STAYING OUT OF FEDERAL COURT-
TIPS FOR LIMITING THE POTENTIAL FOR FDCPA EXPOSURE

By David M. Schultz and John M. Foley*

The Fair Debt Collection Practices Act (FDCPA) was enacted by Congress in 1977 to counteract "debt collection abuse by third party debt collectors", including such things as "obscene and profane language, threats of violence, telephone calls at unreasonable hours."[1] Another motivating factor in the passage of this law was the finding that "the vast majority of consumers who obtain credit fully intend to repay their debts."[2] Whether these findings remain true in this decade is highly questionable, but the fact remains that the FDCPA poses a legal and practical minefield for debt collectors, with substantial penalties for the slightest misstep.

The following overview is designed to assist in limiting the potential for common FDCPA violations which form the basis for federal class action lawsuits.

Overview of the FDCPA

Strict Liability with One Defense

The FDCPA is a strict liability statute, and intentional conduct is not required for liability.[3] Whether or not the debt is owed is also generally irrelevant. The deck is further stacked against debt collectors in this arena by the decisions holding that a debt collector's conduct or collection letters are not judged by the familiar standard of the "reasonable person", but rather by reference to what the "unsophisticated consumer" would believe. As explained by the Seventh Circuit, this standard is designed to protect the debtor who is "uninformed, naive or trusting" and presumes a level of sophistication that "is low, close to the bottom of the sophistication meter."[4] Courts have recently expanded the standard for FDCPA liability beyond an express violation of the statute's terms, and these cases hold that merely causing the unsophisticated consumer to be "confused" is sufficient to hold a debt collector liable.[5]

The sole affirmative defense under the statute, *bona fide* error, has two parts.[6] The debt collector must first establish that the violation was not intentional, usually not a difficult proposition. The second element requires a showing that "the error occurred notwithstanding the maintenance

---

[1]S. Rep. No. 382, 95th Cong., 1st Sess. 7 (1977), reprinted in 1977 U.S.C.C.A.N. 1695.

[2]*Id.*

[3]*Cavallaro v. Law Office of Shapiro & Kreisman*, 933 F. Supp. 1148 (E.D.N.Y. 1996).

[4]*Gammon v. GC Services, L.P.*, 27 F.3d 1254 (7th Cir. 1994).

[5]*Bartlett v. Heibl*, 128 F. 3d 497 (7th Cir. 1997).

[6]15 U.S.C. §1692k(c). *Jenkins v. Heintz*, 124 F.3d 824 (7th Cir. 1997).

of procedures reasonably adapted to avoid such error."[7] The simple belief that the conduct was legal, even if based on an attorney's review of the practice, will not suffice.[8] The *bona fide* error defense requires the existence of a verifiable procedure, preferably written, plus an explanation of how the procedural safeguards unintentionally failed to prevent the alleged violation.

Penalties for Non-Compliance

Each plaintiff in an individual FDCPA case is entitled to up to $1,000 plus attorneys fees and costs.[9] Thus, the statute creates a disincentive to defend questionable cases or to prolong litigation, because the debt collector who does so may wind up paying attorney fees which are far in excess of the maximum award to an individual debtor. Actual damages may also be awarded in these cases, but the Act's strict liability provisions and statutory penalties have had the practical effect of making claims for actual damages the exception, as opposed to the norm.

Class actions impose maximum penalties of a more serious nature. In addition to awarding the individual plaintiff up to $1,000 for serving as the class representative and requiring a losing debt collector to pay the attorneys' fees of the debtor, the FDCPA provides for an award to the class of up to 1% of the debt collector's net worth or $500,000, whichever is smaller.[10] Net worth is not defined in the FDCPA. As a generally statement, it may be defined as assets minus liabilities, according to GAAP standards.[11] In response to lawful accounting measures taken by debt collectors to lower their net worths, plaintiffs' attorneys have advanced a theory that net worth should be calculated from the point of view of the debt collector's cash flow, which is usually a much higher figure.[12]

Regardless of how the definition of "net worth" is defined, class certification class entitles a plaintiff to conduct discovery into a debt collector's finance, a proposition which is understandably disconcerting to many debt collectors. The FDCPA's fee-shifting provisions also result in the additional irony of the unsuccessful debt collector having to pay the plaintiff's attorneys to comb through the debt collector's private finances. For these obvious reasons, a small amount of prevention can often save debt collectors large exposure in such a suit. The following are some of the most common problems, and the most easily avoided.

---

[7]*Id.*

[8] *Baker v. GC Services Corp.*, 677 F.2d 775 (9th Cir. 1982).

[9]15 U.S.C. §1692k(a)(2)(A), §1692k(a)(3).

[10]15 U.S.C. §1692k(a)(2)(B),§1692k(a)(3)

[11]*Sanders v. Jackson*, 209 F. 3d 998 (7th Cir. 2000)

[12]*Scott v. Universal Fidelity*, 98 C 3659 (N.D. Ill. March 19, 1999)(Magistrate Judge Keys).

Common Avoidable Problems

Assume the Act Applies

Both attorney and non-attorney debt collectors fall within the scope of the FDCPA.[13] The key is whether a defendant acted as a "debt collector", defined in the statute as any person who regularly collects or attempts to collect debts, either directly or indirectly, which are owed to another person. The cases interpreting what constitutes "regular" debt collection activity have considered both the percentage of activity devoted to collections[14], and the total amount of activity.[15] As the Third Circuit aptly noted, anyone attempting to collect a debt owed to someone else "more than a handful of times per year" should presume that they are covered by the statute and comply with it.[16]

Assume that the Obligation is a "Debt"

The Act defines a "debt" expansively to include any obligation to pay money arising out of a transaction in which the subject of the transaction is to be used "primarily for personal, family or household purposes..."[17] Although business debts are obviously excluded, questions have arisen as to whether a "transaction" is required, and whether someone who purchases a debt and then seeks to collect now owns the debt so as to be excluded from the definition of "debt collector." The rulings have not been favorable to debt collectors.

The argument that an insufficient funds check did not constitute a "transaction" has been rejected, and courts have held that a returned or insufficient funds check is a "debt" within the FDCPA.[18] Courts have also rejected attempts by wily debt collector who purchase debts in default, and then seek to collect on their own behalf in order to circumvent the definition of "debt collector." The test is whether the debt was in default at the time it was assigned or purchased.[19] Condominium

---

[13]*Jenkins v. Heintz*, 514 U.S. 291 (1995).

[14]*Argentieri v. Fisher Landscapes, Inc.*, 27 F. Supp. 2d 84 (D. Mass. 1998).

[15]*Garrett v. Derbes*, 110 F. 3d 317, 318 (5th Cir. 1997)("if the volume of a person's debt collection activity is great enough, it is irrelevant that these services only amount to a small fraction of his total business activity.")

[16]*Crossley v. Lieberman*, 868 F.2d 566, 569 (3d Cir. 1989)(citing R. Hobbes, *Attorneys Must Now Comply with Fair Debt Collection Laws*, X Pa.J.L.Reptr., No 46, 3 (Nov. 21, 1987)).

[17]15 U.S.C. §1692a(5).

[18]*Bass v. Stolper*, 111 F.3d 1322 (7th Cir. 1997); *Ozkaya v. Telecheck Services, Inc.*, 982 F. Supp. 578 (N.D. Ill. 1997)

[19]*Wadlington v. Credit Acceptance Corp.*, 76 F.3d 103 (6th Cir. 1996); *Brannan v. United Student Aid Foundation*, 94 F.3d 1260 (9th Cir. 1996).

assessments are also debts.[20] The list of what does <u>not</u> constitute a debt is substantially smaller, and shrinking. In view of the expansive interpretations of the Act and the potential for substantial exposure, it is worthwhile to proceed from assumption that the obligation is a "debt" and that the FDCPA applies.

Avoiding Overshadowing in the Initial Letter

The overwhelming majority of cases under the FDCPA involve the first communication to the debtor, and these cases arise out of the Act's goal to give debtors thirty days to verify or dispute the debt. To this end, the Act requires the initial collection notice to contain a "validation notice" with certain statutorily-required statements to the debtor regarding, among other things, an explanation of the federal rights which the debtor may exercise within thirty days of receiving the letter.[21]

In sum, the initial letter must advise debtors that they have thirty days from the receipt of the collection letter to make the following written requests of the debt collector: 1) that the collector obtain verification of the amount of the debt or judgment, 2) that the debt collector obtain the name and address of the original creditor, 3) that the debt collector will assume the debt to be valid unless it is disputed.[22] The initial notice must further advise the debtor of the amount of the debt, the name of the creditor,[23] and that the letter constitutes an attempt to collect a debt and that any information obtained will be used for that purpose.

Even if the required statements are included in the initial communication, a debt collector may be liable for "overshadowing" these rights with other statements so as to render the validation notice ineffective. In the authors' experience, overshadowing constitutes the single greatest area of potential exposure, and collectors should make every effort to reduce the potential for lawsuits in this area.

Overshadowing can take infinite variations. Common violations are found by language which suggests that the debtor has less than thirty days to exercise his validation rights, by demanding payment "now", "today", "immediately", "within ten days", although such language is not required.[24] Likewise, demanding actions other than payment can result in a finding of overshadowing and cases have held that a request for an immediate phone call may violate the Act. Courts have gone so far as to hold that a statement that the account "has been placed for immediate

---

[20] *Newman v. Boehm, Perlman & Bright, Ltd.*, 119 F.3d 477 (7th Cir. 1997).

[21] 15 U.S.C. §1692g.

[22] *Id.*

[23] *Id.*

[24] *Vasquez v. Gertler & Gertler, Ltd.*, 987 F. Supp. 652 (N.D. Ill. 1997)(collecting cases).

collection", while not demanding any specific act, could cause enough confusion to support a class action.[25]

The key to compliance is avoiding any language which would suggest (to an unsophisticated consumer) that any action is required before the expiration of the thirty-day period. Unfortunately, this conflicts with the legitimate economic goal of collecting the debt as soon as possible, and with a minimum of cost. Letters which comply with the FDCPA are often the least effective in producing a quick turnaround on collections, and very often debt collectors cannot see the proverbial forest through the trees when it comes to their own letters. Although review by an independent third party will not provide an affirmative defense, it may be effective in reducing the potential for expensive lawsuits.

Sending multiple letters within the thirty-day validation period also accounts for a large portion of the overshadowing cases. This scenario is often the easiest to avoid, and is the one most likely to give rise to a true defense of *bona fide* error. The Act does not forbid multiple communications within the first thirty days, but sending additional letters without overshadowing debtors' validation rights is a tricky proposition. Collectors must take extreme care not to confuse the debtor about when the validation period will expire, and it is often useful to include a statement in subsequent letters that the thirty-day validation period began to run with the receipt of the collector's first letter. Avoiding any demands for action before the validation period expires is as important in subsequent letters as it is in the original communication.

Debt collectors who wish to altogether avoid the pitfalls accompanying multiple communications during the validation period have a valuable opportunity to proactively plan for a viable *bona fide* error defense. Many suits result from an inadvertent sending (during the first thirty days) of a collection letter which was intended to be sent after that period. Thus, language which would be otherwise unobjectionable if made outside the validation period (such as a demand for immediate payment) often gives rise to liability for overshadowing if sent within the first thirty days. Every debt collector who sends only one letter during the validation period should have a written policy which provides, in substance, that it is the collector's policy to send only one communication containing the validation notice during the validation period and that subsequent letters are to be sent no earlier than thirty-five days. Systems personnel should be clearly instructed, in writing, to implement the appropriate blocks to prevent the inadvertent sending of such letters.

When a collection letter is sent prematurely or out of series, as invariably happens despite the best intentions, the existence of such documentation could very well mean the difference between substantial liability and a complete defense to overshadowing.

---

[25]*Jenkins v. Union Corp.*, 999 F. Supp. 1120 (N.D. Ill. 1998)

Make Meaningful Threats, and Follow Through

One common problems which arises after the first letter is the threat of litigation. Attorneys seem to be particularly prone to suits over threats of litigation in their collection letters. The Act prohibits debt collectors, including attorneys, from threatening to take action which cannot be legally taken, or which the collector does not intend to take.[26] Anyone who threatens suit should have both 1) the authority to follow through and 2) the intention to sue if the debt is not paid. A track record of filing lawsuits over debts of similar amounts is desirable. The collector must not fall into a trap of threatening to sue on all debts simply because he sues on the larger debts, and collectors should set up a process to ensure that only debts of a sufficient minimum size receive such threats.

Attorneys who threaten suits are subjected to a standard which is higher still. If an attorney sends a letter threatening suit, he must intend to follow through and there must be no legal impediment to filing suit, such as a prior bankruptcy. Personal review of the debtor's file prior to sending the letter is also required of the attorney debt collector.[27] Any lower level of involvement, including the use of form letters over an attorney's signature, may give rise to violations of multiple sections of the FDCPA.

Conclusion

Although losing on a technicality is generally rare in the law, the FDCPA's statutory scheme presents a striking exception to this rule. The Act's harsh penalties, combined with a strict-liability system of fault, make it worthwhile for debt collectors to proactively examine their practices and to take the necessary proactive steps to limit their potential for liability.

---

[26] 15 U.S.C. §1692e(5).

[27] *Avila v. Rubin*, 84 F.3d 222 (7th Cir. 1996).

*Biography of Authors

David M. Schultz is a partner in the Chicago office of Hinshaw & Culbertson. He has defended attorneys, debt collectors and creditors in over 100 consumer class actions. Mr. Schultz has defended some of the leading cases which have defined the limits of the FDCPA, including the *Jenkins v. Heintz* decision in which the United States Supreme Court ruled on the applicability of the Act to attorneys. Mr. Schultz also counsels attorneys and debt collectors on compliance issues regarding state and federal consumer laws.

John M. Foley is an partner in the Chicago office of Hinshaw & Culbertson. He concentrates his practice in the defense of lawyers and other professionals. Mr. Foley has defended over fifty class action suits against attorneys and debt collectors brought under the Fair Debt Collection Practices Act. He has also been involved in several precedent setting cases involving issues under the FDCPA. In addition to defending FDCPA lawsuits, Mr. Foley is actively involved in assisting lawyers and debt collectors with minimizing their exposure under the FDCPA.