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[EXEMPT FROM FILING FEES UNDER GOV. CODE, § 6103]

SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF LOS ANGELES

20STCV35275

THE PEOPLE OF THE STATE OF CALIFORNIA, Plaintiff, v. **PEAKS TRUST 2009-1**, Defendant.	Case No. **COMPLAINT FOR PERMANENT INJUNCTION, CIVIL PENALTIES, RESTITUTION, AND OTHER EQUITABLE RELIEF** (BUS. & PROF. CODE, § 17200 et seq.)

The People of the State of California ("People"), by Xavier Becerra, Attorney General of the State of California, bring this action against PEAKS Trust 2009-1 ("PEAKS" or "Defendant") for violating the Unfair Competition Law (Bus. & Prof. Code, § 17200 et seq.), and allege the following on information and belief:

JURISDICTION AND VENUE

1. The Court has jurisdiction over the subject matter of and the parties to this enforcement action. Venue is proper in this county. The Court has jurisdiction to enter this Judgment.

2. This enforcement action is brought under the Unfair Competition Law, Business and Professions Code section 17200 et seq.

DEFENDANT

3. PEAKS is a Delaware statutory trust created for the PEAKS Loan Program (defined below).

FACTUAL BACKGROUND

4. The People bring this enforcement action against Defendant for its involvement with a loan program ("PEAKS Loan Program") that allowed the now-defunct ITT Educational Services, Inc. ("ITT") to perpetrate a scheme wherein ITT presented a façade of compliance with federal laws requiring that 10% of a for-profit school's revenue come from sources other than federal student aid, 20 U.S.C. 1094(a)(24) ("90/10 Rule"), and, in doing so, took unreasonable advantage of ITT student borrowers who were unaware of the scheme associated with this loan program, and therefore were unable to protect their interests in taking out such loans.

I. ITT ENGAGED IN A PRIVATE-LOAN SCHEME TO BENEFIT ITSELF AT THE EXPENSE OF STUDENTS

5. The PEAKS Loan Program originated approximately $350 million in student loans to ITT students. These loans were available only to ITT students. Proceeds from the PEAKS Loan Program were disbursed directly to ITT; and were required to be used to pay only ITT and could not be used by students for any other purposes.

6. Funding for the PEAKS Loan Program was provided primarily by PEAKS through an automatic-purchase agreement with a bank that originated loans.

7. PEAKS continues to own all outstanding loans ("Loans") made to ITT students under the PEAKS Loan Program and directs servicing and collections of those Loans through a loan servicer ("Servicer").

8. ITT was a publicly traded, for-profit corporation that, until September 2016, enrolled consumers in classes at 149 locations throughout the country.

9. The low-income consumers whom ITT targeted could rarely, if ever, afford to pay its high tuition without assistance. Therefore, ITT's business model relied on these consumers

obtaining federal aid, mostly loans, to pay to attend ITT.

10. Federal aid, including federal loans, did not, however, typically provide an ITT student with enough money to cover ITT's entire tuition. Few, if any, of ITT's students could afford to cover this tuition gap with their own money.

11. To close this tuition gap, ITT, when it recruited new students, offered them zero-interest, short-term loans payable in a single payment nominally due nine months later, at the end of that academic year. ITT referred to these loans as "Temporary Credit."

12. If students were unable to pay off the Temporary Credit at the end of the academic year—something ITT knew few students would be able to do—ITT coerced them into paying off their Temporary Credit amounts with private loans, including PEAKS Loans, payable over 10 years.

13. At the same time, to cover the tuition gaps for the upcoming year, ITT coerced students into taking out additional private student loans. If students were unable to pay off the Temporary Credit and pay the second-year tuition gap, and they refused the private loans, ITT threatened them with expulsion. Thus, through December 2011, ITT's Temporary Credit operated merely as an entry point to private student loans, including PEAKS Loans.

14. The staff of ITT's campus financial-aid offices ("Financial Aid staff") engaged in a variety of aggressive tactics, such as pulling students from class, withholding course materials or transcripts, and rushing students through financial-aid appointments, to get those students to sign up for private loans, including PEAKS Loans. Many ITT students did not understand the terms of their private loans, and some students did not realize they had taken out loans at all.

15. While students were left unaware that the zero-interest Temporary Credit was just an entry point for additional private loans, ITT consistently told its investors, from the time the private lending programs were put in place, that it was ITT's "plan all along" that students' Temporary Credit would be paid off through the PEAKS Loan Program and other private lending programs. ITT had established the lending programs to ensure that its income and cash flow would improve, which in turn improved the appearance of ITT's financial statements.

16. Default rates for ITT students on all loans have been high. Default rates on the

PEAKS Loan Program are now, post-ITT school closures and bankruptcy filing, projected to exceed 80%. ITT knew that PEAKS Loans would impose an unsurmountable burden to many of its students: ITT knew that many students ultimately placed into the PEAKS Loan Program were likely to default. Simply to enhance its financial statements and appearance to investors, and to enhance its compliance with the 90/10 Rule and access to funds provided by the federal government under Title IV of the Higher Education Act of 1965, 20 U.S.C. § 1070 *et seq*. ("Title IV"), ITT sacrificed its students' futures by saddling them with debt on which it knew they would likely default.

17. ITT was putting students into these private loans to convert uncollectible zero-interest Temporary Credits into revenue to make ITT's financial statements more appealing to investors.

18. ITT's revenues came from student tuition and fees. ITT's tuition was higher than that of most other for-profit post-secondary institutions. During the period when PEAKS Loans were offered, ITT's two-year associate-degree programs—the programs in which approximately 85% of ITT students were enrolled—cost a total of approximately $44,000, based on a charge of $493 per credit hour. By the same measure, ITT's bachelor's degree programs cost a total of approximately $88,000.

19. ITT students generally had poor credit profiles and low earnings; according to ITT's former Chief Financial Officer, during the period when PEAKS Loans were offered, the average ITT student earned around $18,000 per year and had a credit score under 600 at the time he or she enrolled. These students could very rarely pay for ITT's tuition out-of-pocket.

20. The primary method by which students paid their ITT tuition, and the main source of ITT's cash receipts, was financial aid provided by the federal government under Title IV.

21. In 2011, about 89% of ITT's cash receipts came from the government, and around 7% came from private loans, such as PEAKS Loans.

22. Obtaining these federal and private loans required an extensive application process involving numerous forms and the collection of financial and personal information from students. ITT's Financial Aid staff administered this process from the time students enrolled in ITT schools

through to their graduation.

23. The financial aid process was complicated and difficult to understand. Rather than helping students better understand the borrowing process and make informed decisions in their best financial interests, ITT made a practice of having its Financial Aid staff take control of the students' loan applications and rush them through the process of signing up for loans, leaving many unsure what they were signing.

24. The financial aid process was structured so that ITT's Financial Aid staff were essentially holding the students' hands while they reviewed and signed federal and private loans. Part of the way that Financial Aid staff did this 'hand holding' was through the automated financial-aid platform set up by ITT. ITT provided its Financial Aid staff with software called "SmartForms," which automatically populated and submitted financial-aid applications for its students to the federal government or other lenders, requiring only e-signatures from students.

25. The financial-aid appointments for continuing students with ITT's Financial Aid staff were called "repackaging" or "repack" appointments. To ensure that continuing students (including graduating students) came to the repack appointments, which often occurred months in advance of the applicable academic term, ITT instructed and incentivized its Financial Aid staff to use aggressive tactics ("repackaging tactics") such as calling students at home, finding them in the bookstore or the library or the student lounge, pulling them from class, barring them from class, enlisting the aid of other ITT staff (including professors), and withholding course materials, diplomas, and transcripts. ITT's repacking tactics were so ingrained into the company's operations that even its former Chief Executive Officer personally encouraged ITT's Financial Aid staff to pull students from class and take them to the ITT financial aid office to complete financial aid applications.

II. ITT COERCED STUDENTS TO TAKE OUT PEAKS LOANS FOR ITT'S OWN FINANCIAL GAIN, THROUGH A LOAN-FINANCING SCHEME INVOLVING "TEMPORARY CREDIT"

26. Using the tactics described above and others, ITT's Financial Aid staff coerced students into loans that they did not want, did not understand, or did not even realize they were getting. ITT's Financial Aid staff coerced students into taking out private student loans, including

PEAKS Loans, to cover the tuition gap between what federal loans and grants would cover and the high cost of attending ITT.

27. Through December 2011, ITT sought to have its students pay for the tuition gap with private loans, including PEAKS Loans, because outside sources of payment could be booked as income to the company, improving its free cash flow and the appearance of its financial statements, and because outside sources of revenue helped ITT comply with the 90/10 Rule.

A. Temporary Credit

28. Prior to February 2008, ITT relied on a large third-party lender to provide private loans to its students to cover their tuition gap. In or about 2008, after the third-party funding source dried up, ITT began offering its students loans that it called Temporary Credit to cover their tuition gaps. ITT's Temporary Credit was a no-interest loan payable in a single lump-sum payment, with a due date typically nine months after enrollment at the end of the academic year for which it was offered.

29. ITT had minimal credit criteria that students had to meet to be eligible for Temporary Credit. Even if a student did not meet these minimal criteria, staff at ITT headquarters could—and, when asked, often did—grant exceptions.

30. Before ITT provided Temporary Credit to students, it performed credit checks to determine if they met the limited credit criteria. Thus, at the time ITT provided Temporary Credit to students, it knew their credit scores.

31. Temporary Credit was offered and granted during rushed financial-aid appointments controlled by ITT's Financial Aid staff. Thus, some students who had a Temporary Credit loan obligation did not even know they had received Temporary Credit or did not know that it was a loan that would have to be repaid.

32. ITT's Financial Aid staff also led some students to believe that Temporary Credit would be available to cover their tuition gaps for their entire educational program and that it would be due to be repaid only after the students graduated from ITT.

33. ITT's records show students reported that its Financial Aid staff told them that Temporary Credit would be available throughout their entire ITT education and would not have

to be repaid until after graduation. Moreover, ITT's financial-aid training materials noted that students were not a "reliable source" as to whether they had ever received Temporary Credit.

34. ITT knew that the vast majority of students who received Temporary Credit did not, and would not, have the resources or access to credit, to make the entire lump sum payment within nine months.

35. From 2009 through 2011, ITT was lending students approximately $100 million to $150 million per year in Temporary Credit. ITT did not intend to continue offering Temporary Credit to students throughout their entire ITT education. ITT believed most students were unlikely to repay the Temporary Credit loans and deeply discounted them on its balance sheet, calling them "doubtful accounts."

36. In 2009, ITT's Financial Aid staff began coercing students into repaying their Temporary Credit with private loans, including PEAKS Loans. After implementing the private loan programs, ITT no longer had to maintain those deep discounts on its balance sheet because it expected students would be forced to repay the Temporary Credit with private loans.

B. The ITT Private Loan Programs

37. In 2008, ITT began to build two separate, unrelated private-loan programs from scratch, later to be referred to from time to time as the CUSO Loan Program and the PEAKS Loan Program (together, "ITT Private Loan Programs," and loans associated with these programs, "ITT Private Loans"). ITT intended the ITT Private Loan Programs to be the vehicle for students to pay off their Temporary Credit, enabling ITT to convert Temporary Credit into immediate income and cash-on-hand. The private loans also financed students' second year tuition gap.

38. ITT disclosed to its auditors and its investors that the ITT Private Loan Programs were specifically intended, and would be used, to reduce the amount of Temporary Credit outstanding and to help ITT avoid lending students any further amounts from its own books after their first year.

39. Indeed, ITT's Temporary Credit program operated as a tool to pre-qualify students for the ITT Private Loans, often regardless of their credit profile. Pursuant to the written underwriting criteria for the ITT Private Loans, a continuing ITT student who had received

Temporary Credit could be automatically eligible for ITT Private Loans notwithstanding his or her failure to satisfy the remaining loan underwriting criteria so long as he or she had not declared bankruptcy within 24 months ("Temporary Credit Exception").

40. ITT students did not know this, nor were they made aware that ITT would coerce them into using the ITT Private Loans to repay Temporary Credit, until the point that ITT's Financial Aid staff gave them no choice other than to take the ITT Private Loans or be expelled from ITT schools.

41. ITT instructed its Financial Aid staff to identify students to repackage into the ITT Private Loans as soon as possible to further its scheme and remove the Temporary Credits from its corporate financial reports.

42. ITT's Financial Aid staff used all of the "repackaging tactics" described above to get students to repackage.

43. Some students objected to the ITT Private Loans, but they were told by ITT's Financial Aid staff that if they refused to use them, they either had to pay any outstanding Temporary Credit and the next year's tuition gap—which most could not do—or leave the school in the middle of their program and forfeit the investment they had made so far.

44. Some ITT students did not even realize that they had taken out an ITT Private Loan. For some students, this lack of awareness was due to the rushed and automated manner in which ITT Financial Aid staff processed their paperwork. For other students, it was due to flaws in the SmartForms system that allowed ITT Financial Aid staff unauthorized access to student-loan documents.

45. The interest rate for PEAKS Loans, which carried a 10-year term, was based on a student's credit score. For borrowers with credit scores under 600, the interest rate initially went as high as the prime rate plus 10.5%, with an origination fee as high as 10%. Starting in or around April 2011, borrowers with credit scores under 600 were charged an interest rate of prime plus 13%, in addition to the 10% origination fee.

46. For most of the period since 2009, the prime rate has been 3.25%; thus, the effective interest rate for PEAKS Loans has been 13.75% for some borrowers with credit scores

under 600; for borrowers taking out PEAKS Loans after April 2011 with credit scores under 600, the interest rate has been 16.25%. Approximately 46% of the borrowers of PEAKS Loans had credit scores under 600, and thus were subject to interest rates of 13.75% or 16.25% and origination fees of 10%. Recent increases in the prime rate have increased the interest rates of PEAKS Loans, further impacting borrowers.

47. ITT knew that many students ultimately placed into ITT Private Loans were likely to default. According to models constructed by ITT and the administrators of the CUSO Loan Program, based on the historic performance of private student loans provided to ITT students, 30% of ITT students were projected to default on their loans. For ITT students with credit scores below 600, the projected rate was 58.9%. Prior to the inception of its loan program, ITT estimated that 45.8% of loan recipients would have a credit score below 600.

48. Defaults on PEAKS Loans exceeded ITT's predictions. By 2013, ITT projected defaults across the PEAKS portfolio to reach 49.4% to 55.4%.

49. ITT took steps to temporarily reduce the number of PEAKS Loan defaults. A key feature of the PEAKS Loan Program was a guarantee agreement with ITT. When loan defaults caused PEAKS's asset/liability ratio to fall below certain thresholds, ITT was obligated to make payments to PEAKS. This ensured PEAKS investors received full payments of the amounts due on their investments. From October 2012 until early 2014, ITT made "Payments on Behalf of Borrowers" ("POBOBS")—direct payments on students' loan accounts—to prevent PEAKS Loans from defaulting and thereby defer ITT's financial obligations related to the loans under the guarantee agreement. These payments were undisclosed to PEAKS, student loan borrowers, and ITT's investors until September 2013. Without the POBOBS, the early years of the PEAKS Loan Program would have demonstrated more clearly the eventual scale of default, which is now approximately 80%. An agreement between PEAKS and ITT ended the POBOB program in March 2014.

50. In June 2012, PEAKS's servicer stated, "Based on the portfolio performance, it would not be surprising if 70% or more of loan balances ultimately default."

51. In September 2016, ITT filed for bankruptcy protection and ceased all operations.

52. Neither prospective students nor current students were told by ITT the default rates on PEAKS Loans.

C. PEAKS's Crucial and Ongoing Role in ITT's Private Loan Program

53. PEAKS facilitated the PEAKS Loan Program by helping ITT recruit investors for the program, by immediately purchasing loans from the originating entity, by participating in setting the interest rates and terms of the loans, by distributing payments from students and ITT to investors, and by conducting the management and oversight of loan servicing and collection activities, which continues through the present day.

54. PEAKS knew that the purpose of the PEAKS Loan Program was to convert Temporary Credit into revenue for ITT. PEAKS knew that many of the borrowers consisted of students who held Temporary Credit issued by ITT and were repack-eligible, but who did not have the resources or the access to credit to be able to repay the loans.

55. PEAKS was also on notice about ITT's financial-aid practices: during the period when the PEAKS Loan Program was actively making loans, numerous students lodged complaints with the loan-origination agent and the program's servicer claiming that they did not realize they had taken out loans, were not aware of the terms of the loans, were not aware that the loans were not federal student loans, and that ITT Financial Aid employees had used high-pressure tactics during their financial-aid appointments. Additionally, students lodged complaints that Financial Aid staff had signed PEAKS Loan Program applications and promissory notes without the students' knowledge or authorization.

56. But PEAKS had reason to continue with the PEAKS Loan Program because ITT, through an "out-of-the-money" corporate-guarantee agreement, guaranteed the PEAKS investors' returns. ITT unconditionally guaranteed payment of the investors' and program participants' fees, principal, and interest "as and when due." When the asset/liability ratio in the trust fell below certain thresholds, ITT was required to make payments to PEAKS. This guarantee incentivized PEAKS to make available and service the loans.

57. The guarantee agreement allowed ITT to continue to exert control over the PEAKS Loan Program after origination of the loans. The governing documents of the PEAKS

Loan Program, including the guarantee agreement, gave ITT certain servicing rights, and guarantee payments were made only if PEAKS continued to actively collect the loans.

58. Despite the significant default predictions, actual defaults that exceeded projections, ITT's efforts to manipulate the default rate of the loans, knowledge of numerous consumer complaints, and the Consumer Financial Protection Bureau's enforcement action against ITT alleging unlawful practices related to the ITT Private Loan Programs, PEAKS continued servicing and collecting loans in accordance with its agreement with ITT.

III. ITT FILES BANKRUPTCY AND CLOSES ITS CAMPUSES

59. In August 2016, the U.S. Department of Education took a series of actions against ITT to protect students and taxpayers by banning ITT from enrolling new students using federal financial-aid funds and stepping up financial oversight of the for-profit educational provider.

60. One month later, in September 2016, ITT closed its more than 100 campuses leaving more than 35,000 unable to finish their program at ITT.

IV. BORROWERS, LEFT WITH UNAFFORDABLE LOAN PAYMENTS, DEFAULT IN LARGE NUMBERS

61. Former ITT students, having been coerced by ITT into PEAKS Loans, face a high likelihood of defaulting.

62. PEAKS Loans carry a high monthly payment, with higher interest rates, more-rigid conditions, and fewer options to reduce monthly payments than federal loans offer. For most former ITT students, this monthly payment, on top of all other loan obligations, is unaffordable.

63. ITT and PEAKS facilitated access to capital for PEAKS Loans, and monitored the progress of loan originations within the PEAKS Loan Program.

64. Students were unable to protect their interests in selecting or using PEAKS Loan Program because few students had the resources, particularly in the time permitted, to repay the Temporary Credit or pay the tuition gap out-of-pocket, or to obtain private loans elsewhere. Given the virtual non-transferability of ITT credits, most students were forced to either use the PEAKS Loan Program or forfeit their entire investment.

65. ITT took unreasonable advantage of ITT students' inability to protect their

interests in selecting or using the ITT Private Loans. ITT knew about these vulnerabilities and exploited them by taking control of the complex financial aid process, using aggressive financial-aid packaging tactics, and pushing students into expensive, high-risk loans that ITT knew were likely to default.

66. ITT's above-described business acts and practices were unlawful, unfair, or fraudulent, and therefore repeatedly violated the Unfair Competition Law, Business and Profession Code, section 17200, et seq.

67. The Federal Trade Commission's Rule on the Preservation of Consumers' Claims and Defenses, known as the "Holder in Due Course Rule," or "Holder Rule," 16 C.F.R. § 433, states that "it is an unfair or deceptive act or practice . . . for a seller, directly or indirectly, to . . . [t]ake or receive a consumer credit contract which fails to contain" specific language, prescribed in the rule, that any holder is subject to all claims and defenses that the debtor could enforce against the seller.

68. The loan agreements utilized by PEAKS contained the following clause:

> **NOTICE: IF THE PROCEEDS OF THE LOAN MADE UNDER THIS PROMISSORY NOTE ARE USED TO PAY TUITION AND CHARGES OF A FOR-PROFIT SCHOOL THAT REFERS LOAN APPLICANTS TO THE LENDER, OR THAT IS AFFILIATED WITH THE LENDER BY COMMON CONTROL, CONTRACT, OR BUSINESS ARRANGEMENT, ANY HOLDER OF THIS CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SCHOOL WITH RESPECT TO THE LOAN. RECOVERY UNDER THIS PROVISION SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR ON THE LOAN.**

69. ITT Private Loans are subject to all claims and defenses that borrowers could enforce against ITT, including fraud, unconscionability, and violations of the Unfair Competition Law, as well as the failure to deliver promised degrees and educational services following the closure of ITT's schools, each of which would void the ITT Private Loans.

70. Accordingly, any claims or defense that borrowers have against ITT may be asserted against PEAKS as a defense to repayment of their Loan.

71. Based upon fraud at the origination of PEAKS Loans, among other claims and defenses, borrowers have a total and complete defense to repayment of their Loans.

CLAIM 1

VIOLATION OF BUSINESS AND PROFESSIONS CODE SECTION 17200

(UNFAIR COMPETITION)

72. The allegations in the above paragraphs are incorporated here by reference.

73. Defendant has engaged in unlawful, unfair, or fraudulent business acts or practices, which constitute unfair competition as defined in the Unfair Competition Law, Business and Professions Code section 17200 et seq.

74. Defendant's business acts or practices include (but are not limited to) collecting or attempting to collect consumer debts (i.e., PEAKS Loans) to which debtors have a defense to repayment. These acts or practices are unfair within the meaning of the Unfair Competition Law and also violate the Rosenthal Fair Debt Collection Practices Act, Civil Code section 1788 et seq.

75. Defendant's conduct was in continuing violation of the Unfair Competition Law, beginning at a time unknown to the People and continuing to within four years of the filing of this Complaint.

PRAYER FOR RELIEF

WHEREFORE, the People pray for judgment as follows:

1. Under Business and Professions Code section 17203, that Defendant, its affiliates, subsidiaries, successors and assigns, its officers and employees, and all persons who act in concert with Defendant, be permanently enjoined from committing unfair competition in violation of Business and Professions Code section 17200 as alleged in this Complaint;

2. That the Court make such orders or judgments as may be necessary to prevent the use or employment by Defendant of any act or practice that constitutes unfair competition or as may be necessary to restore to any person in interest any money or property that may have been acquired by means of such unfair competition, under the authority of Business and Professions Code section 17203;

3. That the Court assess a civil penalty of $2,500 against Defendant for each

violation of Business and Professions Code section 17200 in an amount according to proof, under the authority of Business and Professions Code section 17206; and

4. For such other and further relief that the Court deems just and proper.

Dated: September 15, 2020

Respectfully Submitted,

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