

# THE DEBT MACHINE

HOW THE COLLECTION INDUSTRY HOUNDS  
CONSUMERS AND OVERWHELMS COURTS



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**NCLC**<sup>®</sup>  
NATIONAL  
CONSUMER  
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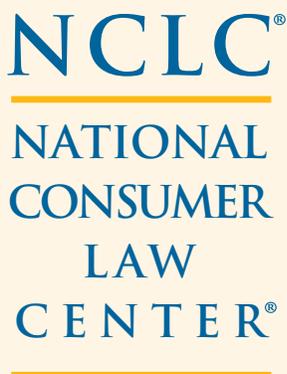
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#### ABOUT THE NATIONAL CONSUMER LAW CENTER

The National Consumer Law Center<sup>®</sup>, a nonprofit corporation founded in 1969, assists consumers, advocates, and public policy makers nationwide on consumer law issues. NCLC works toward the goal of consumer justice and fair treatment, particularly for those whose poverty renders them powerless to demand accountability from the economic marketplace. NCLC has provided model language and testimony on numerous consumer law issues before federal and state policy makers. NCLC publishes an 18-volume series of treatises on consumer law, and a number of publications for consumers.

## EXECUTIVE SUMMARY

While financial crisis and recession have wreaked havoc on the American economy, the pain has been especially intense for consumers. Millions are now burdened with unpayable debts after they were enticed into borrowing during the credit boom.

During that boom, loans became easy to get, difficult to understand and eventually—for many—impossible to repay. These consumers and debts are now fodder for a vast machine that converts consumer misery into corporate profits.

This debt collection machine—financed by Wall Street and closely tied to credit card issuers and other lenders—includes collections companies with an army of 400,000 deployed in call centers and other operations. It also includes large law firms, speculators that buy and sell consumer obligations and other specialists.

The debt machine sometimes generates revenue by persuading willing and able consumers to make payments. When that fails, it grinds on by securing legal judgments that empower creditors to garnish wages, attach bank accounts, seize cars and other assets and extend the lives of uncollected debts, sometimes for decades. Often, the grab extends to people who have already repaid or never owed the debts—parents, children, people with similar names, victims of identity theft. Harassment, threats and even jail become tools of the collection trade.

In pursuit of judgments, creditors and collectors have swamped small claims and other state courts with a torrent of lawsuits. They file mass produced suits that do not clearly identify the debt involved. They often send notice of lawsuits to old or incorrect addresses. And by inserting forced arbitration clauses in millions of credit card and other consumer loan contracts, collectors and creditors have carved out shortcuts to judgments, and denied many consumers a day in a real court.

The operations of this well-funded and insatiable debt machine long ago outstripped existing consumer protections. To protect consumers and the American economy, urgently needed measures include:

- strengthening and updating of the three-decade-old Fair Debt Collection Practices Act.
- establishment of a Consumer Financial Protection Bureau as well as updated rules and enhanced enforcement by the Federal Trade Commission.
- a restoration of fairness and due process to debt collection suits in state courts.
- a permanent ban on forced arbitration of disputes between creditors and consumers.
- enactment of laws that ensure that consumers can pursue class actions and injunctions against abusive collectors.

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## I. IN THE JAWS OF THE MACHINE

“Forgive my spelling,” read the answer filed in March 2008 by the defendant in a debt claim lawsuit in a Montana court. “I have a head injury and writing dose (sic) not come easy.”

The writer was Tim McCollough, a Laurel, Mont., man living on Social Security after a disabling head injury in 1990. He said that he had not had any dealings with the issuer of the credit card for “well over 8 ½ years” and so the debt claim was barred by Montana’s five-year statute of limitations.

“This is the third time they have brought me to court on this account,” he wrote. “Do I have to sue them so I can live quietly in pain?”

To a consumer, falling into the jaws of the debt machine can be a humiliating, infuriating and damaging experience. A Boston *Globe* 2006 investigative report on the debt industry’s treatment of consumers described “a debtor’s hell where bank accounts are drained, wages are attached, property confiscated, and threats of jail are an everyday occurrence.”<sup>1</sup>

First come the calls, from employees of a confusing alphabet soup of corporate claimants and law firms that the alleged debtor may never have heard of.

Then there may be a summons to appear in state court or a notice of arbitration. Neither is likely to offer a clear explanation of how the process works or what rights a consumer has in it.

Later there is likely to be a judgment that empowers the creditor to garnish wages or seize a debtor’s car, bank account or other property. That judgment may also prolong the life of a consumer’s obligation to pay the claimed amount, sometimes for decades.

<sup>1</sup>“No Mercy for Consumers” by the Boston Globe Spotlight Team, July 30, 2006.

Typically, such judgments are issued by default after a consumer fails to receive or respond to a notice of the hearing or arbitration, or show up to contest a creditor’s claim.

But, as McCollough’s ordeal showed, even a consumer who contests an invalid claim faces an uphill battle to win justice.

The suit to which McCollough was responding had been filed on April 17, 2007 by a North Dakota law firm representing CACV, a Colorado debt buyer which had bought the claim against McCollough six years earlier. CACV’s lawsuit claimed that he owed nearly \$10,000, including \$3,800 in charges he allegedly made to a credit card he got from Chase Manhattan Bank in 1994 as well as \$5,500 in interest and collection costs and \$480 in attorney fees.

The lawsuit triggered anxiety, pain, anger and adrenaline. It also caused McCollough to fight with his wife and suffer severe headaches.<sup>2</sup>

Court records show that McCollough’s pursuers knew that in going after him they were stretching the envelope on a claim that Chase had charged off in 2000. In January 2007, a lawyer at Johnson, Rodenberg & Lauinger (“JRL”), the law firm that filed the suit, wondered in writing whether the claim had expired under Montana’s five-year statute of limitations. But CACV, without providing any documentation, said the claim was alive and the law firm went ahead and filed suit against McCollough. Even after CACV backtracked and informed its lawyers that the claim was time-barred, the law firm pursued the lawsuit

<sup>2</sup>“Order Denying Defendant’s Motion for a New Trial and to Amend the Judgment,” entered July 27, 2009, in Timothy McCollough vs. Johnson, Rodenberg & Lauinger, CV-07-166-BLG-CSO, U.S. District Court for Montana, Billings Division, p. 25.

for months. It even tried to get McCollough to waive his defense.

Things turned around only when McCollough got his own lawyer. Facing an alleged debtor with legal representation,<sup>3</sup> the collections law firm quickly emailed CACV, the debt buyer it was representing, asking for “everything you can get for documentation as soon as possible. We need to request everything available from the original creditor, **not just the things that you normally request**” (emphasis added). Among the materials the law firm wanted for the credit card account were the “application, statements, card member agreement, copies of payments (and) copies of any correspondence.”

But the debt buyer had bad news for its lawyers. Such “media” are only kept for seven years after charge-off, it responded. The collection law firm’s subpoena for Chase Manhattan, the original card issuer, to supply documents was also unsuccessful.

With nothing to buttress its claim, CACV in December 2007 instructed its lawyers to drop the collection lawsuit against McCollough.

McCollough didn’t go away. He then filed his own lawsuit alleging that “JRL took a ‘factory’ approach to litigation, filing a high volume of lawsuits against alleged debtors based upon scant, often unverified information.”<sup>4</sup> During one 18-month period the law firm filed 2,700 debt collection lawsuits in rural Montana

<sup>3</sup> McCollough’s lawyer, John Heenan, is a member of the National Association of Consumer Advocates and one of 300 lawyers listed at the organization’s web site ( [www.naca.net](http://www.naca.net) ) who do not require a fee to take the cases of harassed consumers.

<sup>4</sup> “Order Denying Defendant’s Motion for a New Trial and to Amend the Judgment,” entered July 27, 2009, in Timothy McCollough vs. Johnson, Rodenberg & Lauinger, CV-07-166-BLG-CSO, U.S. District Court for Montana, Billings Division, p. 13.

courts, and a majority of those lawsuits resulted in default judgments against consumers, according to a document introduced by McCollough’s attorney.<sup>5</sup>

In April 2009, a federal court jury in Montana awarded McCollough \$250,000 in compensatory damages, \$60,000 in punitive damages and \$108,000 in attorney’s fees and costs. McCollough was awarded only \$1,000 in statutory damages, a seeming pittance that actually is the maximum amount allowable because that provision of the Fair Debt Collection Practices law has not been adjusted for inflation since its enactment in 1977.<sup>6</sup>

By pursuing their lawsuit, McCollough and his attorney also provided a valuable exposure of the abuses that occur in the modern debt industry. For example, a lawyer for JRL said that his firm had sued McCollough when it had no documentation of his debt, and that in that case and “probably” in others it had sought to collect attorney’s fees without having a contract that gave the firm that right.<sup>7</sup>

Such abuses have become more widespread as automation and industrialization have increased the reach, scope, efficiency

<sup>5</sup> Ibid, p. 8, also Order re Judgment, entered June 3, 2009, p. 18.

<sup>6</sup> The final outcome of McCollough’s case remains to be decided. JRL’s appeal of the jury verdict and damage award is pending before the U.S. 9th Circuit Court of Appeals. But McCollough feels that he has already accomplished something important. He said that his lawsuit and local news coverage of it has “started an avalanche of people standing up to the collection agencies. This is the first thing I’ve been truly proud of since (my) head injury.”

<sup>7</sup> “Order Denying Defendant’s Motion for a New Trial and to Amend the Judgment,” entered July 27, 2009, in Timothy McCollough vs. Johnson, Rodenberg & Lauinger, CV-07-166-BLG-CSO, U.S. District Court for Montana, Billings Division, pp. 20-21. The verdict has been appealed.

## A Credit Boom

The modern debt industry is a byproduct of the massive expansion of consumer lending by banks, other major financial institutions and aggressive small lenders. The total of loans outstanding to consumers exceeded \$2.5 trillion in 2009, having doubled in about 13 years. Total credit card and other revolving credit outstanding alone approached nearly \$1 trillion at its peak.

and profitability of collecting debts. Secondary markets have grown, where creditors sell “bad” debts for pennies on the dollar to bargain hunters who know how to squeeze more money out of debtors. Law firms specializing in debt collection have expanded geographically and now offer a range of services to creditors. By 2007, the debt industry employed 217,000 collectors and others and posted annual revenue of \$58 billion.<sup>8</sup>

Millions of consumers are now vulnerable to painful encounters with the debt industry. A single episode of unemployment, illness, disability, divorce or other financial difficulty may trigger forceful collection activity. An error or overreach by a collector may also embroil a consumer in a debt dispute.

<sup>8</sup> *Value of Third-Party Debt Collection to the U.S. Economy in 2007: Survey and Analysis*, prepared for ACA International, June 12, 2008, p.8. Credit card issuers also employ thousands of collectors who mainly pursue consumers with accounts that are delinquent but not yet charged off. See U.S. Government Accountability Office, “Credit Cards: Fair Debt Collection Practices Act Could Better Reflect the Evolving Debt Collection Marketplace and Use of Technology,” GAO-09-748, September 2009, p. 19.

Millions of debt disputes end up in court or in private arbitration proceedings that frequently ride roughshod over the rights of consumers.<sup>9</sup>

The Great Recession has put even more stress on consumers. The rate at which consumers fell from one to six months behind on credit card payments averaged about 4.4 percent from 1991 to 2007, then jumped to 6.6 percent in early 2009.<sup>10</sup> By the end of the year, insured banking institutions charged off 9.1 percent of their credit card loans, nearly triple the 3.4 percent rate at the end of 2006.<sup>11</sup>

Now it seems that debt collectors are everywhere. The industry estimates that it has more than 1 billion contacts with consumers annually.<sup>12</sup> In a recent survey by Scripps Research Center at Ohio University, nearly half of the respondents reported that they had received a telephone call from a collector. Two in five said they had been asked to pay an incorrect amount, and one in three reported

<sup>9</sup> This report focuses on debt collections through state small claims courts. Problems in the forced arbitration system are described in “Forced Arbitration: Consumers Need Permanent Relief” by Robert J. Hobbs and Rick Jurgens, National Consumer Law Center, April 2010. A call by regulators for stronger consumer protections in both venues is laid out in “Repairing a Broken System: Protecting Consumers in Debt Collection Litigation and Arbitration,” Federal Trade Commission, July 2010.

<sup>10</sup> U.S. Government Accountability Office, “Credit Cards: Fair Debt Collection Practices Act Could Better Reflect the Evolving Debt Collection Marketplace and Use of Technology,” GAO-09-748, September 2009, p. 5.

<sup>11</sup> See FDIC—Statistics on Depository Institutions Report, at [www2.fdic.gov/sdi/rpt\\_Financial.asp](http://www2.fdic.gov/sdi/rpt_Financial.asp).

<sup>12</sup> U.S. Government Accountability Office, “Credit Cards: Fair Debt Collection Practices Act Could Better Reflect the Evolving Debt Collection Marketplace and Use of Technology,” GAO-09-748, September 2009, p. 35.

receiving multiple calls that seemed to constitute harassment.<sup>13</sup>

<sup>13</sup> See results of a Scripps Survey Research Center poll of 1,001 respondents completed Sept. 26, 2009 and posted at [www.newspolls.org/surveys/SHOH42](http://www.newspolls.org/surveys/SHOH42).

Abuses aren't rare. In 2009, the Federal Trade Commission received about 88,200 complaints from consumers about third-party debt collectors—more than it received about any other industry.<sup>14</sup> Add in another 32,100 complaints

<sup>14</sup> Federal Trade Commission, *Annual Report 2010: Fair*

## The Collectors

The basic tool of a debt collector is the telephone. Each day tens of thousands of collectors file into cubicles in cities from Buffalo to Yuma, and use automated dialers to call alleged debtors and try to persuade them to send money.<sup>1</sup>

As a group, third-party collectors posted \$11.5 billion in contingency fee revenue in 2007, according to an industry study.<sup>2</sup> The average contingent rate—the portion of collections that collectors kept for themselves—was 28 percent in 2005.<sup>3</sup> Total employment at third-party collection firms was 152,000.<sup>4</sup> The largest collector is NCO Group, a Pennsylvania company with annual revenue of \$1.5 billion that is owned by JPMorgan Chase. NCO grew through a series of acquisitions, most notably a February 2008 deal in which it bought Outsourcing Solutions Inc., the number two debt collector, for \$339 million.<sup>5</sup>

<sup>1</sup> See “Collecting Consumer Debt in America” in Federal Reserve Bank of Philadelphia *Business Review*, Second Quarter, 2007, p. 11-24.

<sup>2</sup> *Value of Third-Party Debt Collection to the U.S. Economy in 2007: Survey and Analysis*, prepared for ACA International, June 12, 2008, p. 8.

<sup>3</sup> See “Collecting Consumer Debts: The Challenges of Change,” a Workshop Report from the Federal Trade Commission, February 2009, p. 3.

<sup>4</sup> *Ibid.*, p. 13.

<sup>5</sup> See Form 10-K for the fiscal year ended Dec. 31, 2008, filed with U.S. Securities and Exchange Commission by NCO Group Inc., p. 42. Debt collectors' profits are not immune to economic setbacks. OSI, which NCO obtained for \$325 million, commanded a much loftier price tag in a 1999 deal where Madison Dearborn Partners, a private

equity firm, ponied up \$800 million for OSI. According to its most recent securities filings, NCO Group deploys 6,800 automated dialers in 98 collection centers in the United States and eight other countries, including Canada, Mexico, the Philippines, Australia and the UK.<sup>6</sup> About 17,700 NCO employees and 1,400 subcontractors worked those phones. NCO Group posted \$1.2 billion in debt collection revenue in 2009, including about \$600 million in contingency fees retained after consumers handed over more than \$3 billion.<sup>7</sup>

In recent years, collectors have expanded globally, enlisting low-wage employees in distant countries in the campaign to extract payments from American consumers. For example, Encore Capital Group, a debt buyer with an in-house collection operation, has said that it plans to boost from 350 to 1,100 the number of collectors at its “high performing, low cost site in India” that opened in late 2005. The Indian site, which had already posted gross collections of \$4 million by early 2009, will have operating costs only one-third as high as its United States operations, Encore said.<sup>8</sup>

<sup>6</sup> Form 10-K for the fiscal year ended Dec. 31, 2008, filed with U.S. Securities and Exchange Commission by NCO Group Inc., pp. 10, 37.

<sup>7</sup> Form 10-K for the fiscal year ended Dec. 31, 2009, filed with U.S. Securities and Exchange Commission by NCO Group Inc., pp. 9, 30.

<sup>8</sup> Encore Capital Group, “Leveraging Intellectual Capital,” Investor Presentation, June 9, 2009.

## FTC Complaints 2009

NATURE OF COMPLAINTS AGAINST COLLECTORS	NUMBER RECEIVED IN 2009
Called repeatedly or continuously	41,028
Sought to collect debts that were not owed, amounts over what was owed, debts that had been discharged in bankruptcy or impermissible fees, interest or expenses	37,052
Failed to send consumers required notices of their FDCPA rights and the claims against them	22,708
Falsely threatened lawsuits or other actions	18,438
Repeatedly called third parties seeking information about consumers with alleged debts	16,926
Called and used obscene, profane or abusive language	14,321
Called consumers at work	11,973
Falsely threatened to arrest consumers or seize their property	11,505
Disclosed purported debts to consumers' employers, relatives, children, neighbors or friends	10,758
Failed to provide written verification of debts after it was requested by consumers	10,158
Called consumers outside the permissible hours of 8 A.M. to 9 P.M. or at other inconvenient times	9,684
Continued to contact consumers even after consumers sent written "cease communication" notices	7,411
Used, or threatened to use, violence against consumers	2,517

*Sources:* Federal Trade Commission, Annual Report 2010: Fair Debt Collection Practices Act, p. 6-10, posted on-line at [www.ftc.gov/os/2010/04/P104802fdcpa2010annrpt.pdf](http://www.ftc.gov/os/2010/04/P104802fdcpa2010annrpt.pdf).

about creditors' in-house collectors, and debt collection accounted for nearly 120,000 complaints to the agency—more than one of every five complaints received.<sup>15</sup>

That record only tells part of the story. The FTC notes that its complaint data "may understate the extent to which consumers have concerns about the practices of debt collectors" because some consumers, perhaps not aware of the FTC's enforcement role, may only file complaints with collectors, creditors or

other enforcement agencies.<sup>16</sup> The increasing volume of consumer complaints to the FTC is strong evidence that the FDCPA needs more teeth to pull rogue debt collectors into line.

Other consumers filed lawsuits against collectors and creditors. The volume of such lawsuits has increased steadily in recent years, so that in 2009 a total of 6,463 civil cases were filed in federal courts alleging violations of the Fair Debt Collection Practices Act or Fair Credit Reporting Act.<sup>17</sup> The FDCPA regulates third party debt collectors, and allows consumers to file lawsuits as individuals or as a

*Debt Collection Practices Act*, p. 3-4, posted on-line, [www.ftc.gov/os/2010/04/P104802fdcpa2010annrpt.pdf](http://www.ftc.gov/os/2010/04/P104802fdcpa2010annrpt.pdf).

<sup>15</sup> Federal Trade Commission, *Annual Report 2010: Fair Debt Collection Practices Act*, p. 4-5, posted on-line, [www.ftc.gov/os/2010/04/P104802fdcpa2010annrpt.pdf](http://www.ftc.gov/os/2010/04/P104802fdcpa2010annrpt.pdf)

<sup>16</sup> Federal Trade Commission, *Annual Report 2010: Fair Debt Collection Practices Act*, p. 2, posted on-line, [www.ftc.gov/os/2010/04/P104802fdcpa2010annrpt.pdf](http://www.ftc.gov/os/2010/04/P104802fdcpa2010annrpt.pdf)

<sup>17</sup> "Civil Suits Against ARM Companies Soar in 2009: US Courts," InsideARM, March 17, 2010.

class against alleged violators. The law entitles consumers who prevail to collect actual and statutory damages, attorney fees and costs.<sup>18</sup> The amounts that may be recovered by consumers have not been adjusted since the law was enacted in 1978, so that the law now provides substantially less deterrence to debt collection abuses.

## II. LIMITS ON COLLECTORS

During the early years of the United States, consumers unable or unwilling to pay creditors' claims were imprisoned. While the jailing of debtors has become rare in the 21st century, creditors continue to pursue consumers and treat them harshly.

A series of investigative reports by the Chicago Tribune in April 1974 shone a spotlight on such harsh treatment. Headlines included "Bill Collection Terror Tactics," "Bill Collectors Here Show No Fear of the Law," and "They Try Anything to Catch a Debtor."

Underneath the headlines, Tribune reporters described a grim reality facing debtors and consumers. "Hoaxes are an integral part of bill collection," the Tribune reported. One collector offered this advice to an undercover reporter trying to learn the ropes: "You've got to overpower them. Shout them down. Don't let them get a chance to tell you anything."<sup>19</sup>

The Tribune's debt collection expose—which ran on the front page alongside reports of the Watergate break-in, Hank Aaron's home run record and the kidnapping of Patty Hearst—focused on the lack of collection laws

or licensing requirements in Illinois and ineffectual federal regulation. "Disregarding the FTC is no big thing," the Tribune noted. "The most unscrupulous do it all the time, and do not worry about it." Collectors frequently posed as police or lawyers, called and threatened consumers' employers, forged court orders and sent collection notices on fabricated letterhead of a non-existent law firm.<sup>20</sup>

In the wake of the Tribune series, Illinois Congressman Frank Annunzio filed legislation that, after wending its way through Congress, was signed into law on Sept. 20, 1977 as the Fair Debt Collection Practices Act.<sup>21</sup> The FDCPA mainly aimed to prevent the use of threats and harassment by third-party collectors.

But since the FDCPA was passed, much has changed. Lending and some credit prices soared as decisions by federal courts and regulators cleared the way for banks to ignore state usury laws that had previously imposed ceilings on interest rates. Free to hike interest rates and levy fees as much as they wanted, banks went on a lending spree, aggressively marketing home loans and credit cards. Extensive borrowing became integral to millions of household budgets, a contributing factor to economic growth and a profit bonanza for lenders.

Along the way, the doors of the credit market swung open to some previously excluded consumers—the young, the elderly, females, minorities, people in cyclical industries and blue collar workers. Yet many of those same consumers found themselves obligated to pay unsustainably high fees and interest rates.

<sup>18</sup> Fair Debt Collection, by Robert Hobbs, et al, National Consumer Law Center, Sixth Edition, 2008, p. 327.

<sup>19</sup> Chicago Tribune, April 7 to April 11, 1974.

<sup>20</sup> Ibid.

<sup>21</sup> "Rollercoaster Ride" by Anne Rosso, Collector magazine, May 2008, p. 72.

And it became harder to escape debt. Obligations lasted longer and extended further than would have been imaginable in an earlier era. Credit card debt accumulated in many households, and it came with higher interest rates and fees—which lenders could unilaterally increase, making it even more difficult for a borrower to pay off a high balance. Federal bankruptcy “reform,” passed in 2005, put additional obstacles and much higher costs in front of desperate debtors considering that path as a way to pay down their debts or get a fresh start.

Even as the law raised the costs and risks faced by debtors, aggressive corporate collectors moved into the business. Just how aggressive was revealed in a 2004 civil complaint by the Federal Trade Commission that characterized Capital Acquisitions & Management Corp. (CAMCO) as “a debt collection company gone wild.”<sup>22</sup>

The FTC had been paying attention to CAMCO since at least 2002. CAMCO specialized in buying—and then hounding consumers to pay—debts that were so old that they could no longer be pursued in court or reported to credit agencies.<sup>23</sup> CAMCO’s collectors aggressively threatened consumers with arrest, lawsuits or bad credit reports. Ignoring the FDCPA, CAMCO’s collectors regularly used profanity, called consumers at their workplaces and continued to call after being told to stop, the FTC found.<sup>24</sup>

In 2004, the FTC filed its first civil complaint against CAMCO.<sup>25</sup> Without admitting civil liability, CAMCO agreed to pay a \$300,000 penalty and entered into a consent order barring future violations of the FDCPA.<sup>26</sup>

But that didn’t stop CAMCO. In the eight months after it signed the consent order, the FTC received more than 2,000 consumer complaints about the company. The FTC eventually found that CAMCO had violated the consent order by continuing to threaten and abuse consumers, and by continuing to threaten to file lawsuits on debts on which such actions were barred by state statutes of limitations.<sup>27</sup>

FDCPA violations seemed programmed into the corporate DNA of CAMCO, which had its headquarters in an eight-story office building in Rockford, Ill., and several hundred employees who collected millions of dollars annually from consumers. Former employees estimated that anywhere from half to 80 percent of the millions of dollars the company collected came from harassed consumers who had *never* owed the money in the first place! “In many cases, CAMCO does not even have the social security number of the original debtor,” the FTC said. “Thus CAMCO simply makes efforts to find people with the same name in the same geographic area and then calls trying to collect.”<sup>28</sup>

In December 2004, the FTC filed a second complaint against CAMCO, and a judge appointed a receiver to take over CAMCO and

<sup>22</sup> FTC vs. CAMCO, 04C7781, Memorandum filed Dec. 2, 2004, p. 1.

<sup>23</sup> Ibid, p. 3.

<sup>24</sup> “Debt Buyer/Debt Collection Companies and Their Principals Settle FTC Charges,” Federal Trade Commission release, March 24, 2004.

<sup>25</sup> FTC vs. CAMCO, 04C7781, Memorandum filed Dec. 2, 2004, p. 2

<sup>26</sup> FTC vs. CAMCO, 04C7781, Consent Decree, March 24, 2004, p. 2.

<sup>27</sup> FTC vs. CAMCO, 04C7781, Memorandum filed Dec. 2, 2004, p. 3, 4-8.

<sup>28</sup> Ibid, p. 4.

sell its assets.<sup>29</sup> Eventually, CAMCO and its top executive were each ordered to pay \$1 million to settle FTC charges.<sup>30</sup>

The demise of CAMCO didn't mark the end of abusive collections. In Texas, a debt collector demanding payment of a disputed \$81 credit card bill during the summer of 2007 unleashed a barrage of more than 40 telephone calls to Allen Jones. The collectors, who were employed by a Berwyn, Pa., company called Advanced Call Center Technologies LLC, also left eight racist and obscenity-laced messages on the answering machine of Jones, a 26-year-old African American small businessman.

With the voice mails—in which obscenities were interspersed with the N-word and urgings that he go pick cotton—as evidence, Jones sued ACCT.<sup>31</sup> He also presented corroborating testimony from a Virginia consumer who had received a voicemail message from an ACCT collector asking if the consumer was in bed with his mother or his sister.

Although the company denied that its employees had made the calls as part of their jobs, and suggested that a collector might have had a personal beef with Jones, a jury

<sup>29</sup> *FTC vs. CAMCO*, 04C7781, Temporary Restraining Order with Asset Freeze and other Relief, issued Dec. 3, 2004.

<sup>30</sup> "Debt Collector Settles with FTC for Abusive Practices," Federal Trade Commission release, March 12, 2007.

<sup>31</sup> Jones' lawsuit showed the importance of voice recordings as evidence in lawsuits against debt collection abuses. Jones was fortunate that the collectors pursuing him left voice mail messages, since Texas, like a dozen other states, makes it a crime for consumers to tape record harassing debt collection calls without the debt collector's consent. Federal law needs to override state laws so consumers can tape record harassing live calls from debt collectors. That would be a real deterrent to the increasing number of harassing calls by debt collectors.

disagreed and awarded Jones \$50,000 for mental anguish and \$1.5 million in punitive damages. It found that ACCT and its employees violated the Texas Debt Collection Act, engaged in unreasonable collection efforts and invaded Jones' privacy, and that the company was negligent in hiring, supervising, training and retaining a supervisor.<sup>32</sup>

Collection abuses remain widespread. In New York during 2009, Attorney General Andrew Cuomo shut down two debt collection operations, including one that he said was run by a convicted felon with collectors who posed as police officers and threatened to jail consumers.<sup>33</sup> The attorney general later obtained court orders that barred from the debt collection industry the convicted felon and two other principals of debt operations that used eight names at four locations in western New York State.<sup>34</sup> Cuomo also sued to shut down another operation that he accused of sexually harassing consumers and threatening

<sup>32</sup> "Chesco-based collection firm loses harassment case" by Trish Wilson, *Philadelphia Inquirer*, June 4, 2010, p. B3; Jason Whitely, "Vulgar voicemails force debt collector to pay \$1.5 million" (May 28, 2010) ("This is your mother\*\*\*\*\* wake-up call you little lazy a\*\* b\*\*\*\*," a collector said on one. "Get your mother\*\*\*\*\* n\*\*\*\*r ass up and go pick some mother\*\*\*\*\* cotton fields."), available at [www.wfaa.com/news/consumer/Vulgar-voicemails-force-debt-collector-to-pay-15M-95163714.html](http://www.wfaa.com/news/consumer/Vulgar-voicemails-force-debt-collector-to-pay-15M-95163714.html).

<sup>33</sup> "Attorney General Cuomo Shuts Down New York Debt Collection Operation that Used Illegal Scare Tactics to Threaten Consumers across the Country," release dated June 23, 2009; Attorney General Cuomo Launches Inquiry into Debt Collectors across New York State," release dated May 27, 2009.

<sup>34</sup> "Attorney General Cuomo Secures \$275K in Restitution for Victims of a New York Debt Collection Operation that Used Illegal Scare Tactics to Threaten Consumers," Release dated Feb. 9, 2010.

## The Lawyers

Within the debt machine, about one out of every 20 delinquent accounts gets referred to a law firm that specializes in debt collection. Specialized collection law firms posted about \$1.2 billion in revenue in 2006, according to one industry estimate.<sup>1</sup>

A majority of those referrals come from debt buyers.<sup>2</sup> In 2009 Encore Capital Group spent \$113 million to file 375,000 lawsuits against alleged debtors who forked over \$233 million, accounting for about 48 percent of Encore's total collections for the year.<sup>3</sup> That same year, Portfolio Recovery Associates Inc. spent \$31.3 million to file lawsuits that generated \$86.7 million in collections.<sup>4</sup>

A revealing picture of the role of debt collecting lawyers emerged in the wake of the collapse of Mann Bracken, the self-proclaimed leader of the sector. Before it shut down in early 2010, Mann Bracken's web site described the enterprise as "a national law firm that combines (via recent merger) 3 of the top 5 law firms specializing in the practice of collections and creditors' rights law."

Bankruptcy filings by Axiant, Mann Bracken's back-office affiliate, showed the scope of the firm's operations. In 2008, Mann Bracken and Axiant had 1,069 employees, operated two call centers and "had an infrastructure that supported 35,000 lawsuits per month, 20,000 arbitration filings per month

and \$55 million in collections per month."<sup>5</sup> The firm also offered its clients "skip tracing" of elusive alleged debtors, execution of garnishments and liens and pursuit of claims through arbitration.

Mann Bracken's shut-down followed exposure by Minnesota's Attorney General of Mann Bracken's ties to the leading arbitration provider.<sup>6</sup> The shutdown of Mann Bracken gave some relief to debtors, including the dismissal of tens of thousands of debt lawsuits in Maryland and some other states. It also opened the door to challenges to the validity of judgments already won by the law firm.

A rare glimpse at the working and financial relations between a debt collecting law firm and its debt buyer client came in a recent filing by debt buyer Asta Funding that spelled out some of the terms of its March 2007 agreement with the Wolpoff & Abramson law firm. The law firm, which later merged into Mann Bracken, kept 24 percent of the money it collected itself or 30 percent of collections made by vendors that it had engaged. In the deal, Asta engaged the law firm to collect 335,000 "receivables" with a face value of \$896.5 million, and required the law firm to "initiate litigation" on each claim within 18 months and keep "employed ... in a senior capacity" its name partners, Ronald M. Abramson and Stuart J. Wolpoff.<sup>7</sup>

<sup>1</sup> See [www.creditcollectionsworld.com/pagedisplay.html?pagename=topcollectionslawfirms](http://www.creditcollectionsworld.com/pagedisplay.html?pagename=topcollectionslawfirms), viewed Aug. 26, 2009.

<sup>2</sup> National Association of Retail Collection Attorneys (NARCA) Comments for Federal Trade Commission Debt Collection Workshop, p. 4.

<sup>3</sup> Form 10-K for the fiscal year ended Dec. 31, 2009, filed with the U.S. Securities and Exchange Commission for Encore Capital Group, pp. 31, 46.

<sup>4</sup> Form 10-K for the fiscal year ended Dec. 31, 2009, filed with the U.S. Securities and Exchange Commission by Portfolio Recovery Associates Inc., p. 43-4.

<sup>5</sup> Declaration of Keith Bolt in Support of Chapter 11 Petition and First Day Motions, filed Nov. 20, 2009 in re Axiant LLC debtor in the United States Bankruptcy Court for the District of Delaware, Case No. 09-14118, p. 2.

<sup>6</sup> See "Attorney General Swanson Sues National Arbitration Company for Deceptive Practices," release dated July 14, 2009, posted on-line at [www.ag.state.mn.us/consumer/pressrelease/090714nationalarbitration.asp](http://www.ag.state.mn.us/consumer/pressrelease/090714nationalarbitration.asp).

<sup>7</sup> Exhibit 10.4, Subservicing Agreement dated March 2, 2007, filed with Form 10-Q/A filed March 12, 2009, for the quarterly period ended March 31, 2007, with U.S. Securities and Exchange Commission by Asta Funding Inc.

them with arrest or physical harm.<sup>35</sup> Cuomo charged each of the firms with attempting to collect non-existent debts or debts no longer valid because of the state's statute of limitations.<sup>36</sup>

And to this day, some debtors end up behind bars. In 2009, Minnesota courts issued 845 arrest warrants against debtors, half of whom owed less than \$3,500 and one who owed only \$85. Other states where debtors can end up jailed include Arkansas, Arizona, Illinois, Indiana and Washington.<sup>37</sup>

### III. SMALL CLAIMS COURTS

To observe the reach and power of the modern debt machine, one need only pay a visit to a local small claims court. Every day hundreds of these low-level state courts mass produce judgments against debtors. These judgments can be used—depending on each state's laws—to garnish wages or seize assets from a “debtor.” A judgment can also extend the life of a claim decades beyond limits imposed by state statutes.<sup>38</sup>

Collection claims are handed over to lawyers “where it appears the debtor is able,

but unwilling, to pay,” according to one large collector.<sup>39</sup> That appearance must be pretty widespread, judging by the huge volume of creditors' and collectors' claims that clog many low-level state courts. Ira Leibsker, a Chicago collection attorney, told a recent FTC workshop “that there are literally probably tens of millions of lawsuits being filed, and more will be filed as time goes on.”<sup>40</sup> Faced with mounting claims and exhausted judicial resources, state courts sometimes do little more than rubber stamp claims.<sup>41</sup>

The debt machine has transformed the character of many small claims courts. Such courts were created in the early 20th century to allow quick and inexpensive resolution of disputes where the financial stakes were small.<sup>42</sup> Reformers envisioned streamlined and

<sup>35</sup> “Attorney General Cuomo Sues to Shut Down Buffalo-based Debt Collection Operation that Illegally Harassed and Threatened Consumers Nationwide,” release dated Aug. 18, 2009.

<sup>36</sup> “Attorney General Cuomo Announces Reform Deal with Three NY Debt Collection Companies over Deceptive Techniques,” release dated June 2, 2009.

<sup>37</sup> “Debtors and the New Breed of Collectors” by Chris Serres and Glenn Howatt of the Minneapolis Star Tribune, June 6, 2010, p. 1A.

<sup>38</sup> *Collection Actions: Defending Consumers and their Assets*, First Edition, 2008, National Consumer Law Center, p. 30.

<sup>39</sup> Form 10-K, filed Feb. 11, 2009 by Encore Capital Group with the U.S. Securities and Exchange Commission.

<sup>40</sup> See transcript for Aug. 5, 2009 for “Protecting Consumers in Debt Collection Litigation and Arbitration: A Roundtable Discussion” a workshop hosted by the Federal Trade Commission and Northwestern Law School's Searle Center, p. 239, posted on-line at <http://www.ftc.gov/bcp/workshops/debtcollectround/090805-CHIL/transcript-90805.pdf>.

<sup>41</sup> See “Dignity faces a steamroller: Small-claims proceedings ignore rights, tilt to collectors” by Boston Globe spotlight team, July 31, 2006 as well as “Debt Weight: The Consumer Credit Crisis in New York City and its Impact on the Working Poor” (October 2007) available online at [www.urbanjustice.org/pdf/publications/CDP\\_Debt\\_Weight.pdf](http://www.urbanjustice.org/pdf/publications/CDP_Debt_Weight.pdf) and “Debt Deception: How Debt Buyers Abuse the Legal System to Prey on Lower-Income New Yorkers” (May 2010), available online at [www.nedap.org/pressroom/documents/DEBT\\_DECEPTION\\_FINAL\\_WEB.pdf](http://www.nedap.org/pressroom/documents/DEBT_DECEPTION_FINAL_WEB.pdf).

<sup>42</sup> “Small Claims, Complex Disputes: A Review of the Small Claims Literature,” by Barbara Yngvesson and Patricia Hennessy, *Law & Society Review*, Vol. 9, No. 2 (Winter 1975), pp. 221-3.

simplified court proceedings where litigants represented themselves that would reduce “the wide disparity between the ability of the richer and poorer classes to utilize the machinery of the law.”<sup>43</sup>

From the beginning, skeptics worried that such courts might gradually be transformed “from a forum in which the ‘average man’ could recover a legitimate claim, to a forum in which businessmen and landlords (some ‘average’ but others both politically and economically powerful) would bring claims to be dealt with (in their favor) in a summary manner.”<sup>44</sup>

Turns out the skeptics were right. Lenders, debt buyers and other creditors have learned how to use small claims and other low-level courts as a low-cost machine for turning claims into judgments against consumers who have fallen behind on payments.<sup>45</sup>

Costs vary. A recent study found that the cost of filing a \$1,000 claim in small claims court ranged from \$30 in Maryland to \$130 in Illinois.<sup>46</sup> A large debt buyer told investors that it decides whether to file collection law-

suits after analyzing the alleged debtors and the “legal process, state-specific, and jurisdictional information.”<sup>47</sup>

Collectors have taken over small claims and other low level courts in state after state. In **Massachusetts**, “the people’s court has become the collectors’ court,” the Boston Globe said in its 2006 investigation into the debt industry.<sup>48</sup> The Globe found that the state’s debt collectors filed 575,000 lawsuits between 2000 and 2005, or three out of every five civil lawsuits. In Boston, 40,000 debt collection suits accounted for 85 percent of all small claims cases over a five year period. Credit card giant Capital One alone filed 38,000 lawsuits in a four-year period.<sup>49</sup>

The vast majority of court cases resulted in judgments in favor of creditors. In Massachusetts, such a judgment extends the life of a debt to 20 years or more, allows it to accrue interest at an annual rate of 12 percent (doubling in less than 6 years if not paid down) and empowers collectors to get court orders that

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<sup>43</sup> Reginald Heber Smith, quoted in “Small Claims, Complex Disputes: A Review of the Small Claims Literature,” by Barbara Yngvesson and Patricia Hennessy, *Law & Society Review*, Vol. 9, No. 2 (Winter 1975), p. 221.

<sup>44</sup> “Small Claims, Complex Disputes: A Review of the Small Claims Literature,” by Barbara Yngvesson and Patricia Hennessy, *Law & Society Review*, Vol. 9, No. 2 (Winter 1975), p. 227.

<sup>45</sup> A large debt buyer said that filing cases against debtors in small claims and similar courts “allows us to work accounts that we would not normally pursue through the use of contingent fee collection attorneys because of cost.” See Portfolio Recovery Associates Inc. Form 10-K for 2008, p. 11.

<sup>46</sup> “Broke but not Bankrupt: Consumer Debt Collection in State Courts” by Richard M. Hynes, *Florida Law Review*, January 2008, p. 10.

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<sup>47</sup> Encore Capital Group, “Leveraging Intellectual Capital,” Investor Presentation, June 9, 2009. Such state-specific and jurisdictional variations in court rules, costs and operations provide one motive for buying and selling debt. In cases where “debtor-friendly laws” in a certain jurisdiction prompt a large debt buyer to view claims there as less valuable, other debt buyers and collectors familiar and experienced with collections in that jurisdiction may see an opportunity to transform their expertise into profits. As a large debt buyer told investors, “Certain states have more debtor-friendly laws than others and, therefore, are less desirable from a collectability perspective.” Portfolio Recovery Associates Inc. Form 10-K for the fiscal year ended Dec. 31, 2007, filed with the U.S. Securities and Exchange Commission, p. 8.

<sup>48</sup> “Dignity faces a steamroller: Small-claims proceedings ignore rights, tilt to collectors” by Boston Globe spotlight team, July 31, 2006.

<sup>49</sup> *Ibid.*

obligate consumers to make payments or face the threat of jail. Creditors can also use judgments to seize automobiles or other property, garnish wages, put a lien on a home or have a civil arrest warrant issued.<sup>50</sup> The *Globe* characterized Massachusetts small claims courts as “a de facto arm of a fast-growing and aggressive industry that has swamped court dockets with lawsuits—cases that often lead to threats of jail for debtors.”<sup>51</sup>

Debtors were at a disadvantage in Massachusetts courts. Notices were vague and confusing, and often sent to the wrong addresses. Only one in five defendants even showed up for court hearings. In addition, while defendants generally represented themselves, creditors were usually represented by a lawyer. And although creditors technically had the burden of proving their claims, they were rarely asked to provide supporting evidence or documentation.<sup>52</sup>

A recent study found creditors had had a huge impact on Virginia’s legal system. A review of two decades of electronic court records found that “each year hundreds of thousands of Virginians are sued for defaulting on consumer debts.”<sup>53</sup> Low level courts processed creditors’ claims against consumers at an astonishing annual rate of one collection lawsuit for every 20 residents, and the great majority of those lawsuits resulted in judgments against consumers.<sup>54</sup>

The Virginia study also found that debt collections, which accounted for a majority of

filings in the state’s civil courts, were “concentrated in cities and counties with lower median income and homeownership rates; higher incidences of poverty and crime; and higher concentrations of relatively young and minority residents.”<sup>55</sup>

In **New York City**, a deluge of 180,000 collection lawsuits filed by seven large collection firms during 2007 accounted for three out of 10 civil court filings, according to a 2007 study.<sup>56</sup> Similarly, 26 debt buyers filed 457,000 lawsuits and obtained \$1.1 billion in judgments during a 31-month period that ended in July 2008. The debt buyers prevailed in 94 percent of the lawsuits, while only 10 percent of the alleged debtors responded to a summons and complaint and only 1 percent had legal representation.<sup>57</sup>

MFY Legal Services, which conducted the 2007 study, concluded that many “defendants do not appear in court because they are unaware of the lawsuit due to improper service.”<sup>58</sup>

Why many alleged debtors didn’t know that they were being sued was spelled out

<sup>55</sup> Ibid, p. 6.

<sup>56</sup> “Justice Disserved: A Preliminary Analysis of the Exceptionally Low Appearance Rate by Defendants in Lawsuits Filed in the Civil Court of the City of New York,” MFY Legal Services Inc., Consumer Rights Project, June 2008, p. 4.

<sup>57</sup> “Debt Deception: How Debt Buyers Abuse the Legal System to Prey on Lower-income New Yorkers” by The Legal Aid Society, Neighborhood Economic Development Advocacy Project, MFY Legal Services and the Urban Justice Center’s Community Development Project, May 2010, p. 1.

<sup>58</sup> “Justice Disserved: A Preliminary Analysis of the Exceptionally Low Appearance Rate by Defendants in Lawsuits Filed in the Civil Court of the City of New York,” MFY Legal Services Inc., Consumer Rights Project, June 2008, p.5.

<sup>50</sup> Ibid.

<sup>51</sup> Ibid.

<sup>52</sup> Ibid.

<sup>53</sup> “Broke but not Bankrupt: Consumer Debt Collection in State Courts” by Richard M. Hynes, Florida Law Review, January 2008, p.46.

<sup>54</sup> Ibid, p. 48-9, 55.

in criminal complaints filed in April 2009 by New York Attorney General Andrew Cuomo. Cuomo alleged that tens of thousands of defendants in New York debt collection lawsuits were denied their day in court by improper service, often referred to as “sewer service.”<sup>59</sup> Three months later, Cuomo filed a lawsuit seeking to void about 100,000 default judgments with a total face value of more than \$500 million. Those judgments were won in lawsuits by 35 law firms that hired a firm that Cuomo alleged regularly failed to serve notice to defendants.<sup>60</sup>

Courts in other states also churn through collection lawsuits. At a recent FTC workshop, judges from **Iowa** and **Michigan** estimated that 85 to 90 percent of the collection lawsuits filed in their courts resulted in defaults, while an **Illinois** judge noted that in his court “the tubs of default records are enormous, so you’ll have sometimes, in a collection call, 300 to 600 default orders to go through.”<sup>61</sup>

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<sup>59</sup> “Attorney General Cuomo Announces Arrest of Long Island Business Owner for Denying Thousands of New Yorkers Their Day in Court,” news release of April 14, 2009, posted on-line at [www.oag.state.ny.us/media\\_center/2009/apr/apr14a\\_09.html](http://www.oag.state.ny.us/media_center/2009/apr/apr14a_09.html). Cuomo filed five felony charges (forgery, fraud and three counts of filing a false instrument) against American Legal Process, a Long Island process server, and the same charges, as well as a misdemeanor charge of committing fraud as a notary public, against ALP’s owner. The company “failed to provide proper legal notification to thousands of New Yorkers facing debt-related lawsuits, causing them unknowingly to default and have costly judgments entered against them without the chance to respond or defend themselves,” the attorney general said.

<sup>60</sup> “Attorney General Cuomo Sues to Throw Out over 100,000 Faulty Judgments Entered Against New York Consumers in Next Stage of Debt Collection Investigation,” release dated July 23, 2009.

<sup>61</sup> See transcript for Aug. 5, 2009 for “Protecting Con-

Mass processing of claims against consumers is widespread. In **Minnesota** during 2008, state courts issued more than 51,000 uncontested judgments in favor of collectors—mostly large banks and debt buyers—seeking \$462 million from consumers, the Minneapolis Star Tribune found.<sup>62</sup>

A year earlier, Illinois’ Cook County Circuit Court topped that output by issuing about 60,000 default judgments to resolve more than half of the 119,000 lawsuits filed by creditors, according to the Chicago Tribune.<sup>63</sup>

In some areas, hospitals led the collections charge. In western Virginia during a 66-month period, nonprofit Carilion Clinics obtained 40 percent of all judgments issued by the Roanoke District Court, or 33,000 judgments that had a face value of \$61.6 million and yielded \$25 million in revenue.<sup>64</sup> In **Maryland** during a five-year period, Johns Hopkins and other non-profit hospitals filed 132,000 collection lawsuits that yielded \$100 million in judgments.

Evidence indicates that debt collectors’ use of some small claims and other low level

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sumers in Debt Collection Litigation and Arbitration: A Roundtable Discussion” a workshop hosted by the Federal Trade Commission and Northwestern Law School’s Searle Center, p. 34, posted on-line at <http://www.ftc.gov/bcp/workshops/debtcollectround/090805-CHIL/transcript-90805.pdf>

<sup>62</sup> “Default surge: Misery by numbers; A deteriorating job market is blamed for a record amount of judgments in Minnesota in 2008, and 2009 might be worse” by Randy Furst and Glenn Howatt, Minneapolis Star Tribune, March 8, 2009.

<sup>63</sup> “Debt collectors pushing to get their day in court: More aggressive strategies fill court dockets, result in mistaken identities” by Ameet Sachdev, Chicago Tribune, June 8, 2008.

<sup>64</sup> “Carilion cases dominate general district docket” by Laurence Hammack, Roanoke Times, Sept. 14, 2008.

state courts increased in recent years. In Cook County, the annual crop of default judgments doubled from 2000 to 2007.<sup>65</sup> In Minnesota, the volume of debt collection lawsuits doubled from 2006 to 2008, and the volume of default judgments rose 58 percent in a single year.<sup>66</sup> In three counties in the San Francisco Bay Area, the number of lawsuits filed to collect consumer debts rose to 96,000 in 2009 from 53,700 in 2007.<sup>67</sup> In New York City, researchers concluded that a surge in debt collection lawsuits was a major contributor to a near tripling in all civil court lawsuits, from 213,000 in 2000 to 618,000 in 2007.<sup>68</sup>

Disclosures from some debt buyers show a similar trend. Encore Capital Group, which hires outside law firms to do collections on a contingency fee basis, reported that its lawyers filed nearly 450,000 lawsuits in 2008, up 18 percent in a year.<sup>69</sup> That same year, Portfolio Recovery Associates Inc. paid outside attorneys \$33 million in contingency fees, up 14 percent from \$29 million in 2007.<sup>70</sup>

<sup>65</sup> “Debt collectors pushing to get their day in court: More aggressive strategies fill court dockets, result in mistaken identities” by Ameet Sachdev, Chicago Tribune, June 8, 2008.

<sup>66</sup> “Default surge: Misery by numbers; A deteriorating job market is blamed for a record amount of judgments in Minnesota in 2008, and 2009 might be worse” by Randy Furst and Glenn Howatt, Minneapolis Star Tribune, March 8, 2009.

<sup>67</sup> “Some Lawyers Want to Keep Debt Collection Out of the Courts” by Bernice Yeung, in the New York Times, April 22, 2010.

<sup>68</sup> “Justice Disserved: A Preliminary Analysis of the Exceptionally Low Appearance Rate by Defendants in Lawsuits Filed in the Civil Court of the City of New York,” MFY Legal Services Inc., Consumer Rights Project, June 2008, p.5.

<sup>69</sup> Encore Capital Group Form 10-K for 2008, p. 3, 39.

<sup>70</sup> Form 10-K for the fiscal year ended Dec. 31, 2008, filed with the U.S. Securities and Exchange

The huge volume of collection lawsuits has nearly exhausted the capacity of state courts and created an urgent need for state laws that provide a more robust framework to ensure that small claims and other courts respect and protect the rights of consumers who are sued.

#### IV. CREATIVE COLLECTIONS

Back in February 2008, early in the Great Recession, members of DBA International, a trade association for companies that buy, sell and collect debts, gathered in a plush Las Vegas hotel ballroom for their annual convention. The scene posed a striking contrast to the dreary routine in local small claims courts.

Platters of shrimp and fountains of chocolate were set out for the attendees. Former baseball great Johnny Bench gave a rambling but entertaining “motivational” speech. Two tickets to attend an upcoming party at the Playboy mansion were auctioned off. (The winning bid was a mere \$4,000).

“We’re really an optimistic business,” Samir Shah, president of a Syosset, N.Y., debt buyer called RJM Acquisitions/Island National Group, told the gathering. “We believe man is good and wants to pay their debts.”

But Bob Deter of Hudson & Keyse, another debt buyer, warned of hard times coming: “Debt

Commission by Portfolio Recovery Associates Inc. But because of the lack of uniform data, it is hard to generalize about trends in filings in small claims and similar courts. A recent study of small claims courts concluded that “the civil filing rate of most states has remained fairly stable since the mid-1970s. “Broke but not Bankrupt: Consumer Debt Collection in State Courts” by Richard M. Hynes, Florida Law Review, January 2008, p. 32.



DBA conference session

collectors are going to have to get creative . . . in order to keep the liquidations up.”<sup>71</sup>

Creativity is nothing new for collectors. The techniques and scope of collections have grown with the debt industry. Collectors use sophisticated data collection and marketing practices more typically associated with selling products and offers of credit.

One collector specializes in pursuing debtors to the grave—and beyond. “Dead people are the newest frontier in debt collecting, and one of the healthiest parts of the industry,” the

<sup>71</sup> Remarks at DBA International Conference in Las Vegas, Feb. 6, 2008.

New York Times reported recently.<sup>72</sup> DCM Services LLC, a Minneapolis company, describes itself as a “collection agency focused exclusively on decedent debt resolution.” DCM says its “estate-focused, survivor-sensitive recovery” will help creditors protect their brands and reputations by eliminating “unnecessary contact with loved ones of the deceased account holder.”<sup>73</sup>

Other collectors aim to extract payments of alleged debts from consumers by dangling

<sup>72</sup> “You’re Dead? That Won’t Stop the Debt Collector” by David Streitfield in the New York Times, March 4, 2009.

<sup>73</sup> “Executive Brief: Deceased Debt Sales” and “Credit Solutions for Life,” both by DCM Services LLC, on file with authors.

## Debt Buyers

In a strange twist, debt has begun to attract interest from investors and speculators. Always on the prowl for new places where money can generate a hefty profit, these debt buyers acquire portfolios—some quite large—made up of receivables. These receivables represent claims against debtors that are valuable if they generate revenue that exceeds the costs of acquiring them and extracting payments from borrowers.

Debt buyers generally keep a low profile. The industry's most recent estimate for the face value of receivables—mostly credit card accounts—that changed hands between debt buyers sellers dates back to 2005, when volume was put at \$110 billion. That marked a dramatic increase since 1993, when the volume of receivables sold was only \$6 billion.<sup>1</sup>

Creditors sell debt in order to clean up their books and generate some revenue. Buyers pony up because they usually pay only pennies on the dollar, so that even relatively meager collections can generate rich profits.

For example, the chief executive of Sherman Financial Group, a Greenville, S.C., company that describes itself as the largest debt buyer, said in a 2006 presentation that in 10 years it had invested \$2.6 billion to purchase 25 million accounts from which it had collected \$3.8 billion.<sup>2</sup> In 2009, Sherman posted revenue of \$1.25 billion and net income of \$135.6 million.<sup>3</sup>

From 2006 through 2008, Encore Capital Group paid \$584 million, or 3 cents on the dollar, to acquire more than 11,000 portfolios of debt with a total face value of \$17.1 billion. Encore, which in a recent presentation to investors touted its “demonstrated

history of generating strong cash flows,” has collected nearly triple what it has paid for its debt portfolios and posted annual profits ranging from \$15 million to \$31 million.<sup>4</sup>

Consumers can be the losers in these deals. They can face years of badgering from creditors to pay debts—even when claims are erroneous, disputed, already settled, discharged in bankruptcy or older than allowed by a jurisdiction's statute of limitations.

In fact, some debt buyers exult in their ability to prolong the life of debt. At a trade association conference in Las Vegas, David Rosenberg, chief executive of debt buyer Unifund, boasted of a long earning curve: “There are parts of the portfolio that continue to perform even after 10 years.” Not to be outdone, Samir Shah of RJM Acquisitions said his collection firm—which sends out glossy fliers offering premiums and “rewards programs” to consumers who pay up—looks at debt “as a forever sort of thing.”

This is more than hot air. During the summer of 2009, Portfolio Recovery Associates reported that it continued to collect revenue from debts purchased as many as 13 years earlier.<sup>5</sup>

Some leading debt buyers are playing with chips provided by JPMorgan Chase and other giant financial institutions. Encore Capital and rival Asset Acceptance Corp. are each backed by more than \$200 million in credit from JPMorgan Chase. The bank group behind Portfolio Recovery includes JPMorgan Chase, Bank of America, SunTrust, Wells Fargo and Royal Bank of Canada.

The Great Recession, by cutting prices paid for bad debts, proved a boon for debt buyers with deep pockets or rich backers. For example, Encore Capital

<sup>1</sup> *Comments of ACA International Regarding the Debt Collection Workshop*, FTC File P074805, filed June 6, 2007, p.40.

<sup>2</sup> See “Radian 2006 Investor Day—Final,” Nov. 9, 2006, on FD (Fair Disclosure) Wire.

<sup>3</sup> Radian Group Form 10-K for 2009, filed with the U.S. Securities and Exchange Commission, p. 225. , Radian, a mortgage insurance company, recently sold its 28.7 percent stake in Sherman to a group of Sherman's managers.

<sup>4</sup> See Form 10-K for the fiscal year ended Dec. 31, 2008, filed with U.S. Securities and Exchange Commission by Encore Capital Group, pp. 20, 36, 41; Encore Capital Group, “Leveraging Intellectual Capital,” Investor Presentation, June 9, 2009.

<sup>5</sup> “Buyers of bad debt bide time as U.S. consumers fret” by Sweta Singh, Reuters, July 22, 2009.

Group reported “prices for fresh charge-offs (receivables that are sold immediately after charge-off) have declined from 8%–13% of face value in early 2008 to 6%–10% of face value in late 2008.”<sup>6</sup> One industry source noted some old debts selling for less than a penny on the dollar.<sup>7</sup>

Debt buying can be perilous for investors. In February 2007, Asta Funding Inc. paid \$300 million to purchase a portfolio of bad debts, or receivables, with a face value of \$6.9 billion from Great Seneca Financial Corp., an affiliate of the former Wolpoff & Abramson law firm. The deal, Asta’s Chief Executive Gary Stern told analysts, put “Asta in a very solid position for

potential future revenue and earnings growth.”<sup>8</sup>

That’s not how it worked out. Asta posted a staggering \$91 million loss in 2009, prompting a competitor to identify it as one of the “key players” in the debt industry that had been forced to the sidelines by “large purchasing mistakes.”<sup>9</sup>

Recently, debt prices have begun to firm. The cost of recently charged off credit card receivables reached 8 cents on the dollar by May 2010, up from as low as 3 cents on the dollar in March 2009, according to an industry source.<sup>10</sup>

<sup>6</sup> Encore Capital Group Form 10-K for 2008, filed with U.S. Securities and Exchange Commission by Encore Capital Group, p. 22.

<sup>7</sup> “Getting Current on Pricing in the U.S. Credit Card Debt Purchasing Market” by Mark Russell of Kaulkin Ginsberg, posted March 24, 2009 by InsideARM and viewed on-line at [www.insidearm.com/go/arm-analysis/getting-current-on-pricing-in-the-u-s-credit-card-debt-purchasing-market](http://www.insidearm.com/go/arm-analysis/getting-current-on-pricing-in-the-u-s-credit-card-debt-purchasing-market), July 1, 2009.

<sup>8</sup> See “Asta Funding Signs Definitive Agreement to Purchase \$6.9 Billion Portfolio” on PR Newswire, Feb. 9, 2007, and transcript of Asta Funding conference call, March 9, 2007.

<sup>9</sup> See Asta Funding Inc. Reports Fourth Quarter and Fiscal Year-End 2009 Results” on PR Newswire, Dec. 15, 2009, and “Leveraging Intellectual Capital” November 2009 Investor Presentation by Encore Capital Group, slide 13.

<sup>10</sup> “Debt Buyers Experiencing Bumpy Ride on Prices” in InsideARM, May 20, 2010.

offers of luxury items. Shah told the Las Vegas debt buyers gathering that at his firm, “We believe we’re in the direct marketing business and we’re selling collections.”

How do you “sell” collections? Shah said his firm sends a targeted debtor a letter every 60 days with a different settlement offer. The letters include glossy fliers that offer flat panel TVs and other gifts as premiums to consumers who make payments. “We get a lot of calls out of curiosity, just to see if we’re real.”

Other collectors pursue debtors in what Business Week magazine called “a financial version of Night of the Living Dead, (where)

debts forgiven by bankruptcy courts are springing back to life to haunt consumers.”<sup>74</sup> That occurs when collectors acquire and pursue claims against consumers who have sought relief under the bankruptcy law. That law exists in part to offer a fresh start to debt-burdened consumers who submit to a court-supervised distribution of their existing assets.

<sup>74</sup> “Prisoners of Debt; The fresh start promised by bankruptcy is under attack as big lenders keep squeezing money out of consumers whose debts were canceled by the courts,” by Robert Berner and Brian Grow in Business Week, Nov. 12, 2007, p. 44.



DBA conference speakers: Sherman Financial Group executive Bryan Faliero (top); Unifund founder and CEO David Rosenberg (bottom)

One company describes itself as “the provider of choice for the complex and often legally intensive bankruptcy debt recovery and servicing process for many leading credit card and durable consumer goods creditors.”<sup>75</sup> Its advertisements promise prospective clients “an unparalleled increase in profitability from your bankruptcy consumer receivables.”<sup>76</sup>

<sup>75</sup> Web site of B-Line LLC at [www.blinellc.com/careers.htm](http://www.blinellc.com/careers.htm), viewed Sept. 18, 2008.

<sup>76</sup> Advertisement at [www.insidearm.com/special/index.cfm?ad=4412](http://www.insidearm.com/special/index.cfm?ad=4412), viewed Sept. 18, 2008.

Among those who looked toward bankruptcy for new collections opportunities was credit card giant Capital One. In November 2008, Capital One acknowledged filing thousands of claims against consumers that had been discharged, or erased, in earlier bankruptcy cases. The bank estimated that it had filed 5,600 previously discharged claims and improperly collected \$340,000 but blamed a glitch that occurred when it outsourced and automated its bankruptcy claims filing work.<sup>77</sup>

Other collectors seek to give new life to seemingly expired debts using credit card offers. For example, Atlanta-based CompuCredit Corp. offered so-called zombie cards to consumers whose debts to CompuCredit or other lenders were older than the applicable statutes of limitations or the seven-year limit for reporting to credit agencies, the FTC said.

The offered cards were designed to function as “a debt collection device, not new credit,” federal regulators said in a 2008 action that resulted in orders to CompuCredit and three bank partners to pay \$127 million in fines and restitution to credit card customers.

Creditors offer consumers the opportunity to charge debts to the new zombie cards because the transaction has the potential to erase the statute of limitations on the old debt and restart the clock on a new cycle of delinquency and default for the debtor.

For example, CompuCredit’s offer “misrepresented that consumers would receive immediately a credit card if they agreed to

<sup>77</sup> First Interim Report of Court-Appointed Auditor, Melanie L. Cyganowski, filed Sept. 25, 2009 in Adversary Proceeding 08-01272 in U.S. Bankruptcy Court for the District of Massachusetts, Eastern Division.

transfer an existing debt to the credit card,” according to the FTC.<sup>78</sup>

Many took the bait. More than 3.6 million consumers signed up for the cards even though the credit offered equaled only 5 percent of their existing debt and they did not receive cards or have the debts cleared from their credit reports until they paid off a portion, ranging from 25 percent to 50 percent, of that old debt.<sup>79</sup>

## V. TAG TEAM COLLECTORS, DAISY CHAIN DEBT

To a consumer, a debt may seem like a simple—if painful—obligation. A bank or company that extended a loan seeks to get repaid.

But as the debt industry has metastasized into a confusing amalgam of big and small collectors, mysterious buyers and multifaceted law firms, debt has been transformed into a type of financial asset that frequently changes hands in giant portfolios.

So a beleaguered borrower being pressured to repay an overdue or disputed obligation is likely to wrestle against not just a single bank or creditor but an entire tag team of creditors, buyers, collectors and lawyers.

The results can be daunting. Collection calls and lawsuits may come from a dizzying array of corporate and legal entities. Claimants and claims may be unfamiliar or undecipherable to alleged debtors. Meanwhile,

collectors and lawyers may lack documentation of their ownership of those claims or of how the alleged obligations were incurred or computed.

### *An affidavit factory*

It promised to be no easy undertaking when, in May 2007, Jeanie Cole of Hill County, Mont., engaged a lawyer and set out to challenge the claim by Portfolio Recovery Associates, a New York debt buyer, that it owned and had the right to pursue a \$5,900 claim against Cole.

Nine months earlier, Portfolio Recovery had sued Cole claiming that \$5,900 was the balance on an inactive account left over from when she had held a credit card from Providian National Bank. In response to Cole’s challenge, Portfolio Recovery produced a notarized affidavit signed by a Providian representative named Martha Kunkle affirming that in December 2005 Providian had sold Portfolio Recovery its right to collect from Cole the money Providian had lent her years ago.

Then things got odd. Cole, with the aid of her lawyers, discovered another affidavit from Providian that was also signed by Martha Kunkle—but in different handwriting. After Cole’s lawyer pointed out the discrepancy, a judge ordered Portfolio Recovery to produce Kunkle and the notary for her depositions. When, after 16 months, Portfolio Recovery still hadn’t produced Kunkle or the notary, the judge threw out the company’s lawsuit and hit it with \$6,000 in sanctions.

Cole didn’t stop. She next filed a federal lawsuit alleging violations of the FDCPA and the Racketeer Influenced Corrupt Organizations Act by Portfolio Recovery, a Colorado debt buyer called CACV LLC, a North Dakota collection law firm and two bank employees.

<sup>78</sup> Complaint for Permanent Injunction and other Equitable Relief, Federal Trade Commission vs. CompuCredit Corp. and Jefferson Capital Systems LLC, United States District Court for the Northern District of Georgia, Atlanta Division, 1:08-CV-1976.

<sup>79</sup> *Ibid.*, pp. 7-8.

Cole's lawsuit, which was later certified as a class action, describes the web of transactions that ensnared Cole and tens of thousands of other alleged debtors after Provident, a major credit card issuer, was acquired by Washington Mutual in October 2005. When Washington Mutual then sold charged-off credit card "receivables" to debt buyers like Portfolio Recovery and CACV, it faced the prospect of providing evidence to support collection efforts by the debt buyers.

Cole's lawsuit alleged that the bank came up with an unconventional, and illegal, solution. Washington Mutual "operated a false affidavit factory whereby hundreds of false and misleading affidavits were signed and notarized each day." The notary public sat between two other WaMu employees and notarized their affidavits" which they had been ordered to sign with Martha Kunkle's name.<sup>80</sup>

In March 2010, a federal magistrate in Montana gave final approval to a pair of settlements with the debt buyers who bought claims from WaMu in which 15,000 alleged debtors would be awarded settlements ranging from \$25 to \$555 each depending upon the types of notice they received and whether they contested debt lawsuits.<sup>81</sup>

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<sup>80</sup> See Seconded Amended Complaint filed March 9, 2009 in *Jeanie Cole, et al vs. Portfolio Recovery Associates LLC*, 2008cv00036, in U.S. District Court for the District of Montana, Great Falls Division.

<sup>81</sup> See Final Order and Judgment and Final Order and Judgment as to Defendants CACV of Colorado LLC and CACH LLC,, both issued March 19, 2010 in *Jeanie Cole, et al vs. Portfolio Recovery Associates LLC*, 2008cv00036, in U.S. District Court for the District of Montana, Great Falls Division.

### *An industry lags*

The problems exposed by Cole's lawsuit are the tip of an iceberg. With billions of dollars of debt obligations, legal claims and judgments changing hands each year, volume has far outstripped the record-keeping capability and commitment of the debt machine. Meanwhile, the industry has failed to invest to create the infrastructure necessary to keep track of vital information about the "receivables" that pass between collectors, debt buyers and lawyers.

As a result, debt buyers pursuing a claim rarely have the application for the credit card that supposedly was the source of that claim. Nor are debt buyers likely to have a copy of a signed contract, charge slips, records of payments or disputes or a written assignment of the claim.<sup>82</sup>

"When accounts are transferred to debt collectors, the accompanying information often is so deficient that the collectors seek payment from the wrong consumer or demand the wrong amount from the correct consumer," an FTC workshop found.<sup>83</sup> A debt buyer commonly gets "only a computerized summary of the creditor's business records when it purchases a portfolio."<sup>84</sup>

An industry newsletter recently described the resulting chaos. Debt passes among collectors and buyers. Each may use hardware and software that is different from and incompatible with that of other firms. Paper records don't always follow or "may have been damaged, miscopied or otherwise (be) incorrect."

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<sup>82</sup> See *Fair Debt Collection* by National Consumer Law Center, 2008, Sixth Edition, p. 9.

<sup>83</sup> See "Collecting Consumer Debts: The Challenges of Change," a Workshop Report from the Federal Trade Commission, February 2009, p. 22.

<sup>84</sup> *Ibid.*

That leaves collectors trying to document the validity of a debt “at the mercy of a wayward box of files.”<sup>85</sup>

Consumers’ rights are compromised as obligations pass through the debt selling bazaars. Elusive or missing records can present a serious obstacle to consumers seeking to recognize, question or challenge a claim that they owe a debt. And even when an obligation appears settled, consumers may find themselves still pursued by a new corporate adversary who has jumped into the ring.

Just how crazy it gets was illustrated recently when a New Jersey judge threw out a \$17,492 judgment against the holder of a Chevy Chase Bank Visa card after a lawyer for the debt buyer pursuing the claim attempted to prove its validity by using a Wikipedia page about J.P. Morgan & Co.’s 2004 purchase of Bank One. Noting that it was “entirely possible for a party in litigation to alter a Wikipedia article, print the article, and thereafter offer it in court in support of any given position,” the appeals court ruled the debt buyer had not proved the validity of its claim. The court also noted that the debt buyer’s lawyer testified that he had personally reviewed a bill of sale for the debt that had been delivered in a compact disc, but that compact disc had not been entered in evidence.<sup>86</sup>

In February, a district court judge in Nassau County, New York slapped a large debt

collection law firm with \$14,800 in sanctions after a consumer challenged what the judge characterized as typical abuses in the operations of the debt machine. In August 2004 the law firm of Eltman, Eltman & Cooper had sued Patricia Bohnet, a bookkeeper for a charity, on behalf of a debt buyer, Erin Services Co., that had purchased a debt that Bohnet allegedly owed to credit card issuer First USA. The collection complaint included an affidavit claiming that Bohnet had been personally served at an address that she had moved away from six years earlier, and a default judgment was entered in October 2004. But after Bohnet went to court to dispute the debt, Judge Michael Ciaffa found that the collection firm had “failed to provide a scintilla of evidence that defendant was actually indebted to First USA many years ago, or that (the debt buyer) acquired a lawful assignment of a bona fide debt.” The judge also wrote in his decision that lawyers representing debt buyers “seem especially prone to pursuing claims improperly, often at the expense of the most vulnerable members of our society.”<sup>87</sup>

Sometimes the victims of the industry chaos are other debt buyers. In November 2009, Florida debt buyer Steven Goldberg pled guilty to counts of wire fraud and mail fraud and was sentenced to 71 months in prison. Goldberg admitted as part of a plea deal that he had broken promises to pay \$13.6 million to buy 94,000 consumer debt accounts from creditors and collectors. Then, without even

<sup>85</sup> “Debt Portfolio Registration Services Fill an Operational and Regulatory Gap,” InsideARM, July 22, 2009.

<sup>86</sup> See Superior Court of New Jersey, Appellate Division, Docket No. A-1388-07T31338-07T3, Palisades Collection LLC v. Steven Graubard, per curiam, posted on-line at [lawlibrary.rutgers.edu/courts/appellate/a1338-07.opn.html](http://lawlibrary.rutgers.edu/courts/appellate/a1338-07.opn.html).

<sup>87</sup> See Linda Almonte v. JP Morgan Chase Bank NA, Cause No. 2010ci02947, in the District Court of Bexar County, Texas, Plaintiff’s Original Petition filed Feb. 22, 2010; “Ex-Chase VP sues over her firing” by Patrick Danner in the San Antonio Express-News, March 4, 2010, p. 1C.

getting titles to those claims, he had pocketed \$2.8 million by reselling some of those accounts to other debt buyers.<sup>88</sup>

Some states have begun to address this problem. In North Carolina, the Consumer Economic Protection Act of 2009 requires that debt buyers document their ownership of a claim, the terms of the contract, the amount and the original creditor, and itemize all fees and charges.<sup>89</sup>

The FTC has also addressed the issue. In September 2008, the FTC accused Bear Stearns, an investment bank acquired by JPMorgan Chase in 2008, of “paying inadequate attention to the integrity of consumers’ loan information” in a portfolio of 475,000 mostly subprime mortgage loans that it serviced and securitized.<sup>90</sup>

The agency alleged that Bear Stearns violated the FDCPA as well as lending laws when it “neglected to obtain timely and accurate information on consumers’ loans, made inaccurate claims to consumers and engaged in unlawful collection and servicing practices.” The FTC also alleged that Bear Stearns’ servicing unit routinely made collection calls and sent collection notices “before it has obtained complete loan information from the seller and before it

<sup>88</sup> See Sentencing Minutes filed Nov. 13, 2009 and Factual Proffer Supporting Change of Plea filed Aug. 14, 2009 in United States of America vs. Steven Goldberg, 2009cr80030, in U.S. District Court, Southern District of Florida.

<sup>89</sup> See Consumer Economic Protection Act of 2009 posted on-line at <http://www.ncleg.net/EnactedLegislation/SessionLaws/PDF/2009-2010/SL2009-573.pdf>.

<sup>90</sup> Plaintiff Federal Trade Commission’s Complaint for Permanent Injunction and Other Equitable Relief in Federal Trade Commission v. EMC Mortgage Corp. and the Bear Stearns Companies, U.S. District Court for the Eastern District of Texas, Sept. 9, 2008, pp. 3-4.

has conducted quality control and other data integrity checks to ensure the accuracy of the representations it makes to borrowers.”<sup>91</sup>

Bear Stearns paid \$28 million “to redress consumers” and was ordered to “possess and rely upon competent and reliable evidence to support claims made to consumers about their loans.”<sup>92</sup>

That order caught the attention of debt collectors and buyers. An article in a trade publication characterized the decision as “the most important regulatory action to impact the ARM (debt collection) industry since the passage of the Fair Debt Collection Practices Act.” The article warned collectors that “changes are required in the whole process of buying/selling debt” to ensure that the chain of title can be verified and that holders of claims can have access to records of loan agreements and account statements.<sup>93</sup>

## VI. RECOMMENDATIONS

Robust consumer protections are needed to ensure that debtors’ rights are respected throughout the collection process, beginning when collectors contact consumers, and continuing through court and arbitration proceedings and as judgments are enforced.

Over the past decade, the debt industry grew rapidly in reach, clout and resources. Yet until the current crisis, debt industry leaders

<sup>91</sup> Ibid, p. 5.

<sup>92</sup> “Bear Stearns and EMC Mortgage to Pay \$28 Million to Settle FTC Charges of Unlawful Mortgage and Debt Collection Practices,” release from Federal Trade Commission, Sept. 9, 2008.

<sup>93</sup> “\$28 Million FTC Settlement with Bear Stearns/EMC has Significant Impact on ARM Industry” by David Mertz, InsideARM, Oct. 16, 2008.

and some government officials shrugged off calls for stronger consumer protections or expressed their preference for “self-regulation.”

But others saw that the party had to end. As one debt buyer warned his peers in early 2008, “If we don’t regulate ourselves, somebody is going to come in and regulate us for us.”<sup>94</sup>

The time for intervention is now at hand. Recent exposures of excesses, abuses and conflicts of interest have demonstrated a need for change that even many in the industry find themselves hard-pressed to deny. That has created an unusual opportunity to enact substantial reforms and ensure that strong consumer protections are part of any plan to repair a broken industry.

Effective reform must ensure that all players in the debt industry are bound by the rule of law, principles of fairness and respect for individual consumers. Anything less will only contribute to lingering economic stagnation and the financial devastation of millions of households.

The Federal Trade Commission recently called upon Congress to update the 33-year-old Fair Debt Collection Practices Act.<sup>95</sup> **The National Consumer Law Center joins in that call and recommends that, in order to both update and strengthen the FDCPA, it be amended to:**

- give consumers the right to record collection calls, so that collectors can be

<sup>94</sup> Stacey Schachter, an executive of Outsourcing Solutions Inc., a debt collection firm later acquired by NCO Group, speaking at the DBA International conference in Las Vegas in February 2008.

<sup>95</sup> FTC, *Collecting Consumer Debts: The Challenges of Change—A Workshop Report* (Feb. 2009), available at [www.ftc.gov/bcp/workshops/debtcollection/dcwr.pdf](http://www.ftc.gov/bcp/workshops/debtcollection/dcwr.pdf).

made accountable for their illegal use of insulting and obscene language.

- increase to at least \$5,000 the statutory damages that can be awarded to abused consumers and allow courts to award statutory damages for each violation so that the bad apples pay for multiple offenses. This increase is needed to offset the effect of inflation since the law was passed.
- base class action damages on a collector’s revenue, not manipulated net worth computations, so that debt collectors will begin to pay attention to consumer complaints about their unresponsive and abusive practices.
- prohibit confidentiality requirements for all settlements of consumer claims so that rogue debt collectors are held accountable for their disregard of the law.
- require that debt collectors, before initiating collection efforts, possess certain basic information about the debt including, at the minimum: (1) proof of indebtedness; (2) the date that the debt was incurred and the date of the last payment; (3) the identity of the original creditor as known to the consumer; (4) 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; and (5) the chain of title if the debt has been sold.
- require that debt collectors, before filing a complaint, possess the basic information listed above in a form admissible in the court, certify that fact in the

complaint, and certify to the court or arbitrator that the collector possesses any license required by state law.

- require that 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 parties.
- require that initial written communication to the consumer should include the name of the original extender of credit, as well as an itemization of fees and interest included in the debt.
- require that when a consumer requests verification of the debt, collectors verify with a reasonable investigation that is responsive to the consumer's specific dispute.
- require that collectors disclose to a consumer that she or he cannot be sued when the collector seeks payment for a time barred debt.
- require that debt collectors inform consumers of their right to have the collector cease communications and consumers are allowed to exercise this right orally.

- limit to statutory damages the application of the FDCPA bona fide error defense for debt collectors, so that a consumer can recover actual damages, such as illegal fees that she or he paid.

**Congress should also make permanent the recent breakthrough in the struggle to end binding mandatory arbitration.** Mandatory predispute arbitration clauses should be banned from all consumer credit contracts (as called for by the Arbitration Fairness Act of 2009).

## VII. CONCLUSION

It is time to reshape the debt collection industry upon a foundation that includes effective prohibitions on abusive collections and shuts down “legal” assembly lines that mass produce judgments against alleged debtors.

The growth of consumer credit leads to the growth in consumer debt, and in collections. The failure to rein in collection abuses with effective consumer protection laws and oversight by regulators will block households and the economy from reaping the potential benefits of available and reasonably priced consumer credit.

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## APPENDIX

A limited window into the wealth and power of the debt industry comes from the securities filings of five debt companies as well as some other securities filings and reports from industry publications.

The industry has a massive appetite for debt. In 2009, five companies that disclosed results in filings to the Securities and Exchange Commission—Asset Acceptance, Encore Capital, Portfolio Recovery, Asta Funding and NCO Group—paid \$744 million to acquire debt receivables purportedly owed by consumers with a combined face value of about \$24 billion.

Similarly, *Collections and Credit Risk Magazine* reported that in 2008 a group of seven companies—including those five and two others: Sherman Financial Group and Unifund—purchased debt with a combined face value of \$42 billion.

The disclosures also show big banks' financial stakes in the debt industry. Most notably, JPMorgan Chase is the majority owner of NCO Group and leads or participates in bank groups that in 2009 provided more than \$940 million in loans and credit lines to three other debt firms.

### Some Large Debt Companies 2009

COMPANY	STOCK SYMBOL	HEADQUARTERS	NUMBER OF COLLECTORS	ANNUAL REVENUE (\$MILLION)	NET INCOME (\$MILLION)	FACE VALUE OF DEBT PURCHASED, (\$MILLION)
Sherman Financial Group	na	Greenville, S.C.	not disclosed	\$1,245.7	\$135.6	not disclosed
Asset Acceptance Capital Corp.	AACC	Warren, Mich.	1,009	\$ 171.3	\$(16.4)	\$4,459.8
Encore Capital Group	ECPG	San Diego, Calif.	888	\$ 316.4	\$ 33.0	\$6,500.0
Portfolio Recovery Associates	PRAA	Norfolk, Va.	1,903	\$ 281.1	\$ 44.3	\$8,109.7
Asta Funding	ASFI	Englewood Cliffs, N.J.	105 total employees	\$ 70.3	\$(90.7)	\$ 577.0
NCO Group	na	Horsham, Pa.	19,100	\$1,563.9	\$(84.2)	\$4,300.0

Sources: Filings by companies with Securities and Exchange Commission; also filings by Radian Group Inc.

Some Large Debt Companies 2009 (continued)

EXPEN- DITURE ON DEBT, (\$MILLION)	COLLECTIONS RECEIPTS (\$MILLION)	YEAR	FINANCING	OWNERSHIP
not disclosed	not disclosed	2009	not disclosed	Sherman Capital LLC and Meeting Street Partners II own "all outstanding membership interests" in SFG, according to an SEC filing by Radian Group Inc. in May 2010 when it sold its 28.7 ownership stake to those entities for \$172 million.
\$121.9	\$334.0	2009	<b>JPMorgan Chase</b> administers syndicate that provides \$100 million revolving credit and \$150 million term loan	35.7 percent by <b>Quad-C Management</b> , a Charlottesville, Va., investment company; 16.1 percent by <b>D3 Family Funds LP</b> , an investment company founded by David Nierenberg; 12.3 percent by <b>CEO Nathaniel F. Bradley IV</b> ; and 11 percent by <b>Heartland Advisors</b> , an investment company founded by William Nasgovitz
\$256.6	\$487.8	2009	<b>JPMorgan Chase</b> administers syndicate that provides \$327.5 million revolving credit	24.9 percent by funds controlled by <b>J. Christopher Flowers</b> ; 14.9 percent by <b>Red Mountain Capital Partners</b> ; 10.7 percent by <b>Heartland Advisors</b> ; 7.2 percent by <b>Dimensional Fund Advisors</b> (2009 proxy, need to update)
\$288.9	\$433.5	2009	Group of banks including <b>Bank of America, Wachovia, RBC Centura, SunTrust</b> and <b>JPMorgan Chase</b> provide a \$365 million line of credit.	10.2 percent by <b>Capital Research Global Investors</b> ; 6.9 percent by <b>BlackRock Inc</b> ; 6.7 percent by <b>Waddell &amp; Reed Financial</b> ; 5.4 percent by Riverbridge Partners.
\$19.6	not disclosed	2009	<b>Bank Leumi</b> provides \$6 million revolving credit line	25.4 percent by entities related to the family of CEO <b>Gary Stern</b> ; 12.6 percent by <b>Peters MacGregor Capital Management</b> ; 9.2 percent by <b>Private Capital Management</b> ; 5.9 percent by <b>Wellington Management Co.</b> ; 5.7 percent by <b>First Wilshire Securities Management</b>
\$56.6	\$1,246.6	2009	<b>Morgan Stanley</b> administers syndicate that provides \$569 million term loan and \$100 million revolving credit	80.0 percent by affiliates of <b>JPMorgan Chase</b> ; 6.0 percent by affiliates of <b>Citigroup</b>

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