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FINANCIAL SERVICES

ALERT

CAVEAT EMPTOR: BUYERS OF CONSUMER DEBTS THAT ARE IN DEFAULT MAY BE SUBJECT TO GREATER SCRUTINY UNDER FEDERAL LAW

By Ronald J. Shaffer

Companies that service, collect, or acquire debts in their business must be very careful regarding their obligations under the federal Fair Debt Collection Practices Act (FDCPA), 15 U.S.C. §§ 1692 *et seq.* and other federal statutes. A recent court ruling has helped to define the previously broad terms of "creditor" and "debt collector" - making companies that purchase consumer debts already in default "debt collectors" subject to the FDCPA.

The Fair Debt Collection Practices Act

The FDCPA protects consumers from unfair, harassing, and deceptive debt collection practices by debt collectors. These prohibited practices include threats of violence, use of obscene language, certain contacts with acquaintances of the consumer, late night telephone calls, threatened law suits, and confusing or deceptive collection letters. FDCPA provisions generally apply only to debt collectors.

Under the FDCPA, a "debt collector" is broadly defined as one who attempts to collect debts owed to someone else. A "creditor" is not generally subject to the FDCPA and is defined as one who "offers or extends … credit creating a debt or [one] to whom a debt is owed." One cannot be both a creditor and a debt collector with regard to the same debt under the FDCPA. The distinction between a "debt collector," who is subject to the FDCPA, and a "creditor," who is not subject to the FDCPA, is critical and continuing to evolve, as reflected in this latest ruling.

Federal Trade Commission v. Check Investors, Inc.

A recent case in the United States Court of Appeals in Philadelphia, *Federal Trade Commission v. Check Investors, Inc.* , ___ F.3d ___, 2007 WL 2505589 (3d Cir. 2007), has clarified the differences between a creditor and debt collector under the FDCPA.

In *Check Investors*, a company that purchased consumer checks that were returned for not sufficient funds (NSF) was held to be a debt collector even though the company owned the NSF checks and was attempting to collect on its own behalf. Check Investors was in the business of purchasing millions of dollars worth of checks written on accounts with insufficient funds. The company purchased these checks, which arose from consumer transactions, from several check guarantee companies such as Telecheck. When checks are dishonored, Telecheck pays the merchant the full face value of the NSF check, so the merchant has no need to attempt to collect from the customer on its own behalf. If unsuccessful in attempting to collect on the NSF checks, Telecheck sells the rights it acquired from the original merchant to Check Investors for pennies on the dollar.

After purchasing the NSF checks, Check Investors engaged in offensive and abusive collection efforts. The company accused consumers in letters and telephone calls of being criminals and crooks, threatened legal action and arrest, made multiple harassing calls in short periods of time, and called at all hours of the day and

night. Check Investors told one consumer that if she did not pay, her children would "watch their mother being taken away in handcuffs" and they would "be bringing their mommy care packages in prison." Check Investors' threats of prosecution were all false. The company never sued anyone nor sought prosecution because of the small amount of most NSF checks. Check Investors also added a fee of $125 or $130 to each NSF check it purchased and sought to collect. The fee exceeded the face amount of many of the checks and was illegal in most states.

The FTC brought an action against Check Investors seeking to enjoin its abusive and unfair collection activities under the FDCPA and for restitution. Check Investors claimed it was not subject to the FDCPA because: 1) NSF checks were not "debts;" 2) individuals that bounce checks are not "consumers" but rather criminals and tortfeasors; and 3) Check Investors was not a "debt collector," but rather a "creditor" because it owned the NSF checks and was seeking to collect on its own behalf, not on behalf of another. The lower court granted summary judgment on behalf of the FTC, and Check Investors appealed.

The Court of Appeals rejected all three of Check Investors' arguments. The Court reasoned that because a check evidences an obligation to pay for goods or services, it falls within the definition of a "debt" under the FDCPA, even if the individual never intended to pay for the goods and services and knew the check was bad at the time it was written. The Court also held that an individual that writes a bad check is still a "consumer" under the FDCPA even though the intentional issuance of a bad check is a crime in many states and is fraudulent. The FDCPA defines a "consumer" as "any natural person obligated …to pay any debt." The protections of the FDCPA do not distinguish between deserving and undeserving consumers.

Finally, the Court held that Check Investors was a "debt collector" even though it owned the debt and sought to collect on its own behalf. Although Check Investors' status was similar to a creditor, the significant fact was that it purchased the "debt" (NSF checks) after they went into default. The Court of Appeals held that a purchaser of an obligation is not a "debt collector" if the obligation is not in default at the time of assignment or sale. On the other hand, a purchaser may be deemed a "debt collector" if the obligation is already in default when it is assigned or purchased. In this case, since Check Investors purchased NSF checks which by their very nature are already in default, the company was a debt collector subject to the FDCPA.

Businesses Beware

The FDCPA outlines strict and technical requirements in the collection of debts. Any company engaged in such activities must take care in communications between the debt collector and the consumer. The FDCPA is a virtual strict liability statute that also provides for recovery of attorneys' fees and costs to a successful plaintiff. The courts broadly construe these statutes to provide protection to consumers, often at the expense of businesses. Unfortunately, bad cases involving outrageous collection activities provide the rationale for many broad decisions in this area.

Fox Rothschild advises clients on FDCPA matters and other issues critical to financial institutions. For more information on how we serve our clients, please visit us on the web at www.foxrothschild.com.

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