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September 5, 2007

Louise McClain, Chair, and Commissioners
California Student Aid Commission
10811 International Drive
Rancho Cordova, CA 95670

PRIVILEGED ATTORNEY-CLIENT COMMUNICATION

RE: Legal Analysis of EdFund Agreements With Lenders For Payment of Default Fees

Dear Chair McClain and Commissioners:

At its June 2007 closed-session meeting, the California Student Aid Commission (CSAC) voted to request this office, in its role as CSAC's legal counsel, to review memoranda of understanding entered into between EdFund and institutions providing loans to students under the Federal Family Education Loan Program (FFELP).

As background, I note that my office provided CSAC with an advice letter on this topic on October 17, 2006. A copy of the letter is attached as Exhibit A. My office produced the October letter in response to CSAC's request that we review a proposed policy called the "Default Fee Strategy" ("the policy"). The policy is set forth in a September 7, 2006 document entitled "CSAC/EdFund Confidential & Proprietary Policy; Student's First: A Partnership for America's Future" which is attached as Exhibit B.

Specifically, the policy provided that "CSAC/EdFund" would pay the federal default fee on behalf of the student borrower if at least 80% of amount of the lender's loans guaranteed by "CSAC/EdFund" in the previous federal fiscal year were "consolidation" loans. It also provided that "CSAC/EdFund" would pay half of the default fee if the lender paid the other half and provided "CSAC/EdFund" with at least $500 million in consolidation loan guarantee volume in the previous federal fiscal year; or if 30% of the lender's consolidated loans were guaranteed by "CSAC/EdFund" in the previous federal fiscal year.

In our October letter, my office advised CSAC not to adopt the policy for two reasons. First, in our opinion, the policy conflicts with federal regulations prohibiting an institution authorized to provide federal loan guarantees from offering inducements to lenders to obtain the loan guarantees through that institution. (Exh. A, pp. 6-9.) Second, CSAC is not expressly authorized by state law to pay the default fee. (Exh. A, p. 10.) Third, selective payment of the default fee may be contrary to state legislative intent that FFELP loans guaranteed through CSAC benefit the greatest number of eligible students. (Exh. A, p. 10.)

In our letter, we also considered and disagreed with legal analyses by EdFund's counsel and by private counsel contracted for by EdFund. (Exh. A, pp. 8-9.) Copies of EdFund legal analyses are attached as Exhibits C and D, respectively.

Before providing any advice beyond what we stated in our October letter, I requested copies of the ten MOUs regarding default fee payments that EdFund has entered into with lenders. My office was provided these MOUs on the afternoon of Friday, August 24th. Therefore, I have not yet had time to perform a complete review and analysis of the MOUs. My review thus far, however, confirms the concerns my office previously expressed.

The MOUs were entered into between January and June 2007 for a one year period beginning July 1, 2007 and ending June 30, 2008. All of the MOUs incorporate the terms of the policy. In six of the MOUs, EdFund agreed to pay the full 1% default fee based on the lenders meeting the policy benchmarks for the previous year. These six MOUs raise the same concerns my office expressed in the October letter.

The other four MOUs require the lender to pay the 1% default fee but obligate EdFund to reimburse the lender for all or a portion of the 1% based on the lender's performance during the first six months of the MOU. Our preliminary opinion is that these four reimbursement MOUs are at least as likely as the six which implemented the policy to conflict with the federal prohibition of inducements.

With additional time, we will be able to provide a more in-depth analysis which will include a search for any opinion letters recently issued by the U.S. Department of Education regarding guarantor inducements to lenders. In the meantime, should you have any questions regarding our opinions thus far, please do not hesitate to contact me.

Sincerely,

GEOFFREY GRAYBILL
Deputy Attorney General

For EDMUND G. BROWN JR.
Attorney General

Attachments

cc: Diana Fuentes-Michel - CSAC Executive Director
Keith Yamanaka - CSAC Chief Deputy Director

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EXHIBIT A

BILL LOCKYER
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October 17, 2006

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Diana Fuentes-Michel, Executive Director
California Student Aid Commission
P.O. Box 419026
Rancho Cordova, CA 95741-9026

RE: Federal Family Education Loan Program --
Proposed Policy for Payment of Borrower Fees

Dear Ms. Fuentes-Michel:

The California Student Aid Commission (CSAC), a state body that administers the state's participation in the federal guaranteed student loan program, has requested informal advice regarding a business policy proposed by its auxiliary organization, EdFund, in connection with the administration of the program. The proposed policy is in response to a federal requirement that CSAC collect a 1% fee for each loan it guarantees as of July 1, 2006. Under the proposed policy, CSAC would agree to pay the fee on behalf of the borrower, or split the cost of such payment with certain lenders, for loans guaranteed for such lenders. CSAC's payment of the fee would be conditioned upon whether the lender had selected CSAC as the guaranty agency for a specified amount of consolidation loan business in the past. CSAC has asked this office to review the proposed policy to determine whether there are any impediments to its adoption.

Background - Federal Family Education Loan Program

The Federal Family Education Loan Program (FFELP), established pursuant to Title IV of the federal Higher Education Act ("Act") (20 U.S.C. §1071 et seq.), allows students at post-secondary institutions to obtain federally guaranteed loans from private lenders to fund post-secondary education. Students, lenders and schools must meet federally-established eligibility requirements to participate. The U.S. Department of Education (USDE) contracts with state agencies or nonprofit corporations, referred to as guaranty agencies, to administer the FFELP on its behalf. (34 CFR §§682.200, 682.400.) CSAC is the state's designated guaranty agency for purposes of administration of the FFELP. (Educ.Code §69761.5.) EdFund is an auxiliary organization that provides operational and administrative services to CSAC in connection with the state's participation in the FFELP. (Educ.Code §69522.)

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CSAC receives revenue from the USDE in connection with its administration of the FFELP, including: (1) a loan processing and issuance fee based on the principal amount of new loans originated during a federal fiscal year and guaranteed by CSAC; and (2) an account maintenance fee paid annually based on the original principal amount of outstanding loans guaranteed by CSAC. (34 CFR §682.401.) CSAC deposits these fees into the Student Loan Operating Fund (Operating Fund), a special fund established in the state treasury for administration of the FFELP. (Educ.Code §69766.) If a borrower defaults on a guaranteed loan, CSAC pays 98% of the principal and interest owed by the borrower to the lender pursuant to the guarantee, and USDE reimburses CSAC for a percentage of its guarantee payments. CSAC attempts to collect the amount owed from the borrower. (34 CFR §682.102, subd.(e)(7).) CSAC retains a percentage of any amounts collected in the Operating Fund, and remits the balance to the Federal Fund, a second special fund established in the state treasury. (Educ.Code §69766.) The federal government owns the funds in the Federal Fund. (20 U.S.C.§1072a, subd.(e).)

Post-secondary schools that participate in the FFELP select the guaranty agency for the FFELP loans issued to its students from among the 35 established guaranty agencies. CSAC competes with these guaranty agencies in California and in other states. The borrower may choose to obtain a loan from the school's preferred FFELP-eligible lenders or may elect to use a different eligible lender, but cannot select a different guaranty agency for the loan. EdFund indicates that schools generally consider the cost of the loan to the borrowers as a factor in selecting the guaranty agency.

Fees Charged to Borrowers for New Loan Guarantees

Prior to July 1, 2006, the Act permitted but did not require guaranty agencies to charge borrowers a 1% insurance premium for loans that it guaranteed. Beginning in 1996, CSAC waived this fee for all loans it guaranteed. We note this policy applied uniformly to all borrowers.

In 2005, Congress amended the Act to eliminate the discretionary insurance premium fee and replace it with a mandatory federal default fee. Specifically, for loans guaranteed as of July 1, 2006, guaranty agencies are required to "collect and deposit" into the Federal Fund a federal default fee equal to 1% of the principal amount of the loan, by deduction from the loan proceeds disbursed to the borrower or by payment from "other non-Federal sources. . . ." (20 U.S.C. §§1078, subd.(b)(1)(H)(ii), 1078-8, subd.(h).)

CSAC elected to pay the federal default fee on behalf of borrowers whose loans it guaranteed from July 1 through September 30, 2006, the remainder of the federal fiscal year in which the requirement took effect. This decision was based on its prior commitment to waive the insurance premium fee for all borrowers and to be competitive with other guaranty agencies that paid the fee for their loans. We again note that the payment of the fee occurred for all borrowers. The fee was paid from the Operating Fund. EdFund indicates that for the remainder

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of the 2006-07 academic year, through June 30, 2007, lenders holding CSAC-guaranteed loans elected to pay the some or all of the required fee on behalf of borrowers.

Guarantees for Consolidation Loans

The Act also provides for guarantees for consolidation loans. Borrowers may choose to consolidate existing guaranteed loans to reduce their monthly payments and extend the time for repayment. The borrower applies to an eligible lender, and the consolidation lender in turn selects the agency to guarantee the consolidation loan.

Consolidation of existing loans can affect CSAC's revenue, depending on whether CSAC is selected as the guaranty agency for the consolidation loan. If the borrower of a CSAC-guaranteed loan or loans chooses to consolidate the loan(s) with a lender who does not select CSAC to guarantee the consolidation loan, CSAC loses the annual account maintenance fee that it otherwise would have received for the underlying loan. Conversely, if the lender selects CSAC as the guaranty agency for a consolidation loan, CSAC receives the account maintenance fee for the consolidation loan. If CSAC did not previously guarantee the underlying loans, the consolidation loan increases the total outstanding amount of loans guaranteed, with a commensurate increase in the total annual account maintenance fee. In addition, the guarantee of the consolidation loan generally will result in a longer stream of income from the account maintenance fee, due to the extended loan repayment period for a consolidation loan compared to the initial student loan.

The Proposed Policy

The proposed policy specifies that as of July 1, 2007, for certain CSAC-guaranteed loans, CSAC will pay the entire federal default fee, or share the cost of such payment with the lender. The amount paid by CSAC, if any, will depend on the volume of consolidation loan business the particular lender had provided to CSAC in the prior year. Specifically, with respect to loans issued by lenders and guaranteed by CSAC during the 2007-08 academic year:

1. CSAC will pay the entire federal default fee for the loan issued by a particular lender, if at least 80% of the total loans guaranteed by CSAC for that lender during the prior year[1] were consolidation loans.

2. Alternatively, CSAC and an individual lender will each pay 50% of the fee for the loan issued by that lender, if:

[1] The policy would consider the lender's loan volume during the 2006 calendar year to determine whether the lender qualified for cost-sharing in the 2007-08 academic year, but for subsequent academic years, if any, the qualification criteria would be based on the prior federal fiscal year.

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(a) that lender had selected CSAC to guaranty at least $500M in consolidation loans in the prior year, or
(b) if at least 30% of the total loans guaranteed by CSAC for that lender during the prior year were consolidation loans.

3. The cost-sharing policy will expressly state that it will be subject to annual review, and that there is no assurance that CSAC will engage in a similar cost-sharing arrangement in subsequent years.

4. The policy will state that a lender who subsequently consolidated a loan for which CSAC paid all or part of the default fee pursuant to the policy would be "expected" to select CSAC as the guaranty agency for the consolidated loan.

5. The stated purpose of the policy is to benefit students by insuring that cost is not an impediment to an individual wishing to attend college.

EdFund's business strategy in proposing the policy is to make CSAC competitive with other guaranty agencies by lowering the cost of loans to borrowers, and to maintain or obtain additional consolidation loans and the associated account maintenance fees. Upon approval of the policy by CSAC, EdFund proposes to enter into "memoranda of understanding" with some of the lenders for whom CSAC has guaranteed loans. EdFund intends to market CSAC to schools based on its ability to provide guaranteed loans that do not require the borrower to pay the federal default fee. EdFund regards the details of the proposed policy, including who pays the fee and the criteria for lender participation, as confidential proprietary business information, and does not intend to disclose that information to schools or borrowers. We do not have any further information regarding what information EdFund would provide to schools and/or borrowers regarding the fee payment. EdFund would disclose the information to lenders who are interested in providing no-fee loans guaranteed by CSAC only if the lenders enter into a nondisclosure agreement with CSAC and/or EdFund. We do not have any information regarding the terms of the proposed nondisclosure agreement or the memorandum of understanding, as the proposed policy is at this stage only conceptual.

A lender who meets the criteria for participation in the policy could decline to participate or could choose to enter into a memorandum of understanding to participate with CSAC in sharing the cost of the federal default fee. A lender who does not meet the criteria could elect to pay the fee on behalf of its borrowers, or may be able to enter into a similar cost-sharing arrangement with other guaranty agencies.

CSAC currently provides guarantees to approximately 30 lenders. It is unknown how many lenders would currently qualify for participation under the criteria in the proposed policy. It is unknown whether other guaranty agencies will institute similar policies, although EdFund believes that two other guaranty agencies are considering arrangements with lenders that will provide no-fee loans to borrowers.

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Analysis of Federal Program Requirements

We have reviewed the applicable requirements of the Act and its implementing regulations to determine whether the proposed policy is consistent with federal program requirements. As discussed below, the proposed policy does not appear to violate any federal restrictions regarding treatment of borrowers, but does appear to be inconsistent with provisions of the Act that regulate the relationship of guaranty agencies and lenders.

Restrictions Regarding Treatment of Borrowers

As an initial matter, the Act expressly permits payment of the federal default fee by someone other than the borrower, by providing that the fee may be paid from "non-Federal sources" rather than from deduction from the loan proceeds. The Operating Fund is state property and thus is a "non-Federal source." Similarly, a lender who makes the payment on behalf of the borrower is a potential non-Federal source. Payment of the fee on behalf of the borrower by CSAC or lenders is thus permitted. If CSAC adopted a policy to pay the fee for all its guaranteed loans, as it elected to do between July 1 and September 30, 2006, or to charge the fee to all borrowers, either option would be entirely consistent with the federal default fee requirement.

The proposed policy, however, would not pay the fee for all borrowers with CSAC-guaranteed loans. Unlike the prior waiver of the insurance premium fee, which all borrowers uniformly received, the proposed policy would selectively pay the default fee for some borrowers. Because government programs are generally required to treat similarly situated participants equally, this aspect of the proposed policy requires careful consideration.

In terms of the statutory provisions, the Act does not expressly require that the guaranty agency treat all borrowers uniformly with respect to payment of the federal default fee. The statute specifies that the fee may be paid by either deduction from the loan proceeds or from other non-Federal sources, and does not state that the guaranty agency must elect only one of the two payment methods to be applied uniformly. (20 U.S.C. §§1078, subd.(b)(1)(H)(ii), 1078-8, subd.(h).) In at least one other section of the Act, which allows a lender to charge an origination fee to a borrower, the statute specifically requires that if the lender chooses to charge the fee, it must "assess the same fee to all student borrowers." (20 U.S.C. § 1087–1, subd. (c)(2)(A).) The absence of any similar express restriction with respect to the federal default fee suggests that the guaranty agency is not required to treat all borrowers identically with respect to payment of the default fee.

The selective treatment of borrowers in the proposed policy also does not appear to violate the Act's prohibition against discrimination with respect to borrowers. The Act prohibits discrimination against borrowers on specified bases. Specifically, the Act provides that a lender or guaranty agency may not "exclude from receipt or deny the benefits of, or discriminate against

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any borrower or applicant in obtaining . . . credit or insurance on the basis of race, national origin, religion, sex, marital status, age, or handicapped status." (20 U.S.C. §1071, subd.(a)(2).) The Act also prohibits the guaranty agency from engaging "in any pattern or practice which results in a denial of a borrower's access to loans . . . because of the borrower's race, sex, color, religion, national origin, age, handicapped status, income, attendance at a particular eligible institution within the area served by the guaranty agency, length of the borrower's educational program, or the borrower's academic year in school. . . ." (20 U.S.C.§ 1078, subd.(c)(2)(F).)

The proposed policy would not discriminate against borrowers based on the school attended, one of the prohibited bases, because all borrowers attending a school for which CSAC is the guaranty agency could potentially obtain a no-fee loan through CSAC's guarantee program. The sole factors that would determine whether the borrower obtained this benefit are the borrower's choice of the lender and the nature of the lender's business relationship with CSAC. CSAC would not deny the benefit of the proposed policy to any borrower based on any of the protected characteristics of the borrower identified in the Act. Nonetheless, we note that although any borrower can potentially benefit, the actual ability of an individual borrower to benefit will depend on whether the borrower is aware that the no-fee loan is available only through certain lenders. It is unknown how EdFund will market the payment of the fee to schools and what information borrowers will receive regarding how to obtain the no-fee loan from participating lenders.

Restrictions Regarding Relationships with Lenders

As noted above, the Act regulates the relationship between the guaranty agencies and lenders, and these restrictions appear to be inconsistent with the proposed policy. First, the Act requires that the guaranty agency must provide for participation in its program by all eligible lenders under "reasonable criteria." (20 U.S.C.§ 1078, subd.(b)(1)(U).) In this case, the proposed policy does not exclude any eligible lender from "participation" in terms of receiving a CSAC guarantee, but it would only apply to a lender's participation in a portion of CSAC's guarantee program, specifically, the cost-sharing policy. We have not located any guidance regarding the meaning of the term "reasonable criteria" and whether this requirement applies to the conditions for participation in the guarantee program as a whole or in a particular benefit of the program, such as the proposed policy.

Presumably, the purpose of the "reasonable criteria" requirement is to assure that educational loans are available to borrowers by encouraging the participation of private lenders in the FFELP, and avoiding exclusion of otherwise willing lenders based upon "unreasonable" criteria. If so, the criteria in the policy may not be considered reasonable if they have the effect of excluding participation by lenders who would otherwise be interested in sharing the cost with CSAC but do not qualify under the criteria in the policy. It is unclear if the effect of the proposed policy could be to discourage some lenders from participation in the student loan program because they cannot effectively compete with other lenders who qualify under the proposed policy. Because some lenders elected to pay some or all of the default fee on behalf of

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borrowers this year, it appears that the market for student loans is competitive and that lenders are willing and able to compete for the loans. EdFund also anticipates that other guaranty agencies will pay all or part of the fee on behalf of borrowers. Accordingly, the proposed policy may be a reasonable response by CSAC to competitive pressure. It is unclear, however, whether or how the proposed policy would affect the availability of loans.

Further, while it may be reasonable to encourage a lender to participate in the payment of default fees on behalf of borrowers, the criteria in the proposed policy do not assure fee payments for all borrowers. Instead, the primary goal appears to be to obtain guarantee business for CSAC with subsidiary concern for the benefits to borrowers. The criteria may be reasonable as a means for CSAC to obtain offsetting revenue to fund the payment of the fee, by assuring that the lenders that obtain some benefit from the cost sharing have provided other loan volume in the past that generates such offsetting revenue for CSAC. While there may be arguments to advance, no legal authority allows us to conclude that the proposed policy satisfies the "reasonable criteria" requirement.[2]

Even if the criteria in the proposed policy satisfy the "reasonable criteria" requirement, the policy must also comply with the prohibition in the Act against "inducements" to the lender to select CSAC as the guaranty agency for lender-issued loans. The Act prohibits a guaranty agency from offering "directly or indirectly, any premium, incentive payment, or other inducement to any lender, . . . in order to administer or market loans made under this part . . . for the purpose of securing the designation of that guaranty agency as the insurer of such loans." (20 U.S.C.A. § 1078, subd.(b)(3)(B).)

Federal regulations provide examples of prohibited inducements, including but not limited to compensating lenders or their representatives for the purpose of securing loan applications for guarantee, performing functions normally performed by lenders without appropriate compensation, and offering to pay a lender a fee for each application forwarded for the agency's guarantee. (34 C.F.R. § 682.401, subd. (e)(2)(i).) The regulation states that "inducement" does not include "services directly related to the enhancement of the administration of the FFEL Program the guaranty agency generally provides to lenders that participate in its program," but does apply to "other activities specifically intended to secure a lender's participation in the agency's program." (34 C.F.R. § 682.401, subd. (e)(2)(ii).)

Under the proposed policy, CSAC would not offer or provide any direct "payment" to lenders, nor would CSAC pay a fee that the lender would otherwise be required to pay. The beneficiary of the payment is the borrower, who would otherwise be required to pay the fee. The

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2 Assuming the "reasonable criteria" requirement applies to the proposed policy, and to the extent the policy reflects a change in the criteria for the lenders' eligibility, the Act requires CSAC to report such changes to the USDE. (20 U.S.C. § 1078, subd.(b)(1)(U)(ii).) This may be inconsistent with the level of confidentiality that EdFund believes will be critical to the success of the proposed policy.

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prohibition, however, extends to "indirect" as well as "direct" inducements. The payment of the fee by CSAC would provide an indirect economic benefit to participating lenders. We have assumed that a lender is able to generate additional loan volume by offering borrowers a no-fee loan. Accordingly, CSAC's payment of all or part of the fee that a lender might otherwise pay to assure it can offer a competitive no-fee loan to borrowers has economic value to the lender.

In our view, the policy creates a prohibited inducement because it directly links the fee payment by CSAC, which benefits the lender, to the lender's selection of CSAC as the guaranty agency for other loans. The fee sharing policy would not qualify for the safe harbor in regulation because it is not a "service . . . the guaranty agency generally provides to lenders that participate in its program," but is instead offered only to certain lenders. Because of the link between the benefit to the lender and the lender's selection of CSAC, there are strong arguments that the proposed policy is "specifically intended to secure a lender's participation in the agency's program" in violation of the 34 CFR section 682.401, subdivision (e)(2)(ii).

EdFund's counsel has suggested in discussion with this office that the policy does not constitute a prohibited "inducement" because the lender obtains any benefit in the current year based solely on events in the past. EdFund asserts that because the lender cannot obtain the benefit in the current year by selecting CSAC as the guarantor of current year loans, the benefit does not "induce" lenders to make such a decision. Moreover, to the extent the lender alters its behavior in the current year to designate CSAC as the guaranty agency for consolidation loans, there is no assurance that the lender will obtain a benefit in the following year, since CSAC makes no commitment to offer the same terms in the following year. The policy creates at most an expectation of potential future benefit by stating that the policy may continue into future years.

We consider these arguments unpersuasive. The payment of the fee appears to be a quid pro quo or reward for the lender's selection of CSAC as the guaranty agency for its consolidation loans and thus provides an incentive or inducement for the lender to select CSAC as the guaranty agency for its consolidation loans.

Although EdFund indicates that it is common to offer benefits based on past behavior of the recipient to avoid the prohibition on inducements, we have found no information that the USDE has accepted such arrangements. The USDE has issued some informal guidance on the issue of prohibitions on inducements, but it did not address this practice. The pertinent guidance from the USDE is a sub regulatory guidance issued in the form of a letter to program participants ("Dear Colleague" Letter 89-G-157, February 1989) that addresses inducements offered by guaranty agencies or lenders to eligible schools for the purpose of securing loan applicants.[3]

[3] At the date of the guidance, the Act did not prohibit payments by guaranty agencies to lenders, so the guidance is limited to inducements to schools. The guidance is therefore not directly applicable to inducements offered by guaranty agencies to lenders but has some value in terms of indicating the USDE's interpretation of what activity constitutes an impermissible inducement.

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The guidance states the view of USDE that the provisions against inducements are broad and intended to prohibit the direct or indirect offering or payment of "any kind of financial incentive" for the prohibited purpose of securing applicants, "regardless of the form of the incentive or its mode of payment." The guidance also identified activities that the USDE considered permissible. These included: the payment of financial incentives that were expressly permitted by statute (such as a lender choosing not to charge the borrower an origination fee); activities that provided some financial benefit to the school of only nominal value (such as the guaranty agency providing a school with free pens bearing with the guaranty agency's name); activities that were undertaken as a form of "generalized marketing or advertising" rather than for the purpose of directly securing applications from individuals; and the provision of improved services that incidentally conferred a financial benefit to a school (such as providing schools with training or improved informational materials for borrowers).

None of the permissible activities described in the guidance applies precisely to an arrangement such as the proposed policy. The proposed policy is likely to provide more than "nominal" value to the lender in terms of competitive advantage. While the statute expressly permits the payment of the default fee by the guaranty agency, the sharing of that fee based on the lender's selection of CSAC is not expressly permitted by statute, and arguably is prohibited. There are strong arguments that the proposed policy is analogous to the impermissible activities described in the guidance. The USDE guidance focused on the purpose of the activity. In the case of the schools, the impermissible activities had the prohibited purpose of securing applications from borrowers. In the case of the proposed policy, although the stated purpose is to benefit borrowers, the true purpose appears to be a prohibited one, to confer a financial benefit to a lender in return for the selection of CSAC as the guaranty agency.

Based on the available information provided to date, and the limited timeframe provided for our review, we are unable to conclude that the proposed policy is legally consistent with the applicable federal law, and in particular with the prohibition on inducements to lenders.

Analysis of State Law Requirements

We also reviewed the provisions of the Education Code applicable to the FFELP to determine whether the policy is inconsistent with any state law requirements. The Legislature has identified the purposes of the state's participation in the FFELP to be ensuring that a source of loans to meet educational costs is available to assist the "greatest number" of eligible students; and to accept, receive and administer funds provided under the Act and extensions thereof. (Educ.Code §69761.) CSAC is authorized to receive federal funds "for administrative costs and payments of insurance obligations." (Educ.Code §69761.5, subd.(a).) The moneys in the Operating Fund are continuously appropriated for the identified purposes. (Educ.Code §69766, subd.(d).) CSAC is authorized to "requisition" the funds in the Operating Fund in carrying out the purposes of the FFELP and the Act. (Educ.Code §69768, subd.(a).)

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Nothing in the Education Code expressly authorizes CSAC to pay the federal default fee on behalf of borrowers. While the Legislature has delegated broad authority to CSAC in the foregoing statutes, the exercise of authority must be consistent with all applicable statutory provisions. In this regard, we note that Education Code section 69761.5, subdivision (f), provides that CSAC "may" charge an insurance premium to student borrowers at a rate not in excess of the maximum allowed by law. As discussed above, the new federal default fee replaced the insurance premium fee as of July 1, 2006. The Legislature has not amended the Education Code to specify whether CSAC may pay the federal default fee, the successor to the insurance premium, on behalf of the borrower. Given the broad authority the Legislature committed to CSAC to administer the FFELP in compliance with the Act and "any extensions thereof," it can be argued that the authority regarding collection of the insurance premium should extend by implication to the successor federal default fee to accomplish the legislative intent. It is not obvious, however, that authority to determine the amount of the insurance premium authorizes CSAC to pay the successor federal default fee. Moreover, the use of the term "may" in Education Code section 69761.5, subdivision (f), confers discretion to determine the rate of the insurance premium that borrowers will pay. The statute does not address whether CSAC may selectively impose the premium. It is arguable that selective imposition may be contrary to the legislative intent that the FFELP benefit the "greatest number" of eligible students. How a court would interpret the state statute as applied to the new federal default fee is unclear.

Implementation of the proposed policy also implicates state laws regarding access to public records. EdFund has described the details of the proposed policy as confidential and proprietary information. It proposes that CSAC (or EdFund on CSAC's behalf) disclose the details of the policy only to lenders who execute nondisclosure agreements. As a state agency, CSAC is subject to the California Public Records Act (CPRA). The CPRA, codified at Government Code section 6250 et seq., provides for the inspection of public records maintained by state and local agencies. Public records include "any writing containing information relating to the conduct of the public's business prepared, owned, used, or retained by" a state agency. (Govt. Code § 6252, subd. (e).) The CPRA embodies a strong policy in favor of disclosure of public records, and any refusal to disclose public information must be based on a specific exception to that policy. (See *Connell v. Superior Court* (1997) 56 Cal.App.4th 601, 616-17 [public has interest in records pertaining to government's conduct in managing public revenues].) It is questionable whether CSAC could effectively protect the details of the proposed policy from public disclosure.

Some case law indicates that EdFund, as a private corporation, may not be subject to the CPRA. In *California State University v. Superior Court*, 90 Cal.App.4th 810, 829 (2001), a newspaper sued to obtain information regarding the identity of private donors who had entered into license agreements with a university-affiliated, nonprofit auxiliary corporation. The agreements allowed the licensees to use luxury suites in multi-purpose arena on the university campus in exchange for donations to a second university-affiliated auxiliary corporation. The university asserted that the identity of the donors was confidential. The court concluded that the

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non-governmental auxiliary organization was not a "state agency" for purposes of the CPRA, noting that the definition of state agency in the CPRA does not reference any "state corporation" or "state controlled corporation." (*Ibid.*) Nonetheless, the university, as a state agency subject to the CPRA, was required to comply with the CPRA and to disclose the information in its possession.

The CPRA offers some protection from disclosure for trade secrets. (Govt.Code §6254, subd.(k), incorporating Evid.Code § 1060.) Civil Code section 3426.1 states that for purposes of the CPRA, the scope of "trade secrets" is defined by case law as it existed in 1984. If a member of the public, including other lenders or guaranty agencies, requested the proposed policy under the CPRA, the burden would be on CSAC to persuade a court that the information qualifies as a trade secret under applicable law and is protected from disclosure.

It is impossible to analyze the proposed policy under other state laws that, for example, regulate business practices, consumer lending and other matters, based on the limited information available. The implementation of the proposed policy may create other issues, depending upon facts to be developed in the future, such as the specific terms of the MOU and nondisclosure agreements with lenders, the content of marketing communications, the number of lenders who will or will not qualify for participation, and the effect of the policy on lenders, borrowers and other guaranty agencies.

Based upon available information, we would recommend against approval of the proposed policy. We believe there are strong arguments to support a finding that the policy is inconsistent with applicable federal law. In addition, as discussed, other potential issues exist regarding CSAC's authority to pay the fee absent statutory amendment. The effect of the proposed policy cannot be fully analyzed based on the limited information available and limited timeframe for review.

Thank you for this opportunity to provide assistance. Please feel free to call with any questions or comments, or if you would like to discuss this further.

Sincerely,

CATHERINE H. BROWN
Deputy Attorney General

For BILL LOCKYER
Attorney General

CHB:

EXHIBIT B

CSAC/EDFUND CONFIDENTIAL & PROPRIETARY POLICY

Subject:
"Student's First: A Partnership for America's Future"

Date:
September 7, 2006

WHEREAS: It is the policy of CSAC, as a state agency, and EDFUND, as a nonprofit public benefit corporation, to provide students with the most affordable options to attend a post-secondary institution and achieve their dream of a higher education.

WHEREAS: CSAC/EDFUND recognizes that the cost of higher education in California and the United States is increasing at a rate faster than that of family incomes and state and federal resources available to students. In many instances, even if a student receives a maximum grant or scholarship award, they still must rely on the Federal Family Education Loan (FFEL) Program to cover the substantial costs associated with room and board, books, fees, and travel.

WHEREAS: It is CSAC/EDFUND's belief that no student with the ability and desire to attend a post-secondary institution should be denied this opportunity based upon the lack of available personal or family resources. Under the FFEL Program, the federal default fee is the only expense that is "passed on to students" that the federal government permits lenders and guaranty agencies to pay.

WHEREAS: The federal default fee requires that one percent of the value of the student loan be deposited in a federal account to insure against student loan defaults.

THEREFORE, BE IT RESOLVED: In order to insure that cost is not an impediment to an individual wishing to attend a post-secondary institution, CSAC/EDFUND in partnership with its lenders will implement a program called "Student's First: A Partnership for America's Future" (hereinafter "Partnership") beginning with the 2007-2008 academic year to pay the federal default fee through non-federal sources.

The Partnership shall exist for the benefit of students and shall serve as an example of the benefits that can be provided when lenders and CSAC/EDFUND work cooperatively for the greater public policy of educating our future generations.

The Partnership is a cost sharing program designed to pay 100 percent of the federal default fee on behalf of the students and shall be an open program that any lender can voluntarily agree to participate. The Partnership recognizes that cost sharing among participating entities is necessary to implement this program. CSAC/EDFUND shall develop an annual default fee strategy to implement this policy. This policy shall be a continuing policy of CSAC/EDFUND; however, the default fee strategy shall be reviewed annually for amendments, including a review of any and all expectations.

DEFAULT FEE STRATEGY

In order to insure that revenue will be available for the benefit of the students, CSAC/EDFUND shall require, in the federal fiscal year prior to each academic year (with the exception of the first year of the Partnership which shall be based on the 2006 calendar year), participating lenders within the Partnership to have either:

(1) had at least 80% of their total CSAC/EDFUND loan guarantee volume comprised of consolidation loans; in which case CSAC/EDFUND will pay the federal default fee on behalf of the borrower for CSAC/EDFUND guaranteed loans, OR

(2) provided a minimum of $500 million in consolidation loan guarantee volume to CSAC/EDFUND OR in the alternative had at least 30% of their total CSAC/EDFUND loan guarantee volume comprised of consolidation loans; in which case CSAC/EDFUND and the participating lender will share in paying the federal default fee on behalf of the borrower by each paying 50% of the federal default fee for CSAC/EDFUND guaranteed loans.

It is the expectation that participating lenders will retain CSAC/EDFUND guaranteed underlying loans with CSAC/EDFUND by including them in consolidation loans guaranteed by CSAC/EDFUND.

EXHIBIT C

From: David Reid <DReid@edfund.org>
To: <Catherine.Brown@doj.ca.gov>
Date: 9/11/2006 8:08:34 PM
Subject: Default Fee Program

Catherine--

My apologies for the delay. As we discussed earlier today, there is no specific black letter law that authorizes CSAC/EDFUND to enter into a partnership to pay down the federal default fee for students BUT at the same time there is no restriction either. The proposal at-hand is similar to that which has been entered into by at least two other federal guarantee agencies (although all similar agreements to-date have been protected by non-disclosure and confidentiality agreements similar to EDFUNDs).

In general, I would direct you to section 428 of the Higher Education Act of 1965 (20 U.S.C. 1078). The federal default fee is discussed at section 428(b)(1)(H)(ii).

The issue that we had to insure that we did not violate is the prohibition on inducements which is found at section 428(b)(3)(B). Specifically, it reads:

"A guarantee agency shall not--

(B) offer, directly or indirectly, any premium, incentive payment, or other inducement to any lender, or any agent, employee, or independent contractor of any lender or guaranty agency, in order to administer or market loans made under this part (other than a loan made under section 1078-8 of this title or a loan made as part of a guaranty agency's lender-as-a-last-resort program) for the purpose of securing the designation of that guaranty agency as the insurer of such loans;"

FIRST, CSAC/EDFUND is not offering anything to lenders (there is no premium, no incentive, and no inducement) to participate in the proposed EDFUND program.

SECOND, it is important to remember that neither CSAC/EDFUND nor the lender is required to pay the default fee * the student is required to pay it. (A hypothetical example of an inducement would be if a lender were required to pay the default fee and CSAC/EDFUND were to pay it for the lender * but that is not the case).

THIRD, it is important to remember that the benefit goes directly to the student (whether it is paid by CSAC/EDFUND or jointly by CSAC/EDFUND and the lender).

I know that this is fairly complicated and would like to answer any questions you might have after you read this. Also, Sam Kipp, Therese Bickler, Martin Scanlon, Janet McDuffie (I believe I had asked her but if I didn't she should be present as well), and I would like to meet or conference call with you later this week on this topic. I will be out of the office for the rest of this week but will be available by phone on either Wednesday or Thursday.

Many thanks!

David

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