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Federal Trade Commission Workshop
Collecting Consumer Debts: The Challenges of Change

November 9, 2007

Thank you for the opportunity to comment regarding the present state of the debt collection industry and the effectiveness of existing consumer protections regarding debt collection. I am a Staff Attorney at the Neighborhood Economic Development Advocacy Project (NEDAP) and the Director of NEDAP's Consumer Law Project. NEDAP is a nonprofit resource and advocacy center that provides legal, technical and policy support to community groups in New York City's low income neighborhoods and communities of color. NEDAP's mission is to help groups in underserved communities increase access to affordable and equitable financial services and credit needed for local community development.

NEDAP's Consumer Law Project provides free legal information, advice, referrals, and representation to low income New Yorkers who have problems concerning debt collection, credit reporting, and lending discrimination. We provide services through a legal hotline, a *pro se* legal clinic, and direct representation of consumers in state and federal court. We have served more than 2,000 individuals since the project was launched in 2005.

From our position on the front lines, we see directly how individual consumers, and their communities, have been impacted by debt buying and the concomitant rise in debt collection activity. **We urge the FTC to amend the Fair Debt Collection Practices Act to address new, problematic issues that are undoubtedly related to the recent surge in debt buying activity.**

I. *Demographic and Industry Information*

b. *Please provide information regarding consumers subject to debt collection action, particularly any information showing changes in overall numbers of such consumers, and demographic data about the consumers ourselves.*

In 2006, NEDAP's Consumer Law Hotline received 1,453 calls from hundreds of low and moderate income New Yorkers. Our callers were predominantly:

- Women (66%)
- Very low income (54% receive government benefits or have no income; 40% have household incomes less than 10,000 per year)
- People of color (40% African-American; 26% Latino)
- Often immigrants (40%) and senior citizens (18%)

Of the 1,453 calls we received, 66% concerned debt collection issues. Three out of four collection-related calls were from people who were facing debt collection lawsuits, nearly all of which were brought by debt buyers.

c. *Please provide information about trends in the nature of the underlying debt subject to debt collection actions (e.g. mortgage, automobile, educational, credit card, personal, etc.)*

The majority of our clients' cases concern credit card debt. The credit card issuers are major banks (Chase, Citi) and known sub-prime lenders (Capital One, Aspire).[1] We also see retail credit cards, particularly Sears cards, and debts connected to cellular telephone service (ATT Wireless). We see a smaller quantity of medical debt, student loan debt and automobile debt.

d. *Please provide information detailing recent changes in the extension and use of credit and how, if at all, this has affected the collection of debts*.

As many commentators have discussed, deregulation of the credit card industry has generated a significant shift in the extension and use of credit. Anecdotally, we have observed that many of our very low income clients, who perhaps would not have been able to get even one credit card ten years ago, now are overextended, with multiple credit cards on which they owe thousands of dollars. Similarly, we have observed that the amounts charged our clients in fees and interest on those cards often dwarf the principal amounts actually charged on the card. Many of our clients try to pay off their credit card debt for years before giving up. With $39 late fees, over-the-limit fees, and penalty interest rates over 30%, it is not irrational for our clients to conclude that they will never be able to pay off their credit card debt and to simply stop paying.

Not surprisingly, the debt collection industry has grown in recent years as the business of collecting debts has become more lucrative than ever. Debt buyers have also contributed to a rise in collections activity by resurrecting old debts that formerly were not worth the time and money to collect. Thus we regularly see low income consumers hounded by debt buyers for cellular telephone bills or health club membership fees that are quite old, sometimes past the New York State statute of limitations (6 years). Debt buyers can afford to collect such apparently worthless debt because they acquire it for as little as 1.9 cents on the dollar.[2]

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[1] Because we are rarely able to obtain information about the original debt, and because major banks have both prime and sub-prime offerings, we do not know the relative percentages of prime v. subprime credit cards.

[2] Asset Acceptance, a publicly traded debt buyer, recently reported that in the third quarter of 2007, it spent 1.9 cents on the dollar to acquire charged off debt, down from 3.5 cents on the dollar spent in the third quarter of 2006. Cynthia Wilson, "Asset Acceptance to Post 15 Million in Revenue Impairments," Oct. 26, 2007, *available at* http://www.insidearm.com.

2. *Industry Trends*

e. *Please provide data illustrating how the practice of debt buying has evolved over the years and what impact, if any, it has had on the practice of debt collection. In addition, please discuss the frequency with which debt is sold more than once in the course of collection, the age of debts that are sold, and the impact, if any, that trends in this area have had on business and consumers.*

As other commentators have noted, the debt buying industry has exploded in recent years. In 1995, the industry purchased $12 billion worth of consumer debt; by 2004 that number had grown to $77.2 billion.[3] In 2005, according to the Global Debt Buying Report, U.S. debt buyers bought $100 billion worth of credit card debt, $5 billion of telecommunications debt, $3 billion of bankruptcy paper, and $2 billion of auto deficiencies.[4] Even medical debt is sold to debt buyers.

We have found that the majority of our clients must deal with debt buyers, and not with their original creditors. We find that the debt buyers are most often collecting debts that are four to five years old. A significant number of debts have aged past the New York statute of limitations, generally six years on a credit card debt and four years on a debt that would fall under the Uniform Commercial Code.

Debt buyers have had a tremendous leverage over consumers for one major reason: once a debt has been sold, it becomes almost impossible for a consumer to obtain information about it. In a typical scenario, a debt buyer (or a collection agency working for a debt buyer) contacts a consumer and asserts that the consumer owes money on an account. The consumer usually has no information about the account, because he or she has long ago thrown out the statements. The balance typically seems shockingly high, further confusing the consumer. If the consumer is older or memory-impaired, or if the original creditor has since merged with another financial institution, the consumer may not recognize the account at all. Unfortunately, when the consumer requests more information from the debt buyer, such as a copy of a bill, the debt buyer cannot or will not provide it. The consumer often reaches out to the original creditor in an attempt to gain more information about the account. Frustratingly, the original creditor refers the consumer right back to the debt buyer. As the creditor and the consumer no longer have a business relationship, the creditor either cannot provide information (because it no longer exists) or chooses not to provide information (because it is not easily retrievable).

This scenario becomes far worse when the consumer is an identity theft victim or when the debt arose from a billing error. The lack of documentation means that it is very difficult for the consumer to establish to the debt buyer's satisfaction that the fraud or billing error actually occurred. Consumers are often left with a smeared credit report and

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[3] Carolyn Mayer, "As Debt Collectors Multiply, So Do Consumer Complaints," *Washington Post*, July 28, 2005,
available at http://www.washingtonpost.com/wp-dyn/content/article/2005/07/27/AR2005072702473.html
[4] Kaulkin & Ginsburg, *Global Debt Buying Report*, March 2006, p. xxviii.

an ongoing dispute that cannot be resolved – unless the consumer gives in and makes a payment.

Consumers rely on the verification provisions of the FDPCA as a means of gaining information about the debt. Many consumers mistakenly believe that if they dispute the debt, the debt collector or debt buyer will have to provide them with a meaningful response to their dispute. Unfortunately, case law in the Fourth and Ninth Circuits has eviscerated the verification requirement.[5] Under these cases, it is sufficient for a debt collector to confirm that the amount it seeks to collect is the same as the amount set forth in the debt buyer's computer spreadsheet. Consumers never receive a useful response from the debt buyer that would enable them to resolve the debt.

g. *Please provide data illustrating how the work that collection law firms do has evolved over the years and what impact, if any, this evolution has had on the practice of debt collection. In addition please provide data, particularly from the past ten years, regarding the number or percentage of debts being assigned to collection law firms relative to the number or percentage being assigned to collection agencies.*

73% of our clients with a debt collection issue have been sued by a debt collection law firm, most often representing a debt buyer. We find that collection law firms routinely take actions that appear to violate the FDCPA as well as raise troubling ethical questions. Unfortunately, the FDCPA in its current form is not an effective tool for addressing these serious violations by debt buyers and the collection firms who represent them.

Debt buyers report that collection lawsuits are on the rise. For example, Asset Acceptance reported that in 2002 it collected most of its debts through traditional collections, and 24.2% through legal collections. By 2006, the percentage of debts collected through litigation had risen to 39.3%.[6] Portfolio Recovery reported that legal collections currently comprise 32% of total collections,[7] and Encore Capital Group disclosed: "We generate a significant portion of our revenue by collecting on judgments that are granted by courts in lawsuits filed against debtors."[8]

<u>*Default Judgments*</u>

Most debt buyer lawsuits result in victory by default. A recent report found that in 2006, plaintiffs in consumer credit cases in New York City were able to obtain default judgments in 80% of cases.[9] 90% of cases were brought by debt buyers.[10] The other

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[5] *Clark v. Capital Credit & Collection Servs., Inc*, 460 F.3d 1162 (9th Cir. 2006); *Chaudhry v. Gallerizzo*, 174 F.3d 394 (4th Cir. 1999).
[6] Asset Acceptance Annual Report, filed March 5, 2007, p. 44.
[7] Portfolio Recovery Associates Annual Report, filed March 1, 2007, p. 14.
[8] Encore Capital Group Annual Report, filed February 28, 2007, p. 13, 25-26, 32.
[9] Urban Justice Center, *Debt Weight: The Consumer Credit Crisis in New York City and its Impact on the Working Poor*, Oct. 2007, p. 1. The report suggests that a major reason for the very high default rate in New York City is that consumer defendants often do not receive notice of the lawsuit. This suggestion comports with our experience. Debt buyers usually possess old address information, and if a defendant has

20% of cases were resolved by settlement or discontinued; none went to trial or were otherwise adjudicated on the merits.[11] The lawsuits had a face value of $1 billion and resulted in judgments for almost $800 million, a staggering success rate.[12] In 2007, debt buyers and creditors have filed approximately 60,000 new cases in Brooklyn alone and have obtained approximately 52,000 default judgments, an 86% default rate.[13] Armed with default judgments, debt buyers aggressively restrain bank accounts and garnish wages in order to collect the debt.

Lack of Documentation of the Debt

The staggering number of default judgments masks the fact that debt buyers and collection law firms rarely have any admissible evidence of the debt. Debt buyers do not typically obtain documentation of the debt at the time of purchase. Rather, the debt buyer receives an electronic spreadsheet that contains the consumer's name, social security number, last known address, charge-off date, the amount owed, date and amount of last payment. The debt buyer may have an exemplar contract acquired at the time of purchase; however, it is usually impossible to tell whether that exemplar actually applied to the consumer's specific account. Debt buyers typically do not have access to the original application with signature, the specific contract that applied to the consumers account, copies of original credit card statements, or customer service records that could confirm or clarify a fraud claim or legitimate customer dispute.

I have reviewed numerous contracts for the sale or assignment of debt, all of which state that the original creditor will provide the debt buyer with a limited quantity of documentation in a limited percentage of cases for a limited period of time. Beyond these limitations, the original creditor has no obligation to provide the debt buyer with documentation. This is not a problem for the debt buyer, because debt buyers primarily rely on default judgments. If viewed on a larger scale, however, it becomes apparent that *in the majority of cases it is actually impossible for debt buyers and collection law firms to produce any documentation of the underlying debt.*

In my own practice, I have never seen a debt buyer or collection firm provide what would be considered admissible evidence of the debt, although I have demanded it on behalf of my clients and advised many *pro se* defendants to do so as well. I have sometimes seen debt buyers provide an isolated statement or statements, but this information has come in an inadmissible form and would not be accepted by a court as evidence of a debt. More often, the debt buyer has no documentation at all.

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moved since defaulting on the account, a summons will often go to the defendant's prior address. In the case of an identity theft victim, the summons will go to the address that the thief used to open the account. New York City also has a rampant problem with "sewer service," in which the summons is never delivered at all, and the process server files a false affidavit of service. This problem has been recognized by the New York courts and state legislature.

[10] *Id.* p. 13.

[11] *Id.* p. 18.

[12] *Id.* p. 9.

[13] Comments of the Hon. Ellen Spodek, Supervising Judge of Kings County Civil Court, Oct. 30, 2007.

This lack of evidence gives the debt buyers and collection law firms an unfair advantage in litigation. Although I, an attorney, understand how to challenge their claims, an unsophisticated *pro se* debtor does not. My clients tend to assume that the debt buyer plaintiff would not have sued them if it could not prove its case. They believe that they have no choice but to make payments if they wish to avoid a judgment. They do not understand that, statistically, debt buyers have no possible way of obtaining evidence in the vast majority of cases they file.

The filing of large numbers of lawsuits for which there is no evidence of the underlying debt is a fundamentally unfair and deceptive practice. Debt buyers should not be allowed to resort to the courts unless they have actual, admissible evidence that a debt is owed. The FDCPA should be amended to outlaw this practice.

Perjurious Affidavits

New York Court rules require that, in order to obtain a default judgment, the plaintiff must submit an affidavit from a party to the action who has personal knowledge of the facts alleged. Debt buyers and collection law firms routinely submit perjurious affidavits in order to obtain default judgments. The affidavits typically swear that: (1) the signer has personal knowledge of the facts set forth in the affidavit; (2) that the defendant requested a credit account; (3) that terms and conditions were mailed to the defendant; (4) that the defendant used the account; (4) that statements were mailed to the defendant; and (5) that the defendant defaulted in payments.

The employee of the debt buyer who signs these affidavits typically has no personal knowledge of any of the facts set forth in the affidavit. The employee of the debt buyer has no connection to the original creditor, no access to the underlying documentation of the account, and knows nothing about the debt except that it is his or her job to sign the affidavit in order to collect it. Employees of debt buyers routinely sign statements under penalty of perjury attesting to facts of which they have no knowledge. In the case of identity theft victims, not one single statement in the affidavit is true. These fraudulent affidavits are then submitted to the courts in order to obtain default judgments.

I know of at least one case in which employees of a major debt buyer were ordered to sign affidavits under penalty of perjury without even verifying that the name and amount on the affidavit matched their own records. In another instance, I have seen the same name and signature on affidavits involving at least four different debt buyer plaintiffs. In each affidavit, the individual claimed to work for a different company. These different debt buyers happen to be represented by the same collection law firm. Although there could be a reasonable explanation for these affidavits, I do find it difficult to believe that one person would be employed by so many different businesses at the same time.

The filing of false affidavits to secure default judgments not only violates the FDCPA but raises serious ethical questions about the attorneys who have aided the fraud and allowed this practice to flourish.

Restraint of Bank Accounts Containing Exempt Funds

When a debt collection law firm obtains a default judgment against a consumer, it gains a powerful tool – the ability to "freeze" a consumer's bank account in execution of the judgment. In New York, attorneys need no additional court order to restrain a bank account. Rather, acting as "officers of the court," they may send an electronic information subpoena and restraining notice directly to the bank. The restraining notice has the power of a court order.

Judgment debtors typically receive no notice of the freeze until after their bank account has been frozen. Often, they were never served with a summons at all, and the frozen bank account is their first notice of the lawsuit against them. This practice is so common that the New York City Civil Courts have created pro se forms with checkboxes for consumers to request that a default judgment be vacated because the frozen bank account was their first notice of the lawsuit.

More than half of our clients survive on some form of government benefits or have earned income so low that it is entirely exempt from debt collection. These clients routinely suffer frozen bank accounts even though their income is exempt from debt collection by state and/or federal law. At NEDAP, we receive calls almost every day from seniors, people with disabilities, and others who have no access to their exempt funds. I estimate that 20% of my workload is devoted to helping clients regain access to exempt funds that have been restrained in violation of state and federal law.

For example, our client, Carmen T., is an elderly, Spanish-speaking, identity theft victim who receives Supplemental Security Income (SSI). Carmen was sued over a fraudulent wireless account. She learned of the lawsuit for the first time when her bank account containing only directly deposited SSI benefits was frozen. Carmen sent bank statements to the law firm to establish that her funds were exempt, but the law firm refused to release the account. Next, Carmen went to court and filed a *pro se* order to show cause to vacate the judgment and release her funds. The debt collection attorney talked Carmen into signing a stipulation that conditioned the release of her exempt funds on her providing the law firm with the name and address of the thief. Carmen does not read English and did not understand what she was signing. Of course, she had no such information. Four months later, her account still frozen, Carmen called us for assistance. With our help, Carmen finally obtained the release of her SSI benefits and the discontinuance of the lawsuit against her.

Another client recently called us because his bank account, containing nothing but directly deposited SSI benefits, was recently frozen <u>for the third time</u> by the same law firm. This law firm restrained his account even though it was well aware of the exempt status of his funds. Although he was able to obtain the release of his account on his own, his bank charged him $100 for processing the restraining order and refused to waive the fee. The restraint prevented him from paying his rent on time, and he incurred late fees.

Unfortunately, under current law, it is difficult to hold collection law firms accountable for their wrongful actions in restraining exempt funds. Our elderly and disabled clients need much stronger protections. The FDCPA should be amended to provide specifically that *any* restraint of exempt funds violates the statute, subject to the bona fide error defense. Collection law firms should be required to enact procedures to ensure that restraining notices do not snare funds that are categorically exempt from collection. And where collection firms do not have such procedures in place, they should be held liable under the FDCPA.

6. *Legislative Issues*

a. *Are any modifications to the FDCPA warranted in light of technological, economic, or legal changes affecting the debt collection industry? If so, what specific modifications are needed and what are the costs and benefits of these modifications for consumers and businesses?*

i. **The FTC should clarify that debt collectors must provide meaningful verification that is specific to the consumer's dispute**. As discussed above, the FDCPA verification requirement has been watered down to the point where it is no longer useful to consumers. Debt collectors should be required to provide verification that is specific to the consumer's dispute. For example, if a consumer raises an identity theft dispute, the debt collector should provide verification that relates to the identity of the cardholder. If the consumer raises a dispute as to the amount, the debt collector should provide verification that relates to the amount. The verification should consist of copies of actual documents, not just a confirmation and renewed demand for the amount.

ii. **The FDCPA should be amended to prohibit debt collectors from filing lawsuits unless they have admissible evidence that the debt is owed.** As discussed, one of the greatest problems consumers currently face is a rash of debt collection lawsuits filed by debt buyers that cannot provide documentation of the debt. The FDCPA should be amended to outlaw this practice, which is fundamentally unfair and deceptive. Consumers should not be hauled into court unless there is a realistic possibility that the debt buyer could win the case on the merits by submitting admissible evidence of the debt. This change would most likely reduce the overall numbers of debt collection cases in our courts. This change would have the great benefit of reducing caseloads for overworked local judges and ensuring that courts preside over legitimate disputes, not rubber stamps for the collections industry. The change would level the playing field between unsophisticated consumers and collection lawyers. At the same time, consumers who are sued would have a greater incentive to settle cases, because they would know that the plaintiff has the ability to prove its case.

iii. **The FDCPA should be amended to prohibit debt collectors from restraining funds that are exempt from collection under federal or state law.** As discussed, one of the greatest problems that we see in the legal services community is the freezing of bank accounts that contain exempt funds. The FDCPA should specifically prohibit this practice, subject to the bona fide error defense. Disabled and elderly consumers would benefit immeasurably from this change, as collection law firms would enact procedures designed to prevent the restraint of exempt funds. Where collection law firms fail to enact such procedures, consumers will gain an effective tool to use to obtain the release of their exempt funds.

iv. **The FDCPA should be amended to provide for injunctive relief.** The FDCPA does not currently provide for injunctive relief. The lack of an injunctive remedy impairs my ability to advocate for my clients. As a legal services attorney, the kinds of violations I see most often do not create significant actual damages for my clients as individuals, but they are repeated on a large scale and thus cause great harm to the community as a whole. An example is the repeated filing of false affidavits in order to obtain thousands of default judgments against low income New Yorkers. A money judgment in an individual case simply will not curtail this illegal behavior or prevent it from occurring in the future. Nor do I think that a class action would effectively address the problem. A class action would require the defendant to pay more money, but it would not have to change its behavior. What consumer advocates need is the ability to obtain a declaration that the act is illegal and a court order barring the defendant from engaging in that act in the future.

v. **Statutory damages must be raised to a meaningful level.**
Statutory damages of $1000 per plaintiff per case are so low as to be meaningless. In today's dollars, the statutory damages are so low that collection agencies can break the law with impunity. The $1000 penalty is simply a cost of doing business. Statutory damages must be raised to a meaningful level, and they should be available <u>per violation</u>, not per case. Only then can statutory damages serve their intended purpose as an effective deterrent of unlawful behavior.

vi. **The Internal Revenue Code should be amended to eliminate the unfair tax burden imposed on successful plaintiffs.**
The IRS views attorney fee awards to successful plaintiffs as taxable income to the plaintiff. The Supreme Court endorsed this view, at least insofar as contingent fee awards are concerned, in the case of *Commissioner v. Banks*. Following this case, Congress amended the Internal Revenue Code to provide an above the line deduction for attorney

fees in employment and discrimination cases. This deduction should be extended to apply to consumer cases. Counting attorney fees as taxable income is completely unfair to our low income clients, as they never see or benefit from that income in any way. In the case of our clients, who are poor enough to qualify for free legal services, the attorney fee award generally exceeds their own recovery, and may even surpass their income for the entire year. Depending on the size of the fee award, counting it as income could prevent our clients from qualifying for the Earned Income Tax Credit, on which they depend for basic survival. Thankfully, that factual scenario has not yet arisen in our practice. Nevertheless, the idea that our low income clients should have to pay taxes on our attorney fee awards is completely unjust and should be remedied.