**No. 14-2202**

**UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT**

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**LEE PELE**,
*Plaintiff - Appellant*,

v.

**PENNSYLVANIA HIGHER EDUCATION ASSISTANCE AGENCY** d/b/a American Education Services,
*Defendant – Appellee*.

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On appeal from the U.S. District Court for the Eastern District of Virginia
(Hon. James C. Cacheris, U.S. District Judge)

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# APPELLENT'S OPENING BRIEF


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## CORPORATE DISCLOSURE STATEMENT

Pursuant to Fed. R. App. P. 26.1 and 4th Cir. R. 26.1, appellant Lee Pele states he is a natural person who has no parent corporation and there is no publicly held corporation that owns 10% or more of his stock. Lee Pele knows of no publicly held corporation that has a direct financial interest in the outcome of the litigation by reason of a franchise, lease, other profit-sharing agreement, insurance, or indemnity agreement. Appellant is not a trade association.

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## REQUEST FOR ORAL ARGUMENT

Appellant Lee Pele respectfully requests oral argument in light of the importance of the issue presented. The answer to the question whether one of the nation's largest loan servicers is immune from suit will determine whether legal remedies are available to student borrowers and others aggrieved by that entity's conduct. *See, e.g.*, *Lang v. Pa. Higher Educ. Assistance Agency*, No. 14-1080 (3d Cir., appeal docketed Jan. 15, 2014) (alleging federal and state wage-and-hour law violations); *United States ex. rel. Oberg v. Pa. Higher Educ. Assistance Agency*, No. 1:07-CV-960 (E.D. Va., mot. for summ. j. filed Oct. 17, 2014) (action under the False Claims Act alleging that the Agency defrauded the federal government).

## STATEMENT OF JURISDICTION

This Court has jurisdiction over this appeal from a district court's final judgment. 28 U.S.C. § 1291. The district court had jurisdiction under 28 U.S.C. § 1331. The district court's judgment, entered October 7, 2014, disposed of all claims in the case, and this appeal was timely noticed on October 31, 2014, within thirty days after entry of judgment. *See* JA 878; Fed. R. App. P. 4(a)(1)(A).

## ISSUE PRESENTED

> Is the Pennsylvania Higher Education Assistance Agency an "arm of the state" of Pennsylvania entitled to sovereign immunity where the state is not legally or functionally responsible for the entity's debts, the entity exercises significant autonomy, and the majority of the entity's business is directed outside of Pennsylvania?

## STATEMENT OF THE CASE

In December 2013, Lee Pele sued the Pennsylvania Higher Education Assistance Agency (PHEAA) under the federal Fair Credit Reporting Act (FCRA) alleging that PHEAA failed to correct inaccurate reports that it had sent to credit reporting agencies stating that Pele had defaulted on student loans. JA 849-50. Pele amended his complaint in February 2014. JA 850.

PHEAA moved to dismiss, arguing that it is an arm of the state protected by sovereign immunity. The district court denied the motion. *Pele v. Pa. Higher Educ. Assistance Agency*, 2014 WL 1329409 (E.D. Va. Apr. 2, 2014).

After discovery, both sides sought summary judgment on the question of the sovereign immunity defense. JA 851.[1] The district court held that PHEAA was an arm of the state and therefore granted PHEAA's summary judgment motion and denied Pele's motion. JA 877. The court did not reach any other issue.

## STATEMENT OF FACTS

### A. The Underlying FCRA Action

In monitoring his credit reports, Virginia resident Lee Pele discovered that his credit file reflected defaulted student loans that he had never authorized, initiated, received, or guaranteed. JA 16, 17 (Am. Comp1. ¶¶ 2, 5-6). In early 2013,

[1] Pele also sought summary judgment on several of PHEAA's other defenses, JA 851, none of which is at issue in this appeal.

Pele received calls from a third-party debt collector demanding thousands of dollars on the loans, which, Pele later learned, PHEAA had erroneously caused to appear on Pele's credit report. JA 17-18 (Am. Compl. ¶¶ 7-8). Pele had an acute need to clear up his credit report because he needed loans of his own to continue graduate school, he was about to get married that summer, and he required a security clearance to maintain his job. JA 19-20 (Am. Compl. ¶ 15).

Pele disputed the inaccuracies both with PHEAA, which serviced the loans erroneously attributed to Pele, and with the credit reporting agencies. JA 18-20 (Am. Compl. ¶¶ 9, 14, 16). The documentation that PHEAA's collection agent sent to Pele in response to his dispute showed that Pele was not obligated on the disputed loans. JA 18 (Am. Compl. ¶ 10). Yet inexplicably, when the credit reporting agencies contacted PHEAA about Pele's dispute, PHEAA responded by modifying but not deleting the erroneous information and continued to attribute the debts to Pele. JA 22 (Am. Compl. ¶ 24).

The record contains evidence supporting Pele's claim that PHEAA violated the FCRA in investigating Pele's dispute because PHEAA lacked procedures for investigating and/or failed to train its employees to investigate disputes properly. *See, e.g.*, JA 586 (PHEAA investigator never given training manual on processing disputes); JA 587-88 (PHEAA investigator failed to contact Pele at his current address provided by the credit reporting agencies); JA 588 (PHEAA investigator

trained to use only the address in PHEAA's own system); JA 590 (PHEAA investigator testified that PHEAA does not have a "fraud package" to send to individuals claiming identity theft). The district court did not address the merits because it granted summary judgment to PHEAA on the basis of sovereign immunity. JA 877.

### B. The Nature of PHEAA

Addressing earlier this year the issue whether PHEAA is an arm of the state, this Court enumerated many of the salient facts about PHEAA and the laws governing its operations. *See United States ex rel. Oberg v. Pa. Higher Educ. Assistance Agency*, 745 F.3d 131 (4th Cir. 2014). Created in 1963 by the Pennsylvania legislature, PHEAA is now "one of the nation's largest providers of student financial aid services." *Id.* at 138. PHEAA continues to administer state-funded student aid programs in Pennsylvania but also operates nationally under the names American Education Services (AES) and FedLoan Servicing (FLS). *Id.* By statute, Pennsylvania is not responsible for PHEAA's debts. *Id.* The entity is self-sustaining, deriving all of its funding from its own operations. *Id.* The only state appropriation PHEAA receives is grant money passed on directly to students. *Id.*

PHEAA is governed by a Board of Directors composed mainly of gubernatorial appointees and state legislators or officials, and "state officials exercise some degree of veto power over PHEAA's operations." *Id.* at 139.

However, "the state treasurer's use of PHEAA's funds must adhere to 'guidelines approved by the board' of PHEAA." *Id.* (quoting 24 Pa. Stat. 5104(3)). PHEAA has the power to enter into contracts, sue and be sued, and buy and sell property in its own name. *Id.*

Discovery in this case confirmed the key facts on which *Oberg* relied and revealed several additional relevant facts. First, PHEAA's operations remain financially independent of state funding, as confirmed by the Chair of PHEAA's Board William Adolph, PHEAA's President James Preston, and its CFO Timothy Guenther. JA 581-82 (Adolph); JA 500-01 (Preston); JA 405-10 (Guenther). As of June 30, 2013, PHEAA's net worth was $951.6 million. JA 362. PHEAA has paid several million-dollar settlements in recent years. JA 349 ($1 million to Mississippi Higher Education Assistance Corp.); JA 379-80 (approximately $10-12 million to the IRS). Yet CFO Guenther, in his twenty years with PHEAA, JA 356-57, is not aware of any appropriations from state coffers to cover the cost of settlement payments; rather, such payments are made from PHEAA's own discretionary funds. JA 385, 421. Guenther could point to no facts suggesting that the Pennsylvania State Treasury is either legally or functionally liable for a judgment against PHEAA. JA 446.

Second, with respect to PHEAA's autonomy, PHEAA regularly engages outside counsel, not only in this litigation, JA 398, but also in other cases, *see* JA

507, 517, 519, 530 (documents from *Education Loan Zone v. SunTrust Bank* (D. Md. filed Apr. 17, 2009), and from *PHEAA v. Mississippi Higher Education Assistance Corp.* (M.D. Pa. filed July 15, 2011), reflecting that PHEAA was represented by Gill, Sippell & Gallagher and by Stevens & Lee, respectively, in those cases). A private law firm also serves as counsel to PHEAA's board. JA 560-61 (the Executive Committee of PHEAA's Board is updated on legal matters by its counsel Stevens & Lee, not the Attorney General's office). In addition, PHEAA is not subject to direction from the governor. *See* JA 503 (PHEAA President James Preston noting that the governor "is asking PHEAA to provide a total of $85 million to supplement the Grant Program" and explaining that while "PHEAA appreciates and respects the Governor's request," its "ability to provide supplemental funding remains contingent upon having sufficient financial resources available" and is "subject to the Board's review and approval").

Third, most of PHEAA's business is now directed outside of Pennsylvania. As was true when the Court decided *Oberg*, PHEAA is one of the nation's largest loan servicers: CFO Guenther estimates that it is around the tenth largest in the country with respect to federal loans alone, JA 356, and in fiscal year 2013 it held, serviced, or guaranteed at least $105 billion dollars in student loans nationwide in the name of PHEAA, AES, or FLS. JA 541-43 (providing totals for "loan holdings," for "commercial (i.e., not-federal loan) servicing operations," and for

"guarantees of FFELP [federal] loans"); JA 551 (PHEAA, AES, and FLS are "one in [sic] the same"). In 2008, PHEAA stopped lending directly to students. JA 361. Its business is now primarily the servicing and guaranteeing of loans, and servicing provides the bulk of PHEAA's income. JA 365.

Although as of fiscal year 2013, PHEAA's remaining loan portfolio (of approximately $7.5 billion) is weighted toward Pennsylvania borrowers and in dollar terms consists of approximately two-thirds Pennsylvania loans, more than two-thirds of PHEAA's much larger federal loan guarantee business (worth approximately $38.5 billion) consists of *non*-Pennsylvania loans, and PHEAA's largest business, commercial loan servicing (worth approximately $59 billion), consists of more than two-thirds *non*-Pennsylvania loans in terms of both dollars and borrowers. JA 541-43. All told, of the $105 billion in loans that PHEAA held, guaranteed, or serviced in 2013 and could break down geographically, approximately $71.7 billion (or around 68%) was for non-Pennsylvania loans. *See id.* These numbers do not include the federal loans that PHEAA services, because PHEAA does not distinguish federal loans made to Pennsylvania residents from those made to non-Pennsylvania residents. JA 543. However, CFO Guenther testified, without qualification, that the majority of the loans that PHEAA services and the majority of loans that PHEAA guarantees are out-of-state loans. JA 375-77; JA 477. And for each year from 2008 to 2013, PHEAA both serviced and

guaranteed more total loans for non-Pennsylvania residents than for Pennsylvania residents. JA 536-59.

In fiscal year 2013, PHEAA contributed $75 million toward grants to Pennsylvania students and spent another $13 million administering student aid programs. JA 502. The $75 million PHEAA added to the grant program — which supplemented approximately $345 million appropriated by the state itself — was less than a third of PHEAA's operating income ($252 million) for 2013. JA 407-09.

Finally, in 2010 and 2011, PHEAA itself invoked federal diversity jurisdiction as a citizen — as opposed to an arm of — Pennsylvania. *See* JA 507-09 (invoking diversity jurisdiction in asserting a counterclaim in *Education Loan Zone v. SunTrust Bank*); JA 519-20 (invoking diversity jurisdiction in the complaint in *PHEAA v. Mississippi Higher Education Assistance Corp.*).

**C. The Decision Below**

In spite of these facts and this Court's decision in *Oberg*, which held that PHEAA is *not* an arm of the state, the district court held that PHEAA is an arm of the state. Although the court applied the same four-factor test as *Oberg*, it reached a different outcome because this Court decided *Oberg* on an appeal from a motion to dismiss, rather than at summary judgment. JA 855.

Looking to the first of the four factors for assessing whether an entity is an arm of the state — the state's potential liability for a judgment — the district court recognized that Pennsylvania disavows PHEAA's debts by statute. However, the court concluded that the state "would be functionally liable for a judgment against PHEAA," JA 857, because PHEAA's money is held in the State Treasury, PHEAA's funds are in part "comingled" for investment purposes within the State Treasury's general fund, the State Treasurer approves PHEAA's expenditures, the state receives PHEAA's assets if PHEAA is dissolved, and the Chair of PHEAA's Board opined that a significant judgment against PHEAA would require the Pennsylvania legislature to appropriate money for PHEAA to operate. JA 857-65. The court held that the first factor therefore favored a finding that PHEAA is an arm of the state. JA 865.

Turning to the second factor — the entity's autonomy — the district court followed *Oberg* in concluding that PHEAA's autonomy weighs against sovereign immunity. Although PHEAA has government-appointed and government-affiliated Directors and although the governor and inspector general exercise some oversight, PHEAA maintains financial independence, the power to sue and be sued, the power to purchase and sell property, the power to enter into contracts, and representation by outside counsel. JA 865-69.

On the third factor — the focus of PHEAA's operations — the court concluded that PHEAA's goals were dispositive in tipping this factor toward arm-of-the-state status, despite PHEAA's out-of-state business. JA 871-72. The court rejected the argument that the relatively low percentage of PHEAA funds that actually reach Pennsylvania students shows that PHEAA's focus is primarily out of state. "Rather, the Court must look to the broader picture of the agency's primary concern," and "PHEAA's expansive out-of-state business ultimately benefits Pennsylvania and its citizens." JA 873-74.

Finally, the court found that state-law treatment of PHEAA (the fourth factor) also favored classifying it as an arm of the state, because of the state authorities cited in *Oberg* and because Pennsylvania treats PHEAA employees as state employees. JA 874-77.

Having found that the majority of the relevant factors supported treating PHEAA as an arm of the state, the court granted summary judgment to PHEAA on the basis of sovereign immunity and denied Pele's motion for partial summary judgment. JA 877.

## SUMMARY OF ARGUMENT

In *Oberg*, this Court considered the precise question presented in this appeal — whether PHEAA is an arm of the State — and answered it in the negative. The difference between *Oberg* and the decision below is the procedural posture: *Oberg*

considered the issue on a motion to dismiss and this case was decided on summary judgment after discovery. But many of the Court's most important conclusions in *Oberg* were legal, not factual, and therefore are controlling here. The question for the Court now is whether anything adduced in discovery so unsettles the factual assumptions on which *Oberg* was decided that a different result is called for. The answer to that question is no. The key factual assumptions the Court made at the motion-to-dismiss stage in *Oberg* were either confirmed in discovery or shown to be overly generous to PHEAA.

This Court examines four non-exclusive factors to determine whether an entity is an arm of the state. On the first and most important factor, the vulnerability of Pennsylvania to paying PHEAA's debts, the statute on which *Oberg* relied remains in effect, and the crucial factual assumption on which *Oberg* relied is correct. Specifically, Pennsylvania law prevents the state from being liable for PHEAA's debts, and discovery has confirmed that PHEAA is financially self-sustaining, with healthy reserves of nearly $1 billion. Accordingly, a judgment against PHEAA will neither legally nor functionally put the state treasury at risk, and so — here as in *Oberg* — this factor weighs "decidedly" and "heavily" against sovereign immunity. *Oberg*, 745 F.3d at 138, 139.

On the second factor, PHEAA's autonomy, *Oberg* concluded that, even though PHEAA's board is composed of governmental appointees and officials and

Pennsylvania officials exercise some degree of veto power over PHEAA operations, "most critically" PHEAA's operations are financially independent of state funding. *Id.* at 139. The record confirms that this is still true. Additionally, the record reflects additional indicia of autonomy not considered in *Oberg*, such as the fact that PHEAA is regularly represented (as it is here) by private, not state, counsel.

On the third factor, the focus of the entity's activities, discovery revealed that PHEAA is less Pennsylvania-focused than assumed in *Oberg*. Unlike *Oberg*, which considered allegations about wrongdoing from 2002 to 2006, Pele's case concerns PHEAA's violation of his FCRA rights in 2013, and discovery has shown that in the past several years, the majority of PHEAA's business has concerned loans to non-Pennsylvania students at schools outside the state. Therefore, unlike in *Oberg*, this factor weighs against a finding that PHEAA is an arm of the state.

As in *Oberg*, the fourth factor, state-law treatment of PHEAA, favors sovereign immunity.

Finally, PHEAA itself has, twice within the past five years, invoked the federal courts' diversity jurisdiction by claiming to be a citizen of Pennsylvania — a status that is mutually exclusive with being an arm of the state itself. This Court should not allow PHEAA to choose, case by case, the form most advantageous for its litigation.

In sum, the undisputed facts show that PHEAA's claim to sovereign immunity is even weaker that it was in *Oberg*. PHEAA is not an arm of the state, and rightly not: disregarding *Oberg* and finding PHEAA protected by sovereign immunity would render one of the nation's largest student-loan entities effectively unaccountable in damages for any wrongdoing. The Court should therefore reverse the grant of summary judgment to PHEAA and the denial of summary judgment to Pele on the issue of sovereign immunity.

## ARGUMENT

### I. STANDARD OF REVIEW.

Grants and denials of summary judgment are reviewed de novo, viewing the facts in the light most favorable to the non-moving party. *Defenders of Wildlife v. N.C. Dep't of Transp.*, 762 F.3d 374, 392 (4th Cir. 2014); *Nourison Rug Corp. v. Parvizian*, 535 F.3d 295, 299 (4th Cir. 2008). Legal questions, including the application of law to facts, are also reviewed de novo. *Fonner v. Fairfax Cnty.*, 415 F.3d 325, 330 (4th Cir. 2005).

### II. PHEAA IS NOT ENTITLED TO SOVEREIGN IMMUNITY.

To assess whether a state-related entity is an "arm of the state" that may partake of the state's sovereign immunity, this Court examines four non-exclusive factors:

(1) "whether any judgment against the entity as defendant will be paid by the State" (either "legally" or "functionally");

(2) "the degree of autonomy exercised by the entity, including such circumstances as who appoints the entity's directors or officers, who funds the entity, and whether the State retains a veto over the entity's actions," as well as "whether an entity has the ability to contract, sue and be sued, and purchase and sell property, and whether it is represented in legal matters by the state attorney general";

(3) "whether the entity is involved with state concerns as distinct from non-state concerns," with the latter category encompassing "non-state interests like out-of-state operations"; and

(4) "how the entity is treated under state law."

*Oberg*, 745 F.3d at 136-38 (citation and internal quotation marks omitted); *accord S.C. Dep't of Disabilities & Special Needs v. Hoover Universal, Inc.*, 535 F.3d 300, 303 (4th Cir. 2008). The first factor — whether the state is liable for a judgment against the entity — is the most important. *See, e.g., Md. Stadium Auth. v. Ellerbe Becket, Inc.*, 407 F.3d 255, 261 (4th Cir. 2005); *Cash v. Granville County Bd. of Educ.*, 242 F.3d 219, 223 (4th Cir. 2001).

The party claiming sovereign immunity as an arm of the state bears the burden of establishing this defense. *Hutto v. S.C. Retirement Sys.*, ___ F.3d ___, No. 13-1523, 2014 WL 6845450, at *3 (4th Cir. Dec. 5, 2014).

This Court's decision in *Oberg*, addressing the same question at issue here regarding the same entity, concluded that the four-factor analysis tips markedly against sovereign immunity. The facts adduced in discovery cannot alter *Oberg*'s rulings of law, and discovery confirmed the key factual assumptions on which *Oberg* relied in assessing Pennsylvania's potential financial liability and PHEAA's autonomy. Additionally, the facts show that the third factor — the nature of the entity's activities — now (unlike in *Oberg*) weighs *against* sovereign immunity.

### A. In Light Of *Oberg* And The Undisputed Facts, Most Of The Factors Weigh Against Finding PHEAA To Be An Arm Of The State.

*Oberg* was a False Claims Act case in which the plaintiff alleged that several state-related loan corporations, including PHEAA, defrauded the U.S. Department of Education. *See United States ex rel. Oberg v. Ky. Higher Educ. Student Loan Corp.*, 681 F.3d 575, 577 (4th Cir. 2012). The district court originally dismissed the case on the ground that state-created loan corporations may not be sued under the False Claims Act, but this Court (in a forerunner to the decision on which Pele principally relies here) reversed and instructed the district court to assess whether the defendant agencies were arms of the state. *Id.* at 578, 579-81.

Applying the arm-of-the-state analysis, the district court again dismissed, and on appeal this Court earlier this year addressed on the merits whether PHEAA is an arm of the state. *Oberg*, 745 F.3d at 134, 138-41. The Court concluded that the first and second factors (liability of the state and autonomy of the entity) counseled against sovereign immunity, and the third and fourth factors counseled for it. *Id.* at 138-40. Balancing these factors, particularly in light of the fact that the state-liability factor weighed "strongly" against immunity, the Court held that Dr. Oberg alleged sufficient facts that PHEAA is not an arm of the state. *Id.* at 140. The Court remanded for limited discovery on the question whether PHEAA is "truly subject to sufficient state control to render it a part of the state." *Id.* at 140-41 (citation, internal quotation marks, and source's alteration marks omitted).

Although *Oberg* was decided under the presumptions applicable to a motion to dismiss, the Court's application of the arm-of-the-state test relied on several conclusions of law and state statutes. And the same benefit of the doubt is due the non-moving party on summary judgment as is due the plaintiff on a motion to dismiss. *Compare id.* at 140 ("construing the facts in the light most favorable to the plaintiff"), *with Defenders of Wildlife*, 762 F.3d at 392 ("We . . . tak[e] the facts in the light most favorable to the non-moving party."). This Court's holding is therefore fully applicable here unless discovery has revealed the Court's factual assumptions to be mistaken. In fact, discovery has either confirmed the key factual

assumptions on which *Oberg* relied or revealed facts that tilt the analysis even further against a finding that PHEAA is an arm of the state.

### *1. As in* Oberg*, the first factor — whether the state is liable for a judgment against the entity — weighs against sovereign immunity.*

*Oberg* held that "[t]he Pennsylvania Treasury is . . . neither *legally* nor *functionally* liable for any judgment against PHEAA." 745 F.3d at 138 (emphasis in original). That holding applies fully here.

The linchpin of *Oberg*'s conclusion that Pennsylvania is not legally liable for a judgment against PHEAA is unchanged: Pennsylvania law provides that "no obligation of the agency shall be a debt of the State and [the agency] shall have no power to pledge the credit or taxing power of the State nor to make its debts payable out of any moneys except those of the corporation." 24 Pa. Stat. § 5104(3); *see Oberg*, 745 F.3d at 138 (relying on this provision). This restriction on the state's liability is so important that it is reiterated later in the statute almost verbatim. *See* 24 Pa. Stat. § 5104(8).[2] The linchpin of *Oberg*'s conclusion that Pennsylvania is not *functionally* liable for a judgment against PHEAA is likewise

[2] In this second rendering, the only changes are: the word "Commonwealth" replaces "State" twice, "nor" becomes "or," "its" becomes "agency's," and "agency" replaces "corporation."

unchanged: PHEAA is financially independent. JA 405-10; JA 500-01; JA 581-82; *see Oberg*, 745 F.3d at 138 (relying on this point).

The court below reached a different conclusion from *Oberg* in part because PHEAA's money is held in the State Treasury and the State Treasurer approves PHEAA's expenditures. JA 858-60, 862. But these two facts were considered in *Oberg*, which expressly rejected the argument that Pennsylvania is functionally liable based on these facts. 745 F.3d at 138 (noting that "state statutes require that [PHEAA's] funds be deposited into the state treasury and that 'no money' be paid from the treasury without approval from the state treasurer" (quoting 72 Pa. Stat. § 307)). As this Court explained in *Oberg*, notwithstanding these requirements, the specific statutory provisions setting forth PHEAA's powers provide that "PHEAA's funds 'shall be available to the agency' and 'may be utilized at the discretion of the board of directors for carrying out any of the corporate purposes of the agency.'" *Id.* (quoting 24 Pa. Stat. § 5104(3)). Thus, this Court has already considered the relationship of PHEAA to the State Treasury under state law and concluded that the question of Pennsylvania's liability for a judgment against PHEAA weighs "decidedly" and "heavily" against sovereign immunity. *Id.* at 138, 139. Here as in *Oberg*, then, a formalistic focus on which bank account holds PHEAA's money cannot control.

The district court relied on several additional findings. First, the court found that PHEAA's money is "comingled" within the State Treasury's general fund, JA 860, not "segregated" as assumed in *Oberg*, 745 F.3d at 139. As the district court acknowledged, however, PHEAA's money remains "segregated 'on paper' as earmarked funds." JA 861 (quoting the declaration of CFO Guenther). In other words, wherever the money goes, it is identifiable as PHEAA's money — a demarcation necessary to comply with the statutory directive that PHEAA retain control over its funds. *See* 24 Pa. Stat. § 5104(3); *cf. Hutto*, ___ F.3d ___, 2014 WL 6845450, at *6 ("While we have recognized that holding funds in a segregated account apart from general state funds does 'counsel [] against establishing arm-of-the-state status,' that fact is not dispositive." (quoting *Oberg*, 745 F.3d at 139)).

Next, the district court noted that PHEAA's money would go to the state if the entity were dissolved. But the Supreme Court indicated in *Hess v. Port Authority Trans-Hudson Corp.*, 513 U.S. 30 (1994), that the sovereign immunity inquiry does not concern the ways in which the state-related entity could provide a benefit to the state, only the ways in which the entity could subject the state to liability. *Hess* addressed whether a bi-state railway (PATH) created by compact between New York and New Jersey enjoyed Eleventh Amendment immunity. In determining that immunity did not apply, the Court explained: "The proper focus is not on the use of profits or surplus, but rather is on losses and debts. If the

expenditures of the enterprise exceed receipts, is the State in fact *obligated* to bear and pay the resulting indebtedness of the enterprise? When the answer is 'No' — both legally and practically — then the Eleventh Amendment's core concern is not implicated." *Id.* at 51 (emphasis added); *accord Hutto*, ___ F.3d ___, 2014 WL 6845450, at *7 (focusing on this instruction from the Supreme Court). In light of *Hess*, it is irrelevant that Pennsylvania is entitled to PHEAA's "profits or surplus" if PHEAA is dissolved: what matters is that Pennsylvania is *not* responsible for PHEAA's "losses and debts." As in *Hess*, here the answer to the key question — "If the expenditures of the enterprise exceed receipts, is the State in fact obligated to bear and pay the resulting indebtedness of the enterprise?" — is "No." *See* 24 Pa. Stat. §§ 5104(3) & (8).

Finally, the district court relied on the statement of William Adolph, Chair of PHEAA's Board, that if PHEAA were required to pay a judgment, Pennsylvania would have to appropriate funds to enable PHEAA to continue its grant programs and "for [PHEAA's] continued operation." JA 863-65. Adolph's speculation is neither plausible as a matter of fact nor relevant as a matter of law. On the facts, PHEAA is financially independent from the state for operational funding — as Adolph agrees. JA 581-82. PHEAA has paid several million-dollar settlements in recent years, JA 349, 379-80, yet CFO Guenther, in his twenty years with PHEAA, is not aware of any appropriations from state coffers to cover the cost of settlement

payments; rather, such payments are made from PHEAA's own discretionary funds. JA 356-57, 385, 421. And PHEAA's current net worth is $951.6 million, JA 362, so there is no serious argument that a judgment in this case would exhaust PHEAA's reserves. Indeed, when asked at deposition, Guenther could point to no facts suggesting that the Pennsylvania State Treasury is either legally or functionally liable for a judgment against PHEAA. JA 446. When viewed in the light most favorable to the non-moving party, the record does not permit the adoption of Adolph's speculation about potential state appropriations as undisputed fact.

In any event, the Supreme Court in *Hess* specifically rejected the legal argument that PATH was entitled to sovereign immunity on the theory that a judgment against PATH would force New York and New Jersey to spend money on services otherwise provided by PATH. 513 U.S. at 50-51; *see also Burrus v. State Lottery Comm'n*, 546 F.3d 417, 421 (7th Cir. 2008) (rejecting the argument that the Indiana State Lottery is an arm of the state because it helps fund state pensions and state public works projects: "[I]n the event of a judgment award[,] [t]he state may be deprived of some of its anticipated (and hoped-for) revenue, but the Supreme Court has rejected the state-benefit theory of sovereign immunity." (citation, internal quotation marks, and source's alteration marks omitted)). Contrary to Chairman's Adolph's prediction in his declaration, Pennsylvania

would not be "obligated" to appropriate funds to cover a judgment, *Hess*, 513 U.S. at 51, according to Pennsylvania's own statute providing that "no obligation of the agency shall be a debt of the State." 24 Pa. Stat. § 5104(3). "Although the Commonwealth might well *choose* to appropriate money to [PHEAA] to enable it to meet a shortfall caused by an adverse judgment, such voluntary payments by a state simply do not trigger Eleventh Amendment immunity." *Christy v. Pa. Tpk. Comm'n*, 54 F.3d 1140, 1147 (3d Cir. 1995) (emphasis in original; citation, internal quotation marks, and source's alteration marks omitted).

In sum, the key premises underlying this Court's consideration earlier this year of the first arm-of-the-state factor are unchanged: Pennsylvania is not legally responsible for PHEAA's debts, and PHEAA is financially independent of the state for its operating revenue. The facts upon which the district court relied were either taken into account in *Oberg* itself or are legally irrelevant. Applying the same law as in *Oberg* to the same material facts as in *Oberg* must yield the same conclusion as in *Oberg*. Therefore the first and most important factor — Pennsylvania's responsibility for a judgment against PHEAA — weighs against finding PHEAA to be an arm of the state.

### *2. As in* Oberg*, the second factor — degree of autonomy — weighs against sovereign immunity.*

*Oberg* balanced several opposing indicators and concluded that the autonomy factor also weighed against sovereign immunity. Supporting PHEAA's

argument that it is an arm of the state were the facts that PHEAA's board of directors consists of gubernatorial appointees and state legislators or officials and that "state officials exercise some degree of veto power over PHEAA's operations." *Oberg*, 745 F.3d at 139. However, as the Court observed, other factors — PHEAA's source of funding, control over its revenues, and power to enter into contracts, sue and be sued, and buy and sell property in its own name — suggested operational autonomy. *Id.* Of these factors, the "most critical[]" was the fact that PHEAA is "financially independent" because it receives no operational funding from Pennsylvania. *Id.*

The fact that *Oberg* considered "most critical[]" to its analysis of this factor, PHEAA's financial independence, was both conceded by PHEAA in *Oberg*, *id.*, and confirmed in discovery here. JA 405-10; JA 500-01; JA 581-82. The remainder of the *Oberg* analysis rested on the powers, duties, and structure of PHEAA, which are laid out in Pennsylvania statutes and not subject to being disproved in discovery. *See, e.g.,* 24 Pa. Stat. § 5104(3) (providing power to control revenues and buy and sell property); *id.* § 5104(1.1)(iii) (power to enter into contracts); *id.* § 5104(4) (same).[3]

[3] One of the statutes *has* changed, slightly, in a manner that makes the Board more autonomous from the state than it used to be. The law governing the composition of PHEAA's Board from 2002-06 (the relevant time period for Dr. Oberg's

*(footnote continues on the next page)*

Additional facts adduced in discovery further show that PHEAA's degree of autonomy counsels against a finding that PHEAA is an arm of the state. For instance, the fact that a state-related entity is represented by private counsel as opposed to the state attorney general is an indication of the entity's autonomy. *See Oberg*, 745 F.3d at 137; *Cash*, 242 F.3d at 225. PHEAA is and has been throughout this litigation represented by a private law firm. JA 1-2; JA 398. PHEAA has been represented in litigation by private law firms in other cases also, *see* JA 507, 517, 519, 530, and PHEAA engages a private law firm as counsel to the Board of Directors, JA 560-61 (the Executive Committee of PHEAA's Board is updated on legal matters by its own counsel Stevens & Lee, not the Attorney General's office). Discovery also showed that PHEAA is not subject to direction from the governor. *See* JA 503 (PHEAA President James Preston noting that the

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allegations) required the Board to be composed exclusively of "gubernatorial appointees and state legislators or officials." *Oberg*, 745 F.3d at 139 (citing 24 Pa. Stat. § 5103, repealed July 2010). Today, a "nonlegislative individual that has relevant experience in a field related to finance, banking, investment, information technology, higher education or higher education finance," 71 Pa. Stat. § 111.2(b)(1), is eligible for appointment to PHEAA's board also. As of the writing of this brief, PHEAA's website, https://www.pheaa.org/about/board-members/index.shtml, lists three Board members who do not currently hold government office: D. Raja, Roy Reinard, and Timothy Thyreen.

Raja is a businessman. *See* http://www.ceiamerica.com/our-culture/leaders.aspx. Reinard is a former state legislator. *See* http://www.house.state.pa.us/bmc/archives/transcripts/Reinard.pdf. Thyreen is Chancellor of Waynesburg University. *See* http://www.waynesburg.edu/who-we-are/about-our-chancellor.

governor "is asking PHEAA to provide a total of $85 million to supplement the Grant Program" and explaining that while "PHEAA appreciates and respects the Governor's request," its "ability to provide supplemental funding remains contingent upon having sufficient financial resources available" and is "subject to the Board's review and approval").

With the facts demonstrating PHEAA's autonomy even more strongly than in *Oberg*, the district court was correct to reach the same conclusion as in *Oberg*: PHEAA's autonomy weighs against finding it to be an arm of the state.

### *3. Because PHEAA's business is focused outside of Pennsylvania, the third factor — nature of the entity's activities — weighs against sovereign immunity.*

The one respect in which the record below significantly differs from the factual assumptions made in *Oberg* is the degree to which PHEAA focuses its activities on Pennsylvania. In assessing this factor in *Oberg*, the Court considered two points: PHEAA's overall objective and the focus of its operations. Regarding the first, *Oberg* concluded that PHEAA's goal of facilitating the education of Pennsylvania students was "clearly of legitimate state concern." 745 F.3d at 140. Regarding the second, *Oberg* examined the period of time to which Dr. Oberg's allegations of fraud related — 2002 to 2006 — and reasoned that, although PHEAA's operations unquestionably extended beyond Pennsylvania, because Oberg alleged that "only one-third of PHEAA's earnings came from outside

Pennsylvania in 2005, it does not seem plausible that by 2006 — the last year encompassed by Oberg's allegations — PHEAA's operations focused *primarily* out of state." *Id.* (emphasis in original).

Whereas Oberg's claims focused on PHEAA's alleged fraud in 2002-06, *see id.*, Pele's case focuses on PHEAA's violation of his FRCA rights just last year, in 2013. Whatever the truth of Oberg's allegations regarding the years from 2002 to 2006, discovery showed that PHEAA's more recent activities are primarily focused outside of Pennsylvania. In 2008, PHEAA stopped lending directly to students; now, servicing loans throughout the country provides the bulk of PHEAA's income. JA 361, 365. Of the $105 billion in loans that PHEAA held, guaranteed, or serviced in 2013 and could break down geographically, more than two-thirds (approximately $71.7 billion or around 68%) was for *non*-Pennsylvania loans. JA 541-43. In deposition, CFO Guenther confirmed that the majority of the loans PHEAA services (through AES and FLS) and that the majority of loans that PHEAA guarantees are all out-of-state loans. JA 375-77; JA 477. In fact, PHEAA both serviced and guaranteed more total loans for non-Pennsylvania residents than for Pennsylvania residents for *each* year from 2008 to 2013. JA 536-59. Therefore, the assumption that seemed implausible regarding PHEAA's activities in 2006 — that "operations focused *primarily* out of state," *Oberg*, 745 F.3d at 140 — is today a fact.

The district court was unconcerned with whether PHEAA's activities are focused in or out of state because PHEAA's purpose is to help educate Pennsylvania students. According to the district court, "even if PHEAA is a national loan servicer, and even if PHEAA only gave back one-third of the profits to the students of Pennsylvania and retained the rest for PHEAA reserves, it is undisputed that PHEAA lends, purchases, services and guarantees loans for the sole purpose of funding its operations and contributions to state grant programs." JA 870-71 (citation and internal quotation marks omitted). The court's solitary focus on purpose is inconsistent with *Oberg*, which examined *both* PHEAA's purpose *and* — separately — the geographic focus of PHEAA's operations. 745 F.3d at 140.

Moreover, in dollar terms, the $88 million that PHEAA spent in 2013 to assist Pennsylvania students — $75 million on grants to Pennsylvania students and another $13 million on administering student aid programs, JA 502 — is dwarfed by the more than $105 *billion* in loans it holds, services, or guarantees. *See* JA 541-43 (breaking down $105 billion worth of PHEAA's loan business and noting that the numbers do not even include all of PHEAA's business). As noted, the majority of PHEAA's business involves out-of-state students and out-of-state schools. And the fact that PHEAA's total grant and student-aid-administration expenditures ($88 million, *see* JA 502) amounted to well under half of PHEAA's operating income in

2013 ($252 million, *see* JA 408), undercuts the suggestion that PHEAA does nothing but pursue its mission and so its multi-billion-dollar national loan-servicing business should be disregarded.

Reviewing PHEAA's activities afresh in light of the discovered facts, the Court should find that the factor no longer weighs in favor of PHEAA's claim to be an arm of the state.

#### *4. The fourth factor — treatment of the entity under state law — favors PHEAA.*

The Court in *Oberg* reviewed several Pennsylvania statutory provisions and state case law to conclude that Pennsylvania law treats PHEAA as a state agency. 745 F.3d at 140. This factor therefore weighs in favor of sovereign immunity.

#### *5. PHEAA's conduct in recent litigation is inconsistent with its argument that it is an arm of the state.*

PHEAA's own past litigation conduct is inconsistent with its argument that it is an arm of the state. "States . . . are not 'citizens of a state' for purposes of [28 U.S.C.] § 1332(a)," the diversity jurisdiction statute. *Md. Stadium Auth.*, 407 F.3d at 260. "In addition, public entities . . . are also not 'citizens of a state' if they are an 'arm or alter ego of the State.'" *Id*. (quoting *Moor v. Alameda County*, 411 U.S. 693, 717-18 (1973)). In both 2010 and 2011, PHEAA invoked the diversity jurisdiction of the federal courts by claiming to be a citizen of Pennsylvania. *See* JA 507-09 (invoking diversity jurisdiction in asserting a counterclaim in *Education*

*Loan Zone v. SunTrust Bank*); JA 519-20 (invoking diversity jurisdiction in the complaint in *PHEAA v. Mississippi Higher Education Assistance Corp.*). This assertion is incompatible with the proposition that PHEAA is an arm of Pennsylvania.

Although the entity's litigation conduct is not one of the enumerated factors in arm-of-the-state analysis, the four factors are "nonexclusive." *Oberg*, 745 F.3d at 136; *Hoover Universal*, 535 F.3d at 303. PHEAA should not be permitted to vary its status with its immediate litigation needs. Along with the first, second, and third factors above, PHEAA's invocation of diversity jurisdiction further counsels against finding it to be an arm of the state.

### B. The Balance Of Factors Tilts Even Further Against Finding Sovereign Immunity Than In *Oberg*.

In light of *Oberg*, weighing the foregoing factors is a straightforward task. *Oberg* found that the first and most important factor (state liability) weighed "decidedly" and "heavily" against sovereign immunity. *Oberg*, 745 F.3d at 138, 139, and that the second factor (autonomy) pointed in the same direction. *Oberg* found that the third and fourth factors (nature of activities and treatment under state law) favored sovereign immunity. Considering these factors together, the *Oberg* court unanimously concluded that based on the allegations before it, PHEAA was not an arm of the state. *Id.* at 140; *accord id.* at 149 (Traxler, C.J., concurring in the judgment in part and dissenting in part) (arguing that the majority had

demanded too much of the complaint, but agreeing that "Oberg's allegations plausibly establish that the companies [including PHEAA] are not alter-egos of their creating states" and specifically that "[t]he sufficiency of the complaint as to PHEAA . . . is not a close question").

Because *Oberg*'s legal conclusions are binding and its key factual assumptions about PHEAA have been confirmed regarding the first, second and fourth factors, *Oberg* would dictate the conclusion that PHEAA is not an arm of the state *even if* the third factor were likewise held constant and no additional evidence supported *Oberg*'s ultimate conclusion. In fact, the case against sovereign immunity is even stronger here than in *Oberg*, because the record here shows that the primary focus of PHEAA's loan business is out of state. In addition, although the application of the four-factor test is sufficient to demonstrate that PHEAA is not an arm of the state, PHEAA's repeated invocation of federal diversity jurisdiction as a "citizen" of Pennsylvania further undermines the claim that PHEAA is an arm of the state.

Applying *Oberg* to an unchanged legal landscape and a factual record that weighs even more strongly against PHEAA's arm-of-the-state claim than the factual assumptions in *Oberg*, this Court should hold, again, that PHEAA is not an arm of the state. The district court erred in concluding otherwise.

### C. The Court Should Direct The Entry Of Partial Summary Judgment For Pele On The Issue Of Sovereign Immunity.

The undisputed facts show that PHEAA is not an arm of the state and is not entitled to sovereign immunity as a matter of law. The Court should therefore reverse both the grant of summary judgment to PHEAA and the denial of summary judgment to Pele on the issue of immunity, and remand with instructions that the district court enter partial summary judgment for Pele on this issue.

## CONCLUSION

The district court's grant of summary judgment to PHEAA and denial of summary judgment to Pele on the issue of sovereign immunity should be reversed.

Dated: December 22, 2014

Respectfully submitted,

/s/ Scott Michelman

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## CERTIFICATION OF COMPLIANCE

This brief complies with the type-volume limitation of 32(a)(7)(B) because this brief contains 7,068 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

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## CERTIFICATION OF SERVICE

I certify that on December 22, 2014, I served this brief by ECF on all registered counsel for appellees.

/s/ Scott Michelman