

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

BRENDA KAY PFFEIFER,	.	
	.	
Plaintiff,	.	
	.	CA No. 07-cv-522
v.	.	
	.	
MARGARET SPELLINGS, et al,	.	Washington, D.C.
	.	November 14, 2008
Defendant.	.	10:10 a.m.
	.	
.....	.	

TRANSCRIPT OF HEARING
BEFORE THE HONORABLE EMMET G. SULLIVAN
UNITED STATES DISTRICT JUDGE

APPEARANCES:

For the Plaintiff:	STEVEN SPRENGER, ESQ. DANIEL C. BRYDEN, ESQ. Sprenger & Lang, PLLC 1400 I Street, NW Suite 500 Washington, D.C. 20005 202-265-8010
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For the Defendant:	JOHN WARSHAWSKY, ESQ. CHRISTIAN JOHN GROSTIC, ESQ. U.S. Department of Justice 1100 L Street, NW Room 10030 Washington, D.C. 20044-0875 202-307-0010 202-307-3243
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Court Reporter:	JACQUELINE M. SULLIVAN, RPR, CRR Official Court Reporter U.S. Courthouse, Room 6720 333 Constitution Avenue, NW Washington, D.C. 20001 202-354-3187
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P R O C E E D I N G S

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2 COURTROOM DEPUTY: Civil Action 07-522, Brenda
3 Pfeiffer versus Margaret Spellings, et al.

4 Would counsel please identify yourselves for the
5 record?

6 MR. SPRENGER: Good morning, your Honor. Steve
7 Sprenger on behalf of the plaintiff, Brenda Pfeiffer.

8 THE COURT: Good morning.

9 MR. BRYDEN: Good morning, your Honor. Dan Bryden,
10 also for the plaintiff, and joining us this morning is the
11 plaintiff, Dr. Brenda Pfeiffer.

12 THE COURT: All right. Good morning.

13 MR. WARSHAWSKY: Good morning, your Honor. John
14 Warshawsky from the Justice Department for the defendants. At
15 counsel table with us is Christian Grostic from the U.S.
16 Department of Justice as well, Mr. Ronald Sann, and S. Dawn
17 Scaniffe from the U.S. Department of Education.

18 THE COURT: All right. Good morning.

19 A very interesting case. Let me ask the government a
20 couple of questions first. How can a person avoid being
21 capitalized? How can a person avoid capitalization?

22 MR. WARSHAWSKY: For a borrower in Dr. Pfeiffer's
23 situation where she's making payments in excess of the scheduled
24 amount under the -- in a negative amortization condition and
25 therefore and also with a contingent payment plan --

1 THE COURT: Let me see if I have this correct. She
2 had the option of electing from a number of plans. She had the
3 option of selecting a payment plan for the debt?

4 MR. WARSHAWSKY: That's correct, your Honor.

5 THE COURT: She could have had, I guess, the more
6 traditional-type of payment plan that most of us have with
7 regards to mortgage fixed amortization over a fixed term.

8 MR. WARSHAWSKY: That's correct, your Honor.

9 THE COURT: Traditional what, is 30 years, 360 months,
10 and all the interest a bank can charge, but she elected for --
11 she elected to participate in a plan that she believed would
12 accommodate her situation. Her income fluctuated, I assume, or
13 maybe that was a factor in her decision. Her income could
14 fluctuate, she didn't want to be tied down to the fixed
15 interest, and that's what, 8-and-a-quarter a year or something
16 like that?

17 MR. WARSHAWSKY: Your Honor, there are a couple of
18 issues, if I may.

19 First of all, when Dr. Pfeiffer took out loans, she
20 actually took out a variable interest loan. The loan that is at
21 issue in this case was taken out in 2001, and that was to lock
22 her into a fixed rate. Dr. Pfeiffer, like all student
23 borrowers, had the option --

24 THE COURT: Let me finish what I'm saying.

25 MR. WARSHAWSKY: I'm sorry.

1 THE COURT: It was 8.25 percent fixed, though,
2 correct? Is that the fixed interest?

3 MR. WARSHAWSKY: I'm not positive.

4 MS. SCANIFFE: That was the maximum.

5 THE COURT: That's what the paperwork says, 8.25
6 percent. Is it something different than what the contract says?

7 MR. WARSHAWSKY: No. No, your Honor, it is not.

8 THE COURT: So she either had the option of paying
9 that at a fixed rate per month, in other words, she would know
10 what her principal and interest payments were for the life of
11 the loan, right?

12 MR. WARSHAWSKY: That's correct, your Honor.

13 THE COURT: All right. Or she opted into this plan
14 that she was in and which was a benefit, I assume, to a
15 borrower, because presumably the payments would be less than the
16 fixed rate of 8.25 amortized over the life of the loan?

17 MR. WARSHAWSKY: Your Honor --

18 THE COURT: Or not? Am I wrong in that regard? Tell
19 me I'm wrong.

20 MR. WARSHAWSKY: I suspect you're right, but I don't
21 know the analysis that was done at the time she took out the
22 loan. Borrowers --

23 THE COURT: Let me get back to my question.

24 MR. WARSHAWSKY: Yes.

25 THE COURT: How does someone avoid capitalization? If

1 I understand this correctly, if she's making monthly payments
2 each month and the monthly payments are less than the amortized
3 interest that's chargeable on her loan, then she runs the risk
4 of being capitalized once a year, every June, ten days remaining
5 in the month of June; is that right?

6 MR. WARSHAWSKY: Yes, generally correct, your Honor.

7 THE COURT: How does one avoid that? Do they just
8 follow the instructions on the statements? I mean, for
9 instance, her statements said send in \$660.24 to avoid
10 capitalization. The borrower can avoid that then; is that
11 right?

12 MR. WARSHAWSKY: What the statement provides, yes, if
13 the borrower makes that payment as the statement indicates, when
14 the secretary does go through the process of determining the
15 amount to capitalize on June 30th, which the secretary does
16 annually for all negative amortization ICR borrowers, the amount
17 up to receipt of the final June payment, if she had paid all the
18 amount indicated on that statement, that would not be part of
19 what is capitalized. The difficulty for --

20 THE COURT: Well, it says to avoid, the loan she got,
21 and I don't think anyone disputes it, To avoid capitalization,
22 you can send a payment to cover all or part of the interest
23 owed, or, two, pay at least the amount of interest charged
24 monthly to your account. About \$660.24. So if she avails
25 herself of the latter and pays \$660.24 for this particular

1 month, then there's no capitalization?

2 MR. WARSHAWSKY: She will avoid capitalization of
3 interest up to that interest -- that interest is accrued up to
4 the point when her final payment is received.

5 THE COURT: Right. So she avoids it?

6 MR. WARSHAWSKY: And that's the important point. If I
7 may, your Honor.

8 THE COURT: Wait a minute. She avoids it up to when?

9 MR. WARSHAWSKY: To receipt of her final payment in
10 June, and that's the neutral rub in this case, your Honor, if I
11 may.

12 THE COURT: So wait a minute. The statement then is
13 misleading then?

14 MR. WARSHAWSKY: The statement -- the statement --

15 THE COURT: I mean, it says, To avoid capitalization,
16 send in \$660.24, so if I'm the borrower and I get this, the
17 statement, and I say, gee, I don't want an additional loan of
18 principal that's going to be subject to interest for the life of
19 the loan, I don't want that, I want to follow the instructions
20 that the government gives me and send in my check for \$660.24,
21 but now you're telling me she won't avoid capitalization if she
22 does that.

23 MR. WARSHAWSKY: She will avoid capitalization of the
24 \$660 or whatever it was that's indicated on that statement. The
25 difficulty, your Honor, is that when that payment is received in

1 June, under the regulations which are part of Dr. Pfeiffer's
2 loan, a calculation is made, an allocation is made of that
3 payment between accrued interest up to receipt of the payment
4 and any excess amount is applied to principle reduction, but
5 once that payment is received, say, for instance, on, you know,
6 it can be any day in June, say June 15th, she in your
7 hypothetical, she pays off all interest that has accrued up till
8 June 15th. There will be no cap --

9 THE COURT: That's not what the statement says,
10 though. It says please send your payment, note. One, your
11 monthly payment is less than interest owed on your loan, and
12 two, the capitalized accrued interest on your account is
13 currently \$216.92, which suggests to me if I'm the borrower
14 that's the amount that's going to be capitalized, that's the new
15 loan I'm going to get unless I avoid capitalization, and then it
16 goes on to say when unpaid interest is capitalized, added to
17 principal once a year, will increase the cost of your loan.
18 Well, we know that it's going to increase it by 292 and 16, plus
19 additional interest. Then it says to avoid cap you can, one,
20 send a payment to cover all or part of the interest owed, or
21 two, pay at least the amount of interest charged monthly to your
22 account, about \$660.24. I mean, those are the instructions that
23 the borrower gets and, you know, her position is, and no one
24 disputes it I don't believe, that for one month, July of '02,
25 she paid \$725, so she's challenging the rationale behind her

1 being capitalized for that month.

2 MR. WARSHAWSKY: She's challenging the capitalization
3 interest between receipt of that payment in June and June 30th,
4 which is roughly a 10-, 15-day period, the period reflected in
5 the statement.

6 THE COURT: How can anyone ever avoid capitalization
7 then? If nothing, the government's own instructions don't allow
8 someone to avoid capitalization, how can a borrower avoid being
9 put in the position of having an additional loan of principal
10 that's going to be subject to interest annualized over the
11 remaining portion of the loan? How can someone avoid that? Or
12 is it impossible to avoid it?

13 MR. WARSHAWSKY: It's not impossible, your Honor.

14 THE COURT: Tell me in plain English how can someone
15 avoid it? What should she have done that she didn't do? She
16 followed the instructions; that wasn't good enough, so what
17 should she have done different? It was critical to Dr. Pfeiffer
18 to avoid capitalization of interest for a 10-day period or 15-
19 day period, she would make a second payment to the government,
20 received on June 30th, which would cover that period of interest
21 that accrued during this very narrow window.

22 MR. WARSHAWSKY: One point, your Honor, I do want to
23 stress, though --

24 THE COURT: But that doesn't say that. There's no
25 footnote that says, now, to really avoid capitalization, this is

1 what you must do.

2 MR. WARSHAWSKY: No. Your Honor, if it's that -- if
3 it's important to the borrower, what the borrower should do,
4 aside from certainly, first of all, contacting Education for
5 guidance, and she did not do that.

6 THE COURT: Why contact? This is plain English.
7 Everyone knows there's a string attached to this accommodation
8 that they're getting. They're individualizing, you know, the
9 traditional loan, the traditional mortgage, 360 amortized equal
10 monthly payments. They're avoiding that because they recognize
11 income can fluctuate, but then people don't want to be straddled
12 with a lot of additional loans either, and it seems to me this
13 is plain English. To avoid capitalization, to avoid that
14 additional loan for the 10-day period. It doesn't say pay it by
15 the 30th. In fact, the statement is not even dated. Well, it
16 had to have been current. Well, I'm not going to assume
17 anything. It says current payment due date, 7/21. I assume it
18 was mailed and received prior to the 21st. It just says to
19 avoid capitalization. There's no footnote. There's no other
20 language to really avoid it. You got to pay on the 30th. Where
21 would a borrower glean that understanding from?

22 MR. WARSHAWSKY: A borrower would glean that
23 understanding, your Honor, from the implementing regulations,
24 which are incorporated in the promissory note which borrowers
25 like Dr. Pfeiffer signed in which she affirmatively certified

1 that she read, understood, and agreed to the terms of that note.

2 THE COURT: Focus my attention on that particular
3 portion of the regulation that is set forth in a note that would
4 put her on notice that there's another condition that she has to
5 fulfill.

6 MR. WARSHAWSKY: Your Honor, the principal regulation
7 that we're talking about, a 34 --

8 THE COURT: You say they're in the promissory note,
9 right? The language is in the promissory note?

10 MR. WARSHAWSKY: They are incorporated by reference in
11 the governing law provision.

12 THE COURT: So they're not set forth clearly in the
13 promissory note?

14 MR. WARSHAWSKY: The specific regulations are not
15 listed in the promissory note.

16 THE COURT: Is the language to the instruction to the
17 borrower about the manner in which she can avoid capitalization
18 set forth clearly or at all in the promissory note?

19 MR. WARSHAWSKY: Your Honor --

20 THE COURT: This is a breach of contract act. This
21 isn't a challenge to the regulation. Breach of contract. So
22 the document would control, I assume, the four corners of the
23 document?

24 MR. WARSHAWSKY: The regulations are part of the
25 contract, though, your Honor, and they are expressly

1 incorporating the Higher Education Act as amended and applicable
2 Education regulation is.

3 THE COURT: So what is the person what's a borrower
4 supposed to do, look at the promissory note, look at the
5 regulation, look at the instruction that I assume these
6 instructions to borrowers, the direct loan statements come out
7 every month, I assume, billing statement.

8 MR. WARSHAWSKY: That's correct, your Honor.

9 THE COURT: All right. So what's the legal effect of
10 the language on the billing statement that addresses negative
11 amortization?

12 MR. WARSHAWSKY: If are you asking -- your Honor, if
13 you're asking does this bind the government.

14 THE COURT: I'm just asking you a straightforward
15 question. What's the legal effect of this billing statement?

16 MR. WARSHAWSKY: I would say it's not legally
17 governing. It is advice to the borrower that if the borrower
18 wants -- it's telling the borrower that because he or she is in
19 a negative amortization condition, interest is accruing during
20 the year, which, if not paid off, will be capitalized, and that
21 is accurate for all borrowers, including borrowers who, like Dr.
22 Pfeiffer, pay --

23 THE COURT: I'm sorry to beat a dead horse. It's just
24 difficult to get a handle on this. Because it does tell the
25 borrower to avoid capitalization, you can send in a payment of

