

NOTES FROM THE TRENCHES: CURRENT TRENDS IN CONSUMER JUNK DEBT BUYER LITIGATION

By Peter A. Holland

My interest in junk debt buyer litigation came about in 2009, and quite by accident. Although I had defended a few collections cases filed by banks in state District Court, I was not aware of – had never even heard of – “debt buyers”. Yet, according to the Federal Trade Commission (FTC), “the most significant change in the debt collection business in recent years has been the advent and growth of debt buying.” Federal Trade Commission (FTC), “Collecting Consumer Debts: The Challenges of Change: A Workshop Report,” 2009, <http://www.ftc.gov/bcp/workshops/debtcollection/dcwr.pdf>. Nor did I appreciate that small claims courts across the country had become so flooded with debt buyer and other collection lawsuits that the FTC would eventually conclude that “[t]he system for resolving disputes about consumer debts is broken. . . because consumers are not adequately protected in either debt collection litigation or arbitration.” <http://www.ftc.gov/os/2010/07/debtcollectionreport.pdf>.





Things changed in 2009, when I stumbled into a few proceedings in state district court that were unlike anything I had ever seen. To me, it was a new world, in which 99 percent of defendants had no lawyers, some courtrooms had no judges in them (bailiffs sometimes sat on the judge's bench), collection lawyers were given physical possession of the court files to run a "settlement docket", and attorneys from different collection firms would "stand in" for each other on the spur of the moment without ever formally entering their appearance in the case. One of my students observed a collection lawyer tell an elderly woman that it was "against the rules" for her husband to be present while the lawyer and the defendant discussed a payment plan in a judgeless courtroom in Prince George's County.

Over the course of the next several years (during which time I was running a Consumer Protection Clinic at the University of Maryland Law School), law students, pro bono lawyers and I began representing people being sued by debt buyers. In addition to clients who "owed it anyway" to the original creditor, we assisted people being sued by debt buyers beyond the statute of limitations, people being dunned on debts previously discharged in bankruptcy, people sued because of identity theft, and a host of other "wrong person" or "wrong amount" types of cases. Among my most vivid memories is the phone call I received from a Veterans Administration social worker who was sitting with an 86-year-old veteran who reportedly had not eaten in two days because all of his government benefits were frozen in a bank account garnishment filed

by a collection lawyer. Most of the people we helped were being sued on credit card debt with predatory interest rates, and most had simply fallen on hard times due to job loss, serious illness or divorce. Most had never heard of the debt buyer who was now suing them.

The Impact

The effects of these lawsuits are particularly hard felt by the poor, the working poor, the elderly and minorities. In fact, every major study shows that most people default on debts because of job loss, illness, and divorce. A judgment in favor of a junk debt investor, in an amount that may be 50 times greater than their initial investment, is literally turning an unsecured junk debt into a secured judgment, which then results in garnishments, depriving legitimate creditors of scarce funds to pay ongoing bills such as food, rent, car loans, student loans and medical bills. Further, a judgment has a direct impact on one's ability to obtain employment, housing and credit, and it drives some people to declare bankruptcy, thus discharging debt even to legitimate creditors who actually provided goods and services.

Junk Debt Buyers: You Get What You Pay For

Being at an academic institution, I began to write about debt buyer issues in 2011. (See here for articles: <https://www.law.umaryland.edu/faculty/profiles/faculty.html?facultyid=065>). A junk debt buyer is an entity that purchases charged off junk debt from banks and finance companies for pennies on the dollar, and then seeks to

collect the full face value of the original debt. Or, in the words of a press release from the Maryland Judiciary:

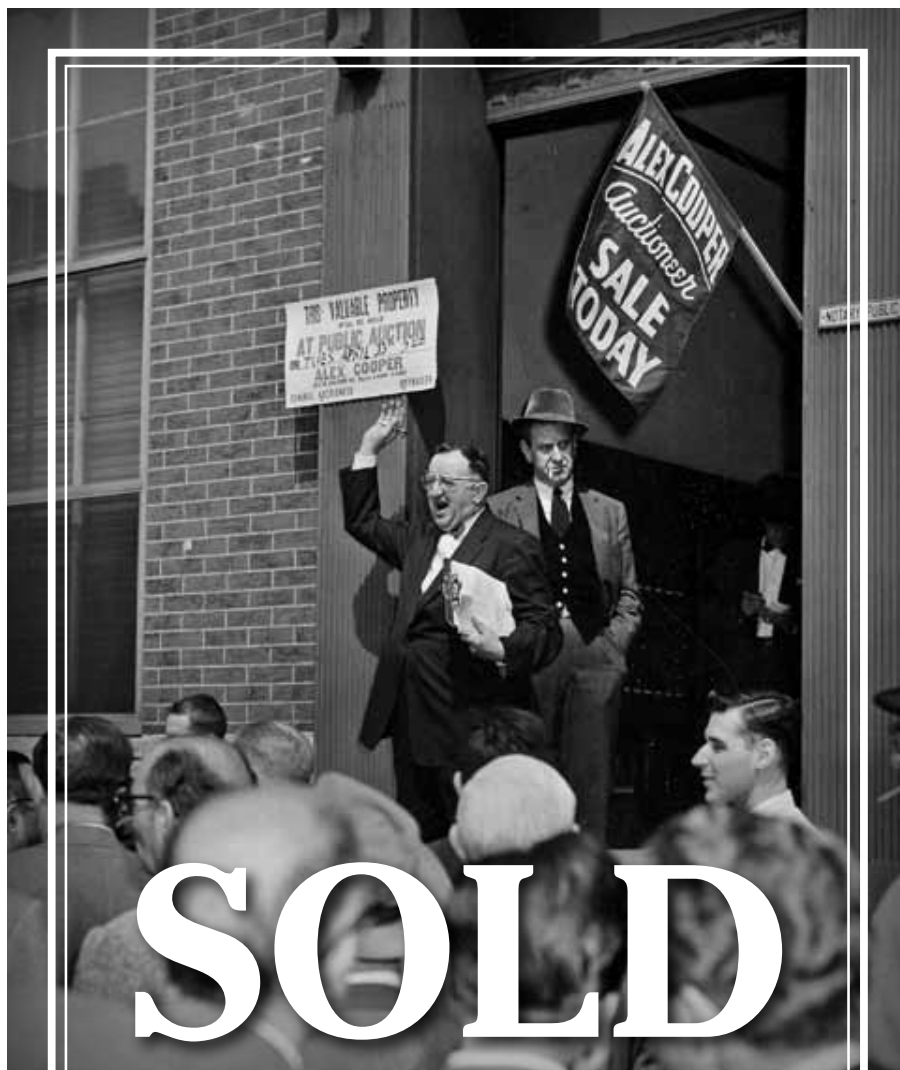
Debt buyers are companies that specialize in buying debts owed to creditors, usually credit card companies. They buy those debts for a tiny fraction of the amount owed. Debts may be sold to other debt buyers several times, and the documentation – the proof – that the debt is owed is sometimes little more than the person's name, last known address and Social Security number. <http://www.courts.state.md.us/media/news/2011/pr20110928a.html>.

The largest debt buyers are publicly traded, such as Encore Capital Group Inc., PRA Group Inc., Asta Funding and Square Two Financial. For example, Encore and its purchasing arm, Midland Funding, LLC, paid on average just 3 cents on the dollar for 60 million accounts over the five-year period of 2009 to 2015, and – according to Consent Decrees signed with the Consumer Financial Protection Bureau (CFPB) – engaged in a broad array of misrepresentation and deceptive practices in their collection lawsuits. Consumer Financial Protection Bureau, *CFPB Takes Action Against the Two Largest Debt Buyers For Using Deceptive Tactics To Collect Bad Debts*, Sept. 9, 2015 <http://www.consumerfinance.gov/newsroom/cfpb-takes-action-against-the-two-largest-debt-buyers-for-using-deceptive-tactics-to-collect-bad-debts/>.

Although the debt is purchased for pennies on the dollar, the debt buyer sues for the full face value of the debt as shown in the bank's charge-off statement. This charge-off amount usually includes 6 months' worth of interest, late fees,

and (often) over-limit fees. Thus, an account with a balance of \$1,000 at the time of default can have a charge-off face value in excess of \$1,250. Most extreme, however, are the “fee harvester” cases, in which the original creditor had issued credit cards with a credit limit of \$300, but with the first \$240 charges assessed as “fees” before the person ever even used the card. My clinic handled a few “fee harvester” cases, and discovered that by the time the bank sold the account to a debt buyer, the face value was several times more than the amount that the client ever actually borrowed. Also, when we started doing these cases (but not since 2012 when the Rules were changed), collection lawyers who owned the debt buying entity that they “represented” were asking the court to award “attorneys fees” for, essentially, representing their alter egos.

Debt buyer lawsuits are literally about litigation for profit, an attempt to turn straw into gold. For a few pennies on the dollar, debt buyers acquire little more than a spreadsheet of electronic data, often subject to explicit disclaimers of accuracy or completeness. The fundamental business model is to file the minimum amount of proof necessary to obtain a default judgment (in Maryland, an Affidavit Judgment pursuant to Rule 3-306). Although debt buyers choose the courts as their playing field, their low-doc business model is fundamentally at odds with a robustly functioning court system governed by rules and procedures that are designed to ferret out the truth through an adversarial process. In short, there is no adversary system in these cases, and courts continue to be overwhelmed with the volume



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of filings, which leads to judgments sometimes being entered despite a lack of proof. (By way of example, while writing this article, I reviewed a judgment in a student loan case in which the claim was time-barred on its face).

Banks Knowingly Sell Bad Paper

The key to understanding the junk debt buyer phenomenon is to appreciate the fact that banks knowingly sell “bad paper” – account data that has been internally red-flagged as being inherently unreliable, and it has been agreed by the banks and the debt buyers not to reveal this fact to the public or the courts in which debt buyers file lawsuits. Jeff Horwitz, *Bank of America Sold Card Debts to Collectors*

Despite Faulty Records, Am. Banker, March 29, 2012 http://www.americanbanker.com/issues/177_62/bofa-credit-cards-collections-debts-faulty-records-1047992-1.html?zkPrintable=1&nopagination=1 Jake Halpern’s book *Bad Paper* (2014) explored these issues in depth.

Banks frequently sell the accounts “as is,” with explicit disclaimers as to the validity or accuracy of the account data. One typical provision, contained in a Loan Sale Agreement between FIA Car Services (a credit card issuer) and CACH, LLC (a debt buyer), states that accounts being sold may have been discharged in bankruptcy, may be the result of fraud or forgery, or may be barred by the statute of limitations. Loan Sale Agreement Between FIA Card Services and CACH, LLC, April 14, 2010. <https://www.document->

[cloud.org/documents/329733-fia-to-cach-forward-flow.html](https://www.documentcloud.org/documents/329733-fia-to-cach-forward-flow.html) (sections 8.1 and 9.4). Pursuant to Section 1.8 of that same document, the parties agreed that the “current balance” may not reflect all payments made on the account. At page 26, both the bank and the debt buyer acknowledged explicitly that in fact the account balances are only “approximate.” These purchase contracts (known in the industry as forward flow agreements) are hidden from courts and from the public, and debt buyers usually fight to prevent their disclosure. Several of these agreements are, however, available at www.debt-buyeragreements.com and at www.dalie.org/contracts. The debt buying industry claims that these terms were a feature of “old” agreements (but they still refuse to disclose



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them). Additionally, as recently as September 2015, the CFPB entered Consent Decrees with two publicly traded debt buyers in which the suing on bad accounts continued unabated.

Common Problems in Debt Buyer Lawsuits

Common problems are that, if challenged, the debt buyer cannot prove

a valid chain of assignment from the original creditor to the existing debt buyer. (I have seen a few cases in which a person was being sued by the alleged 6th Assignee of the debt). Another problem is that supporting documents are either wholly or partially missing, or are not authentic. Many cases are filed beyond the statute of limitations. Several debt buyer lawyers I spoke with accurately pointed out that

the statute of limitations is an affirmative defense, and it is not their job to advise pro se litigants about affirmative defenses. Similarly, one attorney (who “represented” the company that he solely owned) told me that it was not his obligation to advise people about their statutory exemptions from attachment. While this attorney was arguably correct under the Rules of Professional Conduct, the fact remains that we



are talking about people who do not have a lawyer to spot these issues or advise them of their rights. Therefore, judgments are entered every day on time-barred debt, and bank accounts are frozen every day that would otherwise be exempt by filing a simple piece of paper claiming an exemption (\$6,000 in Maryland). And although suing on a time-barred debt is a clear violation of the Fair Debt Collection Practices Act, most *pro se* litigants either don't know that or don't realize that there are attorneys who handle such cases on a contingency basis pursuant to fee-shifting statutes. Thus, most such abuses go without redress.

Debt Buyers Argue That Bank Records are "Inherently Reliable"

Despite knowing about the potentially unreliable data, and the forward flow agreements which explicitly disclaim any warranty of accuracy, debt buyers' lawyers routinely tell judges that because banks are a highly regulated industry and subjectively rely on the accuracy of their own records, therefore, "bank records are inherently reliable." Of course, such an argument is problematic when the lawyer simultaneously argues "reliability" while fighting the disclosure of the very document that may indicate the opposite. In the words of the *Bartlett* partial concurrence and partial dissent, "It seems odd to accord special reliability to those records when the business that actually created and maintained them may have disclaimed their reliability." *Bartlett v. Portfolio Recovery Associates, LLC*, 438 Md. 255, 293 (2014).

But again, most people (including many judges) do not know about the disclaimers in the forward flow agreements, and therefore the "reliability of bank records" argument is not evaluated in the context of the explicit disclaimer of reliability in a given case.

Foreseeable Harm

What is wrong with knowingly trading in "bad paper" for less than two cents on the dollar and then suing people on it? Ask Maryland resident Karen Stevens, who was featured in a 2012 article in the *American Banker*. http://www.americanbanker.com/issues/177_62/bofa-credit-cards-debt-collections-delinquent-robosigning-1047991-1.html. Ms. Stevens settled a debt with Bank of America, and as proof had a copy of her check showing that Bank of America had cashed it. Despite the fact that her account was settled, Bank of America sold her account to a junk debt buyer who later sued her in Maryland District Court. Ms. Stevens filed a counter-claim and reportedly reached a confidential settlement.

With the willingness of our nation's largest banks to knowingly sell bad accounts, it is no wonder that in 2011 the authors of the 171st Report to the Maryland Rules Committee found that:

"Problems with the cases filed by CDP's [consumer debt purchasers] have arisen, including: failure of the CDP to be licensed, the wrong party being named as plaintiff, filing after the statute of limitations period has run, lack of personal knowledge by the affiant, lack of supporting documentation containing sufficient

detail as to liability and damages, failure of the CDP to prove it owns the debt, and incorrect identification of the amount claimed."

<http://mdcourts.gov/rules/reports/171stReport.pdf> at page 41.

Why They Succeed

If the debt buyer's records are not reliable, how do they win in court? As stated, the business model is to file literally millions of lawsuits nationwide, and then depend on default judgments. But in some jurisdictions, even at trial, the consumers lose. In Maryland, winning these cases at trial became easier for debt buyers when the Court of Appeals in 2013 held that in a small claims action, no witness for the plaintiff is required to be present, and no rules of evidence apply other than the universal requirement that hearsay evidence be "reliable" and "probative." *Bartlett, supra* at 282, f.n. 14. As a practical effect, the collection lawyers are able to submit things such as account statements, Bills of Sale and affidavits created solely for the purpose of litigation, but they are not required to produce the forward flow agreement which may very well cast doubt on the reliability of everything else that they produce to the judge. Since there is no discovery in small claims, the debt buyers cannot be compelled to produce the forward flow agreements ahead of time. Many judges and most *pro se* litigants are still unaware of the existence and/or the contents of these forward flow agreements.

Enforcement Actions

The CFPB and other federal regulators including the Office of the Comptroller for the Currency (OCC) and the FTC have stepped up enforcement, and discovered serious debt collection abuse by big banks and the debt buyers they sell to. Notably, in 2015 the OCC found that both Chase and Bank of America engaged in “unsafe and unsound banking practices” in their debt collection activities. <http://www.occ.gov/news-issuances/news-releases/2015/nr-occ-2015-98.html> and <http://www.occ.gov/news-issuances/news-releases/2015/nr-occ-2015-74.html>.

In July 2015, the CFPB and 47 states took action against Chase for “Selling Bad Credit Card Debt and Robo-Signing Court Documents.” <http://www.consumerfinance.gov/newsroom/cfpb-47-states-and-d-c-take-action-against-jpm-organ-chase-for-selling-bad-credit-card-debt-and-robo-signing-court-documents/>. A few months later, the CFPB entered into Consent Orders with the two largest debt buyers, Encore and PRA. Consent Order, Matter of Portfolio Recovery Associates, LLC No. 2015-CFPB-0023 (CFPB, filed Sept. 9, 2015) http://files.consumerfinance.gov/f/201509_cfpb_consent-order-portfolio-recovery-associates-llc.pdf and Consent Order, Matter of Encore Capital Group, Inc., No. 2015-CFPB-0022 (CFPB, filed Sept. 9, 2015) http://files.consumerfinance.gov/f/201509_cfpb_consent-order-encore-capital-group.pdf.

The CFPB Consent Orders were shocking in the scope of findings. Both companies collected debts past the statute of limitations by using misleading language in letters and

telephone calls, thus taking money that could have been used to pay more recent and more legitimate creditors. Further, in their lawsuits both Encore and PRA relied on affidavits attesting to the accuracy of documentation, despite the fact that the affiant did not review any of the attested to actual account documents.

Some purchase agreements “put Encore on notice that some of the accounts [were] likely past the applicable statute of limitations . . . or were previously disputed.” Encore essentially ignored these warnings, and instead “...relied on Consumers to inform [it] when it was attempting to collect a Debt based on inaccurate or erroneous information.” Even then, Encore refused to investigate unless the dispute was made within 45 days of Encore writing to the consumer. Encore also requested *and received* from its sellers affidavits containing “false or misleading statements.”

Like Encore, PRA’s purchase agreements put it on notice that it might have received inaccurate information, and its own Vice President of Collections told a senior manager that PRA doesn’t really know the amount of the outstanding debt on an account. PRA “did not even track consumer disputes by seller to determine whether a particular portfolio . . . was unreliable.” And as was the case with Encore, some PRA affidavits falsely claimed that documents had been reviewed. In the words of its own comprehensive summary of financial performance contained in its 10K filing with the Securities and Exchange Commission from March, 2015, PRA states:

Additionally, in pursuing legal col-

lections, we may be unable to obtain accurate and authentic account documents for accounts that we purchase, and despite our quality control measures, we cannot be certain that all of the documents we provide are error free.

(Italics in original).

In Maryland, the Commissioner of Financial Regulation has taken a lead on these issues, having fined debt buyers for collection abuses including the filing of time barred lawsuits and robo-signed documents. Further, the Court of Appeals amended Rule 3-306, following the Rules Committee Report on the issue to ensure more accurate and complete documentation prior to entering affidavit judgment. However, the problem remains: if there is nobody mounting a defense, then sometimes shoddy claims fall through the cracks and judgments are entered.

For Maryland, things may get better soon, as it is expected that in its 2016 session, the legislature will consider some bills designed to curb abusive debt buyer tactics.

Lawyers are Not Exempt

Although recent years have seen high profile enforcement actions, legislation, rules changes (Maryland amended Rule 3-306 on Affidavit Judgments in 2012) and class action lawsuits, problems remain widespread, and increasingly, lawyers are being targeted by regulators. For example, in its high profile enforcement action against the lawyers in a large Georgia debt collection mill, the CFPB alleged that “the Firm’s attorneys did not determine whether any underly-

ing documentation for the debt was available, nor did they review the contracts governing the sale of accounts to determine whether those contracts disclaimed any warranties regarding the accuracy or validity of the debts.” Complaint, *CFPB v. Frederick J. Hanna & Assocs.*, 1:14-cv-02211-AT(N.D. Ga. filed July 7, 2014), files.consumerfinance.gov/f/201407_cfpb_complaint_hanna.pdf. In the eyes of the regulator, the collection mill was engaged in “intimidating consumers with deceptive court filings” and “introducing faulty or unsubstantiated evidence,” as the CFPB said in its press release. <http://www.consumerfinance.gov/newsroom/cfpb-files-suit-against-debt-collection-lawsuit-mill/>.

But it is not only the regulators who are scrutinizing the lawyers. In 2011, the 9th Circuit Court of Appeals held that reliance on the client’s representation regarding the debt was unreasonable where the underlying service-level agreement had included a disclaimer regarding the accuracy of the data provided to the collection law firm. *McCullough v. Johnson, Rodenburg, et al*, 637 F.3d 939, 949 (9th Cir. 2011).

Solutions

There are a range of options to increase reliability and minimize the number of questionable judgments being entered. The CFPB is currently engaged in rulemaking on debt collection, and one option will be to ban the sale of all junk debt, making it illegal to knowingly sell or collect on accounts that are time barred, fraudulent, discharged in bankruptcy, or otherwise unenforceable or inaccur-



rate. This would still allow banks to sell those accounts which they can affirmatively warrant as valid, accurate and complete, but would ban the sale of “as is” accounts, known to be potentially invalid, inaccurate and incomplete. More likely, the CFPB will use its recent enforcement actions as the template to impose requirements similar to those established by its Consent Decrees. Those orders place a greater emphasis on reviewing original documents before signing affidavits or threatening lawsuits, and they ban the reselling of debt by the initial purchaser.

Conclusion

The current environment was created due to three factors: (1) banks are selling their worst, least reliable accounts; (2) debt buyers sue

despite actual knowledge that some or all of the purchased accounts are inaccurate; (3) the fact of inaccuracy and the documents which prove the inaccuracy are hidden from the public. Clearly, increased enforcement is required, as is increased media scrutiny, and greater awareness within the legal community. I don’t think things will fundamentally change until we outlaw the sale of junk debt known to be faulty. Short of an outright ban on selling junk, judges and legislatures can and should require the full disclosure of the forward flow agreements so that the courts and the litigants can decide for themselves whether the accounts being sued on are indeed “inherently reliable.”

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