Does the FDCPA Cover a Party That Purchases Defaulted Debt for Its Own Account?

CASE AT A GLANCE

The scope of the Fair Debt Collection Practices Act (FDCPA) is the subject of one Supreme Court case last Term and another two this Term. Last Term, in *Sheriff v. Gillie,* 136 S. Ct. 1594 (2016), the Court determined that outside lawyers and law firms delegated by Ohio with the authority to collect governmental debts did not act deceptively when counsel used, as required, the state attorney general's official letterhead. In *Midland Funding, LLC v. Johnson,* which was argued on January 17, 2017, the Court was asked to decide whether the filing of a proof of claim in a bankruptcy case for a time-barred debt violates the FDCPA. Generally, a claim that is unenforceable under state law is subject to disallowance in a bankruptcy case. The *Midland Funding* case addresses whether specific *conduct* triggers the FDCPA: specifically, whether the act of filing a proof of claim for a stale debt is a deceptive or unfair means to collect the debt. The *Santander Consumer* case, on the other hand, examines a party's *status* as a "debt collector." The FDCPA generally distinguishes between a creditor—the party that makes the original loan—and a debt collector that is pursuing the payment of debts owed or due to another. Only the latter are subject to the FDCPA. The courts are uncertain, however, whether a party that acquires defaulted debt from the original lender, and then demands payment for its own purse, is likewise exempt from the reach of the FDCPA.

Henson v. Santander Consumer USA, Inc.
Docket No. 16-349

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INTRODUCTION

The Fair Debt Collection Practices Act (FDCPA) rests on a policy determination by Congress that original lenders, concerned about reputational harm, act with greater self-restraint when collecting consumer debts. Independent debt collectors, on the other hand, have little reason to be concerned either with future business or a consumer's opinion of them and, hence, lack similar incentives to modulate aggressive collection conduct. Thus, the FDCPA only regulates the collection practices of two defined classes of "debt collectors": those whose "principal purpose" is the collection of debts, and those who regularly collect debts "owed or due another." It does help to note that the definition of a debt collector also includes a third category. A creditor (a party to whom a debt is owed) will be treated as a debt collector under the FDCPA if it uses any name other than its own to collect its debts—a practice that might be rather misleading to consumers because it would tend to deflect any sharp practices away from the creditor. Although this article generally differentiates between a creditor (i.e., an original lender, typically not subject to the FDCPA) and a debt collector, the FDCPA itself does not render those terms mutually exclusive.

Lenders who initiate and collect their own loans are not covered by the FDCPA. Most lenders engage in a varied mix of business pursuits, only one of which involves debt collection. As a result, the "principal purpose" of a full-service finance company or bank is usually not debt collection. Recently, the business of buying defaulted consumer debt at deep discounts has grown explosively. In some instances, the purchasers are parties who previously serviced and collected the loans on behalf of the original lender (often as part of a securitization arrangement where individual loans are aggregated and sold to investors). As servicers for debts "owed or due another," these parties may sometimes qualify as debt collectors under the FDCPA. But, if they subsequently buy the debt for their own account, they arguably are no longer acting on behalf of another party. Are these parties purchasing debt for pennies on the dollar merely to evade the FDCPA? Or, alternatively, do the "original lender" incentives (to protect their good standing in the community) travel with the acquisition so that purchasers would not be expected to engage in aggressive collection practices?

ISSUE

Is a party that acquires defaulted debt for its own account treated as a "debt collector" or as a creditor for purposes of the Fair Debt Collection Practices Act?

FACTS

Santander Consumer USA acted as a loan servicer for car loans originated by CitiFinancial Auto, collecting payments from the borrowers and distributing the proceeds to the lender, among other administrative and record-keeping tasks. At the time it was hired, the loans were already in default and Santander was tasked with pursuing the deficiency balances from consumers following the lender's repossession of the cars. As a loan servicer for defaulted obligations "owed or due another," Santander qualified as a debt collector under the FDCPA. (No claim was made that Santander qualified under the second class of debt collectors, those whose "principal purpose" is the collection of debts.)

CitiFinancial, the original lender, later became embroiled in class-action litigation over its repossession practices. (The petitioners in this case were also members of the affected consumer class, which numbered over 3,000.) The parties to the class-action ultimately inked a settlement that, among other relief, resulted in the waiver of the outstanding car loan balances. After the class-action settlement was announced, but before it was finally approved, Santander purchased a $3.5 billion portfolio of loans from CitiFinancial, a portion of which included some of the defaulted debts that were part of the settlement (and which were slated to be extinguished by the settlement). Santander subsequently sought to collect these debts, despite its alleged knowledge that the pending settlement would eventually result in the waiver of any loan deficiencies. Santander was apparently successful in collecting partial payments from two of the petitioners.

The petitioners then commenced a class action claiming that Santander's collection efforts violated the FDCPA, codified at 15 U.S.C. §§ 1692, et seq. Santander filed a motion to dismiss the complaint on the grounds that, having acquired the debt for its own account, it was no longer a "debt collector" for purposes of the statute. The district court agreed. The Court of Appeals for the Fourth Circuit unanimously affirmed in March 2016, finding that the FDCPA does not regulate creditors when they collect assigned debt. According to the court, the FDCPA distinguishes between parties collecting debts "owed or due another" from those collecting their own debts—*whether or not purchased.* The class-action plaintiffs filed a petition for a writ of certiorari, which the U.S. Supreme Court granted on January 13, 2017. With the consent of the parties, various amici curiae have also filed briefs, including the National Consumer Law Center and the state of Oregon (joined by numerous other states).

CASE ANALYSIS

Congress enacted the FDCPA in 1977 in response to "abundant evidence" of abusive collection practices by independent debt collectors. It applies only to consumer debts incurred primarily for personal, family, or household purposes (thus, even though a debt may be incurred between natural persons, it is outside the scope of the FDCPA if the loan is intended for commercial uses). The FDCPA broadly prohibits any "false, deceptive, or misleading" representations to collect a debt and provides a nonexclusive list of sixteen types of communications that automatically qualify as misleading. The act also prohibits a debt collector from conduct that would "harass, oppress or abuse" any person to collect a debt, and lists six deemed violations of this prohibition. Last, the act prohibits any "unfair or unconscionable" means to collect a debt (with a further nonexclusive list of eight such practices). A violation of the FDCPA may subject a debt collector to liability for actual damages (including for emotional distress), statutory damages (deemed inclusive of any punitive damages, which are not otherwise permitted), and attorney's fees. The FDCPA expressly permits class actions. It is enforceable by private civil actions and by administrative proceedings on behalf of the Federal Trade Commission and the Consumer Finance Protection Bureau, among other agencies.

As with the *Midland Funding* case, the *Santander Consumer* case addresses whether players in the debt collection industry are exploiting gaps or ambiguities in the FDCPA to evade its requirements and escape its penalties. Conversely, some argue that the FDCPA has generated its own cottage industry of unscrupulous plaintiffs' attorneys grasping for technical violations in order to take advantage of the fee-shifting provisions of the statute.

It is unquestionably a violation of the FDCPA for a debt collector to commence a state court action to pursue a debt that is barred under the applicable statute of limitation. Filing a proof of claim for the same obligation in a bankruptcy case would likewise appear to run afoul of the FDCPA, even though such a claim is subject to routine disallowance by the bankruptcy court upon objection by a party in interest. Yet, because a proof of claim is deemed allowed *unless* an objection is heard, debt collectors may be taking advantage of the fact that there often is no party with a meaningful economic stake in the outcome of the dispute (a stake that, at minimum, must justify the fees incurred to prosecute an objection). Moreover, it often may be unclear from a proof of claim whether an applicable limitations period has in fact expired, heightening the prospect that some invalid claims may slip through the cracks. In many cases, it may be true that it is cheaper to pay the stale debt than propel the wheels of due process. In that event, if partial payments are in fact made on a time-barred claim, the otherwise stale debt may be revived under some state laws. If so, and the debtor's repayment plan then fails to be consummated (and the majority of chapter 13 plans do in fact fail before completion), the debtor will not receive a discharge and the debt collector may then freely pursue the previously unenforceable obligation.

Similarly, a party that services defaulted loans originated by another is unquestionably a debt collector under the FDCPA. If that same party then purchases the obligations, and employs methods that would otherwise be penalized under the FDCPA, can it exempt itself from the FDCPA merely by the fact of purchase—even for a fraction of the face amount of the loan? In both cases, it appears that parties may be "gaming the system" to pursue the payment of debts by methods that would otherwise trigger the FDCPA.

Is there a bright line that distinguishes between those that collect the debts of another and those that collect their own debts? The Fourth Circuit believed there was and, as a result, did not delve into the various exceptions and counter-exceptions to the definition of a debt collector under the FDCPA. In the court's view, if Santander did not facially qualify as a debt collector (by virtue of its ownership of the debt), there was no reason to determine whether an exception to that status applied. The petitioners assert that the Fourth Circuit erred, first, by overlooking ambiguity in the phrase "owed or due another" (which is not defined in the FDCPA) and, second, by ignoring the overall purpose and policy of the FDCPA.

First, the term "owed or due" suggests, according to petitioners, that a debt can *both* be "owed" to one party (for instance, the loan originator) and "due" to another party (an assignee). This construction is valid, they assert, because the "owed or due" phrasing is not tied to a particular point in time (instead of "owing," the statute uses the term "owed," which implies a wider time frame). Hence, a debt may have been owed to the original lender at the moment the loan was made and later become due to an assignee when the loan is purchased. Under this analysis, an assignee would still be a debt collector for purposes of the statute (as long as it otherwise "regularly" engaged in collection activities) because it was seeking payment of a debt that was previously owed to another. In other words, an assignee would remain a debt collector insofar as it was pursuing payment of debts owed *at some prior point in time* to another party. (Respondents argue that, "as a matter of basic grammar," whether the debts are "due another" should be assessed strictly as of the time of collection.)

Moreover, the definitional structure of the FDCPA indicates that qualification as a debt collector under the "owed or due another" prong does not necessarily end the inquiry. The petitioners urge the Court to engage in a holistic endeavor to construe the FDCPA (a task the respondents deride as a "statutory egg hunt"). For petitioners, the exceptions and exclusions to the definition of a debt collector are critical contextual clues. Specifically, they observe that the phrase "owed or due another" appears both in the general definition of a debt collector and in various exceptions to the definition of a debt collector under § 1692a(6)(F) of the statute. That section excludes, among others, those who acquire a debt in their capacity as a secured party (in other words, following the default of their obligor to whom a third-party debt is owed). This exception suggests that a party can both obtain a debt (by enforcement of a security interest) and be collecting the debt of another—a prospect that the Fourth Circuit's plain text analysis would not easily accommodate.

Additionally, if a party *obtains* a debt that was not then "in default," it too is excluded from the definition of a debt collector by § 1692a (6)(F). According to petitioners, if that exception has any vitality, it must necessarily render into debt collectors those who obtain a debt *after* default (as Santander did in this case). The Fourth Circuit rejected this argument stating that it was based on "upside-down logic that relies on an inaccurate premise and a negative pregnant that does not follow." Simply put, exclusions are just that, not additions.

The petitioners emphasize, however, that each of the exceptions enumerated in § 1692a(6)(F) applies to a person that is collecting or attempting to collect a debt "owed or due another." Thus, the statute both includes as debt collectors those collecting a debt "due another" and, elsewhere, excludes other persons collecting a debt "due another." This internal conflict suggests that the "combined gist" of the exceptions and counter-exceptions is critical to the scope of the predicate definition. According to petitioners, the Fourth Circuit's bright line, thus, is not as pellucid as it appears.

Petitioners also point out that the FDCPA regulates a debt collector pursuing payment of "any" debt—an inclusive term that does not distinguish between acquired debts or collections on behalf of another. The Fourth Circuit rejected the argument that Santander was a debt collector because it simultaneously pursued collection of both types of obligations. Thus, Santander would not be a debt collector with respect to the subset of purchased debts, yet could remain a debt collector with respect to a different subset of serviced debts. The petitioners argue that this distinction finds no support in the FDCPA because a debt collector is treated as such with respect to the collection of "any" debt. Thus, if Santander is a debt collector for one purpose under the statute (serviced debts) it should be viewed as a debt collector for all purposes (serviced as well as purchased debts).

Second, turning to their policy argument, the petitioners stress that the purpose of the FDCPA would be undermined if Santander could, merely by the fact of purchase, evade the rigors of the act. According to the petitioners, buyers of defaulted debt are "virtually indistinguishable" from servicers of defaulted debt that are plainly within the FDCPA's compass. (Debt buyers, of course, may be treated as debt collectors if they meet the alternative "principal purpose" prong of the general definition under the FDCPA.) In the current debt-purchasing market (populated by hedge funds and special investment vehicles), petitioners claim that such buyers are likely indifferent to a consumer's future business.

Indeed, it would not be remarkable to infer that a buyer acquiring defaulted loans for a fraction of their face amount may lack the "original lender" incentives that support the FDCPA's distinction between creditors and debt collectors. A buyer under these circumstances may have so little invested in each loan that a consumer's goodwill is probably irrelevant. In fact, the petitioners emphasize that pure loan servicers are subject to influence by the originator since it would not want the servicer's abusive conduct attributed to it. Yet, following an acquisition, that relationship is untethered implying that the buyer will be less likely to fall under the originator's sway and more likely to behave like a true debt collector. In that scenario, the risks to consumers are heightened following a purchase, not diminished.

Petitioners also assert that parties could employ the Fourth Circuit's decision as a "roadmap" to evade the FDCPA. For instance, large debt buyers could diversify their business sufficiently to fall outside the "principal purpose" test. Moreover, as petitioners point out, if a party purchased debt but agreed to share recoveries with the seller (perhaps even the loan originator, and perhaps even on the same financial terms that previously applied as a debt collector), shouldn't such a party still be treated as a debt collector despite the "transfer" of title to the acquired loan? On this point, respondents counter that the statute explicitly addresses persons who acquire full ownership of a debt but remain obligated to remit payments back to the seller. Under § 1692a(4), such persons are *excluded* from the definition of a creditor (who otherwise are not treated as debt collectors) insofar as they receive "an assignment or transfer of a debt in default solely for the purpose of facilitating collection of such debt for another."

Santander's argument focuses on the foundational distinction between a debt collector (one who pursues the debt of another) and a creditor (one to whom a debt is owed). Was Santander collecting a debt on behalf of another or for its own account? According to respondents, this should be the beginning and the end of the inquiry. The respondents flatly reject the notion that the phrase "owed or due another" can embrace more than one party at different points in time, i.e., owed to lender when funded and due to collector when paid. Calling it a "profoundly atextual interpretation," respondents point out that not a single court has adopted the view that a debt may simultaneously be owing to one party yet due to another party. Basic rules of grammar indicate that the phrase "owed or due" contemplates a present tense assessment. And, Supreme Court precedent holds that a "statutorily required status should be assessed as of the time of the principal action in the statute at issue." If that rule of construction is followed, then an entity that has purchased a debt and seeks to collect it for its own account is seeking to collect a debt owed itself, not a debt owed to another. What matters, thus, is the time of collection, not the earlier point of origination.

Moreover, because Congress could easily have said what it meant if it had wanted a debt collector to encompass all persons that acquired loans, whether immediately or intermediately, from the originator, it was natural to conclude that the statute as written did *not* encompass such persons. In fact, elsewhere in the FDCPA, the statute distinguishes between the "original creditor" and a "current creditor," further evincing Congress's ability to refer to different points in time if warranted. In addition, the respondents point out that the words "owed or due" are not necessarily interchangeable—a debt can be owed to a lender but not yet due if it has a future maturity date. Thus, "owed or due" does not necessarily contemplate multiple parties at different points in time: it simply reflects that a single obligation may be owed but not yet overdue.

For respondents, the petitioner's construction is especially strained because, following a debt purchase, a reasonable debtor would probably not care that the debt was previously owed to the seller—the only relevant question would be the identity of the buyer that holds the enforceable right to payment at the time of collection. After all, even an unsophisticated debtor would not seriously expect that, having paid the person to whom the debt was currently due, he or she also retained an outstanding obligation to the person to whom the debt was previously owed.

Respondents also refute the argument that internal statutory anomalies would surface if the acquisition of debt could exempt an otherwise covered debt collector from the rigors of the FDCPA. The scope of the FDCPA is structured in two interdependent parts—first, the statute defines who may qualify as a debt collector and, second, the statute excludes certain persons and activities from the definition of a debt collector. For respondents, there is no need to examine the exceptions without first passing through the threshold gate. An entity collecting debts owed for its own account is simply not collecting a debt owed or due another—a "plainer-than-plain" construction of the statute.

Even if, however, the definitional structure of the FDCPA were pertinent, the respondents point out that the various exceptions to the definition of a debt collector under § 1692a(6)(F) do not undermine the bedrock distinction between a creditor and a debt collector. The two exceptions for parties who "obtain" a debt prior to default or pursuant to a security interest do not reveal an anomaly, rather, they are consistent with the ordinary meaning of "obtain" and with congressional intent. Respondents argue that a party may obtain a debt without necessarily acquiring ownership. A secured party, for example, may obtain (and proceed to collect) accounts receivable without a transfer of title to the accounts. Additionally, Congress purposefully intended to exclude servicers from the definition of a debt collector "so long as the debts are not in default when taken for servicing." In that circumstance, a servicer may "obtain" the debt (as a result of being hired by the lender to pursue payment) despite the fact that the debt remains due to the lender. Even the petitioners concede that a servicer that obtains debt prior to default shares the reputational incentives of the original lender and, thus, is not classified as a debt collector. Santander, however, was hired after the debts had fallen into arrears and, thus, was a debt collector at the time it purchased the debts.

Finally, in response to the petitioners' policy arguments, respondents claim the plain text of the FDCPA is ample evidence of congressional purpose. The FDCPA was enacted in response to egregious debt collection practices by *independent* debt collectors; Congress was not concerned about regulating larger, more established creditors. The FDCPA adopts this policy determination by purposefully excluding banks, retailers, credit unions, and finance companies from the scope of the act. Each of these entities was presumed to have an interest in an ongoing relationship with the consumer.

The respondents flatly reject the petitioner's "musings" about the motivations and tactics of the debt-buying industry. As they aptly point out, most buyers and sellers of defaulted debt meet the "principal purpose" prong and, hence, are already treated as debt collectors. Respondents also debunk the notion that the Fourth Circuit's analysis provides a "road map" for crafty debt collectors to evade the FDCPA. According to respondents, an entity that is not subject to the FDCPA, and yet engages in abusive practices, would remain subject to the Dodd-Frank Act, the Federal Trade Commission Act, and the Fair Credit Reporting Act, among other statutes. Moreover, the states are free to enact or amend their own laws if they conclude the federal FDCPA is inadequate to protect consumers. (The states, however, contend that their laws either mirror the FDCPA or are interpreted with reference to the FDCPA, rendering the outcome of the case directly relevant to state regulators.) The respondents conclude by asking the Supreme Court to follow Congress's careful delineation between independent debt collectors pursuing amounts due to another and creditors pursuing obligations due themselves.

SIGNIFICANCE

The recent flurry of Supreme Court cases on the FDCPA seems to reflect the growth of the debt-buying industry. In fact, the *Midland Funding* case (on the question whether filing a proof of claim for a time-barred debt violates the FDCPA) was a rare instance where both parties agreed that certiorari should be granted in light of the numerous, and recent, divergent circuit-level decisions on the subject. As Santander observes, the industry for buying defaulted debt did not emerge until after the FDCPA was enacted in 1977. A parallel development is the "burgeoning cottage industry of FDCPA litigation." From the perspective of players in the debt-collection business, consumer lawyers continue to overreach in an effort to find minor violations that can support class-action status. From the consumer perspective, the debt-buying industry preys on unwitting borrowers (and other participants in the bankruptcy process) to make vast profits based on apathy or neglect.

The *Santander Consumer* case may fall somewhere in the middle. On the one hand, it appears that a well-respected company had advance knowledge that certain debts were due to be extinguished under a settlement and yet still pursued payment. But, the payment was for its own account—no foul. On the other hand, the plain text and the history of the FDCPA show that Congress was quite aware that creditors are different creatures than debt collectors. For the sake of certainty in the markets and curtailing frivolous litigation, a strong argument can be made that this distinction should be assiduously respected. The FDCPA's definitional structure and terminology are undoubtedly complex and susceptible to differing opinions. And, as the state amici argue, a definitive, national standard would have significant implications for existing state law (and, if debt buyers are not covered by the FDCPA, would point the way for further state legislation). In both *Midland Funding* and *Santander Consumer,* the Supreme Court now has a chance to provide needed clarity on two very important aspects of the FDCPA.

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PREVIEW of United States Supreme Court Cases, pages 218–222.

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