

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

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Brenda Kay Pfeiffer,)
)
On behalf of herself and all others similarly)
situated,)
)
<i>Plaintiff,</i>)
)
v.)
)
Arne Duncan, in his official capacity as)
United States Secretary of Education, the)
United States Department of Education, and)
the United States of America,)
)
<i>Defendants.</i>)
)
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Civil No. 1:07-cv-00522 (EGS)

CLASS ACTION

**MEMORANDUM IN SUPPORT OF
PLAINTIFF'S RENEWED MOTION FOR PARTIAL SUMMARY JUDGMENT**

Steven M. Sprenger (DC No. 418736)
SPRENGER & LANG, PLLC
1400 Eye Street, N.W., Suite 500
Washington, DC 20005
(202) 265-8010

Daniel C. Bryden (MN No. 302284 *Pro Hac Vice*)
SPRENGER & LANG, PLLC
310 Fourth Avenue S., Suite 600
Minneapolis, MN 55415
(612) 871-8910

Attorneys for Plaintiff and the Class

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INTRODUCTION

Plaintiff Brenda Pfeiffer (“Dr. Pfeiffer”), a student loan borrower, brings this action against the United States Department of Education and other federal government defendants (collectively, “DOE”) for breach of contract. She contends that DOE’s interest capitalization practice with respect to borrowers who, like her and members of the proposed class, have selected the Income Contingent Repayment Plan breaches the terms of the form promissory note governing their student loans. The plain terms of the note state that DOE may only capitalize interest that is “not paid when due.” In direct violation of these plain terms, it is DOE’s regular practice to capitalize accrued interest before that interest is due.¹ Accordingly, Dr. Pfeiffer and the plaintiff class are entitled to partial summary judgment with respect to DOE’s liability for breach of contract.

SUMMARY OF MATERIAL FACTS THAT ARE NOT IN DISPUTE

The material facts that are not in dispute are set forth in full in Plaintiff’s Statement of Undisputed Material Facts (“Plaintiff’s Statement of Facts”) which accompanies this memorandum. In summary, individuals who obtain student loans from the United States Department of Education pursuant to the William D. Ford Direct Loan Program execute identical or substantially identical form promissory notes. Plaintiff’s Statement of Facts at ¶¶ 1- 3.

The form promissory notes state that DOE may capitalize interest if the borrower does not pay the interest when it is due:

Interest. Except for interest [DOE] does not charge me during an in-school, grace or deferment period, I agree to pay interest on the principal amount of my Direct Consolidation Loan from the date of disbursement until the loan is paid in full or discharged. [DOE] may add interest that accrues but is not paid when due to the unpaid principal balance of this loan, as provided under the [Higher Education

¹ Such premature interest capitalization has two adverse financial effects on student loan borrowers: first, it results in an immediate increase in the principal balance of the borrower’s student loan; and, second, the borrower is required to pay interest on the additional principal balance over the term of the loan.

Act of 1965, as amended, 20 U.S.C. 1070 *et seq.*, and applicable Department of Education regulations]. This is called capitalization.

Id. at ¶ 4 (emphasis added). The above-quoted provision is the only language in the form promissory note that addresses interest capitalization. *Id.*

DOE assigns each borrower a monthly “due date” – that is, the day of the month by which the borrower’s monthly loan payment must be received. *Id.* at ¶ 6. When DOE receives a payment on a student loan, it first applies that payment to any outstanding fees, then to accrued interest, and then to principal balance. *Id.* at ¶ 7. On each monthly due date, DOE bills the borrower for the interest that has accrued as of his or her payment due date. *Id.* Interest accruing *after* a borrower’s monthly due date is not billed until the next monthly due date. *Id.*

Approximately half of the 600,000 borrowers who have elected to repay their loans under the Income Contingent Repayment Plan (“ICRP”) are considered by DOE to be “negatively amortized.” This means that the scheduled payment amount (i.e., the amount the borrower is required to pay each month) is less than the amount of interest accruing on the borrower’s loan each month. *Id.* at ¶¶ 8-10. For all such negatively amortized borrowers, DOE capitalizes the borrower’s accrued interest each year on June 30 and has done so since at least March 19, 2001. *Id.* at ¶ 11.

DOE capitalizes interest accrued through June 30 regardless of the borrower’s monthly payment due date. *Id.* Thus, DOE capitalizes interest accruing *after* the borrower’s June payment due date through June 30. *Id.* at ¶¶ 11-12. But the interest accruing after the borrowers’ June payment due date is not billed to the borrower or otherwise expected to be paid, i.e., is not due, until his or her July payment due date. *Id.* at ¶¶ 7, 12. Accordingly, DOE’s undisputed practice is to capitalize interest prematurely.

Dr. Pfeiffer was subjected to the interest capitalization practice described above in 2002, 2004 and 2005. In addition, while Dr. Pfeiffer's scheduled payment amount led DOE to classify her loan as negatively amortized, her actual monthly payments on her loan in these years exceeded the amount of interest accruing on her loan. *Id.* at ¶¶ 16, 18, 20, 23, 24, 26. Nonetheless, on June 30 in each of these years, DOE capitalized the interest accruing on Dr. Pfeiffer's loan between her June payment date and June 30. *Id.* at ¶¶ 17, 22, 25.

These interest capitalizations occurred because DOE does not consider the borrower's *actual* payments when it determines whether to capitalize the borrower's interest. Instead, if the ICRP borrower's scheduled payments are insufficient to cover the interest accruing each month, DOE capitalizes interest on the borrower's loan even if the borrower's *actual* payments *are* sufficient to cover the interest accruing each month. *Id.* at ¶ 28. There are approximately 26,900 borrowers who, like Dr. Pfeiffer, were considered negatively amortized by DOE and whose actual payments exceeded the interest accruing on their loans each month. *Id.*

LEGAL ARGUMENT

In an action against the United States for breach of contract, courts do not look to a specific state's common law of contracts. Rather, courts apply general principles of contract law: "When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals." *Franconia Assocs. v. United States*, 536 U.S. 129, 141 (2002) (quoting *Mobil Oil Exploration & Producing Southeast, Inc. v. United States*, 530 U.S. 604, 607 (2000)). Accordingly, the Court should apply "principles of general contract law." *Id.* at 141 (quoting *Priebe & Sons, Inc. v. United States*, 332 U.S. 407, 411 (1947)).

The starting point for contract interpretation is the plain language of the contract. *See Boeing v. United States*, 75 Fed. Cl. 34, 42 (2007); *Dorocon, Inc. v. Burke*, No. 02-2556, 2004 U.S. Dist LEXIS 29052, *89 (D.D.C. Sept. 27, 2004) (citing *Capital City Mortgage v. Habana Village Art & Folklore, Inc.*, 747 A.2d 564, 567 (D.C. App. 2000)). In reading the plain language of the contract, a court should “give the words of the agreement their ordinary meaning unless the parties mutually intended and agreed to an alternative meaning.” *Harris v. Dep’t of Veterans Affairs*, 142 F.3d 1463, 1467 (Fed. Cir. 1996); *see also Hartford Accident & Indem. Co. v. Pro-Football, Inc.*, 127 F.3d 1111, 1114 (D.C. Cir. 1997); *Nat’l RR Passenger Corp. v. Lexington Ins. Co.*, 445 F. Supp. 2d 37, 41 (D.D.C. 2006). A contract should be interpreted so that it “makes sense.” *McAbee Constr., Inc. v. United States*, 97 F.3d 1431, 1435 (Fed. Cir. 1996).

As set forth below, the plain terms of the form promissory note compel judgment in favor of Dr. Pfeiffer and the plaintiff class with respect to DOE’s liability for breach of contract. To the extent that the Court finds that the note is ambiguous, however, it must construe it against DOE because it is the drafter of the note. *See United States v. Seckinger*, 397 U.S. 203, 216 (1970) (construing contract against government as drafter of contract, and noting “[t]his principle is appropriately accorded considerable emphasis in this case because of the Government's vast economic resources and stronger bargaining position in contract negotiations”); *Mesa Air Group v. Dep’t of Transp.*, 87 F.3d 498, 506 (D.C. Cir. 1996) (where federal agency drafted contracts, such contracts would be construed against agency if ambiguous)(citing *Restatement of the Law (Second) Contracts*, § 206). No deference is due to DOE’s interpretation of a contract to which it is a party. *Id.* at 503 (contracts that an agency is a party to are “subject to interpretation under the neutral principles of contract law”).

Contract disputes such as this one are well-suited for resolution by summary judgment motions. *See United States v. Mass. Housing Auth.*, 456 F. Supp. 2d 46, 55 (D.D.C. 2006) (“[w]hen a case turns on the meaning of an unambiguous contract, summary judgment is appropriate, because ‘no citation of authority is necessary to establish the proposition that the construction of written instruments is a question of law for the court.’”; “[c]ontract interpretation is particularly suited to disposition by summary judgment.”) (quotations and citations omitted). This is true whether the moving party is a plaintiff or defendant.

I. THE FORM PROMISSORY NOTE DOES NOT PERMIT THE CAPITALIZATION OF ACCRUED INTEREST THAT IS NOT YET DUE.

A. Only Accrued Interest That Has Not Been Paid When Due May Be Capitalized.

The form promissory note provides for interest capitalization only when a borrower fails to pay the interest on his or her loan as it becomes due. The sole provision in the note that specifically addresses interest capitalization states, in relevant part: DOE “may add interest that accrues but is *not paid when due* to the unpaid principal balance of this loan.” (emphasis added). The note does not identify any other circumstance under which interest may be capitalized. Accordingly, under the plain terms of the note, the only circumstance under which interest may be capitalized is when interest is not paid when due.

Notwithstanding this language in the promissory note, DOE capitalizes interest on June 30 each year for negatively amortized borrowers who have selected the ICRP, including Dr. Pfeiffer, before it is due. This capitalization includes the interest that accrues *after* the borrower’s June payment date. But borrowers are not billed for or expected to pay the interest accruing *after* their June payment due date until their July payment due date. In other words, the interest accruing after a borrower’s June due date is not due until his or her July payment due date. By capitalizing this

interest on June 30 each year, DOE has capitalized interest before it is due in breach of the plain terms of the form promissory note.

B. 34 C.F.R. § 685.202(b)(4) Does Not Permit the Premature Capitalization of Accrued Interest.

As set forth above, the form promissory notes state in part that DOE “may add interest that accrues but is not paid when due to the unpaid principal balance of this loan, as provided under the [Higher Education Act of 1965, as amended, 20 U.S.C. 1070 *et seq.*, and applicable Department of Education regulations].” Plaintiff’s Statement of Facts at ¶ 4 (emphasis added).

The above-quoted language in the note referring to the “Higher Education Act of 1965, as amended, 20 U.S.C. 1070 *et seq.*, and applicable Department of Education regulations” is the only language in the note that suggests there are regulations that may apply to the note. At her deposition, Cynthia Battle, DOE’s Servicing Director for the Direct Loan Program and 30(b)(6) witness, stated that she does not know to what regulations or portions of the Higher Education Act this language refers. *Id.* at ¶ 5. Other than this general language, DOE does not provide borrowers any information regarding what regulations or portions of the Higher Education Act may be relevant to the note. *Id.*

Notwithstanding the obscure meaning of this language in the note, DOE relies on a regulation, 34 C.F.R. § 685.202, in defense of its practice of capitalizing interest that accrues between a borrower’s June payment date and June 30. The regulation provides, in relevant part:

... the Secretary annually capitalizes unpaid interest when the borrower is paying under the alternative or income contingent repayment plan and the borrower’s scheduled payments do not cover the interest that has accrued on the loan.

34 C.F.R. § 685.202(b)(4). In other words, the Secretary capitalizes interest only one time per year (“annually”) and only when the borrower’s scheduled payments do not cover the interest that has accrued on the loan. The regulation does not authorize the Secretary to ignore the plain

terms of the promissory note and capitalize accrued interest that is not yet due. Nor does it require the Secretary capitalize interest on each borrower's student loan on the same day of the year. Rather, the regulation simply sets forth the number of times the Secretary may capitalize interest each year.

If, as DOE urges, the regulation is interpreted to permit the Secretary to capitalize accrued interest before it is due, then the regulation directly contradicts the form promissory note's interest capitalization provision. Under DOE's interpretation, the regulation would effectively nullify the "not paid when due" language in the phrase "may add interest that accrues but is not paid when due to the unpaid principal balance of this loan."

DOE asks the Court to read the form promissory note's provision out of the contract – a suggestion that is inconsistent with basic tenets of contract interpretation. *See United States v. Insurance Co. of N. Am.*, 83 F.3d 1507, 1511 (D.C. Cir. 1996) (noting the "cardinal principle of contract construction: that a document should be read to give effect to all its provisions") (quoting *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 63 (1995)); *see also YRT Servs. Corp. v. United States*, 28 Fed. Cl. 366, 389 (1993) ("When interpreting the language of a contract, a court must give reasonable meaning to all parts of the contract and not render portions of the contract meaningless."); *Fort Sumter Tours, Inc. v. Babbitt*, 202 F.3d 349, 358 (D.C. Cir. 2000). And as in *Fort Sumter Tours*, "the provision at issue [is not] unimportant to the contract": DOE's construction would render the prominent language meaningless in favor of an unspecified provision buried in a welter of regulations concerning student loans and thus frustrate the reasonable expectations of the student loan borrowers.

A second black-letter principle of contract interpretation precludes an interpretation of the contract that creates rather than harmonizes potential conflicts or inconsistencies. As this Court has stated before:

It is a basic tenet of contract law that where two seemingly conflicting contract provisions exist within a contract, it is the province and duty of the court to find harmony between them and reconcile them if possible. In other words, the court should construe, if possible, all clauses and provisions of a contract so as to harmonize with one another. Only when the parts of a contract are so radically repugnant that there is no way in which they can rationally stand together must any part perish.

Shulman v. Voyou, L.L.C., 251 F.Supp.2d 166, 169 (D.D.C. 2003) (quotations and citations omitted). DOE's interpretation would put the plain language of the promissory note in direct conflict with the unspecified DOE regulation.

These canons of construction are particularly apt here because, to create the supposed conflict between the note and the regulation, DOE also has to violate the canon that regulations be read consistently with "ordinary, contemporary, common meaning." *Motorola, Inc. v. United States*, 462 F. Supp. 2d 1367, 1374-75 (Ct. Int'l Trade 2006). As set forth above, 34 C.F.R. § 685.202(b)(4) provides that the Secretary "annually capitalizes unpaid interest." But "unpaid" interest necessarily means *interest that was not paid as it became due* because "unpaid" is synonymous with "due." *See Roget's II, The New Thesaurus, Third Edition* (1995), available at <http://www.bartleby.com/62/44/U1624400.html> (last visited April 24, 2009); *see also Biggs v. Wilson*, 1 F.3d 1537, 1540 (9th Cir. 1993) (holding that under the Fair Labor Standards Act, wages become "unpaid" if not paid when the wage is "due" on payday). Thus, under the ordinary meaning of the regulation, it provides that the Secretary annually capitalizes interest that was not paid when it was due, which is precisely what the promissory note provides. That is

the best reading of the regulation, and the only reading that conforms to the canons of construction set forth above.

Thus, DOE is in the untenable position of interpreting a regulation so as to render a key concept meaningless in order to create a conflict with the form promissory note that would render a phrase of that note meaningless, all in defiance of the principle that the interpretations should be harmonized rather than placed into conflict. The Court should reject DOE's convoluted interpretations of the note and the regulation.

Moreover, Dr. Pfeiffer's reading accords with the principle that a regulatory section, like a statutory one, should be interpreted in the context of the remainder of the regulation of which it is a part. *McCarthy v. Bronson*, 500 U.S. 136, 139 (1991) (statutory language must be read in its proper context and not viewed in isolation). 34 C.F.R. § 685.202(b)(1) explains that under certain circumstances "unpaid accrued interest" may be added to the borrower's "unpaid principal balance," which increase in the balance is called "capitalization." The use of the two words in succession shows that in DOE's regulations "unpaid" means something different than "accrued." If the words had the same meaning, DOE would only have used one of them. Yet for purposes of this lawsuit, DOE wishes to treat "unpaid" as synonymous with "accrued."

The other subsections of 34 C.F.R. § 685.202(b) also reflect the distinction between "accrued" and "unpaid" interest and place subsection (4) within a more comprehensive scheme concerning capitalization. Subsection (5) permits capitalization of "unpaid interest when the borrower defaults on the loan." A default, however, occurs only if a borrower fails to make an installment payment or otherwise violates the terms of the note and "this failure persists for 270 days." 34 C.F.R. § 685.102(b). Subsections (2) through (4) permit the DOE to capitalize "unpaid interest" that has accrued in three other situations that do not rise to the level of a

