

Comments
To the Federal Trade Commission
Regarding the
Fair Debt Collection Practices Act

Collecting Consumer Debts: The Challenges of Change

By the
National Consumer Law Center
On behalf of its
Low Income Clients
And the
National Association of Consumer Advocates

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I. INTRODUCTION AND SUMMARY

The **National Consumer Law Center**,¹ on behalf of its low income clients, and the **National Association of Consumer Advocates**,² applaud the Federal Trade Commission for taking this long overdue analysis of the adequacy of the current laws protecting consumers from abusive debt collection activities. The FTC's workshop should stimulate critical proposals for changes in the federal laws governing debt collection. Certainly change is needed to protect consumers adequately from the growing problems with debt collection in the 21st Century.

We work with attorneys who on a daily basis assist consumers who have been victimized by illegal debt collection practices. We see the effects of these abuses on people - the stress, the threat to employment, the fear, the lost funds, the frustration, the embarrassment, the raw emotional toll - from the harassment. We also see the frustrating inadequacy of the current legal scheme to stop these abuses.

The current combination of few FTC enforcement actions against only the most blatant violators, combined with private enforcement of both the Fair Debt Collection Practices Act ("FDCPA") and state laws, clearly does not provide sufficient restraints on the bad practices in the collection of debts in this nation.

As the FTC has noted, the abusive activities of debt collectors have consistently been the leading cause for complaint year after year to the FTC. From a high starting

¹The **National Consumer Law Center** is a nonprofit organization specializing in consumer issues affecting of low-income and elderly people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations, from all states who represent low-income and elderly individuals on consumer issues. As a result of our daily contact with these advocates, we have seen examples of abusive practices against low-income people in almost every state in the union. It is from this vantage point--many years of dealing with the abusive debt collection faced by the less sophisticated and less powerful in our communities--that we supply these comments. We publish and annually supplement fifteen practice treatises which describe the law currently applicable to all types of consumer transactions, including the 1045 page treatise, *Fair Debt Collection*. (NCLC 5th Ed. 2004). This comment is filed on behalf of our low-income clients and written by NCLC attorneys Bob Hobbs, Lauren Saunders, and Margot Saunders.

² The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, and law professors and students whose primary practice or area of study involves the protection and representation of consumers. Its mission is to promote justice for all consumers by maintaining a forum for information sharing among consumer advocates across the country and to serve as a voice for its members as well as consumers in the ongoing struggle to curb unfair and abusive business practices. Compliance with federal consumer protection laws in general and the Fair Debt Collection Practices Act in particular has been a continuing focus of NACA since its inception.

point, the sheer number of these complaints has skyrocketed in recent years, from 13,950 in 2000 to 69,204 in 2006 – a 500% increase in just six years.³

Debt collection has become a hugely profitable business.⁴ There are few meaningful restraints on the abuses in this industry. As is evident from consumer complaints, *many debt collectors believe they can make more money when they intimidate, threaten criminal prosecution, harass, and collect fees and charges far in excess of the real debt.* Even more startling, debt buyers have learned to work the system to win judgments and coerce payments *even when they have the wrong person or lack any evidence that the consumer owes the debt.* Even when a debt collector violates the law, the chances of being caught are minimal and the consequences are cheap.

The FTC recognizes that its own enforcement actions - pursuant to both the FDCPA and under Section 5 of the FTC Act - to protect consumers are only a part of the overall scheme that limits inappropriate behaviors in the collection of debts. Private enforcement efforts are a critical partner in establishing restraints on the abusive collection of debts. The primary tool available for individual enforcement is the FDCPA. State laws do provide some additional redress relating to some activities in the states in which they apply, but these protections are also insufficient to address the mounting problems.

As illegal, improper and abusive debt collection escalates, we recommend a multi-pronged approach to addressing these problems. The primary purpose of these comments is to urge the FTC to take a step back from the specifics of the Fair Debt Collections Practices Act and instead look at the broader picture of debt collection abuses in this nation.

SUMMARY OF COMMENTS

PROBLEMS.

Highlights of the current most abusive debt collection practices include:

Abusive credit practices. Debt collection begins with credit. The world has changed dramatically since 1977. Now, debt is pushed on consumers who are already in a

³For the ninth consecutive year in 2006, consumers continue to complain about third-party collectors at a higher rate than any other specific industry. *See* Federal Trade Commission, 2006 Annual Report to Congress on the Fair Debt Collection Practices Act, available at <http://www.ftc.gov/os/2006/04/P0648042006FDCPAReport.pdf>. The number of complaints against debt collectors increases each year in sheer volume and as a percentage of all complaints regarding all industries received by the FTC. *Id.*

⁴See Price Waterhouse Coopers, Value of Third-Party Debt Collection To The U.S. Economy: Survey and Analysis (June 27, 2006), available at <http://www.acainternational.org/images/8652/finaleconomicimpactstudy.pdf>. (citing revenues of \$12.1 billion in 2006).

stressed financial condition with little regard for ability to pay. Frequently, creditors make their profits not from the regular repayment of the debt, but from the piling on of disproportionate fees and penalties. From the lack of underwriting to creditor practices that encourage default, debt collection becomes inevitable.

Growth of the debt buyer industry. Increasingly, debts that have not been collected – perhaps because they are invalid – are sold for pennies on the dollar to debt buyers, severing the connection between the creditor and the collector. The internet and other tools of the information age make it profitable to collect old and previously uncollected debts. Yet ironically, critical information about the debt and the ability to resolve disputes are not preserved – because no one requires this information to be preserved -- even though that information is easier to preserve today than ever before. The rise of debt buyers exacerbates abuses that also plague collections by creditors and contingent debt collectors:

- Confusion over the identify of the original creditor or amount of the original debt;
- Failure to respond adequately to questions about billing errors, payments or settlement agreements not credited, identity theft or mistaken identity;
- Continued and aggressive collection of old debt after records are lost and disputes cannot be resolved;
- Renewed collection efforts by the next collector, who is deliberately kept ignorant of the consumer’s previous efforts to dispute or resolve the debt.

Abuse of the courts. Courts are overwhelmed by thousands of mass debt collection filings, rubber stamping the vast majority with default judgments, despite serious flaws including:

- Failure to serve the consumer with adequate and legal notice of the suit;
- Total lack of any evidence of the underlying debt;
- Falsified or improper affidavits;
- Suits filed against wrong person, or seeking an incorrect or unlawful amount
- Laundering a time barred debt with a new judgment
- Manipulative trial continuances when the consumer appears and disputes the debt, making a future default judgment likely.

Abuse of mandatory arbitration by debt collectors. The abuses seen in the courts are mirrored in arbitration judgments obtained through abusive mandatory arbitration

clauses forced on consumers. Worse even than the abuses with default judgments, arbitration judgments are almost completely unreviewable despite blatant errors of fact or law, and are entered by arbitrators who generally have a strong financial incentive to rule for the creditor.

Increasing abuse of electronic collection methods. Debt collectors and some fringe lenders like payday lenders steal funds directly from consumer accounts – through remotely created checks and illegal electronic transfers – by perverting the ACH and electronic transfer system, and consumers are often unable to stop or control these debits from their bank accounts.

Persistence of the widespread abuses seen in 1977. This paragraph from the 1977 Senate report accompanying the FDCPA is equally applicable to the situation today:

“Collection abuse takes many forms, including obscene or profane language, threats of violence, telephone calls at unreasonable hours, misrepresentation of a consumer's legal rights, disclosing a consumer's personal affairs to friends, neighbors, or an employer, obtaining information about a consumer through false pretense, impersonating public officials and attorneys, and simulating legal process. [T]he suffering and anguish which [unscrupulous debt collectors] regularly inflict is substantial.”

SOLUTIONS.

While a number of critical updates to the FDCPA need to be made, essential, new protections also must be established for future debt collection. Some of these protections are appropriate as additions to the FDCPA; others might be better fitted into other federal statutes.

No debt collection activity should be permitted unless the collector possesses basic information to verify the debt and to resolve disputes.

- No collection activity without proof of indebtedness by the consumer, date of the debt, identity of the original creditor, and itemization of all fees, charges and payments;
- Collectors should respond to verification requests by a reasonable investigation responsive to the consumer’s specific dispute.
- The creditor and each subsequent holder of the debt must retain and pass on to the next holder all communications from the consumer concerning the debt and information about all known disputes and defenses.
- Before seeking a judicial or arbitration judgment, debt collectors should

certify that they possess admissible evidence of the essential facts concerning the debt and hold any license required by state law.

Consumers need protection from unfettered electronic access to their accounts. Consumers need stronger rights to stop or dispute electronic payments and remotely created checks, and collectors should be required to obtain written permission before accessing a consumer's financial account.

Collection of ancient, time-barred debts should be prohibited or discouraged, and certainly should not be conducted deceptively. Collectors make rampant, unlawful threats of litigation that they have no intent or legal right to pursue. At a minimum, collectors pursuing debts beyond the statute of limitations should be required to disclose to the consumer that the debt is time barred and the consumer cannot be sued.

Reforms are needed against certain creditor and collector practices:

- Banks should be prohibited from freezing or permitting garnishment of exempt funds.
- Payday lenders should be barred from check holding and other abusive collection methods.
- Protections are needed against abuses by mortgage servicers.
- Better disclosures are needed to stop abusive practices like deceptive settlement agreements, putting old debt on new credit cards, and cross collection by refund anticipation lenders.

The FDCPA needs critical updates to ensure its effectiveness. The following simple but important amendments will ensure that consumers will receive the protections that Congress originally intended:

- Consumers need notice of their right to cease communications and should be able to exercise the right orally.
- Consumers should be able to record abusive telephone calls.
- A collector's initial communication should identify the original creditor and should itemize fees and interest.
- Collectors cannot plead ignorance of the law as a "mistake."
- Consumers need effective remedies including injunctive relief and damages and class relief adjusted for inflation.

II. DEMOGRAPHIC AND INDUSTRY TRENDS

A. The Increase Of Unaffordable Debt

At the time that the FDCPA was passed, the primary reason that debts were not paid was because of loss of income, caused by either change in employment or illness.⁵ Although loss of income remains a significant factor in delinquent debts, abuses in the credit industry now bear a major responsibility for pushing consumers over the brink. Credit is pushed on Americans with little regard for ability to pay. Destructive high cost credit products that would have been criminal in 1977 are now legal and even widespread. Deceptive and abusive practices by creditors are often designed deliberately to lead consumers into default.

This front-end context – extending credit which will too often lead to debt collection – is important to keep in mind when considering solutions to back-end collection abuses. Moreover, abuses by creditors and their responsibility for the rise of unaffordable debt mandate reforms aimed at creditors as well as debt collectors.

The following discussion focuses on credit cards, one of the largest sources of debt that leads to collection activity, though the issues are emblematic of many other types of debt as well.

1. *The Massive Credit Card Debt Burden*

In 1977, when the FDCPA was passed, there was no interstate banking, and credit card companies had to obey the laws of the borrower's home state. Credit card deregulation, and the concomitant spiraling credit card debt of Americans, began in 1978, with a Supreme Court decision allowing banks to locate in states with lax or no usury caps and to take their home state interest limits across state lines.⁶ At the beginning of 1977, revolving debt was about \$32 billion; by 2007 it had increased more than 27 times to \$880 billion.⁷

Three-quarters of all households now have at least one credit card, and over half of cardholders carry credit card debt from month to month.⁸ Credit card lenders have

⁵Federal Trade Commission, Statement of Basis and Purpose for the Credit Practices Rule, 49 Fed. Reg. 7740, 7747 (Mar. 1, 1984).

⁶Marquette National Bank of Minneapolis v. First of Omaha Service Corp, 439 U.S. 299 (1978).

⁷ See Federal Reserve Board, Statistical Release - Consumer Credit Historical Data (Revolving), available at www.federalreserve.gov/releases/g19/hist/cc_hist_mt.txt.

⁸ Ana M. Aizcorbe, Arthur B. Kennickell, and Kevin B. Moore, *Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances*, Federal Reserve Bulletin (Jan. 2003), at 25.

engaged in aggressive solicitation. In 2006 alone, credit card lenders mailed almost 8 billion card solicitations.⁹ There are now almost 1.5 billion cards in circulation—over a dozen credit cards for every household in the country.¹⁰

Low-income consumers have become a lucrative target for credit card lenders, because those consumers typically carry and pay big balances at high interest rates. The largest increase in credit card debt is among households with a reported annual income of less than \$10,000.¹¹

The negative consequences of this escalating mountain of debt on individual consumers as well as the American economy cannot be minimized. Personal bankruptcy rates increase on an annual basis,¹² and families become destabilized due to the financial pressures.¹³ Although less well documented, more foreclosures result as well. When a homeowner has big credit card balances, it is hard to resist the lure of mortgage refinancing or a home equity line of credit as a way to manage the debt.

2. Abusive Credit Card Industry Practices Increase Debt

A significant amount of debt load is increasingly exacerbated by punitive tactics of the credit card industry which keep consumers on a treadmill of debt, paying fees and charges, for as long as possible. The abusive litany of credit card fees and charges seen today did not exist in 1977. But in 1996, a Supreme Court ruling permitted credit card companies to avoid laws of the borrower's home state governing a wide variety of fees.¹⁴ Uncapping the amount of fees that credit card banks can charge has resulted in the rapid

⁹ Cardtrak.com, *Card Mail*, (Feb. 21, 2007), available at http://www.cardtrak.com/news/2007/2/21/Card_Mail.

¹⁰ U.S. Census Bureau, *Statistical Abstract of the United States: 2003 at 751 (Table 1190): Credit Cards – Holders, Numbers, Spending, and Debt, 1990 and 2000, and Projections, 2005*, available at www.census.gov/prod/2004pubs/03statab/banking.pdf; U.S. Bureau of the Census, *Projections of the Number of Households and Families in the United States: 1995 to 2010 at 9 (1996)*, available at www.census.gov/prod/1/pop/p25-1129.pdf (projecting 108.8 million households by 2005).

¹¹ See Robert D. Manning, *Role of FCRA in the Credit Granting Process*, Testimony before the House Subcommittee on Financial Institutions and Consumer Credit, June 12, 2003, at 5-6 and 18, Table 2, available at www.creditcardnation.com/pdfs/061203rm.pdf.

¹² The number of personal bankruptcy filings has increased steadily since during the past few decades, reaching 1,624,272 in 2004. Administrative Office of the U.S. Courts News Release, *Number of Bankruptcy Cases Filed in Federal Courts Down Less Than One Percent (Aug. 27, 2004)*, available at http://www.uscourts.gov/Press_Releases/june04bk.pdf. Personal bankruptcy filings declined by a small number, 13,111, between 2003 and 2004.

¹³ See Elizabeth Warren & Amelia Warren Tyagi, *The Two-Income Trap: Why Middle-Class Mothers and Their Families Are Going Broke* (Basic Books 2003).

¹⁴ *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735 (1996).

growth of and reliance on fee income by credit card lenders.¹⁵ It has also contributed significantly to the snowballing credit card debt of American consumers.¹⁶

Credit card lenders no longer impose these fees as a way to curb undesirable behavior from consumers, which used to be the primary justification for imposing high penalties. Instead, these fees constitute a significant source of revenue for the bank. Penalty fees now constitute about 10% to 13% of profits for issuers.¹⁷ The income from just three fees – penalty fees, cash advance fees and annual fees – reached \$24.4 billion in 2004, and total fee income topped \$30 billion.¹⁸

Not surprisingly, industry tactics trap consumers into incurring added fees. Strict payment deadlines and short grace periods make late fees more likely, and issuers authorize over limit spending but then charge fees without warning.¹⁹ Credit card issuers have reported that 35 percent of their active U.S. accounts were assessed late fees in 2005, and 13 percent were assessed over limit fees.²⁰ One major issuer has a practice of offering multiple low-limit credit cards to overextended borrowers in order to maximize over-limit fees.²¹ Most issuers will assess an over limit fee even if a payment during the

¹⁵ See Linda Sherry, *Annual Credit Card Survey 2007*, Consumer Action, (Spring 2007) (“Consumer Action Survey”), available at http://www.consumer-action.org/news/articles/2007_credit_card_survey; see also USPIRG, *The Credit Card Trap: How to Spot It, How to Avoid It* (April 2001), available at www.truthaboutcredit.org.

¹⁶ The average late payment fee has soared from \$12.83 in 1995 to over \$33.64 in 2005, an increase of 115% adjusted for inflation. Over-limit fees have similarly jumped from \$12.95 in 1995 to over \$30.81 in 2005, an increase of 95% adjusted for inflation. In contrast, before 1996, few issuers charged late or over-limit fees in the late 1980s and early 1990s, and if they did, it was for amounts such as \$5 to \$10.16.

Government Accountability Office, *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*, GAO-06-929, at 20-21 September 2006, available at www.gao.gov/new.items/d06929.pdf. The GAO also found that many issuers now use a tiered structure for fees, imposing higher late fees on higher balances.

¹⁷ Government Accountability Office, *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*, GAO-06-929, September 2006, at 67 and 72, available at www.gao.gov/new.items/d06929.pdf.

¹⁸ *Id.*

¹⁹ See Alys Cohen, Testimony before the COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

Regarding Credit Card Practices: Fees, Interest Rates, and Grace Periods (“Cohen Testimony”) (March 7, 2007), available at www.nclc.org; Consumer Action Survey, *supra* note 15.

²⁰ Government Accountability Office, *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*, GAO-06-929, at 33. September 2006, available at www.gao.gov/new.items/d06929.pdf.

²¹ Robert Berner, *Cap One's Credit Trap*, Business Week, November 6, 2006.

cycle brings the balance within the consumer's limit.²² Hair trigger default rates can more than double a consumer's interest rates based on as little as a single late payment or a default on an unrelated account.²³

A bankruptcy decision sheds light on how high finance charges and junk fees, not irresponsible spending, may be the root cause of overwhelming credit card debt. The bankruptcy court forced a major credit card lender to break out principal versus interest and fees in its claims against 31 separate debtors. The court's order reveals that on average, 57% of the debts consisted of interest and fees.²⁴

These charges exacerbate the problems of consumers who have hit hard times. Too often, they drive consumers into bankruptcy, resulting in cascading losses to individuals, families and neighborhoods—of lost savings, lost homes, and forced moves, with all of the consequential financial and emotional tolls.

3. Debt Collection Abuses by Credit Card Companies

Credit card lenders, like many creditors, have been known to engage in plain old debt collection abuse – harassment, deception and abuse.²⁵ However, there are a few practices that are unique to credit card companies and their collectors.

Most important is the fact that credit card companies, or the debt buyers to whom they sell the debt, often initiate collection cases against consumers without any documentation of a credit card agreement signed by the consumer or periodic statements to show transaction activity.²⁶ Instead, they simply offer up an affidavit from an

²² *Id.*

²³ Cohen Testimony, *supra* note 19.

²⁴ Amended Order Overruling Objection to Claims, *In re Blair*, Civ. No. 02-1140 (W.D.N.C. Feb. 10, 2004).

²⁵ *See, e.g.*, *State v. Cross Country Bank*, 703 N.W.2d 562 (Minn. Ct. App. 2005) (listing debt collection abuses by subprime credit card lender); *MacDermid v. Discover Financial Services*, --- F.3d ---, 2007 WL 1529406 (6th Cir. May 29, 2007) (finding plaintiff's allegations that card debt collector's accusation of fraud drove consumer to suicide met Tennessee's "formidable" outrageous conduct standard); Assurance of Discontinuance, *In the Matter of Columbus Bank and Trust Co. and CompuCredit Corp.*, New York Attorney General's Office, June 30, 2006 (documenting multiple debt collection abuses by issuer of "Aspire" credit card) *available at* www.oag.state.ny.us/press/2006/jul/Aspire%20Visa%20Assurance.pdf.

²⁶ *See, e.g.*, *Nelson v. First Nat'l Bank Omaha*, 2004 WL 2711032 (Minn. Ct. App. Nov. 30, 2004) (no signed credit card application); *Citibank (S.D.) Nat'l Assn. v. Whiteley*, 149 S.W.3d 599 (Mo. Ct. App. 2004) (judgment for borrower due to lack of documentation); *Citibank (South Dakota), N.A. v. Martin*, 807 N.Y.S.2d 284 (N.Y. Civ. Ct. 2005) (reviewing documents necessary for summary judgment in credit card case, including account agreement, billing statements, proof of assignment, etc.); *Asset Acceptance Corp. v. Proctor*, 804 N.E.2d 975 (Ohio Ct. App. 2004) (debt buyer failed to provide documentation of the charges, debits, and credits to permit court to calculate the balance claimed to be due); *Worldwide Asset Purchasing v. Stern*, Civ. Div. No. AR04-4429 (Pa. Ct. Common Pleas Dec. 29, 2004), *reprinted in* 153 *Pittsburgh Legal J.* 111 (2005); *Atlantic Credit and Fin., Inc. v. Giuliana*, 829 A.2d 340 (Pa. Super. 2003);

employee in their loss recovery department and/or sue on an account-stated theory.²⁷ This deprives the consumer of the ability to challenge erroneous transactions or demonstrate how much of their debt is due to purchases versus questionable finance charges and junk fees. Some courts have precluded recovery for the creditor or debt buyer because of their failure to provide adequate documentation. However, other courts have not required the lender to produce the original signed application or the original account agreement in order to recover from the consumer.²⁸

There is evidence that credit card lenders would be unable to provide the original agreement or application signed by the cardholder. In one case, a major card issuer admitted in litigation that it does not retain the original account application of cardholder's beyond five years.²⁹ Yet these same lenders often sue the consumer, claiming that the terms of the now-destroyed documents justify charges, fees, and the liability of co-signers.

Related to the credit card lenders' failure to keep and provide adequate documentation on credit card accounts are their attempts to impose liability on parties who are not liable for credit card debt. Practitioners report that credit card lenders have attempted to impose liability on surviving spouses or other partners when the cardholder dies. In these cases, the surviving spouse or partner was not a joint account holder, and in some cases not even an authorized user. Some of these cases occurred in states without community property laws, or the partners were not married.

As discussed below, credit card debt is also often sold to debt buyers, creating a whole host of additional debt collection abuses.

First Selection Corp. v. Grimes, 2003 WL 151940 (Tex. App. Jan. 23, 2003) (no written agreement submitted).

²⁷ See e.g., Citibank (S.D.) Nat'l Assn. v. Whiteley, 149 S.W.3d 599 (Mo. Ct. App. 2004); Asset Acceptance Corp. v. Proctor, 804 N.E.2d 975 (Ohio Ct. App. 2004).

²⁸ See Capital One Bank v. Hardin, 178 S.W.3d 565 (Mo. Ct. App. 2005) (credit card lender not required to produce original account agreement, where it had produced original signed application, revised agreement, billing statements for two years, and a log showing telephone calls between lender and cardholder); Discover Bank v. Poling, 2005 WL 737404 (Ohio Ct. App. March 31, 2005) (credit card lender not required to provide original account agreement); Asset Acceptance LLC v. Davis, 2004 WL 2940747 (Ohio Ct. App. Dec 13, 2004)(creditor need not produce signed credit card application, because cardholder's use of credit card creates a binding agreement). The creditor's failure to produce an account agreement may preclude it from suing on a written contract theory, which in some states provides for a longer statute of limitations than other theories of recovery. See, e.g., Rawson v. Credigy Receivables, 2006 WL 418665 (N.D. Ill. Feb. 16, 2006).

²⁹ Johnson v. MBNA, 357 F.3d 426 (4th Cir. 2004) (credit card lender attempted to impose liability for debt on ex-wife of the cardholder, who claimed she was merely an authorized user on the debt; lender admitted in litigation that because of its five-year documentation retention policy, the cardholder's original account application, which would have shown whether the ex-wife was a joint obligor or an authorized user, was no longer in its possession).

B. Debt Buyers

1. *Growth of the Debt Buyer Industry*

The phenomenal growth of the debt buyer industry is the most significant new trend in the debt collection industry. The trade association for debt buyers reports the rapid growth of this new industry:

It is estimated that there were five sellers of delinquent debt in 1992Y [I]t is projected that there will be 300 major sellers of delinquent debt by 2005. The face value of all such debt sold in 1993 was \$1.3 billionY.The Debt Buyers Association estimates that the amount of debt to be sold by the original creditors in 2002 will exceed \$60 Billion.³⁰

This level of growth continues rapidly. Estimates for 2005 are \$110 billion in debt sold.³¹ SEC filings show that revenues and profits of the largest debt buyers have multiplied as much as four to six times from 2001 to 2005.³² Most of the debt sold to debt buyers is bank credit card debt, yet it also includes phone bills, medical bills, water bills, car loans, as well as many other kinds of consumer debt.

The age of the debts sold varies from a few months old to a decade or more. Typically the sold debts are aged by several years. The big debt buyers buy multimillion dollar portfolios from banks, utility companies, automobile finance companies, hospitals, and municipal water departments. The payment generally ranges from pennies per dollar on the debt to only a fraction of a cent on the dollar for an entire portfolio.

The growth of the debt buyer industry has exacerbated a number of problems that have long plagued the debt collection industry. Many of these problems are not unique to debt buyers.

2. *Failure to Identify Original Creditor or to Itemize the Debt*

It is common practice for debt collectors - whether they have bought the debt or are acting on a contingency agreement with the original creditor - to send out notices that fail to identify the original creditor or to itemize the debt between the original principal and penalties and interest. Faced with a debt in a name and amount they do not

³⁰ Comments of the Debt Buyers Association to the FTC regarding Telemarketing Rule 3 (April 4, 2002), available at <http://www.ftc.gov/os/comments/dncpapercomments/04/debtbuyersassociation.pdf#search=%22credit%20america%20debt%20buyers%22>.

³¹ Eileen Ambrose, "Debt That Won't Die," Baltimore Sun (May 6, 2007) (citing Paul Legrady, director of research for Kaulkin Ginsberg, a company that advises the debt collection industry), available at <http://www.baltimoresun.com/business/investing/bal-bz.ambrose06may06,0,5473187.column>.

³² *Id.*

recognize, consumers are at a loss. Even if they can trace it to the original creditor, the failure to itemize the debt makes it next to impossible for the consumer to determine if the amount claimed is valid and if there is a basis for any claimed interest or penalties.

This problem is particularly severe when the debt has been bought by a debt buyer. The debt may be quite old and the amount and name do not match any debt familiar to the consumer.

3. Failure to Validate the Debt

In the process of selling the debt between the creditor, interim debt collectors and the debt buyer, key information about the accounts is rarely forwarded by the seller to the buyer. Critical information that is typically omitted from the sales process includes:

- consumer complaints about billing errors
- payments not credited
- settlement agreements not honored
- identity theft
- mistaken listing of an account user as an account holder responsible for the whole account balance, or
- the consumer's representation by an attorney.

The original creditors generally provide debt buyers with only a minimal amount of bottom line data about the accounts they sell. Credit card banks maintain huge databases about their credit card accounts. These databases may not include electronic versions of all documents the consumer signed and may only note critical information about disputed bills and payments, mistaken identity, or a case of identity theft in the comments field. Debt buyers do not even receive all of this information and usually nothing from the comment field. They generally receive information in a spreadsheet format and are not provided access to any of the primary documents such as charge slips, the contract, or payment history. With multiple sales, some debt buyers cannot even provide a chain of title.

Debt buyers will not, and many cannot, tell consumers much about the debt they are pressuring the consumer to pay. Consumers are left with a guessing game. Is this something I missed years ago when times were tough or is this a mistake? Is the amount claimed correct? Often the underlying information has been destroyed by the original creditor culling their old records.

4. Collection of very old debt.

A substantial proportion of the debt bought by debt buyers is quite old, often beyond the statute of limitations. One debt buyer, Assets Acceptance Corp., reports a five-year or longer time frame for collection of its purchased debts. Its SEC reports show

millions of dollars of consumer payments in 2004 on debt purchased more than 5 years before with some payments going back to purchases made in 1993.³³

The Supreme Court has repeatedly pointed out that “[s]tatutes of limitations are not simply technicalities. On the contrary, they have been long respected as fundamental to a well-ordered judicial system.”³⁴ Indeed, “it is unjust to fail to put the adversary on notice to defend within a specified period of time and that the right to be free of stale claims in time comes to prevail over the right to prosecute them.”³⁵ When a collector pursues a stale claim, “the search for truth may be seriously impaired by the loss of evidence, whether by death or disappearance of witnesses, fading memories, disappearance of documents, or otherwise.”³⁶

The injustice of being forced to defend oneself against an ancient claim is not limited to the courts. Consumers who are confronted with an aggressive debt collector trying to collect on a debt allegedly incurred years ago may not remember the debt, or may be coerced into paying a debt that was not even theirs. These consumers are unlikely to still have the documents to show errors that make the amount claimed invalid. These problems are particularly acute for older consumers. Given the growth of this industry and the inherent potential for abuse when debt buyers collect old debts or lack full documentation on the account, it is not surprising that horror stories are rampant.³⁷

5. Exposure to Identity Theft

The growth of the debt market also increases the possibility of identity theft. Anyone can buy a debt on the internet for pennies on the dollar or less. While the debt buyer does not get much information about the consumer, it does receive personal financial information, including the consumer’s name, an address and phone number, social security number, account number and an amount listed as the account balance. The debt buyer also gains access to that consumer’s credit report that has even more personal financial information.

³³ Asset Acceptance Capital Corp. Annual Report on Form 10-K for 2004 p.2, 29.

³⁴ Board of Regents v. Tomanio, 446 U.S. 478, 487 (1980).

³⁵ United States v. Kubrick, 444 U.S. 111, 117 (1979) (emphasis added) (quoting Railroad Telegraphers v. Railway Express Agency, 321 U.S. 342, 349 (1944)).

³⁶ Kubrick, 444 U.S. at 117; Kimber v. Federal Fin. Corp., 668 F.Supp. 1480 (M.D.Ala. 1987).

³⁷ See “Debt that Won’t Die,” *supra* note 31; “Debtors’s Hell, Part I: No Mercy for Consumers,” *The Boston Globe* (July 30, 2006), available at http://www.boston.com/news/special/spotlight_debt/part1/page1.html; “Debtor’s Hell, Part II: Dignity Faces a Steamroller,” *The Boston Globe* (July 31, 2006), available at http://www.boston.com/news/special/spotlight_debt/part2/page1.html.

6. Reselling of debt.

Some debt originally held by larger debt buyers is resold to smaller debt buyers. Some debt is resold numerous times. This “laundering” of the debt can create particular problems for consumers. Even if the consumer manages to convince one debt buyer that the debt claimed is invalid, the debt can simply be sold again and the consumer has to start the process again. The Baltimore Sun described an identity theft victim, Nancy Rose, who was contacted repeatedly by a series of debt collectors harassing her about a \$5,045 bill that was not hers. Even after she sued and won a \$40,000 settlement, the debt was simply sold again and she had to begin the battle anew with yet another collection agency.³⁸ As the stories in our appendix and news reports indicate, her story is becoming increasingly common.³⁹

C. An Older Population, Seniors With More Debt

The importance of updating the protections against abusive debt collection practices is all the more urgent in the light of the aging of the population. The first baby boomers will turn 65 in four years. Not only are there more seniors, but debt levels among seniors are also rising dramatically.⁴⁰ Among other indications:

- One-third of retirees in a recent poll by AARP described their current personal debt levels as a problem, and 7 percent called it a "major" problem.
- Debt levels for households headed by someone 75 and older averaged \$20,234 in 2004, a 160 percent jump from 1992, the Employee Benefits Research Institute reported.⁴¹

³⁸ Debt That Won't Die, *supra* note 31.

³⁹ See, e.g.,” Press Release, Illinois Attorney General (May 18, 2006), available at http://www.illinoisattorneygeneral.gov/pressroom/2006_05/20060518.html; “Zombie Debt is Hard to Kill.” *MSN Money* (c. May 18, 2006), available at <http://articles.moneycentral.msn.com/SavingandDebt/ManageDebt/ZombieDebtIsHardToKill.aspx>; Caroline Mayer, *New Breed Of Collectors Has Debtors Seeing Red*,” *Washington Post* (May 28, 2005).

⁴⁰ See Deanne Loonin, National Consumer Law Center, *The Life and Debt Cycle: Part OneB The Implications of Rising Credit Card Debt Among Older Consumers* (July 2006), available at http://www.nclc.org/action_agenda/seniors_initiative/content/rising_debt.pdf; Heather C. McGhee and Tamara Draut, *Demos, Retiring in the Red: The Growth of Debt Among Older Americans* (January 19, 2004), available at <http://www.demos.org/pub101.cfm>.

⁴¹ Leslie Haggin Geary, “Debt gaining on many U.S. Seniors,” (June 4, 2007), available at http://www.bankrate.com/brm/news/pf/20070604_seniors_in_debt_a1.asp#1.

Although older consumers generally hold less credit card debt than younger consumers, they are catching up. The average credit card debt for Americans between 65 and 69 years old rose a staggering 217% between 1992 and 2001, to \$5,844. Among seniors with incomes under \$50,000 (70 percent of seniors), about one in five families with credit card debt is in debt hardship -- spending over 40 percent of their income on debt payments, including mortgage debt.⁴²

Not surprisingly, given these and other trends, elders are filing bankruptcy in record numbers. The fastest growth in both Chapter 7 and Chapter 13 petitions is in filers over age 55, and the growth is faster than the aging of the population would indicate.⁴³ That is, not only do elders have more debt than before, but many are buried in unaffordable debt.

There is little margin for error with older populations. Those who lose income over time or who slip in and out of poverty have fewer working years, if any, to replace resources and save. A lack of financial knowledge exacerbates these problems. Researchers have found widespread financial illiteracy among older Americans.

Key factors that explain the rise in debt among seniors include:

- **Shrinking Income:** The largest share of older Americans live on low incomes that stagnated or declined during the 1990's, while their basic costs increased.
- **Higher expenses:** These include higher housing costs, rising out of pocket medical costs, increased energy and utility costs, and rising property taxes.
- **Creditor marketing practices** that tempt consumers daily to borrow beyond their means.

As debt rises among older consumers, they become more likely to face debt collectors. As distressing as abusive debt collection practices are for everyone, they are particular problematic for seniors. A frail elderly person is more easily upset by an abusive telephone call; indeed, the stress from harassing tactics can actually threaten their health. Older consumers living alone are more often targets of abusive tactics because they may be socially isolated; in addition, because they are at home during daytime hours, they are more accessible to collectors.⁴⁴

Seniors may have memory problems that make it more difficult to recall whether a debt is valid, particular when the collector does not identify the original creditor or itemize the original debt and later charges. The rise of the debt buyer industry means that collectors are pursuing older and older debt, which means that seniors may face claims that they may or may not have incurred years ago, involving debts or accounts for which

⁴² Heather C. McGhee and Tamara Draut, Demos, *Retiring in the Red: The Growth of Debt Among Older Americans* (January 19, 2004), available at <http://www.demos.org/pub101.cfm>.

⁴³ John Golmant & Tom Ulrich, Administrative Office of the U.S. Courts, *Aging and Bankruptcy: The Boomers Meet Up at Bankruptcy Court*, ABI Journal (May 26, 2007).

⁴⁴ *See, e.g.*, Charles Duhigg, "Bilking the Elderly with a Corporate Assist," *New York Times* A1 (May 20, 2007).

the paperwork is long gone. Even without memory problems, it can be a complicated process to reconstruct these debts.

Homebound seniors who lack access to office computers and copying machines may find it harder to dispute a claim in writing or to keep records of their communications. Seniors may more quickly assume that a collector will act responsibly in response to the senior's oral dispute.

Much senior debt is also medical debt, which can be particularly difficult to sort out. It can be a full time job to determine whether a medical expense has been properly submitted to Medicare and any secondary insurance and whether the claim was properly paid by the insurance company, particularly when a senior may have multiple bills from a given medical provider. Collectors also at times make threats that are particularly distressing to seniors, such as a threat to cut off their medical insurance or their access to critical medication.

Thus, the growth of the senior population, and the rising debt among seniors, may make it particularly important that protections against abusive debt collection practices be effective and useful to older consumers.

III. DEBT COLLECTION PRACTICES AND TECHNIQUES

A. Abuse of the Courts

Debt collectors in general, and debt buyers in particular, frequently file lawsuits that they are not prepared to litigate - and may not be factually valid - with the expectation that a large number of consumers will default or will not be prepared to defend themselves. Abuses in these suits are rampant, including:

- Failure to properly serve the consumer with notice of the suit
- Lawsuits filed when the debt collector has no evidence of the underlying debt
- Lawsuits filed against the wrong person or seeking an incorrect amount
- Lawsuits filed beyond the statute of limitations.

It is very easy for collectors to bring waves of claims without taking the time to validate each debt or even obtain the documentation necessary to show that each debt exists. It is a gamble well worth taking. In exchange for the rare consumer who shows up prepared to defend themselves, the collector obtains many more judgments based on minimal or nonexistent proof against consumers who fail to appear, may not even have received notice, or are simply unable to afford to take the time to defend themselves.

Claims brought in small claims courts are particularly attractive to debt collectors. The relaxed procedural formalities, low evidentiary standards, inexpensive filing fees,

and negligible pleading requirements allow debt collectors and their attorneys to bring claims with only a small investment and little proof. Overwhelmed court officials do not take the time to ensure that the collector has some proof of the claim. Standards for ensuring that the consumer has been served with notice of the lawsuit may also be weak.⁴⁵

For example, debt buyers are using the Massachusetts Small Claims Courts to obtain tens of thousands of judgments a year against consumers.⁴⁶ In the year 2005 alone, almost 122,000 small claims were filed in Massachusetts, and approximately 60% are claims brought by debt collectors.⁴⁷ By one estimate, about 80% of the consumers sued by debt buyers do not show up to court.⁴⁸ All of those cases result in default judgments which are obtained without any evidence of the debt ever presented to the court.⁴⁹

Of the few consumers who do show up, many are confused and do not understand what is going on because the debt collector's lawyer has no information about the debt and the consumer does not know the workings of the court system.⁵⁰ Some have never heard of the company that is suing them and are unsure as to the facts underlying the claim.⁵¹ The debt collectors rarely send their own attorney but use a pooled attorney to represent them as a group. The pooled attorney generally often does not even have the small bit of information that the debt collector has. If the consumer protests the debt, the case will be continued to another date requiring another trip to court by the consumer with an uncertain outcome. It is difficult, expensive and disruptive for working consumers to take time off for work to attend these hearings.

⁴⁵ The Massachusetts small claims courts, for example, require only that notice be sent by regular mail. *See* MA. R. SM. CL. Rule 3(a) (amended 2004). If the defendant does not show up, and their summons letter was not returned to the court as undeliverable, the court "may render judgment for the plaintiff and make an order for payment to the plaintiff." MA. R. SM. CL. Rule 7(c).

⁴⁶ The Boston Globe estimated 575,000 suits were filed from 2000 to 2005 by professional collectors in Massachusetts district courts. M. Resendez, F. Latour, "No Mercy for Consumers," Boston Globe A1 (July 30, 2006).

⁴⁷ *See* Beth Healy, Michael Rezendes, Francie Latour, Heather Allen, & Walter Robinson, ed., *Dignity Faces a Steamroller: Small-Claims Proceedings Ignore Rights, Tilt to Collectors*, THE BOSTON GLOBE, July 31, 2006, at A1. [hereinafter *Globe Series Part II*].

⁴⁸ Telephone Interview with Paul LaRoche, Esq. an attorney from Gardner, Massachusetts with significant experience in bankruptcy and defending debt collection cases (June 1, 2006).

⁴⁹ *See Id.*

⁵⁰ Telephone Interview with Paul LaRoche, *supra*, note

⁵¹ *See Id.*

Abuses of the small claims courts are not unique to Massachusetts. Attorneys in New York report the same situation:

- Small claims courts are overwhelmed with suits by debt collectors, primarily debt buyers.
- Most cases result in default judgment, generally with no evidence to support the debt.
- Debtors often default because they are not properly served with notice.
- Debtors who appear are rarely represented by counsel.
- Debt collection law firms negotiate settlements without explaining that they work for the debt collector, not the court.
- When the debtor appears, debt collectors request repeated continuances, forcing the debtor to confront child care or work obligations.

Once a creditor obtains a judgment, the effects can be devastating on low-income families. New York's procedures allow a creditor to immediately restrain a bank account, without judicial intervention, regardless whether the account's contents are exempt from execution. As a result, judgment debtors fall into further debt when they are unable to pay the rent, utilities, and other legitimate expenses while the account is frozen. Judgment creditors and their lawyers use this process to bully judgment debtors, regardless of whether they owe the underlying debt or whether their income is exempt from execution, into making unaffordable payments to the debt collector so that the collector will release the bank account. Massachusetts debtors are often threatened with jail for failing to meet court ordered payments.

A class action was recently filed in Nebraska against a debt buyer who allegedly filed hundreds of small claims court actions on debt beyond the statute of limitations. According to the lawsuit, the debt collector routinely submits a standard complaint and affidavit attesting to the validity of the debt, claiming that credit card debt that contains penalties and interest is actually original debt for goods and services. Most of these cases result in default judgments. A similar class action will soon be filed in Ohio.

Consumers in Illinois also report a similar frustrating experience with debt buyer suits in small claims courts. When the consumers appear pro se, dispute the debt, and ask for proof, the court orders documents to be produced at the next status date. Cases have been continued several times – even when the consumer informs the court that she has been the victim of identity theft – and not surprisingly, no documents are ever produced. The consumer is finally forced to retain an attorney. Other consumers give up, often because they cannot get more time off work to go to court, and a judgment is then entered based on incompetent debt buyer affidavits.

Even when they do not use the small claims courts, debt collectors in other states routinely overwhelm the courts seeking default judgments in mass actions by the thousands. For example, one NACA attorney looked at one single docket in one single courtroom on one single morning in the city of St. Louis, Missouri. There were over 500 cases on the docket, and the attorney recognized 330 of the cases as being brought by

debt buyers, and many of the other plaintiffs could have been debt buyers as well. Defaults in Missouri, as elsewhere, are generally granted on debts that the debt buyers cannot validate, often against consumers who have not been served and who may be the victim of identity theft.

Once a debt collector has a judgment - even if it is a faulty one against an individual who was not served, for a debt outside of the statute of limitations, or against the wrong person or in the wrong amount - the judgment effectively launders a bad debt. Even a judgment which is based on insubstantial evidence is good until it is paid,⁵² it generates hefty interest,⁵³ and is very difficult to overturn.⁵⁴ Obtaining a default judgment after the statute of limitations has run revives the enforceability of the debt. In Massachusetts, for example, judgments accrue 12% interest⁵⁵ and may be enforceable for life.⁵⁶ A \$2000 judgment would double to \$4000 if unpaid for 6 years and quadruple to about \$8000 in about 12 years if the interest is compounded as is the questionable practice of some debt buyers. The effect is similar in other states.

B. Increasing Abuse of Electronic Collection Methods

A common complaint by consumers result from the situation when they have provided a debt collector their bank account and routing numbers to allow a specific, single, withdrawal. Instead of the authorized amount, the debt collector makes a withdrawal of all the funds in the account, or makes multiple withdrawals when only one was authorized. Technically these withdrawals can be done either through the electronic debit system,⁵⁷ or as remotely created checks, governed by state laws, as processed through the "ACH" system.⁵⁸

One NACA attorney recently recounted this case:

My client, a soldier in Iraq, gave [a large debt buyer] permission to debit his account for \$300 on May 1. [The debt buyer] instead cleaned out his account. He called [his bank] and asked that the debt buyer be blocked from any further access to the account. [The bank] told him that this is not

⁵² See, e.g., *Haynes v. Blanchard*, 194 Mass. 244, 80 N.E. 504 (1907).

⁵³ See, e.g., Ma. G.L. c. 231 § 6C.

⁵⁴ See, e.g., Mass. R. Civ. Pro. Rule 60(b). Judgments become very difficult to set aside after one year, with the result that sometimes debt collectors do not seek payment for a year.

⁵⁵ Ma. G.L. c. 231 § 6C.

⁵⁶ See *Brown v. Greenlow*, 330 Mass. 88, 111 N.E.2d 744 (1953).

⁵⁷ The Electronic Funds Transfer Act, EFTA, applies to electronic withdrawals, 15 USC § 1693.

⁵⁸ Remotely created checks are governed by Articles 3 and 4 of the Uniform Commercial Code. The ACH system is the automated check clearinghouse.

sufficient to stop these debits from [debt buyer], that it is well known to the bank, and it will simply take further monies under a different name. Apparently this debt buyer routinely does this to soldiers.

Some consumers also say that even when there was no authorization for a withdrawal provided to the collector, the bank account information was taken off a paper check the consumer sent to reduce the balance of the debt or that the consumer acquiesced to the collector's request to provide bank account information to show that there were not sufficient funds to pay the debt or to show "good faith." While these collection activities violate both the FDCPA and the UCC, claims are rarely pursued. The issue in a case challenging an improper withdrawal from a bank account boils down to a "he said, she said." There is seldom any more evidence than the consumer's recollection that the withdrawal was not authorized and the debt collector's computer record saying it was.

An unauthorized withdrawal by a debt collector interferes with a low income consumer's ability to provide for basic obligations for rent, food, medical care, and other necessities. As the consumer did not anticipate the collector's unauthorized withdrawal, the consumer's funds are likely to be further reduced by bank fees as other checks written by the consumer are dishonored for insufficient funds.

It is also very difficult for a consumer to stop the electronic – or ACH – debiting for a payday loan or other electronic debits, including payment plans with debt collectors. Consumers report that their financial institutions refuse to stop payment on a preauthorized electronic transfer despite sufficient notice. Sometimes banks require the borrower to direct the creditor to stop debiting the account or require that the consumer confirm with the creditor in writing that authorization has been revoked. Many payday lending contracts specify that if authorization for the electronic fund transfer is revoked, then the lender will use a remotely created check to debit the very same amount from the borrower's account. Creditors switch back and forth from traditional electronic fund transfers to remotely created checks. Creditors change routing numbers and submit the debit under different names to avoid the consumer's efforts to stop payment. Often the lender will submit the same debit multiple times, so the consumer incurs multiple dishonored check fees.

Allowing unfettered access to a consumer's bank account is just like allowing a lender to take a confession of judgment or an assignment of wages - both activities found to be unfair by the FTC and outlawed by the Credit Practices Rule.⁵⁹ The same rationale used to prohibit those collection activities should be used as the basis for outlawing debt collectors, payday lenders and other creditors the ability to snatch money directly from a consumer's bank account.⁶⁰ Just like wage assignments, payday loans cause disruption of

⁵⁹ 16 C.F.R. 444.

⁶⁰ *See*, the extensive explanation for consumers' inability to avoid the marketplace dynamics in such a ways that would provide them with real negotiating power and therefore the basis for the FTC's prohibition

the family's finances and make it difficult for the debtor to purchase necessities. This disruption can result in costly refinancing or the impossibility of discharging other obligations in a timely fashion.⁶¹

C. Deceptive Settlement Agreements.

Debt collectors frequently offer to settle their claims for a payment of 40%, 50% or 60% of the debt. Yet, if the collector is a debt buyer, the debt will probably have been bought for pennies on the dollar. Consumers are attracted to such offers, often funding settlements with loans from family or friends. A frequent complaint is that collectors accept the settlement payment but then continue to seek payment of the balance of the original claim, sometimes by continuing dunning, sometimes in court, and sometimes by selling the claim to another debt buyer without noting the settlement agreement.

Debt collectors may also coerce a consumer into making a small payment to get the collector off their back for the moment, or in exchange for a false promise to delete a negative mark from a credit report. The consumer does not realize that even a small payment made may revive the legal viability of an ancient debt that was beyond the statute of limitations.

Consumers who think they have reached an agreement with a debt collector may also be misled into thinking they can ignore a summons. For example, one consumer interviewed by NCLC had already entered into a payment plan with the debt collector and had been making payments of \$35 every other week for over a year and a half. She figured there must have been some mistake, ignored the summons, and continued to make her payments. It is likely that this consumer has multiple judgments for old debts against her and that the \$35 is only the interest incurred. In Massachusetts this consumer may be paying these debts off for the rest of her life.

D. Abuse of Mandatory Arbitration by Debt Collectors.⁶²

A rapidly growing number of debts are being collected through mandatory arbitration - nearly all with the National Arbitration Forum (“NAF”) - rather than through the court system. While it is difficult to determine the exact magnitude of this famously secretive organization’s debt collection activity, a number of factors (such as discovery in litigation and the skyrocketing numbers of cases filed to confirm arbitration awards for creditors) indicate that the NAF is processing hundreds of thousands of debt collection cases each year.

against confessions of judgments and assignments of wages. *Statement of Basis and Purpose for the Credit Practices Rule*, 49 Fed.Reg. 7740, March 1, 1984 at 7749 to 7760.

⁶¹ *Id.* at 7758.

⁶² Thank you to Paul Bland at the Public Justice, P.C. for supplying the information on mandatory arbitration abuses.

This is a troubling trend for consumers. The NAF is a notoriously lender-friendly organization that openly advertises its services as being more favorable to and more profitable for lenders and debt collectors than other arbitration companies. A large body of anecdotal data indicates that the NAF's arbitrators nearly always rule for lenders in the full amount that they demand. There are a number of extremely troubling facts and concerns about the manner in which the NAF conducts arbitrations:

- NAF appears to funnel a large number of cases to a few specific arbitrators who nearly always rule for lenders. As one illustration, one arbitrator has decided more than 500 cases where MBNA bank sued customers, ruling for the bank in all but a handful of cases.
- Certain debt collectors file claims with the NAF simply as data streams rather than fully formed complaints. NAF then formats the data streams into documents and sends the documents to the NAF arbitrators with pre-printed orders. The arbitrators are not sent any original documents establishing that the consumers actually agreed to either the arbitration clauses or the credit contracts, but simply receive flat non-evidentiary assertions from the lenders that the consumers agreed to arbitration and the accounts.
- Many NAF arbitrators decide huge numbers of cases, often 40 or more, in a single day. In the overwhelming majority of these cases, NAF arbitrators simply sign the pre-printed orders generated by the home office, which award the lender the full sums that the lender has requested for the loans, any fees related to the loans, attorneys' fees and arbitration fees.
- It is well documented in many situations that the NAF routinely enters awards in favor of MBNA and other lenders against persons who were identity theft victims who never owed the debts.
- It appears that there are thousands, if not tens or hundreds of thousands, of cases where NAF arbitrators have awarded sums to lenders (and particularly MBNA) for debts that were past the relevant statute of limitations.
- There are several documented instances where NAF arbitrators who ruled against lenders, and particularly MBNA Bank, even a single time, were blackballed by the lenders and never permitted to hear further cases involving the lender.
- MBNA Bank and its attorneys boast publicly about a provision of MBNA's contract that purportedly permits consumers to "opt out" of MBNA's arbitration provision if they choose, and argue that this provision means that MBNA's arbitration provision is not mandatory. Nonetheless, there are documented cases of consumers who opted out of MBNA's arbitration system - and have registered mail receipts to prove this fact - who nonetheless had NAF enter awards in MBNA's favor against the consumers, notwithstanding NAF having been notified that the consumer had opted out of the arbitration provision.

- NAF regularly awards large sums for attorneys' fees to lenders against consumers in cases where it appears that the creditors' attorneys did nothing other than send an e-mail with digital data to be manipulated by the NAF into the materials to be sent to the arbitrator and the form award.
- There are a substantial number of cases where NAF officials failed to send notices of debt collection arbitrations to consumers at their actual address, and it appears that NAF makes little effort to ascertain the correct addresses for consumers. Nonetheless, NAF rarely overturns default awards against consumers who report to it that they did not receive timely notices of claims.
- In a great many cases, NAF officials issue sworn certifications that notices were sent to consumers at specific addresses on specific dates, and make these certifications as much as eight months after the dates on which the acts took place. It is not credible to imagine that the persons making these certifications could remember this kind of specific information so long after the fact.
- A substantial body of anecdotal experience from consumer lawyers across the U.S. indicates that NAF rarely if ever grants extensions to consumer debtors, and regularly enters default awards against consumers who were as little as one day late in responding to arbitration notices.
- By contrast, numerous consumers and consumer attorneys report that NAF regularly grants extensions to its lender clients, particularly MBNA Bank, when the lenders request extensions or miss deadlines.
- Although NAF arbitrators regularly include significant sums in their awards for lenders for the lenders' attorneys' fees and both parties' arbitrators' fees, NAF refuses to itemize those awards; it also consistently conceals them in the disclosures it makes on its website related to arbitrations that are conducted in California, rolling the attorneys' fees and arbitration fees into the lender's overall claim, so that consumers looking at NAF's website cannot determine the magnitude of the arbitration fees awarded in consumer cases.

In short, the NAF appears to be an extremely unfair and untrustworthy substitute for the civil justice system for debt collection cases. The NAF appears to operate as part of a debt collection mill, regularly generating substantial awards for lenders that greatly exceed the sums to which the lenders are legally entitled. The NAF system is geared towards quickly awarding lenders the full amount the lenders claim a consumer owes or more, without performing much scrutiny of the magnitude or correctness of these awards.

E. Abuses That Prompted Passage of the FDCPA Continue

Congress enacted the FDCPA in 1977 to combat the “widespread and serious national problem” of debt collection abuse.⁶³ At that time, Congress found:

“Collection abuse takes many forms, including obscene or profane language, threats of violence, telephone calls at unreasonable hours, misrepresentation of a consumer's legal rights, disclosing a consumer's personal affairs to friends, neighbors, or an employer, obtaining information about a consumer through false pretense, impersonating public officials and attorneys, and simulating legal process. [...] While unscrupulous debt collectors comprise only a small segment of the industry, the suffering and anguish which they regularly inflict is substantial.”⁶⁴

Congress hoped that the FDCPA would provide a national framework within which honest collectors could effectively ply their trade. Consumers could rest easier, knowing that the rampant abuses that had characterized the collection industry would be halted.

Unfortunately, the contemporary evidence presented here is bleak testimony that the abusive practices that prompted the FDCPA continue virtually unabated. “Debt collectors have displayed a remarkable lack of willingness to voluntarily comply with the law.”⁶⁵

Our own experience is confirmed by the tide of collection abuses reported to the FTC. Problems caused by debt collectors continue to precipitate more complaints to the FTC than all other types of complaints.⁶⁶ The current litany of abuses is long and troubling, from practices that are clearly violations of the FDCPA, but continue for want of prosecution, to more creative strategies crafted to exploit gaps in the FDCPA’s coverage.

The FDCPA was designed to “prohibit in general terms any harassing, unfair, or deceptive collection practice,” as well as to place restrictions on the manner in which debt collectors could contact debtors.⁶⁷ Congress recognized that debt collectors were harassing family and employers in an effort to shame or scare the debtor into paying.

⁶³ “Consumer Credit Protection Act,” S. Rep. No. 95-382, at 2 (1977).

⁶⁴ *Id.*

⁶⁵ O. Randolph Bragg, “THE FAIR DEBT COLLECTION PRACTICES ACT 15 U.S.C. §§1692 ET SEQ.” at 443, 12th Annual Consumer Financial Services Litigation Institute, Practising Law Institute (2007).

⁶⁶ See Federal Trade Commission, 2006 Annual Report to Congress on the Fair Debt Collection Practices Act, available at <http://www.ftc.gov/os/2006/04/P0648042006FDCPAReport.pdf>. The number of complaints against debt collectors increases each year in sheer volume and as a percentage of all complaints regarding all industries received by the FTC. *Id.*

⁶⁷ S. Rep. No. 95-382, at 4 (1977).

Unfortunately, this practice has not been eradicated. As one attorney recently recounted, “I thought I had heard it all. This as of yet unidentified collector told the nine year old child of my college friend in Texas, who is the victim of identity theft, that they were going to take her mommy away forever. The number on caller I.D was 50000000, obviously fake.”⁶⁸

Stories like this are common parlance nowadays. A debt collector in Florida threatened to call a woman at work until she lost her job. A January 2007 ABC News special titled “Debt Collectors Gone Wild,” turned up several examples of the more flagrant abuses of the FDCPA restriction on phone calls. A woman in Minnesota was contacted, and when she asked if she was speaking to an attorney, received the following response, “I’m the guy who’s going to end your life. That’s what I am.”⁶⁹ Another consumer asked if he was going to be put in jail or prison. The collector responded, “Uh, jail. Then you’re gonna get hurt or killed or stabbed or whatever it is within the first five years.”⁷⁰ Abusive, threatening and illegal telephone calls and threats are so typical that they no longer raise eyebrows among consumer attorneys.

The FDCPA also include a “provision requiring the validation of debts.” The committee hoped that this would eliminate “the recurring problem of debt collectors dunning the wrong person or attempting to collect debts which the consumer has already paid.”⁷¹ However, some companies have made violations of this provision of the FDCPA into their business model. The Attorney General of Illinois recently brought suit against a company that “has made a routine of buying up old debt at pennies on the dollar from creditors and then beginning collection proceedings without even a minimal investigation into the nature and status of each debt... Consumers who contacted the company to request verification of the debts were ignored, and fraudulent statements were made to the consumers in an attempt to induce them to pay debts that were beyond the statute of limitations, previously discharged, or even associated with an entirely wrong person.”⁷² The appendix to these comments list numerous examples of debt collectors failing to validate debts and continuing to pursue debts against the wrong person, in the wrong amount, or after a debt has been settled with a prior holder.

A third abusive practice that the authors of the Act sought to curb in 1977 was “forum abuse,” in which “collectors would file suit against consumers in courts which are so distant or inconvenient that consumers are unable to appear. As a result, the debt collector

⁶⁸ See Appendix at 59.

⁶⁹ “Debt Collectors Gone Wild,” ABC News Report, January 18, 2007, available at <http://abcnews.go.com/2020/BrianRoss/story?id=2799761&page=1>

⁷⁰ Id.

⁷¹ “Consumer Credit Protection Act,” S. Rep. No. 95-382, at 4 (1977).

⁷² Press Release, Illinois Attorney General (May 18, 2006), available at http://www.illinoisattorneygeneral.gov/pressroom/2006_05/20060518.html.

obtains a default judgment and the consumer is denied his day in court.”⁷³ As described above, default judgments are a much bigger problem today than they were in 1977. The growth of the debt buyer industry, the never-ending collection of old debts made possible by the information age, and collectors’ abuse of the court system to frustrate consumers who attempt to defend themselves make default judgments the norm in debt collection. The rise of mandatory arbitration, rigged to favor the repeat player – the creditor or debt collector – is another development that also frustrates Congress’s desire to give consumers their day in court.

The situation today is much worse than the one that Congress faced in 1977. Additional protections are needed to stem debt collection abuses, and the remedies to combat abuses that are already unlawful must be substantially strengthened.

IV. REFORMS NEEDED IN LIGHT OF CURRENT TRENDS AND PRACTICES

The dramatic changes in the debt collection industry, the growth of abusive creditor practices, and the dangers inherent in our new electronic/internet age - as well as the persistence of stubborn problems that prompted the FDCPA - warrant reforms that go beyond simply tinkering with the existing FDCPA provisions.

A. Better Information, Communication And Disclosures

Information is a key ingredient to reforms. The law should ensure that debt collectors have more information, save more information, and provide more information to consumers and to the subsequent collectors of the same debts. In these comments, we recommend seven different – but related – changes to the rules governing the collection of a debt.

- Debt collectors should be required to *possess certain basic information* about the debt before initiating collection efforts.
- *Before a collector files a complaint – in court or before an arbitrator -- the collector should possess information in a form admissible in the court.*
- *No debt should be sold or assigned without disclosure of critical information.* Debt collectors should not be permitted to launder the debt of claims and defenses simply by selling it to another collector.
- The initial written communication to the consumer should include the *name of the original creditor, as well as an itemization of fees and interest included in the debt.* The consumer should not be left guessing when contacted by a debt collector, and should not need to request validation to get this basic information.

⁷³ S. Rep. No. 95-382, at 5 (1977)

- When a consumer requests verification of the debt, collectors should be required to *verify the debts by a reasonable investigation that is responsive to the specific dispute raised by the consumer..* Verification should be real and meaningful, not be a game of ping pong that leaves the consumer screaming in frustration.
- Collectors should be required to *disclose to a consumer that she cannot be sued when the collector seeks seeking payment for a time barred debt.*
- Consumers should be *informed of their right to cease collection activities.*

1. *Debt Collectors Should be Required to Possess Certain Basic Information Before Initiating Collection Efforts*

As discussed above, debt collectors often lack significant information about the debts they are attempting collect, including proof of the original contract or other information showing that the consumer actually owes the debt, the date it was incurred, and a breakdown of the fees and charges added to the original debt. The failure to have this basic information - coupled with collectors' inability or unwillingness to provide what they do have - makes it extremely difficult for consumers to resolve disputes. A court judgment against a consumer, especially a default judgment, is also likely to be erroneous if the collector is permitted to proceed without having the fundamental information to validate the debt.

Ironically, this critical information is disappearing from the debt collection file in an information age when it is a simple matter to retain it. Federal law should require debt collectors to fulfill their responsibility to ensure that they have – at a minimum – certain basic information before they undertake collection activities.

Each holder of the debt should be required to maintain for the life of the debt all documents and notes of conversations related the account. Debt collectors should not be permitted to pursue collection activities unless they possess in hand the primary legal documents involved in the consumer account and all the records of charges, credits, and payments as well as the records of the consumer's prior communications regarding the account. This includes, at a minimum:

- Proof of indebtedness signed by the consumer
- The date that the debt was incurred and the date of the last payment
- The identity of the original creditor as known to the consumer
- The amount of the debt principal and an itemization of all interest, fees or charges added to it by the original creditor and all subsequent holders.
- The chain of title if the debt has been sold.

2. *Information Required to File an Arbitration or Judicial Complaint*

The FTC should declare it to be an unfair practice for a debt collector to file a debt collection complaint or to pursue arbitration unless the collector:

- *Possesses the basic information listed above in a form admissible in court and will be prepared to present it when called for trial;*
- *Certifies that fact in the judicial or arbitration complaint;*
- *Certifies to the court or arbitrator that the collector possesses any license required by state law.*

Experience has shown that debt collectors in general, and debt buyers and particular, frequently pursue litigation or arbitration in the hopes that the consumer will default, without possessing the evidence or documentation that the debt exists, is the right amount, and is against the right person. When the consumer appears for or seeks discovery, the debt collector asks for a continuance or stonewalls. It should be an unfair practice to file a lawsuit or arbitration complaint without being prepared to pursue it if the consumer appears and disputes the debt.

3. No Debt Should be Sold or Assigned Without Disclosure of Critical Information

Similarly, it should be unlawful to sell, assign or purchase a debt – or for the buyer or assignee to collect that debt -- unless certain relevant information is disclosed to the debt buyer or assignee. For example, as part of the sale, the seller should (1) provide documentation of the basic validation information discussed above, and (2) submit a statement disclosing:

- Whether the consumer has disputed or asserted any defenses to the debt, and all related communications
- Any validation, or lack thereof, that the seller has provided the consumer or has received from the original creditor or previous seller in response to a consumer dispute
- Whether any settlement has been reached concerning the debt
- Whether the debt is beyond the statute of limitations
- Whether the consumer is or has been represented by an attorney and the attorney's contact information
- Whether the consumer has informed the collector that a time or place is inconvenient to the consumer for communication
- Whether the debt has been discharged or listed in bankruptcy
- Any illness or disability claimed by the consumer or known to the collector
- Any known or claimed violation of the FDCPA to date
- Any other information relevant to the collection of the debt.

These disclosure requirements should apply both to the original creditor and to all subsequent sellers of the debt, and should be made part of both the Fair Credit Billing Act and the FDCPA.

4. *Collectors Should Be Required to Name the Original Creditor and to Itemize Fees and Interest Included in Debts*

In addition to better verification once a consumer disputes a debt, discussed above, the initial notice given consumers should be clear at the outset. Under the FDCPA, within five days of first contacting the consumer, the debt collector must provide the consumer with the amount of the debt and the name of the creditor to whom it is owed. However, the law does not clearly require either that the original creditor be named, or that the debt be itemized. Collectors often bundle extra charges, fees, and interest into the “amount of the debt.” This causes considerable confusion for consumers, who do not have the essential information to determine exactly where the debt was incurred, or whether the amount of debt includes illegal charges.

These problems are exacerbated by the increase in collections by debt buyers, who may not know or may obscure the information that the consumer needs to determine if the debt is valid. As seniors incur more and more debt, and as debt collectors collect on debt that many be years old, it is particular problem for one with a fading memory to understand whether an alleged debt is valid.

As the FTC has implicitly recognized when it recommends to Congress that this information be provided to consumers,⁷⁴ requiring information on the original creditor and an itemization of charges to be included in the first written notice to the consumer would also benefit collectors. It would reduce the number of questions and verification requests received, as many of the questions inherent in these requests would be answered with the information initially required.

Finally, the requirement to itemize the debt gives effect to the current requirement in the law prohibiting collectors from collecting any charges which are not expressly authorized by law.

Proposed Solution: *Collectors should be required to name the original creditor and to itemize fees and interest included in debts.*

5. *Collectors Should be Required to Verify Debts By a Reasonable Investigation That is Responsive to the Specific Dispute Raised by the Consumer*

Debt collectors are frequently collecting on debts that are simply invalid, or that consumers do not recognize. The first time an American learns that she has been the victim of an identity thief is often when she is called by a debt collector. The FTC estimates that 9 million Americans become identity theft victims each year. The

⁷⁴ See Federal Trade Commission, 2006 Annual Report to Congress on the Fair Debt Collection Practices Act, at 13, available at <http://www.ftc.gov/os/2006/04/P0648042006FDCPARReport.pdf>.

predominant consumer complaint about collection agencies reported to the FTC is that they seek to collect more than the consumer owes.⁷⁵

Americans are frequently confused about who their credit card issuer is because of disappearing banks with increasing bank mergers, payments made to anonymous credit card servicing companies, and cards branded with names unrelated to the issuer. This makes it difficult to meaningfully identify the “original” creditor to the consumer. Increasingly debt buyers are collecting debts, and they typically obtain only partial consumer files with important omissions of information about the charges, payments, errors, and complaints. Debts change hands repeatedly, debt buyers collect on debts that are so old that the consumer no longer has her own files, and mistaken identity is common as the debt buyer tries to track down a consumer who is no longer at the address on the account. The FTC charged that as much as 80 percent of the money one notorious debt buyer demanded was from consumers who never owed the original debt in the first place.⁷⁶

The debt collection industry and the FDCPA’s debt validation process have not dealt well with resolving common errors and providing needed information to consumers. A frequent complaint of consumers is that debt collectors ignore the consumer’s oral disputes and requests for information. The help that the FDCPA originally promised for written disputes was considerably undermined by the 1999 Fourth Circuit decision in *Chaudhry v. Gallerizzo*,⁷⁷ where the court stated: “At the minimum, verification of a debt involves nothing more than the debt collector confirming in writing that the amount being demanded is what the creditor is claiming is owed.” The *Chaudhry* decision did away with the FDCPA standard of “verification,” which suggests some review of the account in response to a consumer dispute, and substituted a lower standard: the mere confirmation of the amount that the creditor claimed.

One of the greatest frustrations consumers face in the marketplace is the stonewall response to a consumer’s complaint about an error by a creditor or debt collector. The FDCPA gives the consumer a right to verification of the debt. Yet even if the consumer provides specific information about why the debt is invalid, the debt collector may respond only with summary information that the creditor has verified that the amount demanded is what is owed, with no explanation. The consumer’s frustration is compounded enormously when the collector is able to out maneuver the consumer in

⁷⁵ See FTC Report on the Fair Debt Collection Practices Act 2007.

⁷⁶ See FTC Press Release, FTC Asks Court to Halt Illegal CAMCO Operation; Company Uses Threats, Lies, and Intimidation to Collect “Debts” Consumers Do Not Owe (Dec. 8, 2004), available at www.ftc.gov/opa/2004/12/CAMCO.htm (“Many consumers pay the money to get CAMCO to stop threatening and harassing them, their families, their friends, and their co-workers.”).

⁷⁷ 174 F.3d 394 (4th Cir.1999).

court or through arbitration and have the erroneous claim reduced to judgment. Yet, this compounding of wrongs appears to be occurring with increasing frequency.

A much stronger informal dispute resolution device needs to be crafted for the FDCPA. As discussed above, the current holder of the debt should be required to maintain all essential information related to the account. Debt collectors must be required to have access to that information and refer to it when an oral or written dispute is lodged.

Consumers should have a right to an accounting without disputing the debt so they can determine why the claim does not match their recollection of the debt. If the consumer raises a specific dispute, the collector should be required to undertake - or require the creditor to undertake - a reasonable investigation that is responsive to the specific dispute raised by the consumer. Debt collectors should be required to furnish a separate telephone number for disputes or notification of errors, with specially trained staff for investigating errors. If the collector sues the consumer for the debt despite the consumer's legitimate dispute, it should be responsible for the consumer's damages and attorney fees.⁷⁸ The notice to the consumer of the consumer's dispute rights should be in simpler English.

6. No Collection of Time Barred Debts Without Disclosing That Fact to the Consumer

While it may be legal in some states to pursue collection short of litigation on a debt outside of the statute of limitations, it is unjust to do so for all the reasons that led to the creation of statutes of limitations. Moreover, consumers typically do not know that the collector may not lawfully sue on a time-barred debt. Debt collectors frequently make false threats to sue, and they also often sue on time-barred debts even though courts have held that doing so is an unfair and unconscionable means of collecting debt.⁷⁹

Accordingly, no debt collector should be permitted to pursue collection of a time barred debt without disclosing in all written communications concerning the debt the following statement: "This debt is so old that the law does not permit us to sue you or obtain arbitration. A payment by you may revive this debt and allow us to sue you or pursue arbitration."

⁷⁸ *Clark v. Capital Credit & Collection Servs., Inc.*, 460 F.3d 1162, 1176 (9th Cir. 2006) (The collection agency and its lawyer are strictly liable for falsely stating the amount of the debt under § 1692e(2)(A) without regard to knowledge of the mistake. The § 1692k(c) bona fide error defense might shield the collectors but they were not entitled to summary judgment where there was evidence that the mistakes in the medical bills of the particular health care provider had come to their attention in consumer complaints, and the consumer was entitled to more discovery on the reasonableness of the collectors' procedures to avoid such errors.).

⁷⁹ *See, e.g., Kimber v. Federal Financial Corp.*, 668 F.Supp. 1480 (M.D.Ala. 1987).

7. *Collectors should be required to provide notice of the debtor's right to cease communications and consumers should be allowed to exercise this right orally.*

Currently, the FDCPA allows consumers to demand that debt collectors stop contacting them if the consumer tells the collector in writing to stop. Yet, nothing in the law requires the collector to inform consumers that they have this right. As a result, vulnerable consumers have no knowledge of their right to exercise this peace-providing protection. Requiring the consumer to implement this right in writing creates unnecessary hurdles for vulnerable and unsophisticated consumers. The Electronic Funds Transfer Act and other federal consumer protection laws recognize the public's preference for the telephone for these types of communications, as should the FDCPA.

Proposed Solution: *The Act should be amended to require the debt collector to provide in every communication to the consumer notice of the consumer's right to request the collector to cease further communications, and consumers should be allowed to exercise this right orally.*

B. Prohibit Unfettered Electronic Access to Consumer Accounts

Debt collectors, as well as payday and other fringe lenders, often gain and abuse electronic access to a consumer's financial accounts. Consumers have unauthorized debits made from their accounts; have difficulty canceling authorizations or unauthorized access; and suffer repeated fees from multiple presentments of the same debit. Federal law should be changed to clearly allow a consumer to cancel - without charge - any authorization to make a payment electronically, whether it is a single payment or multiple payments.

Just as it did for similar practices in the marketplace in the Credit Practices Rule, *the FTC should declare the following practices to be unfair:*

- *Failing to honor a consumer's oral or written instruction to stop or modify electronic or ACH access to the consumer's account;*
- *Debiting a consumer's account, whether by ACH or electronic debit, in an amount other than which the consumer has specifically authorized;*
- *Requiring consumer to inform or obtain consent from the payee before stopping an electronic payment;*
- *Charging the consumer a fee to revoke authorization for a preauthorized electronic or ACH debit;*
- *Permitting or causing multiple representment of an electronic debit.*

Debt collectors should also be required:

- *To obtain written confirmation of any oral authorization of a withdrawal from the consumer's account, which must be signed by the consumer prior to the withdrawal;*
- *To provide consumers with a clear disclosure that any authorization of withdrawal is revocable.*

V. CHANGES NEEDED TO ADDRESS ABUSIVE PRACTICE BY CERTAIN CREDITORS

A. Illegal Freezing of Exempt Funds

Social Security benefits, SSI benefits, Veterans' benefits, were all intended by Congress to be used exclusively for the benefit of the recipients to ensure a minimum subsistence income to the nation's workers and disabled.⁸⁰ To preserve these benefits for recipients Congress specifically provided that they cannot be seized to pay pre-existing debts, precisely because these seizures result in the loss of subsistence funds. States have established similar programs to protect the elderly and disabled poor from destitution.

Despite the clear federal law and the explicit purpose of these benefits, banks routinely freeze bank accounts containing these benefits after receiving garnishment or attachment orders. When an account is frozen, no money is available to cover any expenses - food, rent, medical care. Checks and debits previously drawn on the account (before the recipient knew that the account was frozen) are returned unpaid. Subsequent monthly deposits into the account will also be subject to the freeze and will also be inaccessible to the recipient.

Although some financial institutions do examine bank accounts to determine whether they are comprised exclusively of exempt funds - in which case the attachment order is declined - the majority do not. Instead, upon receipt of a judgment creditor's request for attachment, most financial institutions ignore even clear evidence of exempt

⁸⁰ For example, the Social Security Act, at 42 U.S.C. § 407(a), explicitly says:

The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law.

funds (such as electronic deposit from the Social Security Administration) and simply freeze the recipient's bank account.

The funds remain frozen for a period of time determined by state law before they are turned over to the creditor. To unfreeze the account, the recipient generally must go to the local court house, fill out a form to show that the funds in the account are exempt, obtain a hearing and prove the funds are exempt, then go to the bank and present the order releasing the freeze. This process can be difficult, lengthy, stressful and burdensome to recipients, who are - by definition - elderly or disabled.

The banks also assess expensive fees against these accounts. Although the account is frozen and inaccessible to the depositor, the bank still deducts its fees from the balance. The act of freezing the account itself generates an "attachment fee" deducted from the account - generally between \$100 and \$150. All checks, ATM withdrawals, and preauthorized electronic transfers for rent and other purposes are returned for insufficient funds. Every time a debit is returned unsatisfied a bank fee (the "NSF" fee) - generally in the amount of \$25 to \$30 - is deducted.

Mrs. M, is a single mother with a full-time job who earns \$1600 a month. As a result of identify theft, an \$800 judgment she'd had no notice of was entered against her and her bank account was restrained. The account consisted of exempt wages from the last sixty days. The restraint lasted for six weeks, causing her to be late on a number of bills: rent, credit card, life insurance, and phone. The bank assessed fees because of the restraint. Unable to resolve the matter with the bank and the creditor's lawyer, she retained a legal services lawyer who got the account released. Mrs. M. lost a full week's income -- \$400 -- in lost wages and fees.

The number of people who are being harmed by these practices has escalated significantly in recent years, largely due to the increase in the number of recipients whose benefits are electronically deposited into bank accounts. This is the result of the strong federal policy mandating electronic payment of all federal funds (EFT 99).

***Proposed Solution:** The FTC should recommend statutory or regulatory changes to prohibit financial institutions from freezing accounts containing Social Security funds and other exempt funds under federal and state law.*

B. Payday Loans

In the early part of the 20th century, the abuses of salary lenders and loan sharks were harnessed by the passage of small loan laws. But the wave of credit deregulation that began in the early 1980s has permitted destructively high cost credit to reemerge – this time, legally. Although there are several forms of small loan fringe credit products, we focus on one that poses particular risks of abusive debt collection practices: payday lending.

Payday loans are extremely expensive short term extensions of credit that trap consumers in a cycle of renewals, extensions and rollovers from which they find it difficult if not impossible to emerge. Payday loans go by a variety of names, including “deferred presentment,” “cash advances,” “deferred deposits,” or “check loans,” but they all work similarly. The consumer writes a check to the lender for the amount borrowed plus a fee, or signs an agreement to debit his or her bank account automatically.⁸¹ The check (or debit agreement) is then held for up to a month, usually until the customer's next payday or receipt of a government check. But most commonly, the borrower does not have the funds to cover that check and is compelled to return repeatedly to renew the loan for another large fee. The payday lending business model depends on this repeated loan flipping.

Typical fees for a payday loan are \$15 per \$100 two-week loan. The annual percentage rate (APR) is normally at least 390%, though advocates and credit code enforcement agencies have noted rates of 1,300% to 7,300%.⁸² Payday lenders often fail to comply with the disclosure requirements of the Truth In Lending Act, making it nearly impossible to understand the true cost of these loans.⁸³ Undoubtedly, some consumers agreeing to a fee of 20% of the check would forego the loan in the face of written disclosure that the annual percentage rate was 520%. Even when disclosures are made, they are frequently inaccurate.

The payday industry did not exist in 1977 when the FDCPA was passed; back then, loans at such exorbitant rates would have been criminal loan sharking. By the late 1990's, however, as more and more states repealed their usury caps or created exceptions to them, and as mainstream institutions left the small loan market, the payday industry began to grow swiftly. By 2000, the annual payday loan volume was estimated at \$8 to \$14 billion, and estimates for 2005 range from \$28 to \$40 billion a year.⁸⁴

⁸¹For example, to receive \$300 in cash, the consumer might have to write a check for \$360. If the fee is based on a percentage of the entire check, it represents a form of compounding, since it is calculated on the sum of itself plus the cash received. This methodology is legal under some state payday loan laws.

⁸² See the National Consumer Law Center, *Cost of Credit: Regulation and Legal Challenges* § 7.5.5.3 (3d ed. 2005 & Supp.); Elizabeth Renuart & Jean Ann Fox, *Payday Loans: A High Cost for a Small Loan in Low-Income and Working Communities*, 34 *Clearinghouse Review* 589, n. 3 (Jan./Feb. 2001). The typical payday borrower pays back \$793 for a \$325 loan. Uriah King, Leslie Parrish & Ozlem Tanik, Center for Responsible Lending, *Financial Quicksand: Payday Lending Sinks Borrowers in Debt with \$4.2 Billion in Predatory Fees Every Year* (Nov. 30, 2006), available at http://www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf. Check cashing outlets are among those charging exorbitant rates. In a recent study, typical loans were for over \$300, and cost \$15 to \$30 per \$100 loaned, or 390 to 780 % APR. Jean Ann Fox and Patrick Woodall, *Cashed Out: Consumers Pay Steep Premium to “Bank” at Check Cashing Outlets* (Nov. 2006), available at http://www.consumerfed.org/pdfs/CFA_2006_Check_Cashing_Study111506.pdf.

⁸³15 U.S.C. §§ 1601 *et seq.*

⁸⁴ See Uriah King, Leslie Parrish and Ozlem Tanik, Center for Responsible Lending, *Financial Quicksand* (Nov. 30, 2006), available at http://www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf.

These loans are marketed as a quick and easy way to get cash until the next payday. To qualify, consumers need only be employed for a period of time with the current employer or receive government benefits, maintain a personal checking account, and show a pay stub and bank statement. Credit reports are not routinely reviewed.

Abuses in making and collecting payday loans occur in a variety of ways. Cash-strapped consumers are rarely able to repay the entire loan when payday arrives, because they need the new paycheck for current living expenses. Lenders encourage these consumers to rollover or refinance one payday loan with another; those who do so pay yet another round of charges and fees and obtain no additional cash in return. Lawsuits and news reports describe scores of borrowers who are unable to climb off this debt treadmill.⁸⁵ An Indiana Department of Financial Institutions audit revealed that, on average over a twelve-month period, consumers renewed their loans approximately ten times, though one consumer renewed sixty-six times.⁸⁶

Though payday loans may be unsecured transactions, the use of checks gives these lenders a huge advantage in guaranteeing repayment. If a check is returned for insufficient funds or the loan otherwise goes unpaid, the lender may threaten to file criminal bad check charges, a tactic that is possible only because a check, rather than a mere promissory note, is involved.

The industry uses abusive collection tactics not only in attempts to collect but also to bully consumers into extensions and renewals at triple-digit interest rates. These tactics include the threat of criminal actions for bad checks; repeated harassing calls; and even showing up in person. As one former payday employee related, his customers would not be aware of what they were in for:

“We didn’t tell you that we would show up at your house. We didn’t tell you that we’d show up at your work. We didn’t tell you that we would call

⁸⁵Erik Eckholm, *Seductively Easy, Pay Day Loans Often Snowball*, NY. Times (Dec. 23, 2006); Elizabeth Renuart & Jean Ann Fox, *Payday Loans: A High Cost for a Small Loan in Low-Income and Working Communities*, 34 Clearinghouse Review 589, n. 4 (Jan./Feb. 2001).

⁸⁶Indiana Department of Financial Institutions, Summary of Payday Lender Examinations Conducted from 7/99 thru 10/99. The Department reported that of the 54,508 loans reviewed, the average amount financed was \$165.74 and average finance charge was \$27.29. Thus, the average consumer, who renewed 10 times each year, paid \$272.90 in fees to borrow \$165.74. *See also* Washington State Department of Financial Institutions Payday Lending Report: Statistics and Trends for 2003, *available at* www.dfi.wa.gov/news/DFI_PaydayReport.pdf (shows that 51.4% of borrowers took out 6 or more loans in a year); Florida Office of Financial Regulation Deferred Presentment Program, Annual Report to Legislature 14 (Jan. 1, 2004) (on average consumers took out 7.6 loans per year); Illinois Department of Financial Institutions, *Short Term Lending Final Report* at 26 (2000) (The Department found an average of 13 contracts per payday loan customer, during an average 6-month period). The Iowa Division of Banking also surveyed its payday loan licensees and found that the average number of loans per borrower per year was 12.5. (Dec. 2000). Most recently, the North Carolina Office of the Commissioner of Banks reported that over 38% of all customers made 10 to 19 such loans in 1999. Office of the Commissioner of Banks, *Report to the General Assembly on Payday Lending* (Feb. 22, 2001).

your friends and family to harass them to find you twice a day every day.”⁸⁷

These tactics are especially powerful in the payday context because the lender holds the borrower’s post-dated check, and can threaten to cash it if the borrower does not roll over the loan or come up with a partial payment. If the check bounces, the payday lender can threaten to refer it for criminal prosecution - even in states where the criminal check laws do not apply to posted dated checks.

To make matters worse, if the lender does refer the bad check, the district attorney is likely to farm the case out to a private debt collector who, under legislation passed last year, may be exempt from the FDCPA and can engage in otherwise illegal and abusive collection tactics without fear of liability.⁸⁸ This provision, which we strenuously opposed,⁸⁹ therefore enables the abusive tactics of payday lenders.

In the last several years the payday industry has expanded from store-fronts to the internet. Internet lenders are often hard to identify, locate, or contact. Internet payday lenders routinely evade state consumer protections by locating in lax regulatory states or foreign jurisdictions and making loans without complying with state protections in the borrower’s home state. As a condition of the loan, Internet payday lenders require consumers to authorize electronic debiting of their bank accounts on the next payday and routinely establish the automatic rollover or a renewal of the loan. For example, for an initial loan of \$200, the consumer would authorize a debit of \$260 from her account two weeks from the date of the loan. Unless the consumer faxes a request three days in advance of the due date, and two weeks after the initial loan the lender will deduct the \$60 finance charge and renew the \$200 loan for another pay cycle. Two weeks later, an additional \$60 is debited and the \$200 is still due two weeks after that. This cycle will continue for many weeks. Brick and mortar storefront payday lenders are also increasingly making use of electronic debt authorizations.

Proposed Solutions:

First, as discussed above, consumers need better protection against unfettered electronic access to their accounts.

Second, the FTC should amend the Credit Practices rule to ban the holding of a post-dated check or electronic authorization as security for a payment. The practice by

⁸⁷ See Payday Loans Trap Borrowers (video of interview with former payday employee), available at <http://www.responsiblelending.org/issues/payday/inside-the-payday-industry.html>.

⁸⁸ 15 U.S.C. § 1692p.

⁸⁹ See Margot Saunders, National Consumer Law Center et al., TESTIMONY BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS REGARDING THE CONSUMER IMPACT OF REGULATORY RELIEF PROPOSALS AFFECTING BANKS, THRIFTS AND CREDIT UNIONS (March 1, 2006), available at http://www.nclc.org/issues/debt_collection/content/TestimonyRegulatory%20Relief06.pdf.

*payday lenders of holding a post-dated check - or a deferred electronic authorization - against an expected paycheck is the modern day equivalent of a wage assignment. The FTC has banned wage assignments under the Credit Practices rule, and it should do the same for check holding.*⁹⁰

Third, in light of the predatory nature of payday loans and the history of abusive collection practices by the industry, the FTC should open a rulemaking to consider further protections for payday customers..

C. Mortgage Servicers

In 1977, when the FDCPA was passed, most mortgages were made by lenders who held on to the loan and serviced the loans themselves. These lenders had no incentive to manipulate the servicing; to the contrary, servicing abuses could affect the lender's reputation and could turn a performing loan into a nonperforming loan.

That situation has changed dramatically. Today, most mortgages are securitized and sold on the secondary market. The servicing is handled by a separate entity from the holder of the loan, and consumers have no control over who their servicer is. Often servicers are not originators, so that their abuses have no affect on their ability to bring in new loans to service.

Most significantly, the payment structure for mortgage servicing encourages abuses. Mortgage servicers are generally paid only a small flat fee by the loan holder. However, they may keep any fees that they charge the homeowner after a default. This establishes an incentive to put homeowners into default status.

The explosion in litigation in state and federal courts against mortgage servicers is testament to the fact that mortgage servicing is fueling much of the increase in defaults and foreclosures across the country.⁹¹

Abusive servicing occurs when a servicer seeks to collect unwarranted fees or other costs from borrowers by engaging in unfair collection practices, or through its own improper behavior precipitates borrower default or foreclosure.⁹² Some well documented examples include -

⁹⁰ 16 C.F.R. § 444.

⁹¹ See, National Consumer Law Center, *Foreclosures, 2006 Supplement* (forthcoming - 2006), Chapter 4A. The cases cited below are only *examples*. There are many more for each point. Also see Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers*, *Housing Policy Debate* 15(3): 753 (Fannie Mae Foundation 2004) ("The way a loan is serviced often has a greater effect on the borrower than the way it was originated."); O. Max Gardner, III, *Mortgage Securitization, Servicing, and Consumer Bankruptcy*, American Bar Association, *GP Solo Law Trends and News _ Business Law*, Vol. 2, no. 1 (Sept. 2005).

⁹² *Id.* at 756. These practices are distinguishable from appropriate servicer actions that may nevertheless harm borrowers, such as collecting appropriate late fees or foreclosing on borrowers who have not made their payments despite proper loss mitigation efforts.

- misapplying payments, including failure to apply payments as directed by the consumer;
- force-placing insurance for borrowers who have already provided servicers evidence of insurance;
- failing to pay property taxes when due, triggering governmentally imposed late fees, or sometimes forced sale of the home;
- charging late fees when borrowers are current on their payments;
- engaging in coercive collection practices and falsely claiming amounts due.

The life of a mortgage loan presents many opportunities for servicer error and abuse. The most common documented cases involve the misapplication of payments, including the failure to timely credit payments,⁹³ improper force-placed insurance, and false claims of defaults or amounts due.

The misapplication of payments is one of the most common problems that borrowers are reported to have with servicers. Having failed to properly credit the borrower's payment to principal and interest, servicers frequently compound the problem by improperly imposing late fees and erroneously reporting the homeowner late to the credit rating agencies.⁹⁴ Often, borrowers attempting to correct errors in their accounts are met with the servicer's callous indifference, compounding the problem.⁹⁵ Even the improper application of a single payment can have a snowball effect that leaves the homeowner fighting foreclosure and struggling to repair credit for months, or even years.

Another all too common abuse is the force placing of insurance. Borrowers are required by the terms of the mortgage to provide evidence of hazard insurance. When they do not, the servicer force places insurance on the property. Since the servicer passes on the cost of force placed coverage to the homeowner, in making the decision about which insurer to use, the servicer is often influenced by refunds, kickbacks or other compensation offered by insurance companies.⁹⁶ As a result, there is a built-in incentive

⁹³ Other common examples of misapplication of payments include: crediting payments to fees instead of to principal and interest, placing payments in suspense and therefore not crediting them to principal or interest.

⁹⁴ See, e.g., *Islam v. Option One Mortg. Corp.*, 432 F. Supp. 2d 181 (D. Mass. 2006)(servicer continued to report borrower delinquent even after receiving the full payoff amount for the loan).

⁹⁵ See, e.g., *Hukic v. Aurora Loan Servicing, et al*, 2006 WL 1457787 (N.D. Ill. May 22, 2006)(servicer's clerical error in recording amount of payment left homeowner battling with subsequent servicers and fending off foreclosure for nearly five years); *Rawlings v. Dovenmuehle Mortgage, Inc.*, 64 F. Supp. 2d 1156 (M.D. Ala. 1999)(servicer failed for over 7 months to correct account error despite borrowers' twice sending copies of canceled checks evidencing payments); *Choi v. Chase Manhattan Mortg. Co.*, 63 F. Supp. 2d 874 (N.D. Ill. 1999)(home lost to tax foreclosure after servicer failed to make tax payment from borrowers escrow account and then failed to take corrective action to redeem the property); *Monahan v. GMAC Mortg. Co.*, 893 A.2d 298 (Vt. 2005)(affirming \$43,380 jury award based on servicer's failure to renew flood insurance policy and subsequent uninsured property damage).

⁹⁶ See *Norwest Mortgage, Inc. v. Superior Court*, 85 Cal. Rptr. 2d 18 (Cal. Ct. App. 1999).

for the servicer to select the insurer that pays the servicer the most compensation. Given the opportunity to reap additional revenues, servicers have often forced-placed insurance in cases where the borrowers already had it and provided evidence of it.⁹⁷ The extra charges from the more expensive insurance causes havoc to the homeowner's payment schedule. Disputes about whether the additional insurance premiums are actually owed cause timely payments to be treated as late, triggering late fees, because they do not include the additional charges. Problems from improperly placed forced placed insurance too often escalate into foreclosure, even when the original placement was a mistake.

Perhaps the most serious abuses occur when servicers falsify mortgage balances or arrearages or seek to foreclose on properties even when the borrowers are current on their payments.⁹⁸ Unwarranted claims of default harm borrowers even apart from the risk of foreclosure because they negatively impact credit ratings so that borrowers will find it more difficult to refinance their home loan, or even to obtain a new job or promotion. Moreover, borrowers are typically offered little assistance in navigating a servicer's complex and confusing accounting or provided an opportunity to communicate with any servicing employee who has authority to resolve the issue. Faced with lax or non-existent record keeping by mortgage servicers, courts have been highly critical⁹⁹ and in several cases have noted the servicers' intentional conduct in inflating balances and arrearages.¹⁰⁰

The most devastating result of mortgage servicing abuses is unwarranted foreclosure of the borrower's home. Foreclosures uproot families and children, destroy credit histories, and may preclude future home ownership opportunities. Foreclosures often consume a life's savings and all of a family's assets. Foreclosures present a serious threat to neighborhood stability and community well-being.

Proposed Solution: *A stronger and more specific federal law should be adopted to deal with the terrible problems mortgage servicers cause in the collection of debts, and*

⁹⁷ See, e.g., *Vician v. Wells Fargo Home Mortg.*, 2006 WL 694740 (N.D. Ind. Mar. 16, 2006); *Dowling V. Select Portfolio Servicing, Inc.*, 2006 WL 571895 (S.D. Ohio Mar. 7, 2006); *Barbera v. WMC Mortgage Corp.*, 2006 WL 167632 (N.D. Cal. Jan. 19, 2006).

⁹⁸ See, e.g., *Schlosser v. Fairbanks Capital Corp.*, 323 F.3d 534 (7th Cir. 2003); *Wright v. Litton Loan Servicing, LP*, 2006 WL 891030 (E.D. Pa. Apr. 4, 2006); *Islam v. Option One Mortgage Corp.*, 432 F. Supp. 2d 181 (D. Mass. 2006); *Hart v. GMAC Mortgage Corporation, et al.*, 246 B.R. 709 (Bankr. D. Mass. 2000); *In re Asbill*, 1999 WL 33486100 (Bankr. D.S.C. 1999)

⁹⁹ See, e.g., *Nosek v. Ameriquest Mortgage Co.*, 2007 WL 682581 (Bankr. D. Mass. March 6, 2007); *In re Parrish*, 326 B.R. 708 (Bankr. N.D. Ohio 2005); *In re Wines*, 239 B.R. 703 (Bankr. D.N.J. 1999); *In re Ronemus*, 201 B.R. 458

¹⁰⁰ *Maxwell v. Fairbanks Capital Corp.*, 281 B.R. 101 (Bankr. D. Mass. 2002) ("In a shocking display of corporate irresponsibility, repeatedly fabricated the amount of the Debtor's obligation to it out of thin air."); *In re Gorshtein*, 285 B.R. 118 (Bankr. S.D.N.Y. 2002).

*the FDCPA should be expanded to cover all servicers' collection of all mortgage debts.*¹⁰¹

D. Cross Collection by Refund Anticipation Lenders

Tax refund anticipation loans (RALs) involve a loan secured by the consumer's expected tax refund. RAL lenders require the consumer to file a tax return with the IRS electronically. The lender makes the loan usually in 1 or 2 days, accounting for its appeal as a quick and "painless" way to get cash. The loan is then repaid when the IRS deposits the refund, which takes 8 to 15 days. Often, consumers are not informed that they can receive a quick refund for free in 8 to 15 days by filing electronically and using direct deposit.

Loan fees are typically flat fees, set on a sliding scale based on the amount of the expected refund. Because refund loans are outstanding for about a week or two, the fees charged translate into APRs of 40% to over 500% for a two-week loan. About half of RAL borrowers receive the earned income tax credit, which augments the income of wage earners at the lowest end of the economic spectrum. RAL fees therefore eat into a government subsidy, turning it into lender profit.

A RAL loan is a demand note so the consumer is liable if something happens to refund, for example, if the IRS disallows the consumer's claim of a dependency exemption for a child, or if the refund is set off against the consumer's tax liability from an earlier year. When the consumer's refund does not cover the loan, the consumer can become subject to abusive debt collection methods.

One particularly deceptive development is the cross-lender debt collection, where the current RAL lender acts as a collector on behalf of a previous, delinquent RAL. The consumer receives only belated and hidden notice that, by applying for a new RAL, she is authorizing her refund to be seized to pay an old debt. The basic concept of cross-lender debt collection is "gotcha" collections, relying on the element of surprise and ignorance to grab a consumer's tax refund to repay old debts.

Some of these debts are extremely old, and in fact are past the legal statute of limitations for court collection. RAL debts as old as 7 to 12 years have been cross-collected.

The National Taxpayer advocate has expressed concerns about the legality of cross-lender debt collection arrangements. In her 2005 Report to Congress, she stated:

¹⁰¹ We are well aware of the repeated efforts of the mortgage servicing industry to escape some responsibility under the FDCPA, (see, e.g. HR 1025 in the last Congress) but for the reasons stated in these comments, as well as by the courts cited Note 23 *infra*, we think it a much wiser course to proceed in the opposite direction.

It is unclear if RAL customers fully understand the ramifications of these cross-collection provisions or if they would purchase the products if they knew these agreements exist. It is questionable whether cross-collection terms included in RAL contracts are enforceable under the modern case law approach to contracts of adhesion or standard form contracts.... The banks have a grossly disproportionate bargaining power in relation to the taxpayer and the provision unilaterally benefits the bank. Moreover, a reasonable person may not expect a RAL agreement to provide that the contracting bank may act as the debt collector for a third party bank.¹⁰²

The FDCPA requires that a debt collector inform the consumer in the initial written communication, and, in addition, if the initial communication with the consumer is oral, in that initial oral communication, that the collector “is attempting to collect a debt and that any information obtained will be used for that purpose.”¹⁰³ With cross lender debt collection, every tax preparation session becomes an opportunity to collect on an old RAL debt.

Proposed solution: *The consumer should be told at the beginning of the tax preparation session that if they have a prior outstanding RAL debt, there will be an attempt to collect that debt and any information obtained will be used for that purpose.* In addition, since the initial communication by the tax preparer is oral, the consumer should be orally informed about potential debt collection. If consumers were told up front - you have an old RAL debt, if you choose a RAL or refund anticipation check product with us, your refund will be used to repay the old RAL debt - we believe that many of them would choose not to proceed with the transaction.

RAL lenders easily have the ability to ensure that consumers are informed as to whether they have an outstanding prior debt - they receive databases on this information from all of the other RAL lenders prior to the beginning of tax season. Tax preparers could easily have this information if they were given access to these prior RAL debt databases or even by checking the consumer’s credit report.

E. Abuse of Credit Cards as a Debt Collection Device.

Some debt collectors and debt buyers try to get consumers to put their old debts on new high rate credit card accounts. Companies, like Credit America,¹⁰⁴ market credit card programs to debt buyers. There are two traps here. One is that the debt owed on the

¹⁰² National Taxpayer Advocate, 2005 Annual Report to Congress, at 172-173, available at www.irs.gov/pub/irs-utl/section_1.pdf.

¹⁰³ 15 U.S.C. § 1692e(11).

¹⁰⁴ <http://www.creditamerica.com/index.html>. Genesis Financial Solutions buys debts and issues credit cards to its debtors and those of other debt buyers. Marc Hochstein, “In Brief: Genesis Hires a Card Acquisition Chief,” 171 Amer. Banker 48 March 13, 2006); <http://www.genesis-fs.com/index.asp?pgid=9>.

new credit card is free of all defenses based on the statute of limitations. The second is that the high cost compounding and fees means that the minimum payments do not reduce the principal. The consumer ends up in perpetual debt with nothing to show for it. The debt buyer meanwhile has recovered its investment in the account by the first or second monthly payment by the consumer.

Conversely, some credit card companies engage in a bait-and-switch tactic, offering low-rate credit cards but then tacking on old, charged-off debts often purchased from other lenders. Unbeknownst to the consumer, the ancient debt is revived.¹⁰⁵

Consumers in these situations are offered credit cards without adequate disclosure of the costs of the card. Some debt collectors encourage consumers to accept new credit cards without adequate disclosure that their old debt balance will be transferred to card, that the transfer will generate substantial additional fees (3% of the transferred balance is common), or that the transfer of the old debt is likely to result in an immediate decrease of the consumer's credit score.¹⁰⁶

Paying off an old, time barred debt with a new, high cost credit product has a number of damaging consequences to the consumers. The most important of which is that the consumer is renewing a debt on which collection methods through the courts are not available. These facts should be required to be disclosed to consumers before they are offered the new credit.

Proposed solution: *Debt collectors should be required to disclose to consumers that old debt will be transferred to the balance of a new credit card and that accepting the card will extend the time to collect old debt and may reduce the consumer's credit score.*

VI. SIMPLE - BUT CRITICAL - UPDATES TO THE FDCPA MUST BE MADE.

In addition to the information and disclosure related reforms discussed above, several amendments to the existing structure of the FDCPA are needed to reinforce the Act's basic provisions. These amendments are long overdue, as the Act has not been updated to strengthen its protections against abusive collection efforts since 1986.¹⁰⁷

¹⁰⁵ "Debt That Won't Die," *supra* note 31.

¹⁰⁶ Hendricks, Evan, *Credit Scores & Credit Reports* 30 (2d ed. 2005) ("Another little known fact is that if you pay off an old collection account, it 'updates' to your credit report and once again becomes a 'recent event that is highly damaging to your credit score.'")

¹⁰⁷ Although there have been no consumer friendly amendments to the FDCPA in over twenty years, there have been numerous amendments to ease restrictions on the collections industry - over the vehement objections of representatives of consumers. These include 1) an amendment in 1996 allowing collector to reduce the number of times required to provide the debt collection warning from all communications to only in the first one or two; and 2) an amendment in 2006 making changes, including reducing restrictions

A. Consumers Should be Able to Record Abusive Telephone Calls of Debt Collectors.

One of the worst -- and unfortunately typical -- abuses that collectors use to collect debts are telephone calls. Consumers report that collectors threaten them, yell at them, curse and lie to them. This behavior continues because it is difficult to hold abusive collectors accountable. Consumers face a major hurdle when dealing with this abusive and harassing behavior because of the difficulty of proving this abusive behavior. Clarifying the law to clearly allow recording of abusive telephone calls from debt collectors would enable consumers to protect themselves, and further the protective purposes of the Act. Debt collectors will undoubtedly be more careful to stay within the confines of the law if they are aware that their calls may be recorded.

Debt collectors should also be able to record conversations with consumers. This will eliminate disputes about what the collector and the consumer did or did not say, and will also enable debt collection agencies to supervise the behavior of their employees to ensure that they stay within the law.

***Proposed Solution:** The Act should be amended to provide that a consumer or a debt collector is authorized to record a telephone conversation without the knowledge or consent of the other party, and that recording shall be admissible in court or other proceedings pursuant to this Act or state law respecting debt collection practices.*

B. “Mistakes” of Law Are Not Bona Fide Errors

The FDCPA protects a debt collector from liability if the violation resulted from a bona fide error.¹⁰⁸ This FDCPA provision was copied from the Truth in Lending Act, and until recently, courts followed the established TILA caselaw holding that mistakes of law are not bona fide errors.¹⁰⁹

In 1980, the TILA provision was amended to codify the TILA case law on this point and to specifically exclude errors of law as a defense to TILA violations. Congress thus confirmed the interpretation of the TILA provision that was well established in 1977 when the FDCPA provision was borrowed from TILA.

on check diversion companies, reducing requirements for the notice of verification when the first communication is a pleading, and deleting the requirement for the initial notices in some circumstances.

¹⁰⁸ 15 U.S.C. 1692k(c).

¹⁰⁹ See National Consumer Law Center, Fair Debt Collection § 7.5.4 (5th ed. 2004 & Supp. 2006) (listing cases).

In 2002, apparently unaware of the legislative history of the FDCPA provision, the Tenth Circuit mistakenly found that the difference in language between the FDCPA and TILA provisions indicated that Congress intended to include errors of law within the FDCPA defense.¹¹⁰

Although most courts continue to follow the majority view that excludes errors of law, the Act should be amended to clarify the original intent and to be consistent with the normal view that parties are charged with knowledge of the law.¹¹¹ As one court made clear:

"The intent of the lender was to do exactly what he did. His mistake, if any, was one of law not one of fact. This is no excuse for the violation of the statute. To hold otherwise would violate an established principle of law and would furnish to avaricious lenders a convenient excuse for an evasion of the law."¹¹²

This position also encourages debt collectors to stay well within the law and not to push questionable interpretations of the Act that violate its spirit as well as its letter.

Proposed Solution: Clarify that mistakes of law are not bona fide errors.

C. Remedies provided by the Fair Debt Collection Practices Act should be updated and improved.

The experience of consumers across the country shows that flagrant violations of the FDCPA continue and are widespread. One clear reason is that the Act lacks effective remedies to stop and deter wrongdoers from continuing abusive and illegal collection activities. Three aspects of the Act in particular need to be updated to make its enforcement provisions more effective.

1. Courts Should Be Able to Provide Equitable Relief in FDCPA Cases.

Currently the FDCPA does not allow a court to issue an injunction against a debt collector who consistently ignores the provisions of the Act. In fact, some debt collectors

¹¹⁰ Johnson v. Riddle, 305 F.3d 1107 (10th Cir. 2002).

¹¹¹ Federal Crop Ins. Corp. v. Merrill, 332 U.S. 380, 384 (1947).

¹¹² Burdon v. Unrath, 47 R. I. 227, 231, 132 Atl.728, 730 (1926); see also Atlas Realty Corp. v. House, 123 Conn. 94, 100-102, 192 A.2d 564 (1937) ("To permit a usurer to avoid the consequences of his usury by asserting his ignorance of the law would open the door wide to evasions of the law. The familiar legal maxims, that everyone is presumed to know the law, and that ignorance of the law excuses no one, are founded upon public policy and in necessity, and the idea back of them is that one's acts must be considered as having been done with knowledge of the law, for otherwise its evasion would be facilitated and the courts burdened with collateral inquiries into the content of men's minds.").

have been so successful in avoiding the statutory penalties under the Act, by changing corporate names and hiding assets, that they have flagrantly thumbed their noses at consumers and their attorneys and continued violating the Act with impunity.

Abusive and illegal debt collection practices can be effective. That is why the FDCPA was needed in the first place and why the original problems persist. Yet even if a debt collector is caught using illegal tactics, the current law provides little ability to stop those tactics from reoccurring. The debt collection business involves the mass processing of thousands of claims. This is particularly true now with the growth of the debt buyer industry. For every one consumer who knows their rights and stands up to enforce them, there are hundreds or thousands who submit to illegal, harassing methods of debt collection.

The only way to assure compliance with the FDCPA in cases like this is for a court to enjoin the continued behavior. A number of courts¹¹³ have recently held that because the FDCPA does not explicitly allow for equitable relief, they cannot order it.

Proposed Solution: *The Act should be amended to provide explicitly that consumers may seek injunctive relief to restrain illegal tactics from continuing.*

2. *Civil liability should be increased from \$1,000 to \$3,500 and the Act should be amended to make clear that a penalty can be awarded for each violation under the Act.*

When the FDCPA was originally passed in 1977, statutory damages were set at \$1,000 for actions brought by individuals. Considering inflation, \$1,000 in 1977 dollars is equal to about \$3,500 in 2007 dollars.¹¹⁴ The Act should be updated to that amount and the FTC should be given rulemaking authority to adjust the figure for inflation each year.

Further, since the Act was first passed, courts have disagreed whether collectors who have committed multiple violations of the Act are liable for multiple awards of statutory damages. Now, years after the passage of the Act, there is still no definitive law on whether the FDCPA statutory damages apply to each violation, contact, injured person, debt, or suit. The two courts of appeals that have ruled on the issue have limited the recovery of statutory damages to a maximum of \$1,000 for each debtor regardless of how many times, and in what ways the debt collector violated the FDCPA.¹¹⁵ Other lower courts have allowed multiple statutory damages for multiple violations.¹¹⁶

¹¹³ See, e.g. Weiss v. Regal Collections, 580 F.2d 337 (3d Cir. 2004); National Consumer Law Center, Fair Debt Collection _6.9 (5th Ed. 2004 & Supp. 2006).

¹¹⁴ See, U.S. Dept. of Labor, Bureau of Labor Statistics, inflation calculator at <http://www.bls.gov/cpi/home.htm>.

¹¹⁵ See, e.g. Wright v. Financial Service Inc., 22 F.3d 647 (6th Cir. 1994) (*en banc*); National Consumer Law Center, Fair Debt Collection § 6.4.6.2(5th Ed. 2004 & Supp. 2006).

¹¹⁶ National Consumer Law Center, Fair Debt Collection § 6.4.6.2 (5th Ed. 2004 & Supp. 2006).

Without any meaningful penalties, debt collectors have no incentive to comply with the law. This is another reason why the problems that prompted passage of the FDCPA persist today. Debt collectors who violate the law should face meaningful penalties, and those penalties should be commensurate with the extent of the violations.

Proposed Solution: *The Act should be amended to update the statutory damages and to permit damages for each violation.*

3. Class Relief Should Be Updated

As with the individual statutory damages, the FDCPA's provision for class relief also has not been updated since 1977. The Act limits class relief at the lesser of \$500,000 or 1 per centum of the net worth of the debt collector. The \$500,000 figure should be updated to \$1,700,000, the equivalent in 2007 dollars, and the FTC should be given rulemaking authority to adjust the figure for inflation each year.

In addition, the Act should be clarified to reject the Seventh Circuit's ruling that equated "net worth" to book value. Even for wealthy and thriving debt collectors, accounting manipulations bring the "book value" to nearly zero for virtually all debt collectors. Equating net worth with book value effectively eliminates class relief.¹¹⁷ Thus, the term "net worth" should be replaced by "fair market value" or "annual revenue."

Proposed Solution: *Class relief should be capped at the lesser of \$1.7 million, adjusted annually for inflation, or 1 per centum of the firm's fair market value or annual revenue.*

4. No Double Taxation of Fee Awards

The Internal Revenue Code should also be amended to clarify that attorney fee awards are not taxable income to the consumer. In *Commissioner v. Banks*,¹¹⁸ the Supreme Court upheld the position of the Internal Revenue Service that the portion of a plaintiff's recovery paid to an attorney as a contingent fee is taxable to the plaintiff. The Court left, however, the question of the taxation of fee awards under fee-shifting statutes. The Court acknowledged:

Sometimes, as when the plaintiff seeks only injunctive relief, or when the statute caps plaintiffs' recoveries, or when for other reasons damages are substantially less than attorney's fees, court-awarded attorney's fees can exceed a plaintiff's monetary recovery. See, e.g., *Riverside v. Rivera*, 477 U. S. 561, 564-565 (1986) (compensatory and punitive damages of \$33,350; attorney's fee award of

¹¹⁷ See *Sanders v. Jackson*, 209 F.3d 998 (7th Cir. 2000).

¹¹⁸ 543 U.S. 426 (2005).

\$245,456.25). Treating the fee award as income to the plaintiff in such cases, it is argued, can lead to the perverse result that the plaintiff loses money by winning the suit. Furthermore, it is urged that treating statutory fee awards as income to plaintiffs would undermine the effectiveness of fee-shifting statutes in deputizing plaintiffs and their lawyers to act as private attorneys general.¹¹⁹

The attorney who receives the fees of course must pay taxes on them, but it is completely unjust to tax the consumer on income that she never receives. Moreover, the injustice is the same whether the fees are calculated as a contingency fee or as a statutory fee award.

***Proposed solution:** The Internal Revenue Code should be amended to state that fees paid to a consumer's attorney under the Act are not taxable income to the consumer, regardless of the manner in which the fees are calculated.*

D. Response to FTC Questions

1. A Consumer's Oral Dispute of A Debt Should be Honored

The FTC has asked whether the FDCPA should expressly provide that a consumer's oral dispute is sufficient to require a debt collector (1) to notify credit bureaus of the dispute and (2) to prevent the collector from assuming the debt is valid.

On the first point, the courts have consistently adopted this interpretation of the Act. Most dialogue between debt collectors and consumers happens on the telephone. A debt collector who calls a consumer to demand a debt and is told that the debt is not valid is certainly on notice that the debt may be inaccurate, and should not be allowed to tarnish the consumer's credit report without noting the dispute. Although we believe that the law is clear on this point, we would be happy to have the Act explicitly require that collectors notify consumer reporting agencies about oral disputes.

On the second point, the circuit courts are split. The most recent decision, by the Ninth Circuit, is the better reasoned, both as a matter of statutory interpretation and as a matter of policy.¹²⁰ It is common sense that a debt collector should not be able to assume that a debt is valid when they have just been told that it is not. Similarly, even though a written dispute is required to trigger the validation duty, consumers should be encouraged to communicate a dispute about a debt in any fashion they can. For most consumers - especially older consumers - it is easiest to simply pick up the phone, or to tell the collector when called. Requiring the communication to be in writing simply imposes an unnecessary hurdle that serves to dissuade the consumer from giving material information to the debt collector. Accordingly, we support an amendment stating that an oral dispute prevents the collector from assuming a debt is valid.

¹¹⁹ *Banks*, 543 U.S. at 438-39.

¹²⁰ *Camacho v. Bridgeport Fin. Inc.*, 430 F.3d 1078 (9th Cir. 2005).

2. *Whether the FDCPA Should Make Explicit the Standard for Clarity Required For Collectors' Notices to Consumers*

Courts have consistently held that collectors' notices to consumers should be clear to the "least sophisticated consumer." That standard is the appropriate one to ensure that notices serve their intended purpose and are clear and are understood by the widest possible audience. Indeed, it is the least sophisticated consumers who are often more likely to be deeply in debt and are less likely to know their rights, and therefore to need the information provided in FDCPA notices.

We do not believe that the Act needs to be clarified in this regard, but we would not object to the FTC making the "least sophisticated consumer" standard explicit in a formal advisory letter.

3. *Whether the FTC Should Be Allowed to Issue Model Collection Letters, the Use of Which Would Constitute Compliance with Certain FDCPA Provisions*

Model collection letters that are true to the protections of the FDCPA would be helpful to both consumers and industry. However, imperfect model letters, that embody political compromises, would be worse than the current situation.

4. *Whether the FDCPA Should Clarify That Collectors May Communicate with a Consumer Only Once after Receiving a "Cease Communication" Notice from the Consumer*

Congress clearly intended that collectors should be permitted to communicate with a consumer only once, and only in accordance with 15 U.S.C. § 1692c(c), after receiving a cease communication notice from the consumer. Moreover, notwithstanding the decision in *Lewis v. ACB Business Services, Inc.*,¹²¹ which ignored the language of the statute, the FTC was correct that the single response may not include a demand for payment, whether phrased as a settlement offer or any other way, and is limited to the three statutory exceptions.¹²² We would an amending confirming this interpretation.

5. *Whether Collectors Should Be Encouraged to Provide the Name and Address of the Original Creditor of the Debt in Their First Communication with Consumers*

¹²¹ 135 F.3d 389 (6th Cir. 1998).

¹²² *See id.*

Collectors should not just be encouraged to provide the name and address of the original creditor of the debt in their first communication with consumers; as discussed above, this should be absolutely required. The consumer is left in the dark if the original creditor is not identified, and the only reason for omitting the original creditor's identity is to confuse and trick the consumer.