41,7935

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ARIZONA

GRACE KEAMS, et al. Plaintiffs, v. TEMPE TECHNICAL INSTITUTE, INC., et al., Defendants.	CIV-91-0728-PHX-ROS **O R D E R**

On October 16, 1995, this Court heard oral argument on two motions in this case: Defendant United Student Aid Funds' Motion to Dismiss and Plaintiffs' Motion for Leave to Amend Complaint. At the hearing, the Court indicated that the Motion for Leave to Amend would be granted, that the Motion to Dismiss would be taken under advisement, and that a formal order addressing both rulings would follow. This is that order.

The parties are well-acquainted with the events from which this action arises; the facts have been recited at length in the pleadings and in previous decisions and orders of this Court. Because no general overview is necessary, specific facts will be discussed as they become relevant to the disposition of the motions

305

currently before the Court.

Motion for Leave to Amend Complaint

Plaintiffs have asked the Court's leave to amend their complaint to state a claim for negligence against Defendant United Student Aids Funds ("USAF"). Rule 15(a) of the Federal Rules of Civil Procedure provides that "leave shall be freely given when justice so requires." It is well settled that this policy is to be applied with "extreme liberality." E.g., DCD Programs, Ltd. v. Leighton, 833 F.2d 183, 186 (9th Cir. 1987).

> This liberality in granting leave to amend is not dependent on whether the amendment will add causes of action or parties. It is, however, subject to the qualification that amendment of the complaint does not cause the opposing party undue prejudice, is not sought in bad faith, and does not constitute an exercise in futility.

Id. (Citations omitted.)

USAF argues that three reasons exist for denying leave to amend in this case. First, USAF points to the delay of over four years between the commencement of this action and the instant motion for leave to amend. Second, USAF identifies several areas in which it believes that amendment would prejudice its ability to defend the case. Third, USAF claims that amendment would be futile.

1. Undue Delay

Although undue delay is a consideration in determining whether to permit amendment, in this Circuit, delay in itself, no matter how lengthy, is insufficient to support denial of a motion to amend. United States v. Webb, 655 F.2d 977, 980 (9th Cir. 1981).

In the instant case, the delay in question was largely the result of a stay in discovery entered at the request of USAF and the other Defendants while preliminary matters, including class certification issues, were resolved.

2. Prejudice to Opposing Party

USAF asserts that it will suffer prejudice if Plaintiffs are permitted to amend their complaint because (a) over the six years since the events giving rise to the negligence claim, it is likely that personnel have moved and memories have faded; (b) USAF's questions to school personnel in discovery would have been different had it known that its actions in 1989 with respect to its audit of TTI would be the subject of allegations of negligence; (c) USAF has lost its opportunity to participate in the appeal now pending before the Ninth Circuit Court of Appeals concerning dismissal of the negligence claims against Defendants ABHES and NATTS ("Accreditor Defendants"); and (d) amendment of the complaint will disrupt the class administration and require the establishment of one or more subclasses of Plaintiffs.

Prejudice to the opposing party is the most important of the factors to be weighed in deciding whether to deny leave to amend. Jackson v. Bank of Hawaii, 902 F.2d 1385, 1387 (9th Cir. 1990). The burden is on the party opposing amendment to show prejudice. DCD Programs, 833 F.2d at 187. Furthermore, the prejudice, must be substantial. See, e.g., Morongo Band of Mission Indians v. Rose, 893 F.2d 1074, 1079 (9th Cir. 1990) (no abuse of discretion in denying leave to amend where the amendment represented "radical

shift" in direction and would require defendants to undertake, at late hour, an entirely new course of defense).

USAF has failed to meet its burden to show prejudice. First, the fact that "personnel move" and "memories fade" is an inevitable consequence of delay and affects all parties, including the Plaintiffs, who, it must be remembered, bear the burden of proof. Nor is the Court moved by the possibility that USAF may have to conduct additional discovery in order to defend against the negligence claim. The need for additional discovery is another frequent concomitant of amendment and, especially when discovery is not otherwise complete, should not serve as a basis for denying leave to amend. See Genentech, Inc. v. Abbot Labs., 127 F.R.D. 529 (N.D. Cal. 1989).

The Court also rejects USAF's position that undue prejudice somehow flows from its perceived loss of an opportunity to participate in the appeal now pending before the Court of Appeals. If, as defense counsel concedes, USAF has thus far enjoyed a "free ride" on the negligence claims asserted against ABHES and NATTS, no undue prejudice arises merely because USAF must now complete the trip on its own. The ruling on Plaintiffs' Motion for Leave to Amend will eventually be appealable as will any judgment on the merits of the negligence claim itself.

Finally, the Court is not persuaded that amending the complaint will require the formation of a new subclass of plaintiffs -- i.e., those students who were recruited after an as-yet-undetermined date when, but for USAF's alleged negligence, TTI's

participation in the student loan program would have been terminated. Moreover, even assuming that formation of a new subclass were required, USAF has failed to explain how such restructuring would result in prejudice to USAF.

3. Futility

An amendment is futile only if no set of facts can be proved under the amendment that would constitute a valid and sufficient claim. Miller v. Rykoff-Sexton, Inc. 845 F.2d 209 (9th Cir. 1988). USAF urges that leave to amend should be denied because amendment would be futile for two reasons. First, USAF argues that because it owed no duty to the Plaintiffs in this case, the proposed new count would fail to state a claim upon which relief could be granted. Second, USAF asserts that the claim would be barred by the statute of limitations and that the amendment would not relate back to the commencement of the action under Rule 15(c), Federal Rules of Civil Procedure.

a. Failure to State a Claim

The first aspect of USAF's futility argument is based upon this Court's previous order dismissing negligence claims against ABHES and NATTS. USAF now takes the position, unsupported by any legal argument or citation to authority, that if a private, non-profit accrediting agency owes no duty to the Plaintiffs, then accordingly a private, non-profit guarantee agency likewise owes no duty to the Plaintiffs.

USAF's adherence to this position completely ignores the factual and legal arguments that Plaintiffs have offered to support

their own position that the role of USAF in the events giving rise to this litigation was indeed significantly different from that of the Accreditor Defendants. At this point in the proceedings, a full, adversarial presentation of these issues is lacking. Under the circumstances, the Court is unwilling to find as a matter of law that no set of facts could be alleged to support the existence of a relationship between the parties to establish that USAF was obligated to use some care to avoid injury to the Plaintiffs. See Markowitz v. Arizona Parks Bd., 146 Ariz. 352, 706 P.2d 364 (1985); Daggett v. County of Maricopa, 160 Ariz. 80, 770 P.2d 384 (Ct. App. 1989).

b. Statute of Limitations

USAF also argues that amendment would be futile because the claim would not relate back to the commencement of the action under Rule 15(c) and would otherwise be barred by Arizona's two-year statute of limitations for negligence actions. See Ariz. Rev. Stat. Ann. § 12-542. Certain background facts are relevant to the determination of this issue. According to USAF, Plaintiffs' cause of action for negligence accrued for statute of limitations purposes no later than April 11, 1990, the date on which TTI closed its doors.[1] Less that one year later, on March 25, 1991, Plaintiffs filed the complaint that commenced this action. The

---

[1] Plaintiffs do not dispute this accrual date, nor do they argue that the statute of limitations was tolled until they could reasonably have discovered the facts giving rise to the claim. See, e.g., Angus Medical Co. v. Digital Equip. Corp., 173 Ariz. 159, 162, 840 P.2d 1024, 1027 (Ct. App. 1992) (tort action accrues when plaintiff knows or in the exercise of reasonable diligence should know of defendant's negligent conduct).

negligence claim against USAF would therefore be timely if the amendment relates back to the commencement of the action.

Under Rule 15(c)(2), "an amendment of a pleading relates back to the date of the original pleading when . . . the claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrences set forth or attempted to be set forth in the original pleading." Furthermore, "the relation back doctrine of Rule 15(c) is to be liberally applied." Clipper Exxpress v. Rocky Mountain Motor Tariff Bureau, Inc., 690 F.2d 1240, 1259-60 n.29 (9th Cir. 1982), cert. denied, 459 U.S. 1227 (1983).

In determining whether an amendment relates back, the inquiry is whether the original and amended pleadings share a common core of operative facts so that the adverse party has fair notice of the transaction. Percy v. San Francisco Gen'l Hosp., 841 F.2d 975, 978 (9th Cir. 1988). Furthermore, when the original complaint asserts different claims against different defendants, each defendant is on notice of claims asserted against other defendants and therefore may be named in an amended complaint. Martell v. Trilogy, Ltd., 872 F.2d 322, 325 (9th Cir. 1989).

> Limitation is suspended by the filing of a suit because the suit warns the defendant to collect and preserve his evidence in reference to it. When a suit is filed in a federal court under the Rules, the defendant knows that the whole transaction described in it will be fully sifted, by amendment if need be, and that the form of the action or the relief prayed or the law relied on will not be confined to their first statement.

Id. at 326 (quoting Barthel v. Stamm, 145 F.2d 487, 491 (5th Cir 1944), cert. denied, 324 U.S. 878 (1945)). The original Complaint

alleges negligence claims against ABHES and NAHS. It is at least noteworthy that ASAF now claims that it is similar enough with these accrediting agencies to warrant dismissal of the original Complaint.

In the instant case, the original complaint put USAF on notice that it must collect and preserve all of the evidence in reference to its role in TTI's participation in the federally guaranteed student loan program. The Court thus presently finds that amendment would not be futile on statute of limitations ground.

Motion To Dismiss

USAF has moved to dismiss all of the claims alleged against it in Plaintiffs' original complaint. Nevertheless, USAF appears to acknowledge that insofar as it may have become a "holder" of loans, its continued presence as a defendant in this action is appropriate for determining the validity of Plaintiffs' defenses against the original lenders. USAF's primary focus is on Count 11, which alleges a violation of Arizona's Consumer Fraud Act, Ariz. Rev. Stat. Ann. §§ 44-1521 to 1534. Section 44-1522 provides:

> **A.** The act, use, or employment by any person of any deception, deceptive act or practice, fraud, false pretense, false promise, misrepresentation, or concealment, suppression or omission of any material fact with intent that others rely upon such concealment, suppression or omission, in connection with the sale or advertisement of any merchandise whether or not any person has in fact been misled, deceived, or damaged thereby, is declared to be an unlawful practice.

Money is included within the definition of "merchandise," and a consumer loan is included within the definition of "sale." See Villegas v. Transamerica Fin. Servs., Inc., 147 Ariz. 100, 781 P.2d

781 (Ct. App. 1985).

The allegedly unlawful practice in this case is the omission of "FTC Holder Language"[2] in loan documents devised and supplied by USAF. Plaintiffs allege that they have suffered unspecified damages as the result of this unlawful conduct.[3] Courts from other jurisdictions have held that a failure to comply with the FTC Holder Rule or an attempt to sidestep the provisions of that rule may violate state or local consumer protection laws. See, e.g., Heastie v. Community Bank, 727 F.Supp. 1133 (N.D. Ill. 1989).

USAF offers two arguments to support its motion to dismiss. First, relying on Veal v. First American Savings Bank, 914 F.2d 909 (7th Cir. 1990), USAF urges that pursuant to the 1982 amendments to the Truth in Lending Act, loans made, insured, or guaranteed under the HEA are exempt from the FTC rule on preservation of consumer defenses. See 15 U.S.C. § 1603(6). The Seventh Circuit's holding in Veal, however, was based upon meager legal analysis and the decision is far from persuasive, especially when compared with the

---

[2] The Federal Trade Commission's Holder Rule, 16 C.F.R. § 433.2, requires that any consumer credit contract for the sale or lease of goods or services contain a notice provision that the holder of the contract is subject to claims and defenses that the consumer might assert against the seller.

[3] The precise nature of the damages attributable to this claim is very unclear. In order to prevail, Plaintiffs must establish that they suffered some injury as a result of the omission of FTC Holder Language. See Nataros v. Fine Arts Gallery of Scottsdale, Inc., 126 Ariz. 44, 612 P.2d 500 (Ct. App. 1980) (misled consumer must have suffered some injury as the result of misrepresentation in order to state a claim under this section). Whether, however, Plaintiffs will be ultimately successful in establishing the requisite damages is not to be resolved in this Motion to Dismiss.

treatment given the question in Jackson v. Culinary School of Washington, 788 F.Supp. 1233 (D.D.C. 1992).[4]

In Jackson, the plaintiffs sought to hold lenders, private guarantee agencies, and other secondary holders liable under local law for failing to include FTC Holder Language in student loan promissory notes. After engaging in a comprehensive statutory analysis, the Jackson Court found nothing in the Truth in Lending Act or the FTC Holder Rule to suggest that Congress intended to exclude federally guaranteed student loans from the ambit of consumer protection laws. This Court finds that conclusion to be compelling.

USAF also argues that even if the Holder Rule does apply to these transactions, the Rule on its face applies only to a "seller" who takes or receives a consumer credit contract without the required notice. USAF maintains that far from being a seller in this case, or even a lender, its role here was merely that of a "stationer." Plaintiffs disagree with this characterization of USAF's role in these loan transactions, asserting that USAF was in fact "the originator (and, in may cases, the enforcer)" of the promissory notes that Plaintiffs signed.

What USAF seems to overlook is that its liability under the Arizona Consumer Fraud Act does not necessarily depend upon whether

---

[4] As USAF has noted, Jackson is a case that has not yet come to rest. So far, however, it has survived its trip to the United States Supreme Court and back again. See, 27 F.3d 573 (D.C.Cir. 1994), cert. granted; judgment vacated and remanded, 515 U.S. ___, 115 S.Ct. 2137, remanded, 59 F.3d 254 (D.C.Cir. 1995).

it acted as a "seller" as that term is defined in the FTC Holder Rule. The question is whether USAF's conduct amounted to the use or employment of a deceptive act or practice in connection with the sale of merchandise. The answer to that question will turn on the particular facts of this case as they are revealed.

IT IS ORDERED granting Plaintiffs' Motion to for Leave to Amend Complaint (Document No. 288).

IT IS FURTHER ORDERED denying Defendant USAF's Motion to Dismiss (Document No. 256).

DATED this 19 day of OCTOBER, 1995.

HONORABLE ROSLYN O. SILVER
UNITED STATES DISTRICT JUDGE

copies to all counsel of record