UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WISCONSIN

MEREDITH D. DAWSON,

Plaintiff,

v. Civil Action No. 15-cv-475-jdp

GREAT LAKES EDUCATIONAL LOAN SERVICES, INC., et al.,

Defendants.

DEFENDANTS' SUPPLEMENTAL ANSWER

Defendants Great Lakes Educational Loan Services, Inc., Great Lakes Higher Education Corporation, Jill Leitl, David Lentz, and Michael Walker (referred to herein collectively as Great Lakes), by their undersigned attorneys, file this supplemental answer to set out, in the words of Fed. R. Civ. P. 15(d), certain relevant "transaction[s], occurrence[s], or event[s] that happened after the date of the pleading to be supplemented." Here, those are Great Lakes' efforts, since it filed its answer on October 9, 2015, in its role as a student-loan servicer under contracts with the United States Department of Education, to (1) change, at the Department's direction, the way in which it handles the process of

capitalizing interest in connection with certain forbearance periods and (2) to remedy, at the Department's direction, the consequences of its prior capitalization practices on accounts of all borrowers who had been affected by them.

BACKGROUND ALLEGATIONS

1. Plaintiff Meredith Dawson (Dawson) filed her complaint on July 31, 2015 (Dkt. 1.), alleging that Great Lakes' servicing system had been programmed to capitalize all outstanding interest at the end of B-9 forbearances. The complaint further alleged that Great Lakes recognized in 2011 that it was not authorized to capitalize interest in this manner but chose to "conceal" its capitalization practices from the Department. (*Id*. at 19-22.) Dawson claimed that Great Lakes' motive for this concealment was to avoid adverse action by the Department against it. (*Id.* at 27-28.) Dawson had a B-9 forbearance in late 2013, when she changed to an income-based repayment plan, and thereafter Great Lakes capitalized interest in her account, allegedly contrary to applicable Department regulations. (*Id.* at 29.)

2. Promptly after suit was filed, Great Lakes investigated the way in which it had been capitalizing interest in connection with B-9 Forbearances. As Great Lakes disclosed in its answer (Dkt. 24), its investigation uncovered two technical errors—*neither of them* raised in the complaint—in the way in which it had been capitalizing interest following B-9 forbearance periods.

With the Department's Approval, Great Lakes Undertakes and Accomplishes Its First Remediation Project.

3. ***First***, Great Lakes discovered a problem with the order in which its software had applied payments made during B-9 forbearances to outstanding interest balances. (Dkt. 24 at ¶¶ 114–120.)

4. ***Second***, Great Lakes learned that its systems had been incorrectly programmed to count B-9 forbearances *to* day 60, rather than *through* day 60, thereby incorrectly shortening the period by one day and causing one additional day's worth of interest to be capitalized. (*Id.* at ¶ 121.)

5. Upon discovering these two technical errors, Great Lakes prepared to correct them and fully remedy their consequences for affected borrowers' accounts, including Dawson's (referred to herein as the First Remediation Project). (*Id.* at ¶ 127; Dkt. 66 at ¶¶ 27–32.)

6. By July 2016, Great Lakes had (1) secured approval by the Department of a plan to remedy both issues; (2) fixed both technical errors; and (3) either adjusted affected borrowers' account balances (for loans that remained outstanding) or issued refund checks to the 112 borrowers who had by that time paid off their accounts in full. (Dkt. 66 at ¶¶ 28–39.)

7. In the First Remediation Project, Great Lakes corrected the accounts of *all* borrowers, including Dawson, who had been affected by its programming errors. (Dkt. 66 at ¶ 38.) These are the borrowers whom the Court subsequently certified as the members of "subclass (c)" in its August 28, 2018 class-certification opinion and order. (Dkt. 171.) Included in "subclass (c)" are all borrowers whom the Court certified as the members of "subclass (a)." (*Id.* at 24.)

8. Following completion of the First Remediation Project, the Department reviewed a sample set of ten borrower accounts that had been adjusted and, on August 5, 2016, it informed Great Lakes that the reviewed accounts disclosed no issues with respect to the manner in which Great Lakes had accomplished it and that the First Remediation Project had been appropriate. (Dkt. 83-4.)

At the Department's Direction, Great Lakes Undertakes and Accomplishes Its Second Remediation Project.

9. At about the same time that the First Remediation Project was being completed, briefing on Dawson's first motion for class certification highlighted a legal dispute between the parties — not identified in Dawson's complaint — as to whether, under the applicable Department regulations, *any* interest was supposed to be capitalized at the end of a B-9 Forbearance. (Dkt. 56, 65, 70.) The regulations

provide scant guidance. *In their entirety*, they provide: "Interest that accrues *during this period* [*viz.*, a B-9 Forbearance] is not capitalized." 34 C.F.R. § 685.205(b)(9) (emphasis added); 34 C.F.R. § 682.211(f)(11) (emphasis added).

10. Great Lakes had interpreted this language to mean that, while interest that accrued *during* a B-9 forbearance could never be capitalized, interest that had accrued *before* such a period began should be capitalized at the end of the period, as was the case with the vast majority of forbearances that the Department made available to borrowers. (Dkt. 65 at 53-54.)[1] In light of Dawson's arguments

[1] Before this lawsuit commenced, in April 2014, and based on a related directive from the Department, Great Lakes had actually changed its computer system so as not to capitalize pre-forbearance accrued interest at the end of a B-9 forbearance for most borrowers. (Great Lakes intended to make this change for all borrowers with a B-9 forbearance, but it inadvertently failed to do so for one of the programming subroutines for the B-9 forbearance types in its systems. (Dkt. 66 ¶¶ 11–21.)) Then, in September 2014, the Department issued Change Request (CR) 2785. Change requests are memoranda from the Department to loan servicers providing new instructions or clarifications on how certain servicing transactions should be handled, and they often lead to an extended dialogue between the Department and the servicers about the costs and feasibility of implementing the changes sought. CR 2785 clarified the Department's position regarding the capitalization of pre-forbearance interest, indicating that the Department's then-position was that it intended pre-forbearance accrued interest to be capitalized at the end of a B-9 forbearance. (*Id.* at ¶ 24, Ex. D). In December 2014, the Department's "Capitalization Job Aid" showed that the Department expected servicers to capitalize pre-forbearance accrued interest at the end of B-9 forbearance periods. (*Id.* ¶ 24, Ex. E.) The Department provided its servicers with approval in early 2016 to implement the changes requested by CR 2785 and authorized an effective date for the change of July 31, 2016, at which point Great Lakes was directed again to start capitalizing pre-forbearance accrued interest at the end of B-9 forbearances. Accordingly, Great Lakes' interpretation

in her class-certification motion, Great Lakes sought to confirm with the Department its understanding of the regulations and, in August 2016, began corresponding with the Department about the issue. (Dkt. 83-2 at ¶¶ 6–12.)

11. In the ensuing communications, a Department official told Great Lakes that neither Great Lakes' nor Dawson's interpretation of the language was correct. Instead, the official said that pre-forbearance accrued interest could be capitalized at the end of *some* B-9 forbearances (called "back-to-back" forbearances), but not at the end of another type of B-9 forbearances (called "stand-alone" forbearances), because the Department did not consider the latter type a capitalization "event[]." (Dkt. 83-5.)[2]

12. Given CR 2785 and the "Job Aid" accompanying it (*see* n. 1, above), Great Lakes was surprised by the distinction that the Department was now making between stand-alone and back-to-back forbearances and requested further clarification and confirmation that the official's interpretation was truly that of the Department. (Dkt. 83-2 ¶¶ 8–9; Dkt. 83-8.)

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of the regulations was based on then-existing informal guidance and indications from the Department.

[2] A "stand-alone" B-9 forbearance is one preceded by a repayment status. A "back-to-back" B-9 forbearance is one following other capitalization events, such as a deferment or a forbearance. (Dkt. 83-2 ¶ 8.)

13. Given the significance of this correspondence, Great Lakes filed a supplemental notice with the Court, while Dawson's first motion for class certification was pending, disclosing the informal guidance received and the fact that it was preparing for the possibility that the Department "might direct the defendants to remove all capitalizations of pre-forbearance accrued interest applied at the end of B-9 Forbearances that were not preceded by a capping forbearance or deferment." (Dkt. 83-1 at 2–4; *see also* Dkt. 83-2 at ¶ 11.) But the Department did not answer Great Lakes' confirmation and clarification requests for several months after they were made.

14. When the Court denied Dawson's first motion for class certification on September 28, 2016 (with leave to file a renewed motion) (Dkt. 85.), it found specifically that "the regulations do not make it clear whether the conclusion of a B-9 Forbearance qualifies as a 'triggering event' for purposes of capitalizing the interest that accrued *prior* to the forbearance." (*Id*. at 3) (emphasis in original). This finding underscored Great Lakes's need for the Department's guidance and direction regarding the issue.

15. In October and November 2016, Dawson filed her renewed motion for class certification, and the parties fully briefed it. (Dkt. 90, 111, 121.)

16. In January 2017, while the renewed motion was pending, the Department responded to Great Lakes' request for guidance and directed it to prepare a plan to remove all capitalizations that had occurred after stand-alone forbearances. (Dkt. 133 ¶¶ 3–4.)

17. Great Lakes complied, submitting its proposed plan on January 23, 2017. (*Id.* ¶ 5.) Great Lakes' plan used a formula based on each borrower's financial transaction history, status history, and interest-rate history to calculate the net effect to each borrower caused by the to-be-removed capitalization transactions and then applied the necessary adjustment to the borrower's remaining account balance. Great Lakes' proposal was offered to the Department as a substitute for backing out all account transactions to the earliest capitalization date and then rebuilding each borrower's account going forward on a transaction-by-transaction basis. (*Id.*) Great Lakes believed that the approach it proposed would be simpler and more efficient than a full rebuild but that it would be just as accurate.

18. But before it could proceed with its remediation plan, Great Lakes needed the Department's approval. Accordingly, it sent follow-up correspondence to the Department on February 17, July 12, and August 7, 2017, seeking that approval. (*Id.* ¶ 6.)

19. At the May 18, 2017 hearing on the renewed motion for class certification, Great Lakes informed the Court that it had provided the Department with its remediation plan but that the Department had not yet authorized it.

20. On August 10, 2017, the Department confirmed that it was directing Great Lakes to remove all transactions by which pre-forbearance accrued interest had been capitalized at the end of a standalone B-9 forbearance period. (Dkt. 165 ¶ 8.)

21. In addition, the Department informed Great Lakes that the Department would conduct a full administrative review before authorizing Great Lakes to proceed, because the Department was uncertain whether Great Lakes' proposal would comply with certain Government accounting requirements (*Id.* ¶ 7–8.)

22. The Department informed Great Lakes, however, that if Great Lakes proceeded with a manual account rebuilding methodology, Great Lakes was authorized to being remediating immediately. (*Id.* ¶ 8.)

23. Despite the time-intensive nature of a manual rebuild, Great Lakes decided to proceed with a manual account rebuild, as authorized by the Department, in the interest of resolving capitalization issues promptly. (*Id.* ¶ 10; Dkt. 165-3.)

24. Thus, the "Second Remediation Project" began. Specifically, this process entailed Great Lakes' backing off all transactions on each affected borrower's account to the date of the earliest capitalization transaction at issue, removing that transaction, reapplying all subsequent transactions in the same order, and then manually reviewing the adjusted accounts to confirm that no irregularities had occurred. (Dkt. 165 ¶ 9.)

25. On August 16, 2017, Great Lakes supplemented the statements that it had made at the May 2017 motion hearing by submitting a report to the Court containing this information. (Dkt. 153.)

Great Lakes substantially completes (99%) of the Second Remediation Project by June 12, 2018 and completes the remainder a few weeks thereafter.

26. Before commencing the Second Remediation Project, Great Lakes undertook extensive testing and quality-control measures to troubleshoot issues in advance and minimize or eliminate disruption to borrowers' accounts. (Dkt. 165 ¶ 11.)

27. Even with these advance measures, certain outlier accounts with unusual situations required additional time-intensive review to address. (*Id.* ¶ 17 (identifying, as an example, certain borrowers for whom the removal of the capitalization transaction would have changed the borrower's historical

principal-to-interest ratios and thereby would have caused the borrowers to lose eligibility for certain federal loan subsidies).)

28. In accordance with the Department's direction, Great Lakes wanted to minimize the possibility that borrowers' accounts would be negatively affected by the Second Remediation Project. Accordingly, Great Lakes' staff separately reviewed any adjusted accounts where an account balance was more than $20 higher after the remediation. (*Id.* ¶ 18.)

29. Great Lakes began to apply the Second Remediation Project on borrowers' accounts on November 29, 2017. (*Id.* ¶ 13.)

30. In the course of the Second Remediation Project, a large number of accounts were identified as requiring adjustment. As with the first project, the adjustments that the Department directed for the second project caused a small percentage of affected borrowers who had previously paid off their accounts in full to no longer be paid in full. Great Lakes sent those borrowers reimbursement checks, if the amount of the adjustment exceeded the Department's $5.00 *de minimis* threshold. (*Id.* ¶ 16.)

31. Great Lakes substantially completed the project by June 12, 2018, with 99% of affected borrowers' accounts, including Dawson's, fully remediated by that date. That is, the balances in these accounts reflected the amounts owing

to the Department that would have been reflected had the previous capitalizations following stand-alone B-9 forbearances.

32. On June 12, 2018, Great Lakes reported its progress to the Court, along with its expectation that it would complete remediation of the remaining 1% of affected borrowers, whose accounts presented particular mechanical difficulties requiring further manual review, within the coming weeks. (Dkt. 164 at 8–9; *see also* Dkt. 165 at ¶¶ 19–21.)

33. Great Lakes remedied the accounts of the last few borrowers by August 30, 2018.

34. Accordingly, at this time, all the pre-forbearance interest capitalization issues identified at any point since this lawsuit was commenced have been remedied.

THIRD AFFIRMATIVE DEFENSE

35. By virtue of the First and Second Remediation Projects, neither Dawson nor any member of the plaintiff class has sustained any injury for which further compensation is due, both as a matter of the State tort law under which this action is brought and because the remediations have eliminated any case or controversy between the parties, within the contemplation of art. III, § 2 of the

Constitution, with respect to Dawson's damages claims, on her own behalf and on behalf of the plaintiff class.

FOURTH AFFIRMATIVE DEFENSE

36. The intergovernmental immunity doctrine, founded in the Supremacy Clause of the Constitution, art. VI, § 2, prohibits States from either directly regulating the federal government or discriminating against those with whom the federal government deals. *See Phillips Chemical Co. v. Dumas Ind. School Dist.*, 361 U.S. 376, 387 (1960) (holding Texas statute permitting school districts to tax lessees of federal land but not lessees of state land invalid under intergovernmental immunity doctrine); *North Dakota v. United States*, 495 U.S. 423, 435 (1986) (holding that state regulation is invalid if it "regulates the United States directly or discriminates against the Federal Government or those with whom it deals").

37. A State's attempt to regulate the federal government's contractor in the performance of its contract is a direct attempt to regulate the federal government. *See Goodyear Atomic Corp. v. Miller*, 486 U.S. 174, 181 (1988) ("[A] federally owned facility performing a federal function is shielded from direct state regulation, even though the federal function is carried out by a private contractor").

38. Here, Dawson, in bringing her State-law claims against Great Lakes under this Court's diversity jurisdiction, attempts to use State tort law to impose liability upon Great Lakes for acting pursuant to its contract with, and at express direction from, the Department.

39. In so doing, Dawson attempts to utilize State tort law to directly regulate the conduct of the federal government through its contractor, thereby frustrating the Department's ability to carry out its statutorily-mandated functions in managing Government-owned student loans as the Department chooses.

40. Accordingly, Dawson's claims are barred under the intergovernmental immunity doctrine.

FIFTH AFFIRMATIVE DEFENSE

41. Furthermore, State tort law cannot interfere with the federal government's selection, management, or oversight of its contractors.

42. Throughout the entirety of the events underlying this action, Great Lakes has acted solely in its role as a Government contractor, following the guidance and direction of the Department. By virtue of its contracts with the Department to service borrowers' accounts for student loans held by the Department under the Federal Family Education Loan (FFEL) and the William D.

Ford Federal Direct Loan (Direct Loan) programs, Great Lakes is subject to the Department's direction.

43. The Higher Education Act of 1965, as amended, 20 U.S.C. §§ 1001-1155 (HEA), evinces Congress's intent to establish uniform regulations governing the administration by the Department of student loans under the FFEL and Direct Loan programs.

44. The HEA empowers the Department to prescribe regulations governing third-party servicers, including Great Lakes, under the FFEL program, 20 U.S.C. § 1082(a)(1), and to contract with servicers to administer borrower accounts made under the Direct Loan program, 20 U.S.C. § 1087f. The HEA further mandates that loans made under the FFEL and the Direct Loan programs be subject to the same terms and conditions. 20 U.S.C. § 1087e(a)(1).

45. Subjecting servicers to the varying standards of different States' tort laws would impede uniformity and thus poses an obstacle to accomplishment of Congress's objectives under the HEA.

46. Conflict preemption, another doctrine grounded in the Supremacy Clause, applies where State law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 372–73 (2000) (quoting *Hines v. Davidowitz*, 312 U.S. 52,

67 (1941)); *see also Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996) ("'[T]he purpose of Congress is the ultimate touchstone' in every pre-emption case.").

47. An obstacle occurs when a State law would directly conflict with federal law or would "undermine [its] goals and policies." *See Volt Info. Sciences v. Stanford Univ.*, 489 U.S. 468, 477–78 (1989).

48. Conflict preemption applies where a State's regulation of a federal contractor interferes with the federal government's ability to choose or direct its preferred contractors. *See, e.g. Leslie Miller, Inc. v. Arkansas*, 352 U.S. 187, 189–90 (1956) (holding that Arkansas cannot require a construction company to obtain a state contractor's license to perform work at an Air Force base because it would give the state "a virtual power of review" over the federal government's determination of the appropriate contractor); *See United States v. Virginia*, 139 F.3d 984, 987 n.3 (4th Cir. 1998) (holding that Virginia could not force federal contractors performing federal background checks to submit to state licensure).

49. These principles have recently been applied to enjoin the District of Columbia's attempt to regulate the servicing of federally-owned student loans. *See Student Loan Servicing Alliance v. District of Columbia*, Case No. 18-0640 (PLF) (enjoining the District of Columbia from enforcing a comprehensive licensing and

regulatory scheme against student loan servicers as to their servicing of federally-owned student loans) .

50. Here, Dawson seeks to use State tort law to impose liability on Great Lakes for actions it has taken at the direction of the Department pursuant to its servicing contract; in essence, this is an attempt to use this litigation as a vehicle for second-guessing the Department's oversight of how its contractor services federally-owned student loans.

51. Because the imposition of liability upon Great Lakes for acting pursuant to the direction of the Department would undermine the federal law that permits the Department to service federally-owned loans by contracting with servicers like Great Lakes, Dawson's claims are foreclosed under principles of conflict preemption.

SIXTH AFFIRMATIVE DEFENSE

52. Dawson's claims also fail because Great Lakes is immune from suit for actions it has taken under the authorization of the Department.

53. Federal government contractors are immune from suit "when the government authorized the contractor's actions and the government validly conferred that authorization." *Yearsley v. W.A. Ross Constr. Co.*, 309 U.S. 18, 20-21 (1940). This derivative sovereign immunity extends to actions taken pursuant to

all manner of federal contracts. *See Campbell-Ewald Co. v. Gomez*, 136 S. Ct. 663, 673-674 (2016) (discussing availability of derivative immunity under *Yearsley* to a contractor sued for text messages it sent as part of a Navy recruitment campaign and rejecting application of that immunity because contractor violated federal law).

54. Here, Great Lakes' actions complained of by Dawson were remediated under the authorization of the Department, and, as noted in paragraph 50, above, Dawson is trying to use this litigation to second-guess the Department's determination of how its contractor should service these federally-owned loans.

55. The Department's authorizations to Great Lakes for its remediation projects were validly conferred under Great Lakes' servicing contract.

56. Because Great Lakes is immune from suit for actions it took pursuant to valid federal authorization, Dawson's claims against it are barred.

WHEREFORE, Great Lakes demands judgment against Dawson and the plaintiff class as follows:

a. Upon its answer and supplemental answer, dismissing Dawson's complaint in its entirety, upon its merits, and with prejudice;

b. For its costs of this action; and

c. For such other and further relief as shall be just.

Dated this 4th day of February, 2019.

s/ Eric G. Pearson

Thomas L. Shriner, Jr.
Elizabeth A. N. Haas
Eric G. Pearson
FOLEY & LARDNER LLP
777 East Wisconsin Avenue
Milwaukee, Wisconsin 53202-5306
(414) 271-2400 Telephone
(414) 297-4900 Facsimile
Email: tshriner@foley.com
Email: ahaas@foley.com
Email: epearson@foley.com

Michael D. Leffel
FOLEY & LARDNER LLP
150 East Gilman Street, Suite 5000
Madison, Wisconsin 53703-1482
(608) 257-5035 Telephone
(608) 258-4258 facsimile
Email: mleffel@foley.com

Attorneys for Defendants Great Lakes Educational Loan Services, Inc., Great Lakes Higher Education Corporation, Jill Leitl, David Lentz, and Michael Walker