office of General Counsel
Department of Education
400 Maryland Avenue, SW
Washington, DC 20202

Richard E. Willey
President & CEO
American Education Services & PHEAA
1200 North Seventh Street
Harrisburg, PA 17102-1444