

No Disintegrations:
Enforcing Debts Without Violating Debt Collection Laws

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INTRODUCTION

- **Validation of Debts: An Overview**
- **Collection Activity During Debt Validation Period**
- **Litigation and Class Certification Concerns**
- **Joint Marketing Agreements and Interplay with GLBA**
- **Recovering Deficiencies after Repossessions or Foreclosures**
- **Bona Fide Error Defense**

Validation of Debt Notice

- Timing: within five days of the first written communication (or first oral communication if it precedes the first written communication)
- Contents:
 - Amount of the debt
 - Name of the creditor
 - Statement that unless consumer disputes the validity of the debt within thirty days, the debt collector will assume the debt to be valid.
 - Statement that if consumer notifies collector in writing within the 30-day period that any portion of the debt is disputed, the collector will obtain a verification of the debt or a copy of a judgment and mail a copy to the consumer
 - Statement that upon written request within the 30-day period, the debt collector will provide the name and address of the original creditor, if different from the current creditor

30-Day Verification Period

- While the debt collector may conduct collection activities during the 30-day verification period, these activities and any communications with the borrower may not overshadow or be inconsistent with the consumer's right to dispute the debt or request identification of the original creditor

Who Is The Creditor For VOD Purposes?

- The Act requires creditors to identify in the VOD the “creditor to whom the debt is owed.” This has raised questions among some clients. Can the servicer be treated as the creditor for this purpose? Who is the creditor in a securitization trust?
- There are many cases that address what constitutes a creditor’s name, but essentially none that address what constitutes the creditor to whom the debt is owed
- Clearly the holder of the note would qualify
- But might the servicer also be considered the creditor? One could argue that the debt is “owed” to the servicer because the servicer is the entity to which the borrower is obligated to make the payments. However, many provisions of the FDCPA suggest a distinction between the “creditor” and the person collecting the debt.

Who Is The Creditor For VOD Purposes? (Cont'd)

- When the courts are called upon to determine whether there has been a violation of the FDCPA, the courts apply the standard of the “least sophisticated consumer”
- For example, according to at least one court, stating in the VOD that the original obligation was “assigned” to the debt collector may not satisfy the least sophisticated consumer standard, as that consumer could interpret “assigned” in one of two ways - the loan was either (a) sold to the collector, or (b) assigned to the collector for purposes of collection
- Another court held that identifying the creditor, but also indicating that the creditor could be some other entity, might violate the requirement, *e.g.*, a statement that the “original contract you entered into with ABC Creditor or with the predecessor or assignor of ABC Creditor”
- In a mortgage backed security setting, is the trust itself the creditor?

How Much Detail Should Be Included In Amount Owed

- A debt collector must disclose the total amount of the debt as accurately as possible and must include all portions of the amount due, not just principal and interest.
- Thus, the “amount of debt” figure should include all components, including principal, interest, late charges, and other charges that are due at the time the VOD is prepared.
- Many debt collectors fail to include all charges, instead stating that “other charges may apply.”
- Judge Posner suggested the following as a safe harbor:
 - As of the date of this letter, you owe \$ [the exact amount due]. Because of interest, late charges, and other charges that may vary from day to day, the amount due on the day you pay may be greater. Hence, if you pay the amount shown above, an adjustment may be necessary after we receive your check, in which event we will inform you before depositing the check for collection. For further information, write the undersigned or call 1±800± [phone number].
- While this may serve as a safe harbor in only the Seventh Circuit, many debt collectors use it in other jurisdictions.
- A debt collector should ensure that all other charges included in the total amount due are lawful; courts have held that loan servicers violate the FDCPA’s debt validation requirement by including unlawful charges.

Avoiding Overshadowing With Explanatory Disclosures

- If the consumer exercises her validation rights during the validation period, the debt collector must cease collection of the debt until the debt collector responds to the consumer's notice.
- The debt collector may continue collection efforts until the consumer exercises her validation right, provided that the collection efforts do not "overshadow or [are not] inconsistent with the disclosure of the consumer's right to dispute the debt or request the name and address of the original creditor."
- To determine whether a statement or action overshadows the VOD, a court will ask whether the statement or action would confuse the "least sophisticated consumer" about her validation rights.
- There are no clear rules here, with courts going both ways, often employing a fact and circumstances analysis.
- A majority of courts that found overshadowing focused on the collector imparting a sense of urgency by implying that the consumer would be irrevocably harmed in some way if he did not immediately pay the debt.
- Some courts have held that debt collectors overshadowed by demanding in the VOD payment within a short period of time, or in a letter sent shortly after the VOD. These courts reasoned that the debt collector's demand for immediate payment overshadowed the notice to the consumer that he or she had thirty days to dispute the debt. Some courts have held that a demand for immediate payment may be permitted if the letter has language that clearly harmonizes the demand with the validation notice disclosure.

Avoiding Overshadowing With Explanatory Disclosures (Cont'd)

- Judge Posner, in another decision, suggested that debt collectors could avoid many overshadowing claims by adding language to the VOD explaining that the debt collector will suspend collection efforts if the consumer exercises his verification rights:

The law does not require us to wait until the end of the thirty-day period before suing you to collect this debt. If, however, you request proof of the debt or the name and address of the original creditor within the thirty-day period that begins with your receipt of this letter, the law requires us to suspend our efforts (through litigation or otherwise) to collect the debt until we mail the requested information to you.

- This language might need to be tailored to specific situations.
- Any statement or action during the validation period could, in theory, overshadow the VOD. Thus, including Judge Posner's language in the VOD might not insulate a debt collector from a claim that some other statement it made or action it took outside of the VOD overshadowed the VOD.
- Consider adding "harmonization" language in other subsequent communications that might arguably be deemed to overshadow the VOD. If no "harmonization" additions may be made to forms (e.g., because they are statutory, such as a notice of default), the collector might consider enclosing with a cover letter that provides the harmonization, assuming it is not prohibited under local state law.

Bankruptcy Stays and Injunctions

- Two fundamental protections for debtors under the Bankruptcy Code: the automatic stay and the discharge injunction
 - Automatic stay prohibits nearly all collection efforts during the bankruptcy case
 - Discharge injunction prevents collection efforts on discharged debt after bankruptcy case has been resolved
 - Borrower may nevertheless reaffirm the debt or voluntarily repay the debt – but proceed with caution!
 - The Ninth Circuit has held that an alleged violation of the discharge injunction not actionable under the FDCPA – the exclusive remedy is under the civil contempt provisions of the Bankruptcy Code

Bankruptcy Stays and Injunctions

- Section 1692e of the FDCPA provides that a debt collector "may not use any false, deceptive or misleading representation or means in connection with the collection of any debt."
 - Any communication to a debtor in bankruptcy which claims or implies that the debt is immediately due and payable or that suggests that the debt collector may take action to collect on the debt may be construed to be misleading

Bankruptcy Stays and Injunctions

- In a similar Catch-22, the FDCPA requires the debt collector to conspicuously disclose that it is attempting to collect a debt, but the automatic stay prohibits any such efforts.
 - *Buckley vs. Bass & Associates P.C.*, 249 F.3d 678 (7th Cir. 2001): Communication that asks for bankruptcy information but does not solicit payment is not a communication “in connection with” the collection of a debt that triggers FDCPA notice requirements

Interplay with Gramm-Leach-Bliley Act Notices

- A debt collector may not communicate, in connection with the collection of any debt, with any person other than a consumer, his attorney, a consumer reporting agency if otherwise permitted by law, the creditor, the attorney of the creditor, or the attorney of the debt collector (Section 805(b))
 - Exception for prior consent
 - A representation in a privacy notice that the debt collector may transfer information to a joint marketing partner without the borrower's consent may violate the FDCPA
 - The suggestion that information may be transferred pursuant to a joint marketing agreement may be construed to be a “threat” to take action that the debt collector is not legally entitled to take

Collection Activity During Debt Validation Period

- As we have discussed, Section 1692g requires debt collector to send VOD letter within five days after the debt collector's initial communication "in connection with the collection of any debt." See 15 U.S.C. § 1692g(a).
- Within thirty days after receiving the VOD letter, the debtor may: (a) dispute all or part of the debt; and/or (b) request the name and address of the original creditor, if different from the current creditor.
 - If debtor disputes debt or requests the name of the original creditor, the debt collector must cease collection until it: (1) obtains verification of the debt, a copy of the judgment, if any, or the creditor's name and address; and (2) mails the verification, judgment, or name and address of the creditor to the debtor.
 - If debtor neither disputes debt nor requests the name of the original creditor, the debt collector may continue collection activities provided that collection activity and notices to the debtor "*may not overshadow or be inconsistent with the disclosure of the consumer's right to dispute the debt or request the name and address of the original creditor.*" 15 U.S.C. § 1692g(b) (emphasis added).

“May Not Overshadow Or Be Inconsistent With...”

- “May not overshadow” language added as part of 2006 amendments to FDCPA.
- Whether a communication “overshadows” or is “inconsistent with the disclosure of the consumer’s rights” is determined by the “least sophisticated” or the “unsophisticated” consumer standard, depending on the jurisdiction.
- These standards do not provide much guidance for litigants:
 - **Least sophisticated consumer:** “The hypothetical least sophisticated consumer does not have the astuteness of a Philadelphia lawyer or even the sophistication of the average, everyday, common consumer, but is neither irrational nor a dolt.” *Ellis v. Solomon and Solomon, P.C.*, 591 F.3d 130, 135 (2d Cir. 2010) (internal quotations omitted).
 - **Unsophisticated Consumer:** “The unsophisticated consumer isn't a dimwit. She may be uninformed, naive, and trusting, but she has rudimentary knowledge about the financial world and is capable of making basic logical deductions and inferences.” *Wahl v. Midland Credit Management, Inc.*, 556 F.3d 643, 645 (7th Cir. 2009) (internal quotations omitted).
- Both the least sophisticated and the unsophisticated consumer standards have been held to be objective standards; standard violated where VOD language would cause consumer to be “uncertain” as to his or her rights.
- Most federal circuit courts have held that the determination of whether a notice would confuse the least sophisticated / unsophisticated consumer is a question of law.

Examples: Violation Found

- *Ellis v. Solomon and Solomon, P.C.*, 591 F.3d 130 (2d Cir. 2010). Debt collector that served summons and complaint during 30-day validation period violated FDCPA because the least sophisticated consumer would be confused by a summons that did not inform consumer that her rights under VOD letter were not affected by commencement of action. But, Second Circuit noted that serving a summons and complaint during 30-day period may be permissible, provided that the VOD letter and the summons and complaint set forth “an explanation of the lawsuit’s impact-or more accurately, lack of impact-on the disclosures made in the validation notice.”
- *Dunn v. Derrick E. McGavic, P.C.*, 653 F. Supp. 2d 1109 (D. Or. 2009). Debt collector’s statement that “[i]f our client instructs us to file suit immediately, we may do so even if the thirty (30) day dispute and validation periods described below have not expired. Even if suit is filed during the 30 day dispute and validation periods, you still have all the rights described below[; ...if you exercise your rights,] the law requires us to suspend all efforts ... to collect the debt.” In this case, the Court found the debt collector’s disclaimer to be too “jumbled” and “confusing” for the least sophisticated consumer to understand.

Examples: Mixed Bag:

- *Muha v. Encore Receivable Mgmt, Inc.*, 558 F.3d 623, 630 (7th Cir. 2009). Court reversed summary judgment for defendant and remanded action to district court. Statement in VOD letter that “*your original agreement with the above mentioned creditor has been revoked*” may overshadow debtor’s rights by “intimidation,” but may not because “statement did not appear in or adjacent to the notice of the plaintiffs’ right to challenge the debt, and it was not ... a flat-out contradiction of anything in the letter.”
- *Jacobson v. Healthcare Financial Services, Inc.*, 516 F.3d 85 (2d Cir. 2008). VOD letter that gave debtor option to pay debt immediately or dispute debt and/or request identity of creditor did not violate FDCPA. In that case, the Court noted that “a request for immediate payment does not, standing alone, violate the FDCPA.” But, Court found that requiring receipt of dispute versus mailing of dispute within 30-day period overshadowed consumer’s FDCPA rights.

Examples: Violation Not Found:

- *McCormick v. Wells Fargo Bank*, 640 F. Supp. 2d 795 (S.D.W. Va. 2009). Statement in VOD letter that debt collector “would not delay or cease with its collection of the debt” found not to violate FDCPA because no requirement under Section 1692g(a) to apprise debtor that collection efforts would temporarily stop if debtors exercised their rights under Section 1692g.

Litigation and Class Certification Concerns

- **Litigation Issues**

- Whether communications made during the 30-day debt validation period trigger Section 1692g(b) liability.
 - Does the initiation of a foreclosure action overshadow?
 - Do communications inviting debtor to be considered for loan modification overshadow?

- **Class Certification Issues**

- Standing.
- Predominance: whether individualized issues predominate such that class treatment is not warranted.
- Damages: statutory damages capped at lesser of \$500,000 or 1.0% of defendant's net worth, but state UDAP statutes and state collection laws may impose other penalties.
- Other damages considerations such as serial state-wide class actions.

Recovering Deficiencies after Repossessions or Foreclosures

- Obtaining the Judgment – Consider state anti-deficiency and one action rules
 - Some state laws restrict a a debt collector’s ability to obtain a deficiency judgment (see California’s “one action rule” which prohibits a lender from suing on the underlying obligation without first foreclosing the real property security and prohibits a lender from taking any judicial action to judgment except a judicial foreclosure on promissory note)

Recovering Deficiencies after Repossessions or Foreclosures

- Other states have enacted anti-deficiency statutes that prohibit creditors from obtaining deficiency judgments on the note under certain circumstances, *e.g.*, loans used to purchase a primary residence
- Some states allow deficiency judgments, but only after a foreclosure has been pursued, and then only within a specific time-frame of the foreclosure

Recovering Deficiencies after Repossessions or Foreclosures

- Consider Statute of Limitations – Bars on actions to recover debt versus extinguishing the debt
 - Section 807(6) prohibits misrepresenting the legal status of the debt
 - Unfair practices, especially under Section 808(6)
- Credit Reporting
 - Do you need to change past reporting
 - Report truthful, accurate historical information

Bona Fide Error Defense

- Section 1692k(c) of the FDCPA provides that “[a] debt collector may not be held liable in any action brought under this subchapter if the debt collector shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error.”
- Traditionally, courts have held that the defense applies only to clerical errors. In 2008, the Sixth Circuit joined a growing minority of circuits to hold that the FDCPA’s bona fide error defense may be applied to a an error of legal judgment. *Jerman v. Carlisle, McNellie, Rini, Kramer & Ulrich LPA*, 538 F.3d 469 (6th 2008). In that case, the debt collector – a law firm – sent a VOD letter that incorrectly stated the debtor may only dispute the debt in writing. The Sixth Circuit rejected an older line of cases that analogize the FDCPA’s bona fide error defense to a similar provision in TILA, upon the Court’s observation that the TILA defense expressly excludes errors of legal judgment, while the FDCPA contains no such exclusionary language.
- Last year, the United States Supreme Court granted certiorari to hear plaintiff’s appeal of the Sixth Circuit’s decision. The Court heard oral argument on January 13, 2010. Stay tuned for a decision this Spring.

Thank you for participating in our Servicing and Debt Collection webinar series.

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