Testimony by The Legal Aid Society Before a Hearing on Proposed Legislation to License Debt Buyers held by the New York City Council Committee on Consumer Affairs February 25, 2009

We want to thank the Committee on Consumer Affairs and Councilmember Comrie for giving The Legal Aid Society the opportunity to testify today in favor of Intro 660, and we want to thank Councilmember Garodnick for introducing this much needed legislation. Debt buyers have siphoned millions of dollars out of the poorest residents of our City through illegal means. They have used our overworked courts as their private collection agency, forcing working families with children, senior citizens and the disabled to fall short when the time comes to pay their rent, utilities and even their grocery bills. Many people who receive a summons from a debt buyer believe they will face imprisonment if they do not pay. It is the right time to put some reasonable controls on this unregulated part of collection industry so debt buyers cannot operate unchecked to prey on our communities.

Our Experience

As part of its civil practice, The Legal Aid Society represents low income clients who have been sued by various debt buyers for credit card debts they allegedly owed at one time in the past. We have been part of the planning committees which advanced the CLARO1 pro bono advice projects now operating in the boroughs of Brooklyn, Manhattan and Queens, and organized the first citywide Consumer Debt Conference held at Fordham law School in June, 2008, at which Councilmember Garodnick spoke about the Debt Buyer Licensing Bill.

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1 Cicl Legal Advice and Referral Office

We have assisted hundreds of clients sued by debt buyers and observed that in the vast majority of cases, the amount of the debt being sued on was under $3000.00, but the claimed default interest rates and the fees associated with these old credit card debts doubled or tripled the original sum the debt buyer alleged was owed. Debt buyers typically purchase bundles of discharged debt for less than five cents on the dollar, and together with this potential interest and fee multiplier, and the fact that a large percentage of debtors default, the investment in litigation becomes highly profitable.

In several years of representing clients against debt buyers in the Civil Court, we have never lost a case against a debt buyer—why? Because when put to the test, most debt buyers cannot prove their case. They have no true evidence of the debt, and most often, they do not have the legal right to collect the debt. When challenged by our attorneys, they have either asked to discontinue the case, made a favorable settlement for our clients, or at our request the case was dismissed by the court. The problem is that The Legal Aid Society and other civil legal services programs can only represent an extremely small fraction of the debt buyers' targets. The Civil Court is clogged with 300,000 cases, most of which are brought by debt buyers against unrepresented ("pro se") defendants without the resources to hire attorneys. In general, Legal Aid is forced to turn away seven clients for every one we can assist. In the consumer debt area, the problem is magnified and only stands to worsen given the present state of the economy.

Without the oversight that the licensing process would afford, debt buyers use the court system to their own advantage. They serve legal papers at old addresses and obtain default judgments against the alleged debtors before the defendants know they are being sued. If a debtor does answer the summons, the debt buyers' courthouse-savvy lawyers aggressively pursue them to make one-sided payout settlements, using crowded court hallways to pressure

defendants into agreeing to pay more than they can possibly afford. The settlements provide that when they miss a payment, the entire sum becomes due and their wages can be garnished or their bank accounts restrained.

Another abusive tactic debt buyers use is to utilize out-of court discovery to interrogate defendants about their entire debt history and their credit card accounts to find out facts about their claims which they do not have from the original creditors. Debt buyers serve defendants with "notices to admit" facts which would prove their case, because if the unsophisticated defendant does not answer the notice, or does not answer in time, he or she is deemed to have admitted the debt buyers' claims. When the debtors do file answers, the debt buyers' counsel may slap together a motion for summary judgment, using evidence which could not prove their claim at trial but which forces the unrepresented defendants to respond in writing to unfamiliar legal terms. Debt buyers know that the overburdened Civil Court is ill-equipped to police these kinds of practices despite the best efforts of some judges and the Civil Court administration.

Our clients

For example, Ms. S was sued last year by a debt buyer based on alleged credit card debt of $7000.00. Approximately half of this amount was the alleged debt, the remainder consisted of default interest charges and late charges. Ms. S only found out about the case against her when her employer received an income execution notice. Ms. S obtained representation from The Legal Aid Society and challenged the jurisdiction of the court because she had not been served with the Summons and was unaware of the debt. The process server's affidavit contained so many errors that it was virtually false, including stating that Ms. S lived in a private, two family house when in fact she resides in a large apartment building. In opposition to our motion, the

plaintiff did not even submit an opposing affidavit by the process server and the case was dismissed.

Even for debt buyers which purchase valid claims, there is a great need for licensing and the oversight that the licensing agency could exercise. Debt buying is a high volume business which we have observed is prone to mistakes as well as outright abuse. More than the monetary burden if our clients choose to use their subsistence income or savings to pay back a debt, there are the added unseen costs of their needless frustration and worry, and the time away from work and family commitments. Ms. D's case perfectly illustrates why this is so. In 2007, Ms. D was sued by an unlicensed debt buyer for $2440.00 in payments allegedly due on a credit card dating back to 2001. Ms. D remembered owing a balance of under $1000.00 when she could no longer afford to make payments on this card. During 2006, while Ms. D was recovering from an illness at home, she started receiving frequent calls from a debt buyer representative regarding the alleged balance. Finally, Ms. D agreed to settle the disputed debt for $1500.00. She promptly sent the funds and received confirmation of receipt from the debt buyer's attorneys. She was shocked when despite her payment the Summons for the same claim arrived in the mail. Many other clients have been re-sued for the same debts when their court cases have been dismissed or discontinued.

A licensing requirement would shine a light on debt buyers and allow the Department of Consumer Affairs the power to sanction the abusers. The last time City Council addressed the issue of licensing and regulation of debt collection agencies was in 1984, prior to the growth of third party debt buyers as collectors of consumer debt. When requiring licensing of debt collectors, the City Council did not intend to relieve a debt collection agency of its obligation to obtain a license simply because it engaged a licensed debt collection law firm as its counsel. The

same reasoning should apply to debt buyers. No meaningful distinction between companies whose only business is to buy the discharged debts of others and try to obtain payment through the courts to generate their revenue, and companies calling themselves debt collectors who take others' debts and use collection tactics to generate revenue.

The City Council can make a critical contribution toward curtailing abusive debt buyer practices by enacting the licensing bill. If not all debt buyers abuse the court system, the Department of Consumer Affairs will prove that by monitoring and prosecuting only those which do not operate legally. We also urge the City Council to consider providing more resources for legal representation and advocacy so we do not have to turn away so many clients whose economic situation is threatened by the burden of debts they may not owe but which compound and follow them for years. In addition, we urge that the City agencies along with elected officials and the advocacy community coordinate resources so that together we may better serve distressed consumers.

Thank you again for the opportunity to testify before the Committee on Consumer Affairs.

Respectfully submitted by

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Department of Consumer Affairs

Statement of Andrew Eiler
Director of Legislative Affairs
Department of Consumer Affairs
before the
City Council Committee on
Consumer Affairs
on
Intro 660

February 25, 2009

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Testimony of

Barbara A. Sinsley

On Behalf of

DBA INTERNATIONAL

Before the

Committee on Consumer Affairs

The Counsel of the City of New York

City Hall, New York, New York

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Council Members, and members of the Committee, my name is Barbara A. Sinsley, General Counsel to the DBA International ("DBA"), formerly known as the Debt Buyers Association.

DBA International is a non-profit trade group comprised of over 586 professional debt buyers which are committed to the education, integrity, and professionalism of the industry. With an emphasis on legal compliance, we work alongside of other trade groups to ensure the fair and ethical treatment of consumers.

The members of DBA work to educate consumers on financial literacy while also seeking solutions in resolving the consumer's debt. Debt buyers are in the unique position of often being able to substantially discount the debt in situations where in many instances the original creditor would or could not discount the debt. In a recent study by Price Waterhouse, it was found that over $40 billion dollars in 2007 was returned to businesses that extend credit by debt collectors.[1]

[1] "Value of Third Party Debt Collection to the U.S. Economy in 2007; Survey and Analysis" for ACA International by Price Waterhouse Coopers.

This amount is estimated to benefit consumers by saving the average American household $359.00 annually.

Plaintiffs' counsel are often motivated by the attorney fee provision of the Fair Debt Collection Practices Act ("FDCPA"). Simply put, the FDCPA was intended to be a shield to protect consumers from abusive collection practices. Unfortunately, well aware that the cost of settling a lawsuit is usually less than the cost of defending the suit, the FDCPA is frequently used as a sword by the plaintiffs' bar to pursue legal fees in meritless cases. The FDCPA was enacted with the purpose to eliminate abusive practices by debt collectors, ensuring that those collectors who refrain from using abusive debt collection practices are not competitively disadvantaged, and promoting consistent state action to protect consumers against debt collection practices.[2] DBA's constant concern is that notwithstanding its members' compliance and educational initiatives, time and money which could be spent on assisting consumers to resolve matters is instead being spent on defending frivolous lawsuits

I appreciate the opportunity to testify today on the proposed amendment to the City Code as it relates to the definition of "debt collection agency" and the potential licensing requirements.

As you may know, there are two types of debt buyers, "active" and "passive." "Active" debt buyers purchase and collect on defaulted consumer loans. "Passive" debt buyers purchase debt and do not collect on it themselves but instead, hire third party debt collectors to collect on the debts.

At some point, both "active" and "passive" debt buyers may engage attorneys to file suit after other efforts to collect the debt have been exhausted.

[2] 15 U.S.C. § 1692(e).

The distinction between active and passive debt buyers has been noted by the General Counsel for the Department of Consumer Affairs, Marla Tepper, in a letter dated March 7, 2007 wherein she acknowledges the following:

"A debt buyer that merely purchases or acquires defaulted debt but does not engage in collection activities itself does not require a license from the Department. Administrative Code § 20-489 defines a debt collection agency as "a person engaged in business the principal purpose of which is to regularly collect or attempt to collect debts owed or due or asserted to be owed or due to another."

In enacting this statute, the City Counsel sought to curb abusive practices of debt collection agencies by requiring licensing of those entities dealing directly with the consumer public in the collection of debts. Administrative Code § 20-488. Thus, under the Administrative Code, a "debt collection agency" is an entity engaged in actively collecting or attempting to collect debts."

The key component noted by Ms. Tepper and the City Counsel is abusive collection practices need to be addressed to those who "deal" with the consumers in the collection of debt. This component is adequately and currently addressed by the current definitions of the City Code and the licensing of third party debt collectors and debt buyers, as they "deal" actively with the consumer public. In a March 9, 2007 Press Release from the Department of Consumer Affairs of the City of New York, Commissioner Mintz indicated that "debt buyers must be licensed if collecting from New York City residents".

In contrast, a passive debt buyer does not "deal" or collect themselves directly with the consumer public. As a silent owner of a consumer debt, a passive debt buyer never engages in direct collection activity. Although "collection activity" is not defined under the New York City

Code, the term, under Section 5-76 of the New York City Code, "debt collection procedures" is defined as "any attempt by a debt collector to collect". The Federal Fair Debt Collection Practices Act ("FDCPA") defines a "debt collector" in part, as "any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose is the collection of debts or one who "regularly collects or attempts to collect" a debt directly or indirectly owed to another.[3] Without an affirmative attempt to collect a debt, no duties or prohibition attach under the FDCPA. For example, the FDCPA requires an initial validation notice to be sent to a consumer within five (5) days of the initial communication with the consumer.[4]

Similarly, the prohibitions of the FDCPA all contemplate an active communication whereby a debt collector must conform his or her conduct such as, not calling before 8:00 a.m. or after 9:00 p.m., or falsely representing the legal status of a debt.[5] The FDCPA generally restricts communications in connection with the collection of a debt under categories of time constraints, attorney representation, calls to employment, calls to third parties and ceasing communications.[6] Thereafter, the FDCPA defines specifics of harassment or abuse, specified of what is false or misleading and what are unfair practices.[7]

The issue of passive debt buyers and licensing requirements has been addressed by several states, including Connecticut, Maryland, Massachusetts, and most recently, Tennessee. In Connecticut, in a letter dated June 29, 2008 from the Department of Banking to attorney Jonathon Elliott, the State of Connecticut acknowledged that debt buyers did not need to be

[3] 15 U.S.C. § 1692a(6).
[4] 15 U.S.C. § 1692g(a).
[5] 15 U.S.C. § 1692c(1) and 1692e(2)(A).
[6] 15 U.S.C. § 1692c.
[7] 15 U.S.C. § 1692d,e and f.

licensed as they did not engage in the business of collecting or receiving payment for others. In Maryland, in a letter to attorney Stuart Blatt, the Department of Labor, Licensing and Regulation address the licensing of passive debt buyers and stated that "since it is common practice for the passive debt buyer to retain a licensed debt collector to directly engage in the collection of its purchased debts, it is the position of the Commissioner that a debt buyer who purchases debt in default, but is not directly engaged in the collection of these purchased debts, is not required to obtain a collection agency license."

Similarly, the State of Massachusetts has issued an opinion posted on the website of the Consumer Affairs and Business Regulation office, select opinion 06-060 which exempts passive debt buyers from licensing provided that they hired a properly licensed debt collector or an attorney at law. Lastly, just last week, Tennessee issued a clarification statement via the Tennessee Collection Service Board regarding debt/judgment purchases and "passive" debt buyers and have posted on their website that entities who purchase debts or judgments but do not collect or attempt to collect on the purchased debts but assigned the collection activity to a licensed collection agency or licensed attorney shall not be deemed to be a "collection service" for purposes of the licensing requirement. *(See the attached letters from Connecticut, Maryland, Massachusetts, and the Tennessee web-posting).*

I also have reviewed comments previously filed by the New York City Bar in support of this amendment and I would like to clarify an inaccuracy in their Comment. While it is accurate that a debt buyer can be a "debt collector" if the debt they are attempting to collect was obtained after default, the debt collector/debt buyer is only subject to the Federal Fair Debt Collection Practices Act if they actually engage in collection. The cases citied by the New York City Bar clearly state that the debt buyer was engaging in collection activity on the debt. This concept

was discussed by the Seventh Circuit and cited but not fully briefed by the New York City Bar's comment in the case of *Schlosser v. Fairbanks Capital Corp.*, 323 F.3d 534 (7th Cir. 2003) wherein the court stated "that the focus was the 'activity' on the defaulted debt which extended the reach of the FDCPA to those purchasing the consumer debt." In short, in order to violate the FDCPA, one actually would have to engage in an affirmative conduct.

In summary, passive debt buyers do not engage in affirmative conduct or collection activity. There is no need to license an entity that engages in no conduct. Without conduct to monitor or regulate, there is not abusive practice to curtail. The current licensing of active debt buyers is sufficient.

Conclusion

DBA again thanks the City Counsel and Committee members for the opportunity to present this testimony. It is DBA's position that passive debt buyers should not be licensed for the foregoing reasons. DBA looks forward to continuing discussion on this matter and would ask to be included in all hearings or inquiries.

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STATE OF CONNECTICUT

DEPARTMENT OF BANKING

CONSUMER CREDIT DIVISION

260 CONSTITUTION PLAZA • HARTFORD, CT 06103-1800

June 29, 2005

Jonathan Elliot
Kleban & Samor, P.C.
2425 Post Road
P.O. Box 763
Southport, CT 06890

Dear Attorney Elliot:

This is in response to your letter dated April 29, 2005 wherein you request in writing confirmation as to whether entities which collect only accounts in which they own, regardless of whether the entity originated the debt, would be regarded as a consumer collection agency.

Section 36a-800(1) of the Connecticut General Statutes provides, in pertinent part: "consumer collection agency" means any person engaged in the business of collecting or receiving for payment for others of any account, bill or other indebtedness..."Consumer collection agency" further includes any person who, in attempting to collect or in collecting such person's own accounts or claims from a consumer debtor, uses a fictitious name or any name other than such person's own name which would indicate to the consumer debtor that a third person is collecting or attempting to collect such account or claim."

In light of the above, provided your client would be collecting only on its own accounts and not as a third party collector, pursuant to the provisions of Section 36a-800, licensure as a consumer collection agency would not be required unless your client uses a fictitious name or any name which would indicate to the consumer debtor that a third person is collecting or attempting to collect such account or claim.

Should you have any questions, please feel free to contact me at 860-240-8212.

Sincerely,

Christina M. Kaiko

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Manager, Licensing & Registration

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DLLR
STATE OF MARYLAND
DEPARTMENT OF LABOR, LICENSING AND REGULATION

MARTIN O'MALLEY, Governor
ANTHONY G. BROWN, Lt. Governor
THOMAS E. PEREZ, Secretary

Maryland Collection Agency Licensing Board
Charles W. Turnbaugh, Chairman

DLLR Home Page • http://www.dllr.state.md.us
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June 20, 2007

Stuart R. Blatt, Esquire
Margolis, Ritzier, Epstein & Blatt, P.A.
West Corporate Center
110 West Road, Suite 222
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Dear Mr. Blatt:

RE: HB 1324 – "Passive Debt Buyers"

Thank you for your facsimile communication dated June 13, 2007 following up to a letter addressed to Commissioner Charles Turnbaugh from DBA International relating to the exclusion for licensing of what is commonly referred to as "passive debt buyers" or those who do not engage in collection activity in the State of Maryland. Commissioner Turnbaugh received your letter and asked that I respond on his behalf.

This communication will respond to your request for confirmation from the Commissioner that since it is common practice for the "passive debt buyer" to retain a licensed debt collector to directly engage in the collection of its purchased debts, it is the position of the Commissioner that a debt buyer who purchases debt in default, but is not directly engaged in the collection of these purchased debts, is not required to obtain a collection agency license provided that all collection activity performed on behalf of such debt buyer is done by a properly licensed collection agency in the State of Maryland.

Again, that you for your letter to Commissioner Turnbaugh and if I can be of any further assistance on this or any other matter, please feel free to contact me directly at (410)230-6079.

Sincerely,

Kelly Mack

Kelly Mack
Financial Examiner Lead
Regulatory Policy Unit

cc: Charles Turnbaugh
Michael Jackson

Selected Opinion 06-060

"Passive" Debt Buyer Exemption from Debt Collector License - October 13, 2006

By the Division of Banks

You may view and print this full selected Opinion as Adobe Acrobat PDF File (295KB)

October 13, 2006

The Division is issuing the following opinion pertaining to the licensing of debt buyers as debt collectors in the Commonwealth in response to several recent inquiries.

The Division licenses and examines entities engaged in the collection of debts in the Commonwealth. It is the Division's position that entities purchasing debt in default at the time of purchase, commonly referred to as "debt buyers", must be licensed as debt collectors. This position is set forth in an Industry Letter issued by the Division dated June 16, 2006. Accordingly, debt buyers, as referred to in the June 16, 2006 Industry Letter, are subject to the Commonwealth's debt collection laws, General Laws chapter 93, sections 24-28, inclusive and the Division's regulation, 209 CMR 18.00 *et seq* (collectively the "Debt Collection Law").

Following the issuance of the June 16, 2006 Industry Letter, the Division received several inquiries as to whether a debt buyer that engages only in the practice of purchasing delinquent consumer debts for investment purposes without undertaking any activities to directly collect on the debt would be considered a debt collector under the Debt Collection Law. This type of debt buyer is typically referred to as a "passive" investor or "passive" debt buyer. It is a common practice for the passive debt buyer to retain a licensed debt collector to directly engage in the collection of its purchased debts.

The Division seeks to ensure that collection activities involving Massachusetts consumers are conducted in accordance with the Debt Collection Law and remain subject to appropriate regulatory oversight. It is the position of the Division that a debt buyer who purchases debt in default but is not directly engaged in the collection of these purchased debts is not required to obtain a debt collector license provided that all collection activity performed on behalf of such debt buyer is done by a properly licensed debt collector in the Commonwealth or an attorney-at-law licensed to practice law in the Commonwealth. See Opinion O06059.

This opinion is effective as of October 2, 2006.

The conclusions reached in this letter are based solely on the facts presented. Fact patterns which vary from that presented may result in a different position statement by the Division.

Sincerely,

Joseph A. Leonard, Jr.
Deputy Commissioner of Banks
And General Counsel

CLARIFICATION STATEMENT OF THE TENNESSEE COLLECTION SERVICE BOARD REGARDING DEBT/JUDGMENT PURCHASERS AND "PASSIVE" DEBT BUYERS.

It is currently the opinion of the Tennessee Collection Service Board that entities who purchase judgments or other forms of indebtedness will be deemed a "collection service" if they collect or attempt to collect the debt or judgment subsequent to their purchase of the debt or judgment. However, entities who purchase debt or judgments in the manner described above but who do not collect or attempt to collect the purchased debt or judgment, but rather assign collection activity relative to the purchased debt to a licensed collection agency or a licensed attorney or law firm shall not be deemed to be a "collection service".

The Consumer Affairs Committee of the New York City
City Council Hearing on Local Law Int 660-Licensing of Debt Buyers
February 25, 2008
Testimony on Behalf of Maria V. Ferrer

I am a resident of Brooklyn, New York and a client of the Urban Justice Center's Community Development Project. I am submitting testimony in support of the Debt Licensing Bill because I believe this is an important law that will protect many low income New Yorkers like myself.

If this law was currently in effect I would have had somewhere to go to report the abusive debt collection activities which I have been subjected to by debt buyers, collecting debts in New York City. Instead, I was the victim of these aggressive and abusive tactics for over a year, before I learned of my rights and sought the free legal services of the Urban Justice Center.

My story begins with the simple fact that I have a common name. Over a year ago, a debt buyer began garnishing my wages to pay a debt that was not mine, but rather belonged to a different Maria Ferrer who lived in the Bronx, and had a different social security number than I. I also learned that two other cases had been brought against this other Maria Ferrer who lives on Hughes Avenue in the Bronx.

I have lived in Park Slope Brooklyn for nearly my entire life and never have I resided on Hughes Avenue in the Bronx, but somehow this fact was overlooked the debt buyer, the county marshal and all other parties who were involved in the garnishing of my wages. After attending a consumer debt clinic run by the Urban Justice center I learned of my rights. I also learned that in two of my 3 cases, the debt buyer was either not licensed or had not alleged a license in their pleadings as required by law.

The notice of garnishment I received, bears a different address and different social security than my own, but somehow the debt buyer, Metro Portfolios was able to garnish my wages for over a year. When I submitted my order to show cause to vacate this judgment (with the assistance of the Urban Justice Center) the Debt buyer's counsel then submitted an Affirmation in Opposition to My Order to Show Cause because they claimed I was simply attempting to "forestall the payment of monies due and owing to" Metro Portfolios. If I had not had the advice and counsel, of The Urban Justice Center, I would not have known what to do.

I spent several days going back and forth to the Bronx from Brooklyn where I live and work, in my efforts to clear my name. Ultimately I succeeded and have been working to clear the negative and mistaken information from my credit report. But days after the judgment against me was vacated I learned of another judgment being mistakenly entered against me by another debt buyer. This debt buyer, LR Credit 15, was able to get a default judgment on July 22nd, 2008 against the same Maria Ferrer of Hughes Avenue in the Bronx, but then sought to collect from me. I have been back and forth to the Bronx several times already and must return for my hearing on March 4th.

If this law were in place, I would have been able to go to Department of Consumer Affairs where I could have filed a complaint against both Metro Portfolios and LR Credit for seeking to collect money from me to pay for a judgment against another person.

DC 37 MUNICIPAL EMPLOYEES LEGAL SERVICES

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Testimony of Robert A. Martin
Associate Director, District Council 37
Municipal Employees Legal Services

In Support of Int. 0660
New York City Council
Consumer Affairs Committee
February 25, 2009

Good morning. I am Bob Martin, Associate Director of District Council 37 Municipal Employees Legal Services, or MELS. I am testifying today on behalf of DC 37 in support of legislation to clarify that a "debt buyer" who attempts to collect debts from New York City residents must be licensed as a debt collection agency under the Administrative Code.

MELS provides legal services providing services to some 125,000 city workers and 20,000 retired city employees and their dependents. Our lawyers give representation in a range of legal matters, including consumer and debt cases. I also note that prior to coming to DC 37, I served as general counsel at the Department of Consumer Affairs for seven years and thus have experience in the regulation of debt collection agencies under DCA's licensing statute.

You will hear testimony today about how the debt collection industry has evolved. The computer age has made it viable for companies to buy and sell consumer debt for pennies on the dollar or less and then try to collect. All that the debt buyer purchases, however, is a computer tape. This system of buying and selling facilitates all sorts of abuses, including mistaken identity, identity theft, and creditors failing to respond to consumers who dispute that a debt is owed and then selling the disputed debt to a debt buyer that continues the collection process. Last but not least, we see that debt collectors routinely collect debts that are beyond the statute of limitations, a practice that violates the Fair Debt Collection Practices Act (FDCPA).

The folksinger Woody Guthrie sang, "Some will rob you with a six-gun, some with a fountain pen." Bad collection practices in the past included brazen acts like showing up on a doorstep or calling a debtor at odd hours. Such practices may still occur, but that's not how debt buyers make their money. Debt buyers use the computer – the modern-day equivalent of Guthrie's fountain pen – to collect money that in many instances is not rightfully theirs.

The business model of debt buying companies rests on a high volume of collection efforts, lawsuits and default judgments. Something very interesting happens when my office responds to a debt buyer's lawsuit and asks for documentation of the debt: almost invariably the lawsuit goes away. Debt buyers typically cannot substantiate their claims, and when confronted they simply move on to the next consumer who may not have a lawyer. The real victims in this process are defendants who never receive notice of a lawsuit because the summons is improperly served at an old address in the debt buyer's records. The real victims are those left to defend themselves in court against a debt buyer's claims that may include improper fees and interest exceeding the original debt many times over.

The proposed amendment is an important step to ensure that the Debt Collection Agencies Law applies to collection practices in the modern age. New York City's statute, administered by the Department of Consumer Affairs, needs to be consistent with the FDCPA. The FDCPA applies to debt buyers and the City's law should, also. By bringing debt buyers into the loop, the amendment will heighten DCA's ability to perform its regulatory role.

In fact the biggest single rationale for this amendment is to enable DCA to perform investigations of debt buyers and to bring cases against those who violate the law. The License Enforcement Law already gives DCA broad authority to regulate licensed industries, including the debt collection industry. In any number of court cases, DCA's mandate under the License Enforcement Law and the Consumer Protection Law to protect the consumers of the City of New York has been upheld. Finally, this amendment is consistent with the mission of DCA's new Office of Financial Empowerment to educate, empower and protect low income New Yorkers. After all, these are the citizens most affected by unfair and illegal debt collection practices. The effect of an unfounded lawsuit by a debt buyer goes well beyond the particular matter. The negative impact of such lawsuits on working New Yorkers continues the vicious cycle of subprime credit by depriving them of lower interest rates and costing them money.

In these tough economic times, low income and working New York City residents deserve the best protections that the City can offer. Making clear that debt buyers need a license will give DCA additional leverage to regulate the debt collection industry and to bring cases against agencies that violate the law.

Thank you for the opportunity to testify today.

Good morning, Chairman Comrie, and committee members. I am Andrew Eiler, Director of Legislative Affairs for the Department of Consumer Affairs. Commissioner Mintz asked me to thank you for the opportunity to appear before your hearing on Intro 660 that seeks to strengthen the collection agency licensing law.

First, the bill seeks to expand the type of businesses the law covers by amending the definition of "debt collection agency" to include debt buyers who refer debts to another for collection or to an attorney for litigation.

Second, the bill seeks to expand the businesses the law covers by revising the exemption regarding attorneys to specify more exactly the activities that trigger the exemption.

During this time of economic distress, debt collection agencies are plying their trade more vigorously than ever. The Department currently licenses 1,092 debt collection agencies. The number of docketed consumer complaints about their practices jumped from 760 in FY 2007 to 1,286 in FY 2008, an almost 70% increase that catapulted them into first place in the Department's top five complaint categories. The Committee and the sponsors of this bill have accurately highlighted debt buyers as the newest segment of the industry greatly in need of more stringent regulation because of the added pressures such businesses put upon consumers.

According to the testimony that the Consumer Law Center submitted to the Federal Trade Commissioner in 2007, the debt buyer industry has ballooned from just five players in 1992 to over 300 major sellers of delinquent debts by 2005. The face value of debts sold was only $1.3 billion in 1993; by 2002 the estimated sale of debt by original creditors had skyrocketed to over $60 billion and it was expected to exceed $110 billion in 2005. And that was *before* the massive economic downturn we now face. SEC filings also show that the revenues and profits of the largest debt buyers have multiplied four to six times from 2001 through 2005.

Most of the debts sold to debt buyers are credit card debts, but also includes phone bills, medical bills, water bills, car loans as well as other consumer credit. The age of the debts sold create a fundamental problem for consumers. Typically, the debts sold range from a few months to more than a decade. The collection of old debt poses the following problems for consumers:

- Failure to validate the debt. Key information about the account is often not provided to the debt buyer by the original creditor. Missing data includes complaints about billing errors, payments not credited, settlement agreements not honored, identity theft, and mistaken account listings.
- Failure to identify at the time of the initial contact either the original creditor or the itemization of the debt. Without adequate identifying information, consumers are at a loss to address the issue.

- Collecting stale debts, especially debts beyond the statute of limitations, often occurs without informing consumers that they cannot be required to pay.
- Reselling of debts by debt buyers. The reselling to other debt buyers of debts that one buyer was unable to collect leads to an endless stream of debt collectors harassing consumers in attempts to collect the same debt. This creates an unending nightmare for consumers who then have to refight the same issues over and over again with different debt buyers.

A report released by the Urban Justice Center in October 2007, "Debt Weight: The Consumer Credit Crisis in New York City and Its Impact on the Working Poor," indicates how these collection efforts impact New Yorkers. The report found that in 2006 alone approximately 320,000 consumer debt cases for almost $1 billion in claims were filed in the five boroughs, resulting in judgments against consumers for almost $800 million. The starkest findings, however, are that 89.3% of these cases were filed by debt buyers who had no prior relationship with the consumers, and that over 80% of these cases result in default judgments. Although plaintiffs were technically required to submit proof to support their claims, a review of cases found that the materials provided almost always constituted inadmissible hearsay that fails to meet the standard of proof specified in the Civil Practice Law and Rules section 3215 (f).

The Council is to be commended for tackling the issue of strengthening the law that regulates the practices of debt collection agencies. The Department is concerned, however, that the proposed amendments will not provide the relief that is needed.

For example, the proposed change in the definition of "debt collection agency" requires some discussion. On the one hand, it is too far- reaching by including as a collection agency anyone who bought a debt that was later referred to another for collection. However, some companies, like financing agencies, purchase consumer credit contracts that were current at the time of purchase, but become delinquent thereafter and are then referred for collection. Thus, the proposed language would inappropriately cover such players. On the other hand, the proposed definition change falls short by requiring debt collectors to have referred the debt to another for collection or to an attorney for litigation. This raises doubt about whether buyers of debt who collect themselves rather than referring to others or to attorneys would be included.

The Department strongly supports the objective of including debts buyers as collection agencies regardless of how they seek to collect debts, be it directly or indirectly, by litigation or otherwise and suggests that some tweaking of the proposed definition would accomplish this goal. The key distinction regarding debts buyers is that they purchase debts after they are already in default while other financing agencies purchase them while consumers are still current with their payments.

The Department is also concerned that the more specifically- defined activities for triggering the attorney exemption could exclude attorneys who failed to engage in the particular practices described but who still acted primarily as collection agencies rather

than attorneys. The Department believes that the current exemption is sufficiently specific yet flexible enough to exclude *only* attorneys engaging in the actual practice of law while still *including* attorneys who are actually operating as debt collection agencies.

The Department also suggests that the bill be revised to include provisions that address debt buyer practices that create especially acute problems for consumers. These provisions should address the following issues:

- Specify the required documentation of the debt that debt collectors must provide to consumers in the initial communication.

- Require a written statement of inability to verify debt when consumers request such verification in writing.

- Require that any machine-generated calls relating to a debt must leave a call-back number to a phone that is answered by a natural person and leave a message for the consumer that identifies the name of the agency, the date of the call, the name of the person to call back and the identity of the originating creditor of the debt unless there has been a preexisting contact with the consumer and such information was then furnished to such consumer.

- Provide information to be required by the Commissioner regarding the collection of any debts on which the statute of limitations for initiating legal action has expired.

- Require the confirmation in writing of any debt payment schedule or settlement agreement reached about the debt and the prompt updating of credit reporting agencies about the current status of the debt and payment status on the debt the agency is collecting.

- Offer to provide written and oral consumer translation services when seeking to collect debts from non-English speaking consumers.

- Bar the sale or assignment of debts that have been fully satisfied.

- Bar the sale or assignment of debt without disclosing the information contained in the documentation required to be furnished with the initial contact as well as information identifying the current status and information provided by the consumer about the debt.

Adding such provisions to the bill would significantly strengthen the law to enable the Department to curb abusive collection practices

In closing, let me reiterate that the Commissioner commends the Council for seeking to address the issues the debt buyer industry has created for consumers. The

Department looks forward to working with the Committee to strengthen its bill to ensure it delivers the fill measure of relief consumers deserve. I will be glad to answer your questions.

COMMERCIAL LAWYERS CONFERENCE OF NEW YORK

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February 25, 2009

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Committee Member James F. Gennaro
Committee Member G. Oliver Koppell
Committee Member John C. Liu
Committee on Consumer Affairs
The Council of the City of New York
City Hall
New York, NY 10007

Re: Testimony **in Opposition** to Introduction No. 660 - A Local Law to amend the administrative code of the city of New York, in relation to buyers of consumer debt.

Mr. Chairperson Comrie, Committee Members Barron, Gennaro, Koppell and Liu, and Members of the City Council, thank you for the opportunity to testify this morning in regard to Introduction No. 660 - A Local Law to amend the administrative code of the city of New York, in relation to buyers of consumer debt.

Introduction No. 660 violates Federal and State Law and cannot be passed. Section 1 is an invasion of the federal government's right and responsibility to regulate interstate commerce. Section 2 violates the doctrine of separation of powers as set forth in the New York and United States Constitutions and is an improper extension of powers delegated to the Commissioner of the Department of Consumer Affairs in Chapter 64 of the Administrative Code of the City of New York.

Even if these amendments were legal, their effect would be to increase the difficulties consumers have in obtaining loans and paying their debts, and drive lenders and other financial institutions from doing business in New York City.

I would like to introduce myself to the Committee and then discuss Section 2 as it affects attorneys-at-law admitted to the practice of law in the State of New York, followed by Section 1 which seeks to extended the authority of the Department of Consumer Affairs to regulate debt buyers in addition to debt collection agencies.

I am President of the Commercial Lawyers Conference of New York ("CLC") and a Director the National Association of Retail Collection Attorneys (NARCA). The CLC is a New York State Bar Association whose members represent creditors seeking the recovery of consumer and commercial debts in the State of New York. The members of the CLC are law firms whose attorneys are licensed to practice law in the State of New York and whose practice is regulated by and under the supervision of the Appellate Division of the Supreme Court of the State of New York. The CLC has represented creditors' attorneys in standard-setting proceedings involving New York State and City legislation, and in the development of Court Rules and civil practice. We look forward to continuing these discussions in the hope that we can achieve meaningful changes that will benefit consumers while protecting the rights of creditors.

I am an attorney admitted to the practice of law in the State of New York, but I started my professional career as a musician and then became a public school teacher. This helped me pay my way through night law school. In my post-college years, I, like many others, waited on lines at the New York State Unemployment Office and had trouble paying my bills. I know how it feels to get dunning letters and collection calls, and I use that experience in my law practice to try to minimize the stress debtors experience when contacted about a bill they owe, but cannot pay.

To understand debt collection, you first have to acknowledge that many people owe debts. Attorney General Andrew M. Cuomo states on his website that, "It is important for you to understand that companies do have a right to try to collect money owed to them."[1] In its Economic Report for 2009, the New York State Assembly Ways and Means Committee noted that:

> As banks are unable to raise capital, they will be unable to raise money. In addition, lending standards have been tightened for some time, and have become even tighter despite actions by the federal government and the Federal Reserve.[2]

Without the ability to raise funds and collect the debts that they are owed, banks will be unable to lend money, driving us down in an ever-increasing spiral of recession, though hopefully, not into a full-fledged depression. Many banks sell all or part of their delinquent accounts to raise money and meet capital reserve guidelines set by the Federal government. The more difficult debt collection becomes, the lower the price banks can expect, adding to their financial woes.

As the economy sank into an economic morass, the media spotlighted debt collection as an area of financial and social abuse. Their stories incorporate anecdotes about the poor and disabled being assailed by debt collectors. Consumer advocacy publications do the same.

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[1] http://www.oag.state.ny.us/bureaus/consumer_frauds/tips/debt_collectors.html. Last accessed 2/21/2009.

[2] http://assembly.state.ny.us/comm/WAM/2009EcRep/2009EcRep.pdf, p.24.

Consumer complaints are up. The portrayal of debt collectors is down. The Federal Trade Commission ("FTC") which enforces the Federal Fair Debt Collection Practices Act ("FDCPA")[3] issues an annual report which includes the number of complaints lodged against debt collectors. However, no analysis of the complaints is provided. What is left unsaid in all of these publications is that the number of debt collection complaints is infinitesimal in comparison to the number of contacts debt collectors have with consumers.

There is another side to debt collection that is rarely discussed. Debt avoidance is flourishing. Professional debtors have sprung up, using false claims of identity theft and the courts to avoid payment of their outstanding debts. The Civil Courts have provided debtors with check-off forms to use as answers and discovery demands which go beyond legal entitlement. Court Clerks fill out the forms and tell the debtors where to sign. Judges decide cases on the merits and then, at the request of debtors, sign Orders vacating their own judgments. A segment of the consumer bar uses frivolous allegations of improper debt collection practices to extort payment from collection agencies who are forced to make business decisions to pay rather than incur the costs of fighting baseless lawsuits. The New York State Legislature has changed New York's garnishment laws to severely handicap creditors in recovering the amounts they are owed. And now, the City seeks to require licenses they cannot, by law, administer.

Introduction 660 raises several questions, the answers to which doom its passage. First. Does the City has the legal authority to amend the Administrative Code of the City of New York, as proposed. Second. How will the proposed amendments change current law; and third, what will be the real world impact of those changes?

The short answers are that this body does not have the authority nor the power to amend the Code as proposed; that these amendments are unconstitutional; that the net effect of the amendments would be to add another layer of administration to processes that are already in place and duplicate powers rightfully held by other branches of government; and lastly, these amendments will not help consumers.

Point I. **Section 2. Attorney Licensing**

A. The proposed amendment to Paragraph 5 of subdivision a of section 489 of title 20 of the administrative code of the City of New York, violates the doctrine of separation of powers under the Constitutions of the State of New York and the United States of America.

§2. Paragraph 5 of subdivision a of section 489 of title 20 of the administrative code of the City of New York is amended to read as follows:

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[3] 15 U.S.C. § 1692 *et. seq.*

(5) Any attorney-at-law or law firm collecting a debt [as an attorney] in such capacity on behalf of and in the name of a client [;] through legal activities such as the filing and prosecution of lawsuits to reduce debts to judgments, but not any attorney-at-law or law firm who regularly engages in activities traditionally associated with debt collection, including but not limited to, sending or making collection telephone calls;

New York has a unified court system.[4] New York's Constitution provides that the chief judge of the court of appeals is the chief judge of the State of New York and the chief judicial officer of the unified court system. . .[5] The chief judge . . . establishes standards and administrative policies for general application throughout the state. . .[6] The power to admit, regulate and disbar attorneys is held by the Appellate Division of the New York State Supreme Court.[7] The power to license and regulate New York Attorneys cannot be placed with the New York City Department of Consumer Affairs ("DCA") which is a department of the Executive Branch, as this authority is exclusive and inviolate, and its transfer would create a constitutional conflict whose final determination has only one possible resolution, the status quo.

> The practice of law is so intimately connected with the exercise of judicial power in the administration of justice that the right to define and regulate the practice naturally and logically belongs to the judicial department of the state government. Under the doctrine of separation of powers the courts have inherent power to regulate admission to the practice of law, to oversee the conduct of attorneys as officers of the court, and to control and supervise the practice of law generally, whether in or out of court. It is the prerogative of the judicial department to regulate the practice of law.[8]

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[4]Constitution of the State of New York, Article 6 § 1.

[5]Constitution of the State of New York, Article 6 § 28. a.

[6]Constitution of the State of New York, Article 6 § 28. c.

[7]Judiciary Law, Article 4 - Appellate Division, § 90. Admission to and removal from practice by appellate division; 2. The supreme court shall have power and control over attorneys and counsellors-at-law and all persons practicing or assuming to practice law, and the appellate division of the supreme court in each department is authorized to censure, suspend from practice or remove from office any attorney and counsellor-at-law admitted to practice who is guilty of professional misconduct, malpractice, fraud, deceit, crime or misdemeanor, or any conduct prejudicial to the administration of justice; and the appellate division of the supreme court is hereby authorized to revoke such admission for any misrepresentation or suppression of any information in connection with the application for admission to practice.

[8]*Washington State Bar Assn. v. State*, 125 Wn.2d 901, 907-908, 890 P.2d 1047 (1995).

In another case of Executive Branch overreaching,[9] the New York and American Bar Associations sought a declaratory judgment that the FTC's regulation mandating ". . . attorneys engaged in certain 'financial activities' as part of their legal practices would be subject to the GLBA [Gramm-Leach-Bliley Act],"[10] and that this regulation exceeded the statutory authority of the FTC, was arbitrary and capricious and invalid as a matter of law. The Court agreed, holding that "the Commission's attempt to regulate the practice of law under the Act fell outside its statutory authority.[11] The CLC believes that the same outcome would result should the amendments before us become law.

In his concurring opinion in *William J. Clinton, President of the United States v. City of New York et al,*[12] Associate Supreme Court Justice Kennedy expressed his concerns regarding modifications to the separation of powers:

> Separation of powers was designed to implement a fundamental insight: concentration of power in the hands of a single branch is a threat to liberty. The Federalist states the axiom in these explicit terms: "The accumulation of all powers, legislative, executive, and judiciary, in the same hands . . . may justly be pronounced the very definition of tyranny." [*citations omitted*] So convinced were the Framers [of the Constitution] that liberty of the person inheres in structure that at first they did not consider a Bill of Rights necessary. . . [*citations omitted*]
>
> They used the principles of separation of powers and federalism to secure liberty in the fundamental political sense of the term, quite in addition to the idea of freedom from intrusive governmental acts. The idea and the promise were that when the people delegate some degree of control to a remote central authority, one branch of government ought not possess the power to shape their destiny without a sufficient check from the other two. In this vision, liberty demands limits on the ability of any one branch to influence basic political decisions. Quoting Montesquieu, the Federalist Papers made the point in the following manner:
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> > "'When the legislative and executive powers are united in the same person or body,'says he, 'there can be no liberty, because apprehensions may arise lest the same monarch or senate should enact tyrannical laws to execute them in a tyrannical manner.' Again: 'Were the power of judging joined with the legislative, the

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[9] *New York State Bar Association and American Bar Association v. Federal Trade Commission* (430 F.3d 457, D.C. Cir. 2005).

[10] Safeguarding Rule, 14 C.F.R. Part 314.

[11] *New York State and American Bar Association v. Federal Trade Commission*, Ibid.

[12] 524 U.S. 417, 449-452 (1998) (No. 97-1374).

> life and liberty of the subject would be exposed to arbitrary control, for the *judge* would then be the *legislator*. Were it joined to the *executive* power, the *judge* might behave with all the violence of an *oppressor*.'" [*citation omitted*]
>
> **The principal object of the statute, it is true, was not to enhance the President's power to reward one group and punish another, to help one set of taxpayers and hurt another, to favor one State and ignore another. Yet these are its undeniable effects. The law establishes a new mechanism which gives the President the sole ability to hurt a group that is a visible target, in order to disfavor the group or to extract further concessions . . .** [emphasis added]
>
> . . . Separation of powers helps to ensure the ability of each branch to be vigorous in asserting its proper authority. . . By increasing the power of the President beyond what the Framers envisioned, the statute compromises the political liberty of our citizens, liberty which the separation of powers seeks to secure.

Transplanting the regulation of attorneys-at-law from the Judiciary to the Executive in the form of the DCA, violates the separation of powers and is a cause for concern as discussed by Justice Kennedy. And, the proposed amendment violates the Charter of the City of New York.

B. The proposed amendment to Paragraph 5 of subdivision a of section 489 of title 20 of the administrative code of the City of New York violates Chapter 64 of the Charter of the City of New York.

The intent of this amendment is to require the licensing of attorneys who collect debts, but who are not actively litigating debt collection cases in New York City Courts. This distinction is disingenuous at best, as the FDCPA requires that every person attempting to collect a consumer debt must send a debt collection letter or other document containing the Federal Validation Notice to every debtor from whom they seek to collect. Therefore, all attorneys who do even a minimum amount of debt collection would be subject to licensing by the DCA.

Chapter 64 of the Charter of the City of New York governs the Department of Consumer Affairs[13] and limits the powers of its commissioner from assuming "any of said powers [which] are conferred on other persons or agencies by laws."[14]

As described above, the power to admit, regulate and disbar attorneys resides within the Appellate Division of the New York State Supreme Court and cannot be delegated to the DCA.

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[13] § 2201.

[14] § 2203(c).

Attorneys must practice law in compliance with the Code of Professional Responsibility and Disciplinary Rules.[15] The Rules clearly provide that the practice of law encompasses disciplines and practices that do not involve litigation. The "practice of law" means the giving of legal advice or counsel to, or providing legal representation for, a particular body or individual in a particular situation in either the public or private sector in the State of New York or elsewhere, it shall include the appearance as an attorney before any court or administrative body agency.[16]

A lawyer can serve as an Advisor to a client (Rule 2.1) or as an advocate in non-adjudicative matters. (Rule 3.9) Lawyers have responsibility for the conduct of subordinate lawyers (Rule 5.1) and the conduct of nonlawyers they employ. (Rule 5.3) Lawyers can provide nonlegal services (Rule 5.7) which are defined as being those services that lawyers may lawfully provide and that are not prohibited as an unauthorized practice of law by a nonlawyer. (Rule 5.7 c) Lawyers may not engage in misconduct (Rule 8.4) and are subject to the disciplinary authority of this state. (Rule 8.5)

Many legal disciplines do not require litigation and do use nonlawyers. Law firms which practice in other fields of the law regularly use nonlawyers to take input information from new clients, prepare documents, close real estate sales, notarize documents, investigate accidents and crimes, interview clients and witnesses, and perform a host of other tasks. Lawyers who collect debts owed their clients use nonlawyers for many of these same or similar tasks. All lawyers, debt collectors or not, must supervise the nonlawyers they employ or they are in violation of the Code.

Attorneys who regularly engage in debt collection are also bound by the provisions of the FDCPA and the New York Debt Collection Practices Act ("NYDCPA").[17] The FDCPA governs debt collectors including attorneys who regularly engage in consumer debt collection activity, even when that activity consists of litigation,[18] and gives enforcement powers to the United States Attorney General. The NYDCPA is a penal statute and gives the power of investigation to the New York Attorney General.

Even if these powers were available to the DCA, they would only duplicate the powers held by other government agencies, thereby increasing costs and expense and providing no additional benefit to consumers.

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[15]Rules of the Supreme Court: Appellate Divisions, First Department, Part 603 *et seq*. The Rules governing attorneys admitted in the Second Department are at §691 *et. seq*. New Rules of Professional Conduct take effect on April 1, 2009, but are similar to the Disciplinary Rules in the current Code of Professional Responsibility.

[16]New York Rules of Court, Standards and administrative policies, rules of the Chief Administrator of the Courts, Part 118 Registration of Attorneys, §118.1(g).

[17]N.Y. Gen.Bus. § 600 *et. seq.*

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

Other States have recognized that lawyers admitted to practice law in their states are not required to be licensed as debt collectors if their practice includes debt collection. On October 13, 2006, the Massachusetts Division of Banks issued an opinion pertaining to attorneys at law ("attorneys") who engage in the collection of consumer debt in Massachusetts and the applicability of Massachusetts' debt collection laws[19] and regulations (collectively the "Debt Collection Law").[20]

> [Massachusetts'] Debt Collection Law defines a "debt collector" as "any person who uses an instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of a debt, or who regularly collects or attempts to collect, directly or indirectly, a debt owed or due or asserted to be owed or due another." Within the same definitional provision is a list of exclusions from the "debt collector" definition including in clause (g) "attorneys-at-law collecting a debt on behalf of a client". The Division has been requested to opine on the scope of this attorney-at-law exclusion and applicability of the Debt Collection Law to attorneys.
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> It is the position of the Division that the "attorney-at-law" exclusion applies solely to attorneys licensed to practice law in the Commonwealth since, unlike attorneys licensed in other jurisdictions, they are in fact authorized to practice law and utilize the court system in the Commonwealth. Attorneys licensed to practice law in the Commonwealth are subject to the Supreme Judicial Court's Rules of Professional Conduct and the disciplinary oversight of the Board of Bar Overseers.
>
> This position is consistent with the Division's longstanding practice relative to the licensing of attorneys as debt collectors. Attorneys, licensed to practice law in the Commonwealth, are also subject to the requirements and restrictions of the FDCPA and the debt collection regulations of the Massachusetts Attorney General, 209 CMR 7.00 et seq. The Debt Collection Law contains substantially similar requirements and restrictions as the FDCPA.

Massachusetts' policy exempting attorneys from licensing as debt collectors is echoed by

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[19] General Laws chapter 93, sections 24-28, inclusive.

[20] 209 CMR 18.00 *et. seq.*

many other States including, but not limited to, California,[21] Connecticut,.[22] Florida,[23] Illinois,[24] New Jersey,[25] North Carolina,[26] and Pennsylvania.[27]

The proposed amendment to Paragraph 5 of subdivision a of section 489 of title 20 of the administrative code of the City of New York, is counter to the practice of these and other states, violates Federal and State Law, and for the reasons presented, must be withdrawn from consideration.

Point II. **<u>Section 1. Licensing of Debt Buyers</u>. The proposed amendment to Subdivision a of section 489 of title 20 of the administrative code of the city of New York violates the Federal Government's right to regulate interstate commerce[28] and Chapter 64 of the Charter of the City of New York.**

a. "Debt collection agency" shall mean a person engaged in business the principal purpose of which is to regularly collect or attempt to collect debts owed or due or asserted to be owed or due to another[.] <u>and shall also include a buyer of debt who refers such debt to another for collection or to an attorney-at-law for litigation in order to collect such debt.</u>

The CLC contends that the intent of this amendment is to require licensing of debt buyers to generate revenue for the City despite the City's lack of legal authority to do so. Only the

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[21]The *Rosenthal Fair Debt Collection Practices Act* (RFDCPA), Cal. Civ. Code § 1788.1 *et seq.*, governs the collections of debts in California. Attorneys are expressly exempted from the RFDCPA's definition of debt collectors. Cal. Civ. Code § 1788.2 c.

[22]The *Connecticut Consumer Collection Agencies Act* (CCAA), Conn. Gen. Stat. §§ 36a-800, *et. seq.*, is a regulatory statute providing for licensing and bonding of collection agencies. The CCAA exempts from collection agency status "any member of the bar of this state."

[23]Florida Statutes. Title XXXIII, Chapter 559.553 *Registration of consumer collection agencies required; exemptions.*-- (4) This section shall not apply to: (b) Any member of The Florida Bar.

[24]Debt collection in Illinois is regulated by the *Illinois Collection Agency Act* (ICAA), 225 ILCS 425/1, *et seq.* "Licensed attorneys at law" are not subject to the act. 225 ILCS 425/2.03(5).

[25]The New Jersey *Collection Agencies Act* regulates collection agencies operating in New Jersey. The Act exempts any attorney at law "duly authorized to practice in this state." NJ Rev. Stat. § 45:18-6.

[26]The *North Carolina Collection Agencies Act*, (NCCAA), N.C. Gen. Stat. §§ 58-70-1, *et seq.*, exempts attorneys from licensing as collection agencies if they are handling claims and collections in their own name. N.C. Gen. Stat. § 58-70-15(c)(8).

[27]The *Pennsylvania Unlawful Collection Agency Practices Act*, 18 Pa. Cons. Stat. Ann., § 7311, exempts attorneys at law duly admitted to practice in any court of record in the Commonwealth of Pennsylvania, and the *Debt Pooling Act*, Pa. Cons. Stat. Ann., § 7312(b)(1), exempts any person who is admitted to practice before the Supreme Court of Pennsylvania or any court of common pleas of the Commonwealth.

[28]Commerce Clause, U.S. Constitution art. I, § 8, cl. 3.

federal government can regulate interstate commerce. Business licensing within the State is a power held by the Secretary and Department of State. Neither is available to the City in regard to Debt Buyers who do not collect their own debts in New York City. As enunciated by the Counsel's Office of the New York State Department of State:

> The ability of a state to require a foreign corporation to apply for authority (or "to take out a license" or "to qualify") traces to *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1868). It holds that only natural persons are "citizens" within the meaning of the Privileges and Immunities Clause. U.S. Constitution art. IV, § 2. From this it follows that a state has the power to exclude a foreign corporation from doing intrastate business within its borders. However, no state may exclude or condition admission of a foreign corporation that engages solely in interstate or foreign commerce. The Commerce Clause, U.S. Constitution art. I, § 8, cl. 3, commits to Congress, and impliedly withholds from states, the power to regulate interstate and foreign commerce. Holding that a corporation engaged in interstate commerce need not comply with a foreign corporation statute, the U.S. Supreme Court said, "A corporation of one state may go into another, without obtaining the leave or license of the latter, for all the legitimate purposes of [interstate] commerce; and any statute of the latter state which obstructs or lays a burden on the exercise of this privilege is void under the commerce clause." *Dahnke-Warner Milling Co. v. Bondurant,* 257 U.S. 282, 290 (1921). See also, *International Textbook Company v. Tone,* 220 N.Y. 313, 115 N.E. 914 (1917) ("We have steadily upheld the right of foreign corporations, without aid of any license, to engage in activities incidental to commerce between the states." 220 N.Y. at 318)
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> A foreign corporation may transact some kinds of business within the State without procuring a certificate or submitting to control. If its business be interstate, it is beyond State interference. "A corporation of one State may go into another, without obtaining the leave or license of the latter, for all the legitimate purposes of such commerce; and any statute of the latter State which obstructs or lays a burden on the exercise of this privilege is void under the commerce clause." *Dahnke-Walker Co. v. Bondurant*, 257 U. S. 282, 291.[29]

Debt Buyers are business entities that purchase or take assignments of portfolios of debt instruments from debt sellers who may be the originating creditor such as a bank, or from a debt buyer who originally purchased the debt from an originating creditor and then decides to re-sell it. The assignment of rights under the debt sale contract is the complete transfer of the right to receive the benefits accruing to one of the parties to that contract. The Debt Buyer, through the assignment, owns and holds all title and interest formerly held by the assignor.

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[29] *"Doing Business" in New York: An Introduction to Qualification*, NYS Department of State, Counsel's Office, Legal Memorandum CO01 (2000)

Many Debt Buyers are foreign corporations (or other business entities) which are formed strictly and solely for the purposes of buying and holding portfolios of debt instruments. They have no other existence and engage other companies to service their needs. They do not venture into New York and are not required to be licensed by New York State or New York City. These entities are considered to be "passive" debt buyers.

A Debt Buyer which collect its own debt is considered to be an "active" debt buyer and is subject to licensing as a debt collection agency, but not as a Debt Buyer.[30] Only the act of debt collection requires a license.[31] A debt collection agency is currently defined in § 20-489 as being "a person engaged in business the principal purpose of which is to regularly collect or attempt to collect debts owed or due or asserted to be owed or due to another." The amendment before us seeks to extend the DCA's authority to Debt Buyers, whether or not they actually collect or attempt to collect the debts owed them.

On January 5, 2009, the Tennessee Collection Service Board issued a *Clarification Statement Regarding Debt/judgment Purchasers and "Passive" Debt Buyers,* in which it explained that:

> It is currently the opinion of the Tennessee Collection Service Board that entities who purchase judgments or other forms of indebtedness will be deemed a "collection service" if they collect or attempt to collect the debt or judgment subsequent to their purchase of the debt or judgment. However, entities who purchase debt or judgments in the manner described above but who do not collect or attempt to collect the purchased debt or judgment, but rather assign collection activity relative to the purchased debt to a licensed collection agency or a licensed attorney or law firm shall not be deemed to be a "collection service".[32]

On October 13, 2006, the Massachusetts Division of Banks addressed the passive Debt Buyer issue when it issued Opinion 006060 entitled *Passive Debt Buyer Exemption from Debt Collector License*:

> It is the position of the Division that a debt buyer who purchases debt in default but is not directly engaged in the collection of these purchased debts is not required to obtain a debt collector license provided that all collection activity performed on behalf of such Debt Buyer is done by a properly licensed debt collector in the Commonwealth, or an attorney-at-law licensed to practice law in the

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[30] *Letter from Marla Tepper, General Counsel, New York City Department of Consumer Affairs to Dennis Malen, Esq.*, March 7, 2007.

[31] New York City Administrative Code § 20-489.

[32] http://www.tennessee.gov/commerce/boards/collect/documents/CSBCLARIFICATIONSTATEMENTREGARDINGDEBT.pdf. Accessed 2/23/2009.

Commonwealth.[33]

In 2007, the DCA concurred with the opinion of the Massachusetts Division of Banks.[34]

> The Department of Consumer Affairs was recently asked to address an inquiry as to whether "debt buyers" that do not themselves engage in collection activities must be licensed by the Department. "Debt buyer" is a term commonly used to describe a purchaser or assignee of defaulted debt. The Department responded as follows:
>
> In addressing this question, the Department first confirms its position that a purchaser or assignee of defaulted debt whose principal purpose is the collection of that debt, whether for itself or others, is a "debt collection agency" under New York City Administrative Code § 20-489 (a). Debt buyers that engage in debt collection activities must therefore be licensed by the Department in order to collect debts in New York City. New York City Administrative Code § 20-490.
>
> **A debt buyer that merely purchases or acquires defaulted debt but does not engage in collection activities itself does not require a license from the Department.** [*emphasis added*]

There is no need to change that opinion and amend a regulation that requires no amendment.

Conclusion **For all the reasons cited above, the Commercial Lawyers Conference of New York respectfully requests that Int. No. 660 - A Local Law to amend the administrative code of the city of New York, in relation to buyers of consumer debt, be withdrawn from consideration.**

Respectfully submitted,

Commercial Lawyers Conference of New York

Dr. Eric M. Berman, Esq.
President

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[33] *Selected Opinion 06-060,* Deputy Commissioner of Banks, State of Massachusetts, June 16, 2006.

[34] *New York City Department of Consumer Affairs Clarifies Collection Services Licensing Requirements and Establishes Amnesty Period,* Notice from the City of New York Department of Consumer Affairs, 2007.

ACA
INTERNATIONAL
The Association of Credit
and Collection Professionals

Active v. Passive Asset Buyers

ACA International (ACA) supports the reasonable licensure of **active asset buyers** as debt collectors. ACA recognizes state and local governments have a legitimate interest in protecting consumers from improper and abusive debt collection practices, and wholeheartedly supports such initiatives. However, asset buyers not participating in collection activity should not be subject to unnecessary and unreasonable licensing requirements. ACA urges state legislatures and regulatory agencies to recognize the distinction between an active asset buyer, one who initiates direct contact with consumers by engaging in collection activity and a passive debt buyer, one who uses the services of third-party collection agencies, in determining what businesses may be required to obtain a collection license.

Asset buyers, also termed debt buyers or debt purchasers, purchase charged-off account receivables, often from originating creditors. These receivables are generally purchased for less than the original value of the account. Importantly, the asset buying industry serves the economy by offering creditors and lenders the opportunity to obtain a return on uncollected receivables, thus reducing the cost of credit to consumers and generating greater access to credit.

Today, the collection industry is strictly regulated through existing and overlapping federal, state, and local laws and regulations governing collection practices, credit reporting, and data privacy and security. While certain asset buyers actively engage in the collection process, others do not.

An **active asset buyer** purchases charged-off account receivables and directly engages in the collection of those receivables with the consumer. Active asset buyers seek out those that owe debts by making telephone calls, sending letters and otherwise reaching out and directly communicating with the consumer in an attempt to collect the debt. ACA recognizes these collection activities must always be executed in accordance with and subject to the laws and regulations of the jurisdiction in which the consumer currently resides, including state and local licensing requirements as well as federal laws, rules and regulations.

A **passive asset buyer** purchases charged-off accounts receivable, but does not attempt to collect those receivables by directly initiating contact with the debtor in an attempt to collect the debt. Rather, collection activity is pursued by a retained third-party collection agency or law firm who conducts the collection process directly with the consumer. These retained businesses, rather than the passive debt buyer, are the debt collectors subject to laws and regulations of the jurisdiction in which the consumer currently resides, including state and local licensing requirements. ACA believes it is these businesses, rather than the passive debt buyer, that bears the responsibility of obtaining proper authorization to do business in a particular jurisdiction and complying with all laws, rules and regulations that affect them as debt collectors.

In summary, ACA asks state regulators to recognize the fundamental differences between a passive and active asset buyer. ACA believes a passive asset buyer does not need to be licensed as a collection agency but should only be responsible for hiring collection agencies who are properly licensed and otherwise entitled to do business in a jurisdiction.

jay winston

From: David Cherner [Cherner@acainternational.org]
Sent: Tuesday, February 24, 2009 4:27 PM
To: aw@winstonandwinston.com
Subject: New York City Council Hearing on Licensing of Asset Buyers
Attachments: stateassetbuyers.pdf; Int.mht

Hello Arthur,

Thank you again for speaking with me regarding the New York Council's proposal to license asset buyers. As we discussed, I also appreciate you attending the hearing as a member of ACA International to express ACA's position on this issue. Attached is ACA's position paper regarding the licensure of asset buyers. I have also attached the proposal.

I will also contact the Committee holding the hearing and request they accept written comments from ACA.

Thanks again for your help Arthur and please feel free to contact me at any time.

Sincerely,

David D. Cherner
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Legislative Director of State Government Affairs
ACA International
(952) 928-8000, ext. 112
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Oral Testimony of Melvin Billings
before the
New York City Council Committees on Consumer Affairs
Public Hearing Local Law No. 660 on February 25, 2009

My name is Melvin Billings. I am 60 years old. I am a Vietnam veteran and I am disabled due to a work-related injury in 2004. I survive on Social Security Disability and workers' compensation.

I was sued by an unlicensed debt buyer company. The first time I even knew that I had been sued was when my bank account, which contained only workers' comp and Social Security benefits was restrained. While my bank account was frozen, I had trouble obtaining any information about the company and my life was turned upside down.

I had no money to eat, to wash my clothes, or to pay my bills. I did not understand who was suing me or for what because I had never heard of the company, Rushmore Recoveries X. They never wrote me a letter or informed me of anything, and yet they expected me to just believe them that I owed them money and that I would give them my social security check.

I found out later that this company buys people's debts and then hires a law firm to sue on their behalf, and that they have sued thousands of other New Yorkers.

Finally, with help from my MFY Legal Services attorney, I was able to resolve the problem, but I do not think other New Yorkers should have to go through what I went through.

I believe the City Council should regulate these kinds of companies so they can investigate them when there are problems, and so they can fine them, and so they can take away their license if they do anything wrong.

Thank you for your time.

For more information contact:

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JOAN L. BERANBAUM
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Associate Director

Testimony of Robert A. Martin
Associate Director, District Council 37
Municipal Employees Legal Services

In Support of Int. 0660
New York City Council
Consumer Affairs Committee
February 25, 2009

Good morning. I am Bob Martin, Associate Director of District Council 37 Municipal Employees Legal Services, or MELS. I am testifying today on behalf of DC 37 in support of legislation to clarify that a "debt buyer" who attempts to collect debts from New York City residents must be licensed as a debt collection agency under the Administrative Code.

MELS provides legal services providing services to some 125,000 city workers and 20,000 retired city employees and their dependents. Our lawyers give representation in a range of legal matters, including consumer and debt cases. I also note that prior to coming to DC 37, I served as general counsel at the Department of Consumer Affairs for seven years and thus have experience in the regulation of debt collection agencies under DCA's licensing statute.

You will hear testimony today about how the debt collection industry has evolved. The computer age has made it viable for companies to buy and sell consumer debt for pennies on the dollar or less and then try to collect. All that the debt buyer purchases, however, is a computer tape. This system of buying and selling facilitates all sorts of abuses, including mistaken identity, identity theft, and creditors failing to respond to consumers who dispute that a debt is owed and then selling the disputed debt to a debt buyer that continues the collection process. Last but not least, we see that debt collectors routinely collect debts that are beyond the statute of limitations, a practice that violates the Fair Debt Collection Practices Act (FDCPA).

The folksinger Woody Guthrie sang, "Some will rob you with a six-gun, some with a fountain pen." Bad collection practices in the past included brazen acts like showing up on a doorstep or calling a debtor at odd hours. Such practices may still occur, but that's not how debt buyers make their money. Debt buyers use the computer – the modern-day equivalent of Guthrie's fountain pen – to collect money that in many instances is not rightfully theirs.

The business model of debt buying companies rests on a high volume of collection efforts, lawsuits and default judgments. Something very interesting happens when my office responds to a debt buyer's lawsuit and asks for documentation of the debt: almost invariably the lawsuit goes away. Debt buyers typically cannot substantiate their claims, and when confronted they simply move on to the next consumer who may not have a lawyer. The real victims in this process are defendants who never receive notice of a lawsuit because the summons is improperly served at an old address in the debt buyer's records. The real victims are those left to defend themselves in court against a debt buyer's claims that may include improper fees and interest exceeding the original debt many times over.

The proposed amendment is an important step to ensure that the Debt Collection Agencies Law applies to collection practices in the modern age. New York City's statute, administered by the Department of Consumer Affairs, needs to be consistent with the FDCPA. The FDCPA applies to debt buyers and the City's law should, also. By bringing debt buyers into the loop, the amendment will heighten DCA's ability to perform its regulatory role.

In fact the biggest single rationale for this amendment is to enable DCA to perform investigations of debt buyers and to bring cases against those who violate the law. The License Enforcement Law already gives DCA broad authority to regulate licensed industries, including the debt collection industry. In any number of court cases, DCA's mandate under the License Enforcement Law and the Consumer Protection Law to protect the consumers of the City of New York has been upheld. Finally, this amendment is consistent with the mission of DCA's new Office of Financial Empowerment to educate, empower and protect low income New Yorkers. After all, these are the citizens most affected by unfair and illegal debt collection practices. The effect of an unfounded lawsuit by a debt buyer goes well beyond the particular matter. The negative impact of such lawsuits on working New Yorkers continues the vicious cycle of subprime credit by depriving them of lower interest rates and costing them money.

In these tough economic times, low income and working New York City residents deserve the best protections that the City can offer. Making clear that debt buyers need a license will give DCA additional leverage to regulate the debt collection industry and to bring cases against agencies that violate the law.

Thank you for the opportunity to testify today.

Urban Justice Center
Community Development Project
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Testimony of Harvey Epstein before the New York City Council on behalf of the Community Development Project of the Urban Justice Center

February 25, 2009

Thank you Councilmember Comrie for the opportunity to testify to today. My name is Harvey Epstein, and I am the Project Director of the Community Development Project at the Urban Justice Center. On behalf of the Urban Justice Center .

The Urban Justice Center serves New York City's most vulnerable residents through a combination of direct legal service, systemic advocacy, community education and political organizing. The Community Development Project (CDP) of the Urban Justice Center formed in September 2001 to provide legal, technical, research and policy assistance to grassroots community groups engaged in a wide range of community development efforts throughout New York City. Our work is informed by the belief that real and lasting change in low-income, urban neighborhoods is often rooted in the empowerment of grassroots, community institutions.

I am here to urge you to support Councilmember Garodnick's proposed legislation Intro 660. This is an important piece of legislation that will protect consumers from unlicensed debt buyers in New York from engaging in illegal activity and create a mechanism to punish those buyer who do. Since 2005, the Urban Justice Center's Community Development Project has represented defendants in consumer debt cases in New York City's Civil Court. We have also represented victims of consumer fraud and unfair collection practices in affirmative litigation in State and Federal court. Additionally, the Community Development Project provides general

counsel services to community groups advocating for economic justice, including consumer justice.

Over the last four years, we have seen time and time again the detrimental impact of consumer debt on the low income population of New York City. In 2007, we set out to study consumer debt in NYC, after seeing reoccurring problems among our clients.[1] What we found was that debt buyers make up a significant portion of the debt collection agencies today and that these collectors, free from the Department of Consumers Affairs' oversight, engage in an alarming amount of litigation, often without any evidentiary merit.[2] These days, the debt collection industry obtains over 1 billion dollars a year in judgments, with most collection being initiated by debt buyers, not traditional credit card companies.

We represent clients who get served with court papers that are filed beyond the statute of limitations; who learn about judgments against them from debt that is not their debt, just someone who has the same name; get harassing phone calls threatening to contact immigration. This all from unlicensed debt buyers who act with impunity since there is no fear they will not be able to continue to operate in New York since the government has no power to revoke their license, since none is required..

I. The Consumer Debt Crisis in NYC, Particularly Among Low Income Constituents

Over the last few years, we have seen nationwide a dramatic rise in consumer debt, the impact of which can be felt all over in light of the current economic crisis. However, in New York City, the low-income population is particularly vulnerable to problems associated with consumer debt, namely predatory lending and abusive collection practices.

While we do not allege that all consumer debt held by low-income constituents is subject to predatory lending, it is undeniable that part of today's weight of debt held by the low-income

population is consequent to sub-prime lending. While the rest of the country saw the impact of predatory lending in the sub-prime mortgage crisis, in New York City, where the real estate market is uniquely geared towards renters, lenders instead sought to entice borrowers with sub-prime credit cards. Just as with sub-prime mortgages, these cards were often negligently offered to borrowers with poor credit and issued with the intention of returning a profit, by granting low credit limits with high interest rates and high fees.

The type of debt these credit cards quickly lead to is detrimental to the working poor of New York City, where necessity often requires that they live pay check to pay check. While this is not the whole problem, the sudden growth in consumer debt in the last few years, particularly among low income populations, has created a breeding ground for profiting off debt purchasing. Debt purchasing or buying is a phenomenon that has become increasingly visible in the last 10 years or so. However, as will be mentioned momentarily, debt buyers are poorly regulated in New York City, and thus permitted to engage in aggressive and abusive collection practices, which particularly harm low income constituents. While the law has implemented some regulations to protect against abusive or harassing collection behavior, many collection agencies have found a way to circumvent these regulations, which is why we are here before you today; to advocate for you to pass this legislation which seeks to clarify the existing licensing law and allow for greater oversight and regulation of the growing debt buyer industry.

II. The Law Suggests that Legislators Intended to Require Licensing of Debt Buyers

In 1984, the New York City Council ("Council") passed a law requiring that debt collection agencies be licensed by the New York City Department of Consumer Affairs ("Department") before engaging in collection activities against New York City residents.[3]

However, in the 25 years since, the consumer debt market has changed significantly; one of the most dramatic changes being the previously mentioned rise in debt buyers.

Debt buyers are purchasers of defaulted debt that employ third parties for collection or engage law firms to initiate law suits against alleged debtors. Debt buyers are highly profit driven, purchasing pools of defaulted debt for pennies on the dollar. Thus, they are extremely motivated to collect, and seek to do so by engaging in aggressive tactics, enabled by their exemption from the laws that regulate all other collection agencies in New York City.

Debt buyers' alleged exemption from New York City licensing laws is subject to a letter written by the Department of Consumer Affairs to the Consumer Credit Association of Metropolitan New York in March of 2007. In this letter, the Department alleges that the statute's definition of "collection agencies" does not extend to debt buyers.

The New York City Administrative Code defines a "collection agency" as any "person engaged in business the principal purpose of which is to regularly collect … debts owed or due or asserted to be owed or due to another."[4] The Department interprets this definition as only including entities that "actively" engage in collecting or attempting to collect debts, and subsequently exempting what it qualifies as "passive" entities.[5] The Department thus finds that debt buyers are excused from being licensed, as they allegedly function as "passive" collectors in that they do not themselves engage in collection, rather contract out such activities to collection agencies or law firms or attorneys.[6]

However, we contend that it was the 1984 Council's intention to include in its definition of collection agencies debt buyers, and thus the laws should be amended to reflect such. The law as it stands makes no explicit or implicit distinction between "active" and "passive" collectors, and the Department makes no viable argument as to the intent of the legislators to make such a

distinction. The actual intent of the Council in enacting this law, as is clearly stated Section 20-488 of the New York Administrative Code, was to protect New York City constituents from abusive collection practices. Thus, we contend that the original legislators intended to regulate debt buyers, based on the first part of Section 20-488, which explains that the Council's implementation of a licensing requirement arose out of a need to address "consumer related problems with respect to the practices of debt collection agencies whose sole concern is the collection of debts owed to their clients." In light of this, we believe that a clarification of the statute as set forth here should make sure that all debt buyers are licensed and therefore regulated in the City of New York. This is good public policy and protects consumers, as it is indisputable that debt buyers sole concern is the collection of debts, as what they purchase are generally defaulted debt, thus they should be required to abide by the same rules and regulations as all other debt collectors in New York City.

1. The Federal Act Recognizes Debt Buyers as Regulated Debt Collectors

Further, the federal Fair Debt Collection Practices Act ("FDCPA"), after which the New York City Administrative Code is patterned, clearly shares in this interpretation. The federal act defines "debt collectors" as any person "in any business the principal purpose of which is the collection of any debts.[7] As the New York City Civil Court has held, because the New York City statute was modeled after the FDCPA, the City should look to interpretations of the federal act for guidance in interpreting any ambiguities in the city code.[8] The federal act is consistently interpreted by the federal courts and the Federal Trade Commission as including in its interpretation of debt collectors purchasers of defaulted debt.[9] Thus, the federal law is interpreted to include debt buyers as regulated debt collectors, finding that debt buyers clearly engage in

"business the principle purpose of which is to collect debts".[10] Therefore, supporting the bill before you today will ensure our compliance with existing federal law.

2. The Licensing Requirements are Not Unduly Onerous

We recognize that debt buyers may strongly resist such an amendment, arguing that extending licensing requirements to debt buyers would create onerous paperwork and fees for these entities. However, this argument is without merit. The application for a license is a mere four pages long and asks simple, informative questions that any debt buyer or debt buyer employee should have no problem answering. Likewise, the fee, as stipulated in Section 20-491 of the New York City Administrative Code, is a mere $75.00 annually. Clearly, requiring that debt buyers abide by these licensing requirements is not unduly burdensome. In fact, the minimum effort it would require on their part would provide a great deal of much needed oversight in the consumer debt industry and would add much needed revenue to the city.

III. Impact of Debt Buyers and the Third Parties They Employ for Collection on NYC

The need for debt buyers to be regulated is particularly important in New York City right now, because debt buyers have become exceedingly harmful to New York City's constituents subject to their aggressive collection practices and their use of law firms and attorneys in initiating litigation. Though the New York City Administrative Code lists as examples of abusive tactics, threatening letters and harassing phone calls, the courts have also held that certain litigation techniques, like filing lawsuits with no arguable merit, are equally abusive.[11]

In the last few years, New York City's Civil Court has seen an explosion of consumer debt litigation. In our 2007 study[12], The Urban Justice Center found that in the previous year, over 50% of the total cases filed in the City's Civil Court arose out of consumer credit transactions, and that of the applicable cases reviewed, 99% of the cases brought by debt buyers

where submitted to the court with invalid evidence, almost always constituting inadmissible hearsay and thus failing to meet the minimum standards set forth by section 3215(f) of the Civil Practice Law and Rules. Furthermore, a majority of these cases end in default judgments against unrepresented defendants, with 80.0% of the cases reviewed in our study ending in such judgments. This is troubling for a number of reasons, not the least of which is the fact that such litigation tends to disparately impact low-income constituents, lacking legal representation.

Granting exclusion from the licensing requirements provides a way for debt buyers to circumvent the law, by merely hiring attorneys and law firms to initiate litigation as a means of collection, thereby qualifying them as "passive". Yet this allowance by the Department is baseless. The law focuses on the "principle purpose of the business" to qualify debt collectors, and as stated repeatedly, it cannot be disputed that the principle purpose of debt buyers' businesses is to collect defaulted debts. Additionally, in no other context does the city refuse to regulate the principle. If a landlord owns a building, but is not active in the management or operation, the city does not say, "landlord, don't register here, just register your agent and we will regulate them." No, the city declares that the landlord is liable for the acts and omission of his or her agents. The same should apply in the consumer context.

IV. Recommended Action

In light of these circumstances, we strongly support the Debt Buyer Licensing Bill, which would amend the Administrative Code of the City of New York to include in its definition of "Debt Collection Agencies", "buyers of debt who refer such debt to another for collection or an attorney-at-law for litigation in order to collect such debt", and "attorneys who regularly engage in activities traditionally associated with debt collection." Remember, the New York City would not exempt an owner from being registered with the appropriate agency just because they

have an agent collecting the rents for them. We require all owner and property managers to be registered. Why would be exempt a debt buyer from doing the same thing.

V. Conclusion

We hope that you will pass this bill that will help hundreds of thousands of low income consumers, like our clients here today. Finally, we thank you for the opportunity to testify here today on behalf of the Community Development Project at the Urban Justice Center.

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[1] Anika Singh, *Debt Weight, The Consumer Credit Crisis in New York City and its Impact on the Working Poor*, Urban Justice Center, October 2007, *available at* http://www.urbanjustice.org/pdf/publications/CDP_Debt_Weight.pdf.
[2] *Id.* at 22.
[3] New York City Administrative Code §20-488.
[4] *Id.* §20-489(1).
[5] Letter to Dennis Malen of Malen & Associates from Marla Tepper, General Counsel to the New York City Department of Consumer Affairs, dated March 7, 2007 (hereinafter "DCA Letter").
[6] *Id.*
[7] 15 U.S.C. § 1692a(6) (Supp. II 1979).
[8] Centurion Capital Corp., v. Druce, 2006 NY Slip Op 26521, 2; 2006 N.Y. Misc. LEXIS 3924, 3 (2006) (citing Claim of Lazarus, 268 A.D. 547, 52, N.Y.S.2d 682 [3rd Dept 1944] (federal decisions highly persuasive and uniformity in interpretation of federal statutes and state statutes desirable)).
[9] *Id.*
[10] *See* FTC Official Staff Commentary § 803(6), 1.
[11] *See, e.g.*, Kimber v. Federal Financial Corp., 668 F.Supp. 1480, 1478 (M.D. Ala. 1987); Dutton v. Wolhar, 809 F.Supp. 1130 (D. Del. 1992).
[12] Singh, *supra* note 1.

DEBT WEIGHT

The Consumer Credit Crisis in New York City and its Impact on the Working Poor

Community Development Project
The Urban Justice Center

www.urbanjustice.org/cdp

October 2007

ABOUT THE COMMUNITY DEVELOPMENT PROJECT

The Community Development Project (CDP) of the Urban Justice Center was created in September 2001 to provide legal, technical, research and policy assistance to grassroots community groups engaged in a wide range of community development efforts throughout New York City. Our work is informed by the belief that real and lasting change in low-income, urban neighborhoods is often rooted in the empowerment of grassroots community institutions. Since 2005, CDP's services have included representing alleged debtors on credit card, cell phone and medical debt cases in New York City Civil Court. In addition, CDP represents victims of consumer fraud and unfair debt collection practices in affirmative litigation in state and federal court. CDP also offers general counsel services to community groups advocating for economic justice, including consumer justice.

ACKNOWLEDGMENTS

This report was authored by Anika Singh. The New York City Civil Court Clerk's Office provided us easy access to the case files we reviewed to assemble this report. In particular, Carol Alt was an invaluable resource. Clerks in the five county courthouses, including Eddy Valdez, Lorraine Kenny, Joseph Traynor, Mike Boyle, Kaye Fong, Peter Catella, and their staff, were immensely helpful. Ted DeBarbieri, Chaandi McGruder, Molly Moynihan, Rachel Castelino and John Whitlow provided assistance reviewing case files. Dina Mishra provided research assistance. April Herms and Laine Romero-Alston made it possible for us to review and analyze the data. David Galt produced the maps. Thank you to Indie Singh and April Herms for proofreading the report. The law firm of Skadden, Arps, Slate, Meagher & Flom, LLP helped to make printing this report possible. This report would not have been possible without all of their hard work and that of Ray Brescia and Harvey Epstein, both of whom supervised this project.

CONTENTS

EXECUTIVE SUMMARY

The number of consumer debt cases filed in New York City Civil Court has exploded in recent years. In 2006 alone, approximately 320,000 such cases were filed in the five boroughs; this number is comparable to the total number of civil and criminal cases filed in the federal trial courts nationwide that year. Almost $1 billion in claims were made against New York City residents in consumer debt filings in 2006; in that year, we estimate that creditors ultimately obtained judgments of almost $800 million. In many ways, New York City Civil Court has become the "credit card court", with a majority of the cases filed throughout the five boroughs classified as consumer debt cases.

The impact of this judgment debt is profound. Once a judgment is obtained by a creditor against a debtor, the situation goes from bad to tragic. A creditor with a judgment can garnish wages and freeze bank accounts. Often, due to additional penalties, interest, fees and costs, the ultimate judgment obtained far exceeds any original debt that might have accrued. Sometimes, the defendant never owed the alleged debt, which may have been the result of identify theft, mistaken identity, clerical errors, or illegal fees and charges.

Once an account is frozen, a debtor under such a crushing weight may be unable to pay rent bills, utilities, obtain medicine and pay for food and other necessities. A judgment will invariably show up on credit reports and such a black mark on a credit report will make it more difficult to find an apartment, get a better job, and obtain credit. For the working poor, the judgment blocks their climb up the economic ladder, and they cannot obtain better housing or a better job, or get a loan for a car or home.

The total amount of judgments obtained against city residents in 2006, approximately $800 million, is the equivalent of building one new stadium for the Mets *every year*. Against this backdrop, this report is an attempt to understand the manner in which creditors are using the Civil Court of the City of New York to collect debts. To this end, the Urban Justice Center reviewed 600 randomly selected cases, all filed in February of 2006, in the five borough courthouses of the Civil Part of New York City Civil Court. The results of our research are striking.

Key Findings

Defendants rarely appear to defend themselves against consumer credit litigation. In 93.3% of cases, the defendant neither filed an answer nor entered into a settlement agreement. Anecdotal evidence suggests that this is the result of plaintiffs' failure to serve the summons and complaint on defendants so that defendants have no notice of the lawsuits against them. Other possibilities include defendants' inability to appear in court during normal business hours, defendants' inability to locate affordable legal representation, and defendants' own neglect.

Defendants are virtually never represented by counsel. We estimate that between zero and four percent of defendants are represented by counsel. Given that all creditors are represented by counsel and the defenses available to debtors can be complex, the gross disparity in representation means the overwhelming majority of legitimate defenses to the claims available to the debtors are never raised.

80.0% of cases result in default judgments, which are routinely granted without the requisite proof to establish the damages sought. When applying for a default judgment, a plaintiff is required to submit proof of the facts supporting its claim. In the cases we reviewed, the materials submitted in support of applications for default judgments almost always constitute inadmissible hearsay and do not meet the standard set forth in section 3215(f) of the Civil Practice Law and Rules. Nevertheless, in our study, applications for default

judgment were approved 100% of the time. In other words, plaintiffs are able to obtain judgments against defendants without ever submitting any proof that the defendants owe a debt to anyone or evidence of the amount of the alleged debt. The court system is being used to endorse hundreds of thousands of default judgments, which then wreak havoc on the lives of hundreds of thousands of New Yorkers.

We found that the monetary impact of consumer credit litigation in New York City is massive and approached an estimated one billion dollars in 2006.

The vast majority of litigation, 89.3% of all cases, is brought by debt buyers who have purchased defaulted debt from the company that originally issued the consumer credit, the original creditor. In other words, New Yorkers are sued by companies with which they have had no prior relationship. In addition, the majority of litigation is based on alleged debts with a small number of original creditors, many of which are common issuers of sub-prime credit cards. Furthermore, despite state and local laws that require entities seeking to collect debts through the courts to be licensed by state and city agencies, many creditors have not obtained such licenses. Just twelve of the thirty-nine debt buyers that filed lawsuits reviewed in this study were licensed by New York City's Department of Consumer Affairs.

Recommendations

- **Because the vast majority of debtors are unrepresented, more funding is needed for free legal services for debtors.**
- **Funding should be provided to offer more pro se resources, particularly assistance from court-employed or volunteer attorneys, in the court houses.**
- **The standards for obtaining default judgments must be clarified by the New York City Civil Court.**
- **The New York City Council should clarify the licensing requirements governing debt purchasers to ensure that only licensed debt collection agencies can avail themselves of the city courts. The New York City Department of Consumer Affairs should take a more proactive role in ensuring that the court system is not abused.**
- **Further research is needed to determine the reasons most debtors do not defend themselves in civil court actions brought against them.**
- **New York State should enact the Exempt Income Protection Act to protect the subsistence income of judgment debtors.**
- **Compensate defendants for fees and costs incurred in defending themselves against frivolous cases.**

BACKGROUND: CONSUMER DEBT AS A RISING CHALLENGE FOR WORKING NEW YORKERS

Staff members at the Urban Justice Center (UJC), a provider of free legal services to low-income and working poor New Yorkers, have noticed a steep rise in the number of New Yorkers seeking representation in consumer debt matters in the Civil Court of the City of New York. Anecdotal evidence suggests that this increase in demand for representation in consumer debt matters is a reflection of a larger city-wide phenomenon: that more working New Yorkers are facing lawsuits by credit card companies and other purveyors of consumer debt, at a time when the rising cost of living makes it more difficult for the working poor and the middle class to make ends meet. The UJC set out to explore this phenomenon by assessing the impact of consumer debt litigation on New York consumers. We also set out to examine, to the extent possible, the relative merits of a sample of civil filings, to determine the viability of the consumer credit claims raised in the Civil Court. Research into the nature of consumer debt litigation in New York City has led to the conclusions of this report, which include a finding that few defendants are represented by an attorney, that an overwhelming number of these cases are won by the creditor on default, and that a small number of creditors, typically third-party debt buyers, bring the majority of cases. Based on these findings, we make a number of recommendations, which are set forth at the end of this report. What follows, first, is an overview of the issue of consumer debt, on both local and national levels. Second, we review our findings. Finally, we set forth our policy recommendations outlining how New York City can respond to this growing crisis.

PART I: INTRODUCTION TO DEBT

Casting Judgment: The Explosion in Debt Collection Litigation and its Impact on New Yorkers

The volume of consumer debt litigation in New York City Civil Court has risen dramatically in recent years, with approximately 320,000 consumer debt cases filed in 2006 alone.[1] In fact, the number of consumer debt cases filed in the Civil Court now exceeds by 60% all Civil Court filings in 2001.[2] Indeed, between October 1, 2005 and September 30, 2006, there were 326,401 civil *and* criminal cases filed in all of the federal trial courts, the United States District Courts, combined nationwide.[3] Clearly, as the Civil Court itself recognizes, "[t]he Civil Court of the City of New York is one of the busiest Courts in the world."[4]

There are a number of complementary explanations for the massive increase in consumer credit transaction litigation over recent years. The nationwide volume of consumer debt has risen – more families are in debt and are in more debt than ever before.[5] Nationwide, the total value of consumer debt now exceeds $800 billion, a 31% increase in just the last five years.[6] Furthermore, more and more working families are using consumer credit to pay for basic necessities. Indeed, a recent survey of people with credit card debt revealed that "[s]even out of 10 low- and middle-income households reported using their credit cards as a safety net—relying on credit cards to pay for car repairs, basic living expenses, medical expenses or house repairs."[7]

But this shift in the economy and the manner in which consumers are making ends meet are only part of the explanation for the increase in consumer debt litigation. Through the 1970's, 80's and 90's, regulators and the courts largely gutted the regulatory scheme governing fees and interest charged by creditors.[8] As a result, credit card companies and businesses in similar industries charge ever-increasing interest rates and fees to consumers. Access to credit has increased as well.[9] Furthermore, identity theft, the fastest-growing crime in the country, results in debts which are never paid and are wrongfully ascribed to innocent victims.[10] Lastly, there is a growing market for purchase of defaulted debts.[11] These assignees, also known as third-party debt buyers, having purchased large volumes of debt for pennies on the dollar, then aggressively seek to collect on the full value of defaulted debts plus interest and fees. All of these factors contribute to New York's increase in consumer credit litigation.

More important than the mere increase in the number of Civil Court filings are the outcomes of so many of these cases, and how these outcomes impact average New Yorkers. As this study demonstrates, 80.0% of the cases we reviewed resulted in default judgments against unrepresented defendants. Once a judgment is entered, its effects can be devastating to the average New Yorker. A judgment creditor can enforce the judgment, without any further judicial intervention, and garnish the defendant's wages or restrain his or her bank account for twice the amount of the judgment.[12] Among the cases reviewed in our study, the average default judgment amount is $3,063.83. A judgment creditor can then freeze twice the judgment amount, or, on average, $6,127.65. The effect of this restraint, which can last up to a year, can be devastating. Clearly, for a family living paycheck-to-paycheck, a restraint on over $6,000 freezes the family's entire savings, assuming they had any to begin with. For New Yorkers with the lowest incomes, who may survive on Social Security or disability benefits, pensions, public assistance, child support, or Veterans benefits, their income is exempt from collection and restraint by creditors. Nevertheless, New York law currently allows savings from these sources of income to be restrained by a creditor with a judgment. The burden is then on the judgment debtor to prove that federal and state law exempt such income from collection. Even assuming the judgment debtor is aware of his or her rights to claim the exempt income, the claim process can take months. In the interim, the money remains restrained.

As a result of garnishments and frozen accounts, families are prevented from paying the rent, purchasing necessities like food and medication, and paying for utilities. The effect of a restraint or garnishment is particularly shocking where a person had no prior notice that he or she was the subject of a lawsuit.

Even where a person had notice of the lawsuit, he or she may not have had any knowledge that the lawsuit could result in a judgment and restraint that would far exceed what the person reasonably believed was owed the creditor, given that the judgment typically includes sums that represent the creditor's claims for penalties, interest, attorney fees and other fees and that restraint is twice the judgment amount. And he or she may be faced with the difficult choice of missing a day's wages and appearing in court in an effort to defend oneself, without an attorney, against a corporation represented by counsel.

For example, Ms. DM, a client of the Urban Justice Center and a single mother with a full-time job, earns $1,600 per month. As a result of identity theft, an $800 judgment of which she had had no notice was entered against her in July of 2006. Using the judgment, the judgment creditor restrained Ms. DM's bank account. Ms. DM was completely unaware that she had been sued until her bank account was restrained. The restraint lasted six weeks, causing Ms. DM to be late on a number of legitimate bills, including her rent, credit cards, life insurance premiums, and phone bills. Her bank assessed "legal processing fees" for having restrained the account. Unable to resolve the matter on her own, Ms. DM retained the services of the Urban Justice Center and, eventually, a court ordered the account released and dismissed the lawsuit against her. Nevertheless, as a result of the late payments, Ms. DM incurred hundreds of dollars in fees and interest charges. She also lost wages for days spent in court and meeting with her attorney.

In addition to leading to frozen accounts, high fees, and difficulty purchasing food and necessities, judgments also appear on credit reports. They remain on credit reports for up to seven years and have a significant negative impact on credit scores. Credit reports are frequently used to evaluate applications for loans and credit cards. They are also increasingly used by potential employers, landlords (even affordable housing developments intended for poor and working poor tenants), banks, insurance companies, and automobile financers.[13] In other words, a blemish on a credit report can have a snowball effect that makes it difficult for an individual to save money, find affordable housing, or obtain employment. The result is that a single consumer credit judgment can severely impair a person's attempt to become self-sufficient. As one commentator has noted, the "pervasiveness of destabilizing, high-cost credit in New York's low income neighborhoods is reflected back in people's credit reports, further perpetuating poverty for millions of New Yorkers."[14]

For example, Mr. ES, also a client of the Urban Justice Center, obtained a copy of his credit report only to find that the first item listed was a judgment. Prior to seeing his credit report, Mr. ES had not known that he had even been sued. Mr. ES was applying for jobs and had been unable to obtain employment. Many of the employers to whom Mr. ES applied required access to his credit report and considered his report in determining whether to extend him an offer of employment. When Mr. ES learned of the judgment on his credit report, he was able to find free legal representation. As a result of that representation, the judgment was vacated and the creditor agreed to discontinue the action.

In another example, in January 2006, Mr. OC was told that his wages would be garnished. Mr. OC had never received notice that he had been sued. According to the plaintiff's filings, the process server claimed to have served a non-existent person on a date when Mr. OC's entire family was out of the country, in the Dominican Republic. As a result of his blemished credit, Mr. OC, who was in the process of starting his own business, had trouble raising the necessary capital for his venture. Once represented by the Urban Justice Center, Mr. OC entered into a mutually acceptable settlement and payment plan with the creditor.

The vast majority of default judgments are not vacated, as this study demonstrates, and the judgment debtor must incur the costs and hardship of that judgment. The impact of consumer credit judgments on New Yorkers is immense and growing. The time is ripe to consider the forces underlying these judgments and the impact of consumer credit litigation on New York City. This study is just the first step of what should be a comprehensive review of the use of New York City Civil Court as the primary forum for the resolution of these cases.

Debt and the Working Poor

One out of five New Yorkers and a third of New York's children live in poverty[15] – this despite the fact that in over 46% of poor households, the head of the household is working.[16] 19% of New Yorkers live below the poverty line and an equal number have incomes that measure 100%-199% of poverty.[17] These are the working poor.

The working poor increasingly attempt to bridge the gap between their incomes and their needs with consumer debt. Nationally, consumer debt has increased rapidly over the past decade or so, particularly among low-income families. For example, the share of families with high credit card payments (above 10 percent of income) nearly doubled, rising from 13.5% in 1989 to 23.0% in 2004.[18] In 2004, roughly one out of every three families in the bottom income quintile carried credit card debt.[19] The mean amount of credit card debt was $6,504 for households with incomes less than $35,000 per year.[20] 36% of those who owe more than $10,000 on their credit cards have household incomes under $50,000.[21] On average, low-income families owe roughly 10 percent of their income on credit cards alone.[22] And in 2004, 27% of families in the bottom income quintile faced a debt-to-income ratio of 40% or greater.[23] Since 2005, the consumer savings rate in the United States has been below zero percent.[24]

The working poor fall into debt from hospitalization, trade school tuition (and, in some cases, fraud), student loans, or even prior emergency public benefit assistance. The Center for Responsible Lending has found that "the underlying reason behind some households having higher levels of credit card debt than other households was the occurrence of unforeseen events, such as job loss, medical expenses or car breakdowns."[25] As health costs increase, and since health insurance is no longer a standard employee benefit, medical emergencies will affect household expenses and debts more significantly than in the past.[26]

As a result of meager incomes, the high price of basic necessities, and the often astronomical costs associated with credit, many of New York City's working poor simply cannot pay their debts. We estimate that nearly 400,000 of the city's poorest households spend at least 40% of their monthly income paying their credit card and installment bills. Given that the average New York City family must devote nearly half its monthly income to rent,[27] the gravity of the situation is clear. The Federal Reserve reports that the number of the poorest families that have debts more than sixty days past due has increased by 50% over the past decade.[28] A

University of Michigan study found that more than half of low-income families with high consumer debts and low net worth in 1994 were still mired in debt in 1999, with their average indebtedness growing from $2,900 to $18,500.[29]

Sub-Prime Lending

A subset of the financial services market caters to individuals with spotty credit histories, low incomes, or limited access to the mainstream financial market. Against the backdrop of recent volatility in the housing market and a surge in foreclosure rates, sub-prime mortgages have become a prime area of focus for the media, advocates, and policymakers. New York City is a city of renters, however, where only one-third of New Yorkers own their homes (compared to two-thirds nationwide) and, relative to the rest of the country, a disproportionate number of homeowners have high incomes.[30] While New Yorkers have certainly fallen prey to the sub-prime market's abuses, costly and often predatory practices are not limited to the sub-prime mortgage industry. Sub-prime credit cards, like sub-prime home mortgages, are characterized by their high fees and interest rates. Sub-prime issuers make money by issuing credit cards with low credit limits, high interest rates, and high fees, including annual fees, over-limit fees, user fees, and delivery fees, many of which accrue before the consumer ever uses the card. A new cardholder might easily and immediately exceed a credit limit without making any charges, simply by accruing fees and interest on those fees.[31]

This type of debt can have a debilitating impact on the working poor, who may not be able to pay down balances, and, as a result, might face exorbitant and ever-mounting fees piled upon fees. Once debt accumulates, borrowers face higher interest payments and fees to service their debt. For the working poor, living from paycheck to paycheck, credit card interest and fees can rapidly far exceed the amounts borrowed. A bounced or late check can result in fees that further run up balances, resulting in underpayment of the next month's bill, often before the borrower realizes that there is a problem. As a result, the unexpected fees and interest accumulate and lead to negative credit history and bankruptcy.

The sub-prime sector, once dominated by a few discrete banks, like Providian Financial, became the fastest-growing segment of the credit card industry in the late 1990's.[32] By 2003, regulators and others began to crack down on sub-prime credit card issuers and a number of banks closed their sub-prime operations as a result of high rates of default and bankruptcy among their customers.[33] The New York State Attorney General's office has pursued two enforcement actions against sub-prime credit card issuers: Cross Country Bank, which was ordered to pay $9 million in penalties and refunds in January of 2006, and Columbus Bank and Trust Company and CompuCredit Corporation, which, in July 2006, agreed to reform their business practices and pay $11 million in restitution to New York consumers.[34] Six of the six hundred files reviewed in this study involved debts accrued with one of these three lenders and, as described below, we estimate that 30.0% of the cases reviewed involved sub-prime credit card debt. If we exclude cell phone debt from the study, we estimate that 46.6% of all the non-cell phone cases involved sub-prime credit card debt.

Nevertheless, sub-prime credit issuers continue to court and issue cards to low-income and other consumers.[35] Furthermore, the predatory surcharges and interest fees that plague the sub-prime credit card industry are also prevalent in the mainstream credit card industry.[36] Many of the major credit card issuers charge penalty fees for late payments (averaging $34 per late payment in 2005) or for exceeding one's credit limit (averaging $31 per occurrence in 2005).[37] Some charge higher "default" interest rates as a penalty for exhibiting riskier behavior, and often apply this higher rate retroactively to *all* outstanding balances.[38] In addition, credit card issuers use other tricks to maximize their revenues at low-income card holders' expense; twenty-three of the twenty-eight most popular large-issuer cards allocate payments to lowest interest balances first, and some cards use a double-cycle billing method that eliminates the interest-free period for certain unwitting customers.[39] These tricks catch many low-income and other credit card holders by surprise, especially since credit card agreements are often written at an eleventh- or twelfth-grade reading level while nearly half of the adult population in the United States reads at or below the eighth-grade level.[40]

Regulating Debt Collectors

Debt collectors are regulated on the federal level by the Fair Debt Collection Practices Act (hereinafter "FDCPA"),[41] on the state level by Article 29-H of the General Business Law,[42] and on the city level by the Administrative Code of the City of New York.[43]

The FDCPA prohibits a range of unfair debt collection practices by debt collection agencies. The statute applies with full force to purchasers of defaulted debt who then collect debt in their own name. In the majority of cases, it does not apply to original creditors. Courts have found that the FDCPA's general prohibition of unfair and abusive debt collection practices applies to unfair and misleading litigation practices as well as to other more familiar debt collection techniques, like phone calls and letters. The New York State debt collection statute prohibits certain unfair and abusive debt collection practices. It applies with equal force to both original creditors and debt collection agencies. It does not, however, include a private right of action and is enforced by the New York State Attorney General.

The New York City Administrative Code requires debt collection agencies to be licensed by the New York City Department of Consumer Affairs (hereinafter "DCA"). The licensing requirement was motivated by a finding by the City Council that there exist "consumer related problems with respect to the practices of debt collection agencies whose sole concern is the collection of debts owed to their clients."[44] Such debt collection agencies include third-party debt buyers and assignees.[45] The Council found that "there is a minority of unscrupulous collection agencies in operation that practice abusive tactics . . . which would shock the conscience of ordinary people."[46] "Due to . . . the vulnerable position consumers find themselves in when dealing with these agencies" the Council sought to protect "the interests, reputations and fiscal well-being of the citizens of this city . . . ."[47]

The term debt collection agency includes both companies that are contracted by creditors to perform debt collection services and third-party purchasers of defaulted debt. DCA has, however, issued confusing guidance regarding the need for certain third-party debt buyers to obtain a license where the debt buyer engages a law firm to initiate a lawsuit against the alleged defendant on behalf of the debt buyer. Debt buyers have interpreted this guidance to mean that certain debt buyers need not be licensed by DCA so long as their attorney is so licensed, despite the fact that it is the debt buyer that pursues litigation against alleged debtors. It is our firm belief that when requiring licensing of debt collectors, including purchasers of defaulted debt, the City Council did not intend to relieve a debt buyer of its obligation to obtain a license simply because it engaged a licensed debt collection law firm as its counsel.

Despite the regulatory scheme governing debt collectors, the working poor, like other New Yorkers, are often the victims of illicit debt collection practices. Between 2004 and 2006, the number of consumer complaints received by the City's Department of Consumer Affairs regarding debt collection practices jumped 70%.[48] The complaints range from attempts to collect invalid debts, to home and workplace harassment, improperly damaged credit histories, and more.[49] When their efforts to collect a debt by making phone calls and sending letters fail, debt buyers and creditors take their collection efforts and abusive practices to court.

Our study reveals that in 99.0% of applicable cases reviewed, debt buyers submitted facially invalid evidence in support of applications for default judgments.[50] As a result, it is impossible to tell how many of the 320,000 debt collection lawsuits filed annually have merit. We can only speculate as to the extent to which debt buyers are using the courts as an avenue to engage in unscrupulous, and unlawful, debt collection practices. Nevertheless, the debt buyers' consistent failure to provide relevant evidence in support of their claims suggests that they do not possess such evidence. Furthermore, anecdotal evidence suggests that where defendants appear and, using the discovery process, demand that plaintiffs produce evidence of their claims, plaintiffs often voluntarily discontinue an action. In essence, debt buyers initiate litigation on the presumption that they will prevail as a result of the defendant's default. Given the incredibly high default rate, such an

assessment is, far more often than not, correct. Where the defendant appears and the plaintiff is forced to prove its case, it often chooses not to and instead discontinues the action. If it is assumed that plaintiffs could not, if forced to do so, substantiate their claims in just 50% of the cases where a plaintiff failed to proffer admissible evidence in support of an application for a default judgment, it would call into serious question the underlying legitimacy of a significant percentage of all consumer credit cases filed in the Civil Court.

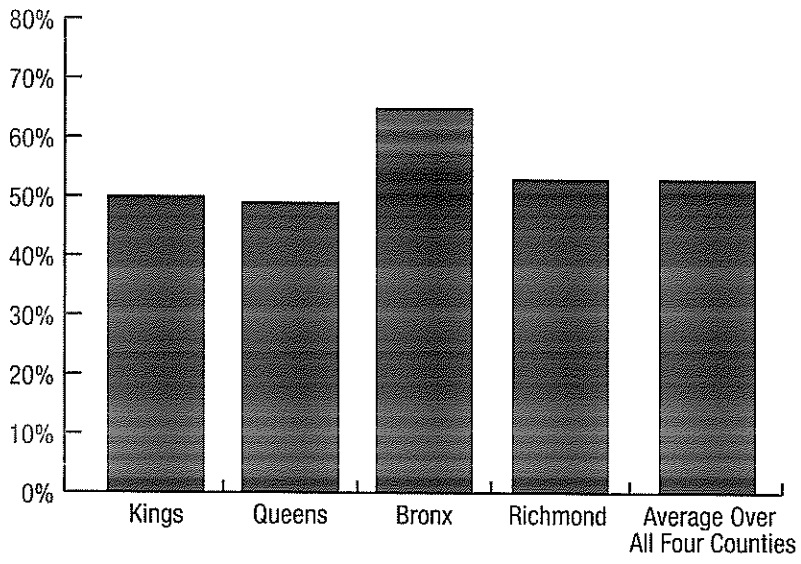
Debt Collection Litigation in New York City Civil Court

As described earlier, the volume of debt collection litigation in New York City Civil Court has risen dramatically over recent years.[51] In New York City Civil Court, non-landlord/tenant civil filings have increased 300% in five years, in large part as a result of consumer credit litigation.[52] According to a ten-year report on New York City Civil Court, "general civil filings exploded over the past five years [2001 to 2006]. Most of the filings involve consumer credit transactions . . . ."[53] Given this explosion, it is an appropriate time to consider these cases more closely and to evaluate the impact that they are having on the court system, creditors, accused debtors and New York City's neighborhoods.

In 2006, 523,186 cases were filed in the Bronx, Kings, Queens and Richmond County courthouses of the Civil Part of New York City Civil Court. Of these, 277,075 cases, or 53% of the total, arose out of consumer credit transactions.[54] In the Bronx, consumer credit cases represented 65% of total civil filings, a substantially larger percentage than the city-wide average.

These numbers represent just four of New York's five counties. Because New York County maintains its records in a different format than do the other counties, it is omitted from these statistics. It is estimated that if New York County is taken into account, there were approximately 320,000 consumer credit transaction cases filed in New York City Civil Court in 2006. More and more, New York City Civil Court is becoming a "credit card court," with over 50% of cases filed in that court arising out of "consumer credit transactions."

CHART 1: Consumer Credit Transaction Filings as a Percentage of Total Filings



SOURCE: New York City Civil Court

PART II: OUR STUDY

This study involved a survey of six hundred randomly-selected consumer debt cases filed in February of 2006 in order to increase our understanding of how consumer debt litigation takes place in New York and how it affects New Yorkers.[55] Specifically, we hope to better understand the following: How many New Yorkers were affected by debt collection litigation? Who are the plaintiffs and defendants in these cases? What types of debt are at issue? How often were alleged debtors represented by counsel? How many cases are settled? What is the average judgment amount? How are cases typically resolved?

Our research found that shockingly few defendants – just 6.7% – in consumer debt cases ever appear in court. Further research is required to determine whether this failure to appear results from fear of the court system, plaintiffs' failure to notify defendants that they have been sued (known colloquially as "sewer service"), or the inability to obtain the resources to defend oneself in court. Of those defendants who appeared in the cases reviewed, just two were represented by counsel. The rest represented themselves without the aid of an attorney.

Unfortunately, as a result of this shocking lack of representation and the utter failure or inability of the overwhelming number of defendants to appear to defend themselves, debt collectors and third-party debt buyers use the court system to obtain judgments against New Yorkers without ever having to concern themselves with proving their case in court. Our research further found that the debt collection litigation in New York City Civil Court has a massive monetary impact on New Yorkers. The estimated impact, almost $800 million,[56] is comparable to that of building a new major league baseball stadium in New York City *every year*.[57]

Abusive debt collection practices are not limited to the use of threatening letters and harassing phone calls. As courts have found, certain litigation techniques, like filing a lawsuit with no arguable merit or filing a suit after the applicable statute of limitations has passed, constitute abusive debt collection techniques.[58] These practices are particularly troubling where a defendant is unrepresented by counsel. In such cases, the vast majority of *pro se* litigants lack the requisite expertise and familiarity to defend themselves against these litigation methods. Alleged debtors, particularly those who are low-income, are rarely represented by counsel. New York's poor, as in so many other contexts, are forced to defend themselves from civil debt collection actions without the aid of an attorney.[59] This imbalance creates an obvious and unacceptable opportunity for harassment and abuse.

Findings

(1) In 2006 alone, debt buyers and creditors filed almost $1 billion worth of lawsuits against New Yorkers and obtained judgments for almost $800 million, a staggering success rate.

(2) To a limited extent, consumer credit litigation is disproportionately concentrated in low-income neighborhoods in Brooklyn and the Bronx. On the whole, however, consumer credit litigation affects residents of all of New York's neighborhoods and city council districts.

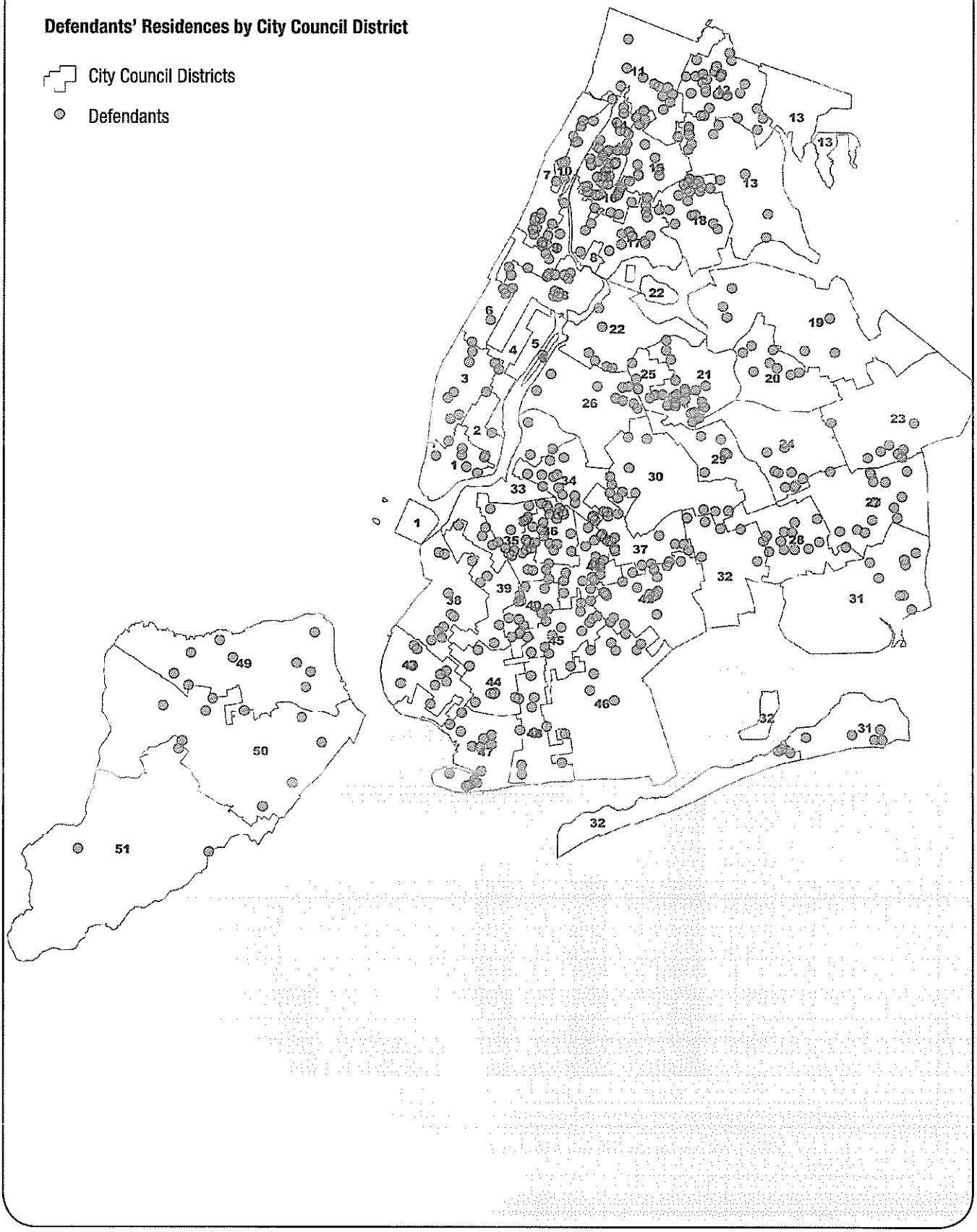
(3) The vast majority of litigation is brought by debt buyers. In addition, the majority of litigation is based on alleged accounts with a small number of original creditors, many of whom are common issuers of sub-prime credit cards.

(4) Defendants rarely appear to defend themselves in consumer credit litigation, suggesting that many defendants are not properly notified that there is a lawsuit against them.

(5) 80.0% of cases result in default judgments. These are judgments based on the defendant's failure to appear to defend himself, not based on the merits of the plaintiff's case.

(6) In 99.0% of the cases where default judgments were entered, the materials underlying those applications constituted inadmissible hearsay and did not meet the standard set forth in section

Defendants' Residences by City Council District



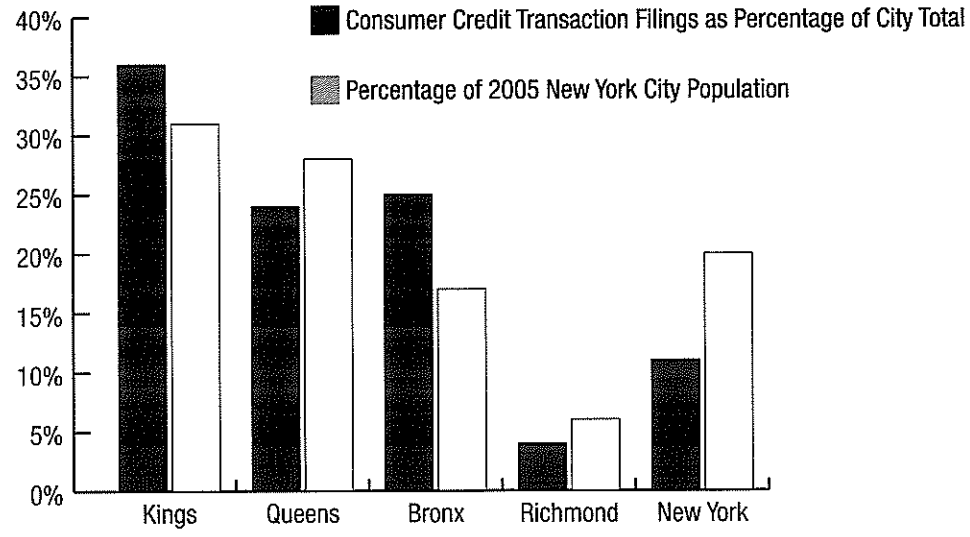
SOURCE: Urban Justice Center calculations from review of New York City Civil Court case filings

3215(f) of the Civil Practice Law and Rules for the entry of a default judgment. Nevertheless, these applications were approved; the default judgments were entered; and New York consumers suffered the consequences.

Who are the Defendants?

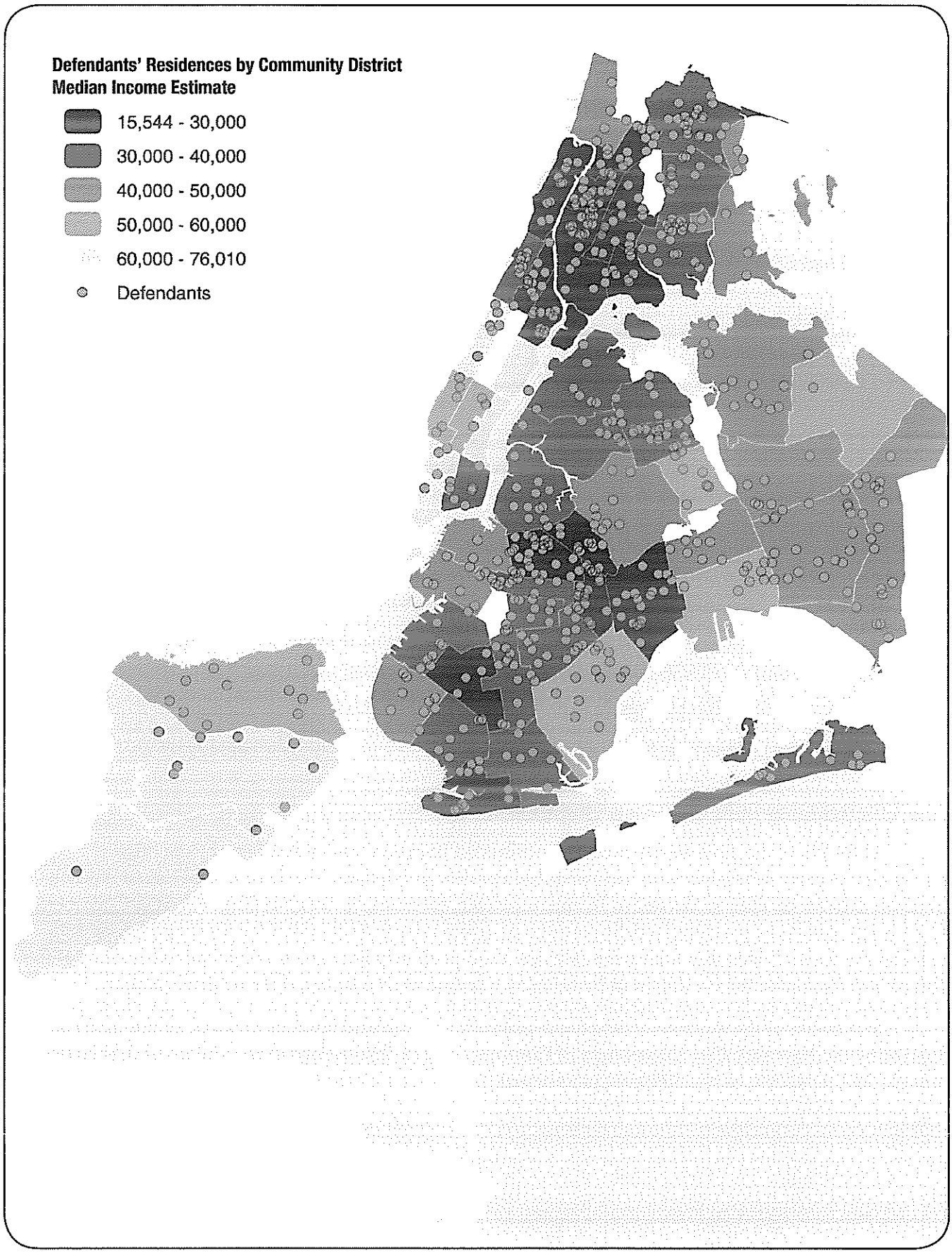
Of the 2006 consumer credit filings in the four counties other than New York, 41% were filed in Kings County, 27% were filed in Queens, 28% were filed in the Bronx and 4% were filed in Richmond County.[60] Based on the total number of cases filed in New York County during February of 2006 and the number of consumer credit cases filed in the four other counties during February of 2006, we estimate that if New York County is taken into consideration, 4% of cases are filed in Richmond County; 25% of cases are filed in the Bronx; 36% are filed in Brooklyn; 24% are filed in Queens; and 11% are filed in New York County. Appendix B includes a table indicating the City Council districts in which defendants in cases reviewed for this study reside. Map 1 displays this information as well. Map 2 shows where defendants reside relative to a neighborhood's average median income. As Map 2 indicates, there is a somewhat greater concentration in areas with lower median incomes, in particular, central Brooklyn and the South Bronx. Nevertheless, Map 1 and Appendix B demonstrate that this phenomenon is a city-wide problem. Defendants reside all over the city and in virtually every Council district. Note that these numbers are out of a sample of 600 cases. Given that plaintiffs filed approximately 320,000 consumer credit transaction cases in New York City Civil Court in 2006, we estimate that in twenty-four city council districts, as indicated in Appendix B, 5,000 or more residents faced consumer credit litigation last year. In an additional eight districts, over 10,000 residents faced consumer credit litigation. These are 12th, 14th and 16th Districts in the Bronx, and the 34th, 35th 36th, 41st and 42nd Districts in Brooklyn.

CHART 2: Consumer Credit Transaction Filings as Percentage of City Total – February 2006



SOURCE: New York City Civil Court and 2005 Census Bureau estimates from the Current Estimates Program

As Chart 2 shows, with respect to their population, both Kings County and Bronx County are overrepresented in terms of the number of consumer credit transaction filings. It is likely no accident that these two counties also have the lowest per capita income in New York City. In 1999 the per capita incomes in the



SOURCE: Urban Justice Center calculations from review of New York City Civil Court case filings. Furman Center for Real Estate and Urban Policy, State of New York City's Housing and Neighborhoods 2006, available at http://www.furmancenter.nyu.edu/SOC2006.htm

Bronx and Kings County were $27,550 and $30,610, respectively, versus $38,042 for Queens, $43,573 for New York County, and $54,252 for Richmond County.

In 93.3% of the files we reviewed, the defendant neither filed an answer nor entered into a settlement agreement filed with the court. Of the forty defendants, 6.7%, who appeared, eight did so only after a default judgment was entered against them. All eight successfully asked the court to vacate the default judgment, usually upon showing that they had had no prior notice of the lawsuit. Just two defendants were represented by counsel.[61] Given how few defendants appear in court and the fact that just two of the six hundred files reviewed reflected an appearance by an attorney on behalf of a defendant, it is not apparent from this study how many defendants have defenses to plaintiffs' claims of alleged debt because an unrepresented defendant may not be aware of all of the defenses he or she might raise.

For example, it is unclear how many defendants are victims of identity theft. Anecdotal evidence, however, suggests that identity theft is a significant problem and often results in debt collection litigation against individuals who have no liability for the debt in question. Almost nine million people, or four percent of the United States population, were victims of identity theft in 2006, according to the Council of Better Business Bureaus.[62] In fact, a recent study found that New York State has the highest rate of identity fraud among the fifty states.[63] Furthermore, New York City has the highest incidence of identity fraud among metropolitan areas.[64] Further research is required to determine how often identity theft plays a role in debt collection cases resulting in litigation. According to attorneys who practice in this area, other common defenses include mistaken identity, that a debt has already been paid, a plaintiff's lack of standing, and the inflation of an alleged debt by fees and interest unauthorized by law.

Total Value of Claims Sought in Debt Collection Litigation

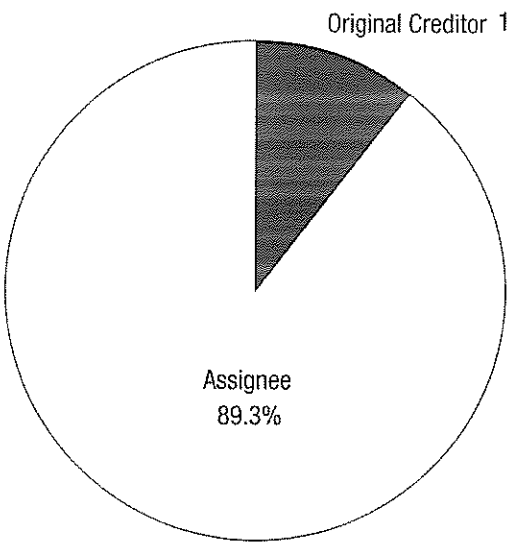
The amount sought in each of the cases reviewed ranged from $400.87 to $24,999.00.[65] The mean amount sought among the files reviewed was $3,062.57. Conservatively estimating that purported creditors filed 320,000 consumer credit cases in New York City Civil Court in 2006, we estimate that these lawsuits demanded an estimated $980,022,870.90, almost one billion dollars, in damages, interest and attorney fees from alleged debtors in New York City Civil Court.

Plaintiffs Initiating Debt Collection Litigation

In 89.3% of the cases we reviewed, debt collection litigation was initiated not by the original creditor but by a third-party debt buyer who had purchased the debt in question. Third-party debt buyers typically purchase debt for pennies on the dollar. In one recent sale, for example, Asta Funding, Palisades Collection, LLP's parent company, purchased a debt portfolio of approximately $6.9 billion for $300 million, or 4.35 cents on the dollar.[66] After purchasing the debt, the third party may attempt to collect the full amount of the alleged debt by contacting the debtor or by bringing a lawsuit as an assignee of the original creditor.

Just twelve of the thirty-nine debt buyer plaintiffs who initiated lawsuits reviewed in this study are licensed by the New York City Department of Consumer Affairs. The twenty-seven unlicensed debt buyers brought 257, or 42.8%, of the 600 lawsuits reviewed.

CHART 3: Percentage of Plaintiffs Who are Original Creditors and Assignees



SOURCE: Urban Justice Center calculations from review of New York City Civil Court case filings

Our research found that a small number of companies bring the majority of the assignee litigation in New York City Civil Court. Indeed, as the following chart shows, out of the files we reviewed, just *one* creditor brought over one-third and just *two* creditors brought over one-half of all six hundred cases reviewed. These findings reflect the overall debt purchase industry in which just ten companies purchased two-thirds of defaulted credit card debt in 2004.[67]

TABLE 1

Assignee Plaintiff	Number of Lawsuits (of sample of 600)	Percentage of Total Sample
Palisades Collection, LLC	234	39%
Wholly-owned subsidiaries of Encore Capital Group, Inc.	72	12
LR Credit 10, LLC	44	7.3
Erin Capital Management, LLC	21	3.5
Colorado Capital Investments, Inc.	16	2.7
NY Financial Services, LLC	13	2.2
RAB Performance Recoveries, LLC	13	2.2
Rushmore Recoveries-related entities	13	2.2
Metro Portfolios, Inc.	11	1.8
LVNV Funding LLC	9	1.5

SOURCE: Urban Justice Center calculations from review of New York City Civil Court case filings

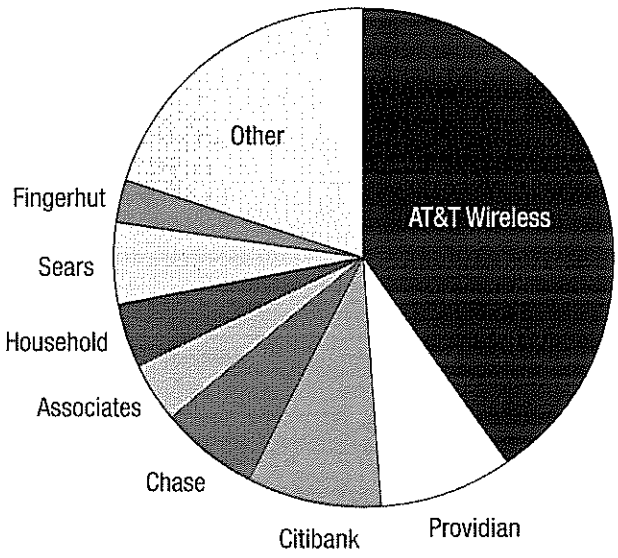
Defendants can expect to receive somewhat less information regarding the alleged underlying consumer credit transaction when they are sued by a third party rather than an original creditor. In the cases reviewed in this study, where the assignee brought the lawsuit, there was a 49.3% chance that the complaint

would not include an account number for the alleged original debt. On the whole, however, the vast majority of complaints, 98.1%, filed by third parties did identify the alleged original creditor.

The majority of debt buyer litigation reviewed in our study was based on alleged credit card accounts. There is one major exception. Notably, the most common plaintiff, Palisades Collection, LLC, claims to have purchased a large portfolio of defaulted debt from AT&T Wireless when that company merged with Cingular in 2004.[68] It is not surprising then that in the plurality of lawsuits, the alleged debt had been incurred with AT&T Wireless. In fact, among cases reviewed in this study, alleged AT&T Wireless accounts were the basis of 43.7% of consumer credit cases brought by a third-party debt buyer and 39.0% of all of the files reviewed.

Interestingly, in September 2006, five individuals who had been sued by Palisades Collection, LLC for alleged AT&T Wireless debts in New York City Civil Court sued Palisades and its law firm, Pressler and Pressler, LLP, in federal court for violations of the federal Fair Debt Collection Practices Act, 15 U.S.C. § 1692 *et seq.*[69] In particular, the five alleged that Palisades sued them without having made any effort to determine whether it had any basis to do so. Furthermore, they alleged that Palisades' complaints were patently untrue and that any materials provided in support of the underlying cases against the defendants constituted inadmissible hearsay and could not be used to support the plaintiff's original claims. In other words, the five alleged that Palisades Collection, LLC and Pressler and Pressler initiated lawsuits against alleged debtors knowing that they could not, if required to do so, prove the elements of their claims.[70]

CHART 4: Incidence of Original Creditors in Litigation



SOURCE: Urban Justice Center calculations from review of New York City Civil Court case filings

Of the other original creditors found in our file review, a number, particularly Providian,[71] Associates,[72] Direct Merchant Bank,[73] First National Bank of Marin,[74] Cross Country Bank,[75] First North American National Bank[76] and Household,[77] are common issuers of sub-prime credit cards. In addition, other lenders, like Citibank and Chase, offer sub-prime products. It is impossible to know exactly which cases involved sub-prime credit cards without reviewing the underlying credit card agreement in each case.[78] Nevertheless, taking into account the number of cases we reviewed that involved credit card issuers specializing in the sub-prime market, we estimate that approximately 29.2% of the cases brought by third-party debt buyers involve sub-

prime credit card debt. If we exclude AT&T Wireless cell phone accounts, sub-prime credit cards are the basis for 48.9% – almost half – of assignee-initiated litigation among the cases we reviewed.

Of the 10.7% of lawsuits brought by original creditors, 59.0% were brought by either of two creditors, Capital One or Discover Bank. Notably, Capital One is a common issuer of sub-prime credit cards.[79] If we include these cases when estimating how many lawsuits arise out of sub-prime credit card transactions, we can estimate that 30.0% of all six hundred cases reviewed involved sub-prime credit cards and that 46.6% of all non-cell phone cases reviewed involved sub-prime credit cards.

TABLE 2

Plaintiff (Original Creditor)	Number of Lawsuits (of sample of 600)
Capital One	25
Discover Bank	11
Federated Department Stores	5
Citibank, N.A.	3
Other	17

SOURCE: Urban Justice Center calculations from review of New York City Civil Court case filings

The prevalence of sub-prime credit card issuers among both plaintiffs and original creditors in these cases suggests, first, that these sub-prime cards are frequently unaffordable to cardholders and, second, that a large number of defendants in these cases are low-income. While many New Yorkers are victims of predatory home mortgage lending,[80] in a city of renters it is likely that larger numbers have fallen prey to sub-prime credit card lending. Low-income homeowners across the country have accessed home equity to pay other bills.[81] The result, in part, has been the depletion of home equity and savings.[82] Because few low-income New Yorkers can tap home equity to pay for basic expenses when their savings fall short, they have fewer credit products from which to choose when borrowing to make ends meet. As discussed above, the sub-prime mortgage foreclosure crisis is mirrored in the arena of consumer debt litigation – we believe this may be particularly true in New York, where the vast majority of low-income people do not own their own home.

Representation

While 100% of plaintiffs initiating consumer credit transaction cases reviewed in our study were represented by counsel, just two of six hundred, or less than one percent of defendants, were represented. A small number of law firms bring the vast majority of consumer credit litigation.

TABLE 3

Debt Collection Law Firm	Number of Lawsuits (of sample of 600)
Pressler and Pressler, LLP	197
Cohen & Slamowitz, LLP	106
Mel S. Harris & Associates, LLP	67
Wolpoff & Abramson, LLP	63
Rubin & Rothman, LLC	37
Eltman, Eltman & Cooper, P.C.	21
Mullooly, Jeffrey, Rooney & Flynn, LLP	19
Forster & Garbus, Esqs.	18
Malen & Associates, P.C.	14
Sharinn & Lipshie, P.C.	11

SOURCE: Urban Justice Center calculations from review of New York City Civil Court case filings

Defendants were represented by counsel in just two of the cases reviewed in the course of this study. In both of these two cases in which an attorney appeared for the defendant, the parties stipulated to discontinuance of the action with prejudice.[83] Based on our research to date, and taking into account the appropriate margin of error for our analysis, we are able to say with 95% confidence that between zero and 4% of defendants overall are represented by counsel. It is widely acknowledged that too many tenants are not represented by counsel in New York City Housing Court; it would appear that even fewer alleged debtors are represented by an attorney.[84]

Resolution

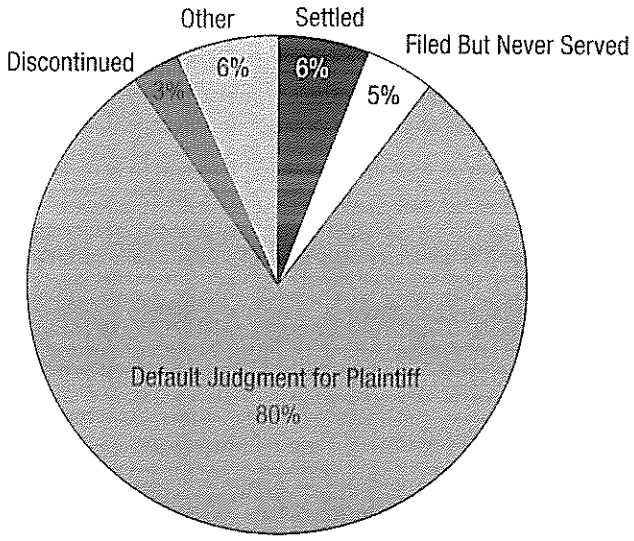
In 81.8% of cases reviewed in our study, the court entered a default judgment against the defendant. A default judgment is a judgment based not on the merits of the case, but on the fact that a party has not responded to a complaint or pleading or has not appeared in court when required to do so. This failure to respond or appear is considered a default. While the judgment is based on one party's default, default judgments require some evidentiary showing in addition to the default. As described below, they should not be entered where the plaintiff has not put forward any evidence of its underlying claim and damages.

In nine of the 491 cases where a default judgment was entered against the defendant, the court later vacated the default judgment upon a request by the defendant. These requests were typically based on the defendant not having received notice of the lawsuit prior to entry of the default judgment. In one of these 491 cases, the plaintiff discontinued the action following entry of the default judgment. As a result, in just under 2% of cases, a default judgment was entered but later vacated. In total, 80.0% of cases resulted in a final default judgment. In other words, the vast majority of plaintiffs secured judgments because the defendant did not appear to answer the complaint or failed to appear at a court-ordered hearing or conference. The number of default judgments we found in the New York City Civil Court corresponds to that found in a 2006 investigation of consumer debt cases in small claims courts in Massachusetts, which estimated that about 80% of people sued on consumer debts in Massachusetts courts failed to appear.[85] According to anecdotal evidence, like the stories of UJC clients described above, the fact that the defendant does not appear in court often results from the plaintiff's failure to provide notice of the lawsuit to the defendant. In addition, many alleged debts are years old and the plaintiffs do not have current contact information for alleged debtors. As a result, defendants do not receive actual notice that there is a lawsuit pending against them.

A much smaller percentage of cases, 5.9%, were settled by both parties. Typically, settlement

agreements provided either for discontinuance of the action or for defendants to make installment payments of $25 to $100 until the defendant had paid approximately 90%, on average, of the amount demanded in the complaint. In one case, the defendant's failure to make payments according to the settlement agreement gave rise to a later default judgment. 3.2% of cases were ultimately unilaterally discontinued by the plaintiff[86] and 4.5% were filed but never served on the defendant. In others, the case appeared to be still pending. Not a single case went to trial or was otherwise adjudicated on the merits.

CHART 5: Resolution of Consumer Credit Lawsuits



SOURCE: Urban Justice Center calculations from review of New York City Civil Court case filings

Section 3215 of the New York State Civil Practice Law and Rules governs the entry of default judgments.[87] Where the plaintiff's claim is for a sum certain, as is the case in most consumer credit litigation, a default judgment may be entered upon application to the clerk. The plaintiff need not make a motion before a judge.[88] When a defendant defaults, the plaintiff need not prove its case at trial. Nevertheless, it must present some requisite proof – "proof of the facts constituting the claim, the default and the amount due"[89] – to make a showing that it has a valid case and that the amount sought is proper. In other words, the simple fact that the defendant has not appeared is not enough to support a default judgment. The plaintiff must make some showing that it has a valid claim. The Civil Practice Law and Rules do "not contemplate that default judgments are to be rubber-stamped once jurisdiction and a failure to appear have been shown. Some proof of liability is also required to satisfy the court as to the *prima facie* validity of the uncontested cause of action."[90] As a result, in its application for a default judgment, the plaintiff must provide some proof of its claim.

A recent case described the obligation of a plaintiff to set forth the basis of its claim when making an application for a default judgment – as well as the obligation of the clerk to confirm that the plaintiff has met its burden – as follows:

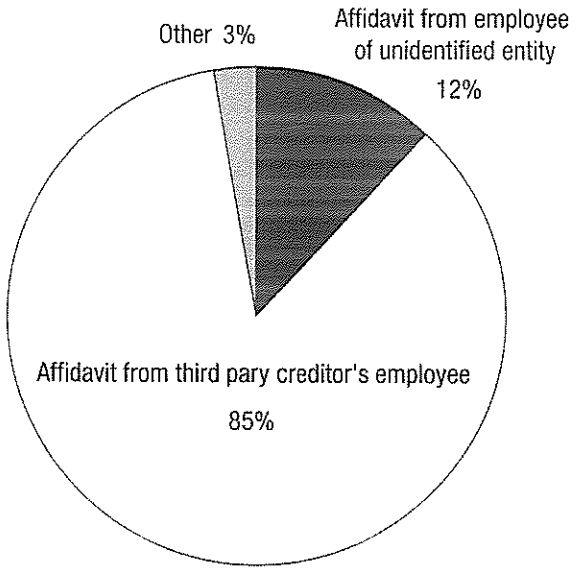
> The defendant's default does not automatically create a mandatory ministerial duty by the clerk to enter a default judgment against that defendant since the plaintiff is required to demonstrate that he or she has a viable cause of action. Section 3215(f) of Civil Practice Law and Rules requires the plaintiff to establish,

> in instances where the damages sought are for a sum certain or for a sum which can by computation be made certain, the facts constituting the claim, the default and the amount due. The plaintiff can satisfy this requirement through an affidavit of a party, *who possesses personal knowledge of the facts*, or with a complaint that is properly verified by a party with personal knowledge.[91]

A plaintiff seeking judgment on an alleged credit card debt must provide some proof of its claims. One court, considering the proof required to support a motion for summary judgment where a defendant has defaulted, required "an affidavit sufficient to tender to the court the original agreement, as well as any revision thereto . . . The same affidavit typically advances copies of the credit card statements which serve to evidence a buyer's subsequent use of the credit card and acceptance of the original or revised terms of credit."[92] "The affidavit must demonstrate personal knowledge of essential facts or the judgment will be assailable, even if the defendant defaults."[93] Where the plaintiff seeks attorney fees, it must also provide evidence in support of its claim for such fees. "A request for legal fees requires presentation of (1) an agreement to pay such fees, tendered by an appropriate affidavit, and (2) an attorney's affirmation detailing the fee arrangement, the legal services provided and the relevant factors bearing upon the claim."[94] In other words, the plaintiff must provide written testimony, or an affidavit, from someone who is familiar with and can testify to the legitimacy of the plaintiff's claim. It is not sufficient that the plaintiff submit an affidavit; the affidavit must by made "by a person with knowledge of [the relevant] facts."[95] Documents evidencing the claim, such as a signed credit card agreement and credit card statements, may also constitute proof of a claim.

In 2000, the New York City Civil Court responded to recent case law regarding the standards for materials provided by a plaintiff in support of its application for a default judgment. The Court issued a directive that "[a] default judgment entered by the Clerk following CPLR § 3215 requires that there be an affidavit of facts *from a party to the action.*"[96] This directive is consistent with recent case law regarding whose affidavit may support an application for a default judgment. What it does not address, however, is the knowledge the affiant must have of the claim in question. Unfortunately, it would appear from the results of our study that plaintiffs are following only the letter of the directive. Typically, a plaintiff submits the affidavit of an agent of the party to the action, but does not follow the case law that requires that the affiant have personal knowledge of the facts constituting the cause of action.[97] In other words, third-party debt buyers provide affidavits from people who cannot actually attest to the legitimacy of their claims. By indicating that a party's representative must support an application for default judgment, the New York City Civil Court has taken one step towards ensuring that default judgments are granted on the basis of proper applications. Nevertheless, as the following discussion demonstrates, more direction is clearly needed.

CHART 6: Materials Provided in Support of Default Judgment Where Plaintiff is an Assignee



SOURCE: Urban Justice Center calculations from review of New York City Civil Court case filings

Of the cases reviewed, in the majority of those brought by a third-party debt buyer, the plaintiff provided an affidavit signed by an employee of the debt buyer. An employee of the third-party debt buyer has no familiarity with the underlying debt and cannot make any claim as to the legitimacy of the business records purporting to prove that a debt liability exists. As a result, the affiant cannot adequately confirm the existence or amount of the debt. One court has found such affidavits to be "irrelevant," "insufficient," and "of no probative value."[98] In the cases reviewed in this study, assignee plaintiffs never provided either a copy of the original contract or account statements and never provided an affidavit from the original creditor. In 12% of the cases reviewed, plaintiffs provided an affidavit from "an employee of plaintiff's assignee" with absolutely no reference to who "plaintiff's assignee" is. These affiants are employed by some unknown entity. It does not appear that "plaintiff's assignee" is the original creditor. We reviewed multiple files involving the same affiant but different original creditors and different third-party debt buyers. Like the affidavits from employees of the third-party debt buyers, these lack probative value and should not have been considered "proof" of the plaintiff's claim. Indeed, granting default judgments based on these affidavits contravenes *both* case law *and* the Civil Court Direction cited above, which requires that affidavits of facts be "from a party to the action."[99] These affidavits neither come from a party to the action, nor do they come from a person with personal knowledge of the facts constituting the cause of action. Notably, in two files reviewed, no materials were provided in support of the application for a default judgment. Nonetheless, the default judgments were granted.

Contrary to the standards described above, in support of their applications for default judgments, assignee plaintiffs provided inadmissible evidence that did not support the claims set forward in their complaints. In the cases we reviewed, the affidavits provided in support of plaintiffs' applications for default judgment were made by people who appear to have had no personal knowledge of the underlying facts. As such, they failed to constitute "proof of the facts constituting the claim," as required by section 3215(f) of the Civil Practice Law and Rules. Based on anecdotal evidence provided by attorneys who represent defendants in these cases, where an opposing attorney demands proof that his or her client owes a debt, plaintiffs often fail to produce such evidence and often voluntarily dismiss their actions.

The Value of Default Judgments

The mean final default judgment amount among files reviewed in our study was $3,063.83. Estimating that there were 320,000 consumer credit cases filed in New York City Civil Court in 2006 and that 80.0% of cases resulted in a default judgment, we can approximate the total impact of default judgments on New Yorkers. In 2006 alone, we estimate that the New York City Civil Court entered judgments worth approximately $784,339,250.77 against New Yorkers in the five boroughs. As a percentage of the amount demanded in complaints filed, just under $1 billion, this represents a staggering success rate for creditors and debt buyers initiating lawsuits in New York City Civil Court and a staggering defeat for New York City consumers.

PART III: CONCLUSIONS AND POLICY RECOMMENDATIONS

Based on our findings, we make the following conclusions and policy recommendations.

(1) Fund legal services for low-income and working poor individuals sued on alleged debts in New York City Civil Court. Fund the provision of assistance, information and resources for pro se defendants on-site at each of the five county courthouses.

Given the massive impact that debt collection litigation has on both individuals and neighborhoods, it is important that individuals have the resources to defend themselves against consumer credit transaction claims. Anecdotal evidence suggests that where consumers are represented by counsel, debt buyers are quick either to settle or to discontinue cases that they may not be able to prove in court. Currently, so few defendants are represented by counsel that it is difficult to know how many defendants have defenses to the claims brought against them by creditors and assignees. There is a dire need for legal services in this area such that people who are already poor and working poor are not further burdened by collection litigation, the monetary impact of which is massive and can be devastating to individual families.

With initial grants from the Skadden Fellowship Foundation and the New York State Interest on Lawyers Account Fund, the members of the Legal Services for the Working Poor Coalition (LSWP), of which the Urban Justice Center is a part,[100] have begun to represent working families with consumer debt problems. Unfortunately, as is too often the case with free legal assistance, the LSWP members are forced to turn away far more families in need of representation in Civil Court matters involving consumer debt than the groups can represent with current funding levels. Clearly, more funding is needed to make it possible for legal services programs such as LSWP to handle a meaningful number of consumer debt cases.

Given the volume of litigation, however, it is unlikely that every defendant could ever be provided a free attorney. Accordingly, the provision of free legal services must be supplemented with the provision of advice and resources to *pro se* litigants. The Civil Legal Advice and Referral Office (CLARO) currently provides such services for two evening hours a week at the Brooklyn Civil Court and is being expanded to Queens and Manhattan. This program should be expanded to all five boroughs. Further, in addition to evening hours, there should be hours of operation during normal business hours that coincide with the times when cases are calendared so that *pro se* litigants need not come to court multiple times to receive the services they need to defend themselves.

(2) Clarify the standards required of applications for default judgments.

Applications for default judgments should be held to applicable standards prior to being granted. At a minimum, plaintiffs should be required to present some admissible proof of their claims and damages sought, as required by section 3215(f) of the Civil Practice Law and Rules. Among cases reviewed in this study, the affidavits that provide the basis for most applications for default judgments in consumer credit transactions are form affidavits. Other than the name of the alleged debtor, the affidavits are largely indistinguishable from

one another. Many do not attest to the assignment of the underlying debt. Most importantly, they constitute inadmissible hearsay. The standards for approving applications for default judgments ought to be clarified. Given the impact of default judgments on defendants' economic health, where such defendants are not present to defend themselves, the importance of ensuring that such judgments are not improperly entered cannot be over-emphasized.

On March 12, 2007, the Civil Court issued a Directive requiring that all consumer credit transaction cases filed in New York County be assigned to a mandatory Mediation Part "[u]pon the filing of an Answer in Person in a consumer credit case for less than $10,000, where the defenses suggest money is owed and a settlement is sought."[101] Prior to March 12, 2007, these cases were "scheduled for a pre-arbitration conference date over eight months away."[102] The mandatory Mediation will take place within 15 days of when the defendant files his or her Answer in Person. Mediations are calendared for Fridays at 10 a.m. Failure by either party to appear is cause for either dismissal or entry of a judgment on default. It is too early yet to know what the effect of this policy will be. Advocates and the court system need to monitor the program, particularly with respect to the ability of defendants to appear in court on a weekday at 10 a.m. to represent themselves at the mediation. In addition, mediators should be trained regarding the elements required to establish a *prima facie* case that a debt is owed so that they are able to evaluate the strength of each party's claims when conducting the mediation.

(3) Confirm that debt buyers engaging in debt collection litigation must be licensed by the New York City Department of Consumer Affairs.

As this study demonstrates, the failure of debt buyers to substantiate the validity of their claims against alleged debtors and these debt buyers' use of the court system to pursue judgments against these debtors in the absence of adequate proof constitute abusive and unfair practices that ought to be subjected to DCA oversight, licensing requirements, and the possibility that a license will be revoked from companies that abuse consumers and the court system. The New York City Council should clarify that referring an account for litigation constitutes collection activity and that debt buyers that engage in such activity must be licensed by the Department of Consumer Affairs.

The court system has become fertile ground for harassment and abuse. Debt collectors and assignees use the courts to intimidate accused debtors, the vast majority of whom are unrepresented by counsel. To the *pro se* defendant, the simple fact that a debt buyer has filed a lawsuit and is represented by counsel lends an air of legitimacy to the debt buyer's case that can be easily abused. Furthermore, the fact that affidavits in support of default judgments are largely devoid of any evidentiary merit and that debt buyers, when faced with a defendant who has successfully obtained counsel, often discontinue pending litigation, suggests that debt buyers routinely initiate lawsuits based on claims that they cannot prove. Accordingly, debt buyers that initiate litigation in an attempt to collect alleged delinquent debts should be regulated by and required to obtain licenses from the Department of Consumer Affairs. This requirement is, in essence, self-enforcing as unlicensed debt buyers cannot bring debt collection lawsuits in New York State courts.[103]

Furthermore, DCA should require information about litigation practices from debt buyers seeking licensure. For example, DCA ought to inquire about the volume of litigation brought by the applicant; the applicant's business records supporting debt collection claims; and the debt buyers' non-litigation debt collection activities. Debt buyers that abuse the court system should be stripped of debt collection licenses by the Department of Consumer Affairs and, as a result, stripped of the ability to bring debt collection litigation in the New York State courts.[104]

(4) Further examine the reasons why defendants do not appear to defend themselves in these cases.

Further research is required to determine why alleged debtors fail to appear in court to defend themselves from consumer debt litigation. Anecdotal evidence suggests that often the problem is "sewer

service," the failure of the plaintiff or its process server to serve the defendant. As a result, many defendants are simply not aware that they have been sued. In 1977, recognizing the prevalence of sewer service in this industry, the New York State legislature passed legislation requiring that a notice be mailed to defendants in consumer credit transactions before a default judgment is entered. A later revision of this law indicated that this notice could be sent simultaneously with service of process. Unfortunately, this means that if the original service of process is ineffective, the consumer also never receives this additional required notice and the provision fails to meet its goal of protecting consumers from sewer service.

The problem of sewer service is not limited to consumer debt transactions. It also happens in other contexts, particularly landlord-tenant cases. To address this issue in the Housing Part of New York City Civil Court, section 208.42(i) of the New York City Civil Court Rules requires that when a landlord sues a tenant, the landlord must provide the clerk a stamped postcard, addressed to the tenant, indicating in Spanish and in English that the tenant has been sued and the index number of the case. The court clerk then mails the postcard to the tenant.

Further research is required to determine whether such an approach would be appropriate in the context of consumer credit transactions. Such research could include focus groups or short phone surveys with defendants who have defaulted in these cases. Further study may also reveal whether adding evening hours, as is done in the Small Claims Part of Civil Court, would better serve the needs of litigants in these cases.

(5) Enact the Exempt Income Protection Act.

In the spring of 2007, New York State Senator Dale Volker and Assemblywoman Helene Weinstein introduced the Exempt Income Protection Act, S.6203/A.8527, in the New York State Senate and Assembly. If enacted, this law would protect bank accounts from restraint by judgment creditors where the funds in the account are exempt from collection under existing New York or federal law. New York and federal laws exempt certain subsistence income from debt collection. Creditors cannot seize income such as Social Security and disability benefits, pensions, public assistance, child support, and Veterans benefits. The exemption laws were enacted to ensure that safety-net income is not diverted from its intended purpose: helping the elderly, disabled and poor to maintain the resources they need for food, rent, medicine and other basic necessities. Despite existing law, each day, bank accounts containing legally exempt income are frozen with "restraining notices" issued after a creditor has obtained a judgment. As a result, hundreds of vulnerable New Yorkers lose access to the funds required for basic needs. Accountholders then experience great difficulty in getting an account released. While New York law provides a straightforward process for judgment creditors to restrain accounts, it does not provide such a process for removing a restraint where the restraint is illegitimate or unlawful.

The Exempt Income Protection Act would prohibit the restraint of bank accounts where the income in the account is exempt from collection under existing law. Further, it would create a streamlined process by which a judgment debtor can ask a court to remove the restraint and require that judgment debtors be notified that such a process exists.

As this study demonstrates, more often than not, judgments in consumer credit litigation are obtained on default. As a result, judgment debtors often have no knowledge that a judgment has been entered against them. Learning that a bank account has been frozen is particularly shocking and debilitating when a person has no knowledge that a judgment has been entered against him or her. When the funds are exempt from collection, freezing an account subjects a person to needless litigation and expense. The sheer volume of default judgments entered in New York City Civil Court suggests that the use of restraining notices and wage garnishments has ballooned over recent years. The Exempt Income Protection Act will limit the use of such enforcement provisions in those inappropriate circumstances where the income in question is exempt. Furthermore, it will create a streamlined procedure for judgment debtors to seek a court order to release funds where the funds have been wrongfully restrained or seized.

(6) Compensate defendants for fees and costs incurred in defending themselves against frivolous cases.

Defendants in these cases, whether represented by counsel or not, incur significant expenses in the form of attorney fees and lost wages for time spent appearing in court. Defendants should be reimbursed for these expenses when a plaintiff fails to substantiate its claim. Two provisions in New York law provide for such recovery. Section 5-327 of the New York General Obligations Law provides that "[w]henever a consumer contract provides that the creditor . . . may recover attorney's fees and expenses incurred as the result of a breach of any contractual obligation by the debtor . . . it shall be implied that the creditor . . . shall pay the attorney's fees and expenses of the debtor . . incurred . . . in the successful defense of any action arising out of the contract commenced by the creditor . . . ." In other words, where a credit card agreement allows the credit card issuer or its assignee to recover attorney fees, the law provides an analogous right on the part of the debtor, when he or she successfully defends him or herself against a collection action. Unfortunately, a review of the case law and anecdotal evidence from consumer advocates indicates that this section is rarely applied in consumer debt cases, despite the fact that plaintiffs are routinely awarded litigation costs.

Section 3217 of the New York Civil Practice Law and Rules allows a court to permit discontinuance of an action "upon terms and conditions, as the court deems proper." Plaintiffs routinely seek to discontinue cases where a defendant appears and refuses to settle the case. Defendants, relieved to have the case come to a close, routinely consent to voluntary discontinuances by the plaintiff. Once twenty days have passed since service of the summons, a party must seek a court order to discontinue an action unless all parties agree and sign a stipulation of discontinuance. Where the court orders a discontinuance, it may do so upon such terms and conditions as are just. *Pro se* defendants should be advised that they may seek costs and expenses from the court even where a plaintiff seeks to discontinue. Similarly, the court ought to be sensitive to the burden of litigation on *pro se* defendants, particularly when they are simply unable to afford the resources to defend themselves effectively.

APPENDICES

Appendix A: Study Methodology

Using data supplied by the Office of Court Administration, we calculated the percentage of total consumer credit transaction lawsuits filed in New York City Civil Court in each borough in February 2006. According to data received from the Office of Court Administration, there were 897 consumer credit filings in Richmond County; 6,258 filings in the Bronx; 9,083 in Kings County; and 6,092 in Queens. Because New York County maintains data in a different format than do the other four counties, we estimated the percentage of consumer credit transactions filed in New York County in as a percentage of total Civil Part filings in New York County. We did so by assuming that consumer credit transactions constituted the same percentage of total filings in New York County as they did in the four other boroughs. There were 5,188 total filings in the Civil Part of New York County in February of 2006. Accordingly, we estimated the total number of consumer credit filings in New York County in February of 2006 at 2,747 filings.

We then reviewed six hundred randomly selected cases filed in February of 2006. Accordingly, we reviewed 22 files in Richmond County; 148 files in the Bronx; 218 files in Kings County; 146 files in Queens; and 66 files in New York County. These files were selected at random.

Appendix B: City Council District in Which Defendants Reside

Borough	District	Council Member	Number of Case Files Reviewed
Manhattan	1	Gerson	5
Manhattan	2	Mendez	4
Manhattan	3	Quinn	9
Manhattan	4	Garodnick	0
Manhattan	5	Lappin	1
Manhattan	6	Brewer	4
Manhattan	7	Jackson	9
Manhattan	8	Viverito	10*
Manhattan	9	Dickens	14*
Manhattan	10	Martinez	10*
Bronx	11	Koppell	12*
Bronx	12	Seabrook	26**
Bronx	13	Vacca	13*
Bronx	14	Baez	22**
Bronx	15	Rivera	13*
Bronx	16	Foster	23**
Bronx	17	Arroyo	18*
Bronx	18	Palma	18*
Queens	19	Avella	5
Queens	20	Liu	4
Queens	21	Monserrate	14*
Queens	22	Vallone	4
Queens	23	Weprin	8
Queens	24	Gennaro	8
Queens	25	Sears	13*
Queens	26	Gioia	13*
Queens	27	Comrie	14*
Queens	28	White	12*
Queens	29	Katz	5
Queens	30	Gallagher	7
Queens	31	Sanders	13*
Queens	32	Addabbo	12*
Brooklyn	33	Yassky	6
Brooklyn	34	Reyna	19**
Brooklyn	35	James	23**
Brooklyn	36	Vann	24**
Brooklyn	37	Dilan	14*
Brooklyn	38	Gonzalez	10*
Brooklyn	39	De Blasio	5

Appendix B: City Council District in Which Defendants Reside...CONTINUED

Borough	District	Council Member	Number of Case Files Reviewed
Brooklyn	40	Eugene	16*
Brooklyn	41	Mealy	21**
Brooklyn	42	Barron	19**
Brooklyn	43	Gentile	11*
Brooklyn	44	Felder	6
Brooklyn	45	Stewart	13*
Brooklyn	46	Fidler	10*
Brooklyn	47	Recchia	14*
Brooklyn	48	Nelson	10*
Staten Island	49	McMahon	10*
Staten Island	50	Oddo	7
Staten Island	51	Ignizio	4

*: Districts in which we estimate that over 5,000 residents faced consumer credit litigation in 2006
**: Districts in which we estimate that over 10,000 residents faced consumer credit litigation in 2006

SOURCE: Urban Justice Center calculations from review of New York City Civil Court case filings

ENDNOTES

[1] Because New York State's Civil Practice Law and Rules (hereinafter "CPLR") distinguish cases arising from "consumer credit transactions" from other civil cases, it is possible to track consumer debt litigation in New York State courts. The term "consumer credit transaction" is defined in the New York Civil Practice Law and Rules as "a transaction wherein credit is extended to an individual and the money, property, or service which is the subject of the transaction is primarily for personal, family or household purposes" at section 105(f) of the CPLR. The term covers cases arising from any debts where credit is extended to consumers. It includes credit card debts and also, for example, cell phone debts.

[2] Chief Clerk's Memorandum, *Subject: Bulk Sale of Index Numbers*, Civil Court of the City of New York, August 14, 2006 (responding to surge in filings by initiating procedure for sale of index numbers in bulk), *available at* http://www.courts.state.ny.us/courts/nyc/housing/directives/CCM/ccm167.pdf. In 2006, an estimated 320,000 consumer debt cases were filed in New York City Civil Court. By way of comparison, through 2001, the New York City Civil Court saw, on average, 200,000 filings a year – only a portion of which were consumer debt cases.

[3] Judicial Caseload Indicators, 12-Month Periods Ending September 30, 1997, 2002, 2005, and 2006 *available at* http://www.uscourts.gov/Press_Releases/Judicial_Caseload_Indicators.pdf. This number excludes bankruptcy filings.

[4] Report of the Civil Court of the City of New York, January 1, 1997 – December 31, 2006, *A Decade of Change and Challenge in "The People's Court" 1997* – 2006 at 17 (hereinafter "*The People's Court*").

[5] *See* discussion *infra* page 5.

[6] Center for Responsible Lending, The Plastic Safety Net: The Reality Behind Debt in America: Findings from a National Household Survey of Credit Card Debt Among Low- and Middle-Income Households 4-5 (2005) (hereinafter "The Plastic Safety Net").

[7] *Id.* at 10.

[8] John Leland, *Couple Learn the High Price of Easy Credit*, The New York Times, May 19, 2007 at A1; Linda Greenhouse, *The Banks Win in Court*, The New York Times, June 9, 1996.

[9] *Id.*

[10] Instances of identity theft are often resolved soon after they are identified by the creditor or consumer. Nevertheless, in many cases, an identity theft victim does not learn about a debt ascribed to him or her until the debt is in default, either by checking a credit report, as a result of a lawsuit seeking to collect the debt, or when the creditor seeks to enforce a judgment obtained on default.

[11] Robert M. Hunt, *Collecting Consumer Debt in America*, Business Review (Q2 2007) at 15, *available at* http://www.philadelphiafed.org/files/br/2007/q2/hunt_collecting-consumer-debt.pdf; Liz Pulliam Weston, *The Basics: 'Zombie Debt' is Hard to Kill*, MSN Money, *available at* http://articles.moneycentral.msn.com/SavingandDebt/ManageDebt/ZombieDebtIsHardToKill.aspx.

[12] CPLR § 5222(b).

[13] *See* http://www.smartmoney.com/consumer/index.cfm?story=20010820.

[14] Sarah Ludwig, *Banking and Poverty*, Gotham Gazette, Sept. 25, 2006, *available at* http://www.gothamgazette.com/article//20060925/200/1981.

[15] The New York City Commission for Economic Opportunity, Increasing Opportunity and Reducing Poverty in New York City 8 (2006) [hereinafter NYC CEO], *available at* http://www.nyc.gov/html/om/pdf/ceo_report2006.pdf.

[16] *Id.* at 14.

[17] *Id.* at 9.

[18] Christian E. Weller, Center for American Progress, Pushing the Limit: Credit Card Debt Burdens American Families 1 (2006), *available at* http://www.americanprogress.org/kf/creditcarddebtreport_pdf.pdf.

[19] *Id.* at 2.

[20] The Plastic Safety Net, *supra* note 6, at 8.

[21] Liz Pulliam Weston, *The Basics: The Truth About Credit Card Debt*, MSN Money, *available at* http://moneycentral.msn.com/content/Banking/creditcardsmarts/P74808.asp.

[22] Weller, *supra* note 18, at 1.

[23] *Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances*, 92 Federal Reserve Bulletin, at A1, A35 (2006) [hereinafter *Recent Changes*].

[24] Leland, *supra* note 8 at A1.

[25] The Plastic Safety Net, *supra* note 6, at 9.

[26] *See* UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, CREDIT CARDS: INCREASED COMPLEXITY IN RATES AND FEES HEIGHTENS NEED FOR MORE EFFECTIVE DISCLOSURES TO CONSUMERS 59 (2006) [hereinafter GAO]; The Plastic Safety Net, *supra* note 6, at 4. *See also* NYC CEO, *supra* note 15, at 14 (explaining that low-wage service workers, who comprise about a third of the working poor in New York City, are significantly less likely to receive health insurance through an employer as compared to all workers).

[27] Community Service Society Press Release, Making the Rent: Escalating Rents Creating New Hardships for the City's Poor (Dec. 14, 2006), *available at* http://www.cssny.org/news/releases/2006_1214.html.

[28] *See Recent Changes*, *supra* note 23, at A35.

[29] Daniel McGinn, *Maxed Out*, 138 NEWSWEEK 34 (2001).

[30] Furman Center for Real Estate and Urban Policy, *State of New York City's Housing and Neighborhoods 2006* at 2, *available at* http://www.furmancenter.nyu.edu/SOC2006.htm.

[31] Testimony of Travis B. Plunkett, Legislative Director, Consumer Federation of America, before the Committee on Banking, Housing and Urban Affairs of the United States Senate, May 17, 2005.

[32] Rishawn Biddle, *Credit cards: defaults force issuers to beat a retreat*, LOS ANGELES BUSINESS JOURNAL, October 27, 2003, *available at* http://www.thefreelibrary.com/Credit+cards:+defaults+force+issuers+to+beat+a+retreat-a0109847989..

[33] *Id.*

[34] Press Release, Office of the New York State Attorney General, Sub-prime Credit Card Issuer Ordered to Pay Nearly $9 Million in Penalties and Refunds (January 25, 2006), *available at* http://www.oag.state.ny.us/press/2006/jan/jan25a_06.html; Press Release, Office of the New York State Attorney General, Sub-prime Credit Card Issuer to Provide $11 Million in Restitution (July 3, 2006), *available at* http://www.oag.state.ny.us/press/2006/jul/jul3b_06.html.

[35] Cara Matthews, *Lawmakers seek tighter control on credit-card lending practices*, THE JOURNAL NEWS, April 17, 2007, *available at* http://www.thejournalnews.com/apps/pbcs.dll/article?AID=/20070417/NEWS05/704170349/1021.

[36] *Id.*

[37] GAO, *supra* note 26, at 5.

[38] *Id.*

[39] *Id.* at 27.

[40] *Id.* at 38.

[41] 15 U.S.C. § 1692 *et seq.*

[42] New York Gen. Bus. L. §§ 600 *et seq.*

[43] NYC Admin. Code §§ 20-488 *et seq.*

[44] NYC Admin. Code § 20-488.

[45] Centurion Capital Corporation a/a/o Aspire Card v. Druce,, No. 29303/2006, 828 N.Y.S.2d 851, 2006 WL 3849021, 2006 N.Y. Misc. LEXIS 3924 (N.Y. City Civ. Ct. Dec. 21, 2006); Department of Consumer Affairs v. Asset Acceptance, LLC, Appeal Determination, Violation Number PL1044927, February 23, 2007.

[46] NYC Admin. Code § 20-488.

[47] *Id.*

[48] Press Release, New York City Department of Consumer Affairs, Department of Consumer Affairs Holds Public Hearing To Explore Debt Collection Practices in New York City (June 12, 2006), *available at* http://www.nyc.gov/html/dca/html/pr2006/pr_061206.shtml.

[49] *Id.*

[50] *See* discussion *infra* page 20.

[51] *See* discussion *supra* page 3. New York City Civil Court has jurisdiction over civil cases involving amounts under $25,000.

[52] *"The People's Court"*, *supra* note 4, at 11.

[53] *Id.* at 20.

[54] For explanation of the term "consumer credit transaction," *see supra* note 1.

[55] The study methodology is described in Appendix A.

[56] *See* discussion *infra* page 21.

[57] The estimated cost to construct the new stadium for the Mets is $780 million. *See* http://www.plannyc.org/project-66-New-Mets-Stadium.

[58] *See, e.g.*, Kimber v. Federal Financial Corp., 668 F. Supp. 1480, 1487 (M.D. Ala. 1987) ("a debt collector's filing of a lawsuit on a debt that appears to be time-barred, without the debt collector having first determined after a reasonable inquiry that that limitations period has been or should be tolled, is an unfair and unconscionable means of collecting the debt"); *see also* Dutton v. Wolhar, 809 F. Supp. 1130 (D. Del. 1992) (finding that debt collector's filing of lawsuit violated the Fair Debt Collection Practices Act).

[59] *Cf.* David Udell & Rebekah Diller, Brennan Center for Justice, Access to Justice: Opening the Courthouse Door 4 (2007) (reporting that the main legal services programs turned away at least one person seeking help in civil matters for each person served, and that fewer than one in ten attorneys doing pro-bono work accepts referrals from legal services programs or other organizations serving the low-income community's needs); *see infra* page 16.

[60] Both the New York Civil Practice Law and Rules and the federal Fair Debt Collection Practices Act require that debt collection lawsuits against consumers are brought in the county where the defendant resides.

[61] One defendant secured counsel only after a default judgment was entered against her. After the defendant retained counsel, the court vacated the default judgment.

[62] Council of Better Business Bureaus and Javelin Strategy & Research, 2006 Identity Fraud Survey Report, January 31, 2006, *available in part at* http://www.bbb.org/alerts/article.asp?ID=651.

[63] News Release: ID Analytics Research Shows Highest Rates of U.S. Identity Fraud in New York and the Western States, idAnalytics, February 14, 2007, *available at* http://www.idanalytics.com/news_and_events/20070214a.html.

[64] *Id.*

[65] New York City Civil Court has jurisdiction over cases involving amounts under $25,000.

[66] The terms of this debt purchase are set forth in a Securities and Exchange Commission filing by Asta Funding, Inc *available at* http://www.secinfo.com/dsvr4.u1wz.htm#1stPage.

[67] Hunt, *supra* note 11 at 15.

[68] *See* Rodriguez v. Pressler and Pressler, L.L.P., 06-5103 (E.D.N.Y.), filed September 21, 2006.

[69] *Id.*

[70] This problem is discussed generally at page 18.

[71] Biddle, *supra* note 32.

[72] Federal Trade Commission, FTC Charges One of the Nation's Largest Subprime Lenders with Abusive Lending Practices, March 6, 2001, *available at* http://www.ftc.gov/opa/2001/03/associates.shtm.

[73] *See* In the Matter of Direct Merchants Credit Card Bank, N.A., Consent Order, available at http://www.occ.treas.gov/ftp/eas/ea2001-24.pdf

[74] *See* Stipulation and Consent to the Issuance of a Consent Order, In the Matter of First National Bank of Marin (January 24, 2004), *available at* www.occ.treas.gov/ftp/eas/EA2004-45.pdf; Community Reinvestment Act Performance Evaluation, First National Bank of Marin (May 20, 2002) *available at* www.occ.treas.gov/ftp/craeval/apr03/20291.pdf.

[75] *See* discussion *supra* page 6.

[76] *See* http://www.epsilon.com/clients-list.html.

[77] Biddle, *supra* note 32.

[78] Given that plaintiffs rarely produce such agreements, it would be extremely difficult to review the credit card agreements on which these cases are based. *See* discussion *infra* page 20.

[79] Robert Berner, *A big lender's credit card trap*, Business Week, November 6, 2006, *available at* http://www.businessweek.com/magazine/content/06_45/b4008048.htm?chan=search.

[80] *See* Joe Lamport, *Predatory Lending Fuels Rise in Foreclosures*, Gotham Gazette, April 26, 2007, *available at* http://www.gothamgazette.com/article/housing/20070426/10/2157.

[81] Demos, A House of Cards: Refinancing the American Dream 3 (2005).

[82] *Id.*

[83] Where a lawsuit is discontinued "with prejudice," it cannot be brought again.

[84] Emily Jane Goodman, *Housing Court: Should Tenants Have a Guaranteed Right to Counsel?*, GOTHAM GAZETTE, Jan. 25, 2006, *available at* http://www.gothamgazette.com/article/law/20060125/13/1735 (11.9% of tenants in New York City Housing Court are represented by counsel).

[85] *Dignity Faces a Steamroller: Small-claims proceedings ignore rights, tilt to collectors*, THE BOSTON GLOBE, July 31, 2006.

[86] Section 3217(a) of the CPLR, which governs voluntary discontinuances, requires that a notice of discontinuance be filed either within twenty days of service of the complaint or before a defendant files and Answer, whichever is *earlier*. In all of the discontinued cases here, the notice of discontinuance was filed well after twenty days had passed and, therefore, in violation of CPLR § 3217(a). Typically, where a plaintiff unilaterally discontinues an action, it maintains the right to reinstitute the action at a later time. If the plaintiff were to seek a court order approving discontinuance, as is required after twenty days have passed, it would be subject to the possibility that the court may discontinue the action with prejudice (so that the plaintiff could not bring the suit again) and with costs.

[87]The CPLR provides as follows: "When a defendant has failed to appear, plead or proceed to trial of an action reached and called for trial, or when the court orders a dismissal for any other neglect to proceed, the plaintiff may seek a default judgment against him." CPLR § 3215(a).

[88]"The clerk, *upon submission of the requisite proof*, shall enter judgment for the amount demanded in the complaint . . . plus costs and interest." *Id.* (emphasis added).

[89] CPLR § 3215(f).

[90] Joosten v. Gale, 129 A.D.2d 531, 535, 514 N.Y.S.2d 729, 732 (1st Dep't 1987).

[91] PRS Assets, a/o Jack LaLanne v. Rodriguez, 2006 NY Slip Op 51148U; 12 Misc. 3d 1172A; 820 N.Y.S.2d 845; 2006 N.Y. Misc. LEXIS 1517 (Dist. Ct. of N.Y., 3d Dist. Nassau County, June 21, 2006) (emphasis added).

[92] Citibank (South Dakota), N.A. v. Martin, 11 Misc. 3d 219; 807 N.Y.S.2d 284 (Civ. Ct. N.Y. Co. 2005) (emphasis added).

[93] *Id.*; see also DeVivo v. Sparago, 287 A.D.2d 535, 536 (2d Dep't 2001) (affirming denial of motion for default judgment).

[94] *Id.*

[95] Levi v. Oberlander, 144 A.D.2d 546, 547, 535 N.Y.S.2d (2d Dep't 1988); see also DeVivo v. Sparago, 287 A.D.2d 535, 536 (2d Dep't 2001).

[96] Civil Court Direction, *Subject: Entry of Default Judgments*, Civil Court of the City of New York, January 20, 2000 (emphasis in the original), *available at* http://www.courts.state.ny.us/courts/nyc/civil/directives/DRP/drp154.pdf.

[97] Mullins v. DeLorenzo, 199 A.D.2d 218, 219, 606 N.Y.S.2d 161, 162 (1st Dep't 1993); Joosten v. Gale, *supra* note 90.

[98] Palisades Collection, LLC v. Gonzalez, No. 58564 CV 2004, 2005 N.Y. Misc. LEXIS 2774 (Civ. Ct. N.Y. County, Dec. 12, 2005) *available at* http://www.courts.state.ny.us/reporter/3dseries/2005/2005_52015.htm.

[99] Civil Court Direction, *supra* note 96.

[100] LSWP is made up of the Urban Justice Center, Housing Conservation Coordinators, CAMBA Legal Services and the Northern Manhattan Improvement Corporation.

[101] Directive and Procedures, *Subject: Mandatory Consumer Credit Mediation in New York County*, Civil Court of the City of New York, March 12, 2007, *available at* http://www.courts.state.ny.us/courts/nyc/civil/directives/DRP/drp177.pdf.

[102] *Id.*

[103] CPLR § 3015(e); Centurion Capital Corporation a/a/o Aspire Card v. Druce, 14 Misc. 3d 564, 828 N.Y.S.2d 851 (N.Y. City Civ. Ct. Dec. 21, 2006)

[104] CPLR § 3015(e).

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Oral Testimony of Carolyn E. Coffey
before the
New York City Council Committees on Consumer Affairs
Public Hearing Local Law No. 660 on February 25, 2009

My name is Carolyn Coffey, and I am a staff attorney in the Consumer Rights Project at MFY Legal Services. I am here today to address the important issue of licensing of debt buyers who prey upon vulnerable New Yorkers, many of whom are our clients.

MFY Legal Services provides legal services to more than 5,000 low-income and immigrant clients in New York City every year. We are the largest legal services provider for people with mental disabilities in New York City and we have several other projects to help low-income New Yorkers, including our Foreclosure Prevention Project, Lower Manhattan Justice Project, and Consumer Rights Project, which we launched over three years ago in response to our clients' growing demand for legal representation and information about debt collection and other consumer issues.

Low-income consumers in New York City face a myriad of issues, including being targeted for subprime credit cards and mortgages, identity theft, poor credit scores, tenant blacklisting, and unfair and illegal debt collection tactics. Low-income consumers are also the subject of thousands of debt collection lawsuits each year brought by debt buyers, which are flooding the New York City Civil Court.[1]

Debt buyers, which comprise a large segment of the debt collection industry, purchase debts owed to original creditors, usually in bulk, and often for only a few cents on the dollar.[2] Debt buyers profit by purchasing these debts cheaply, by hiring other debt collectors to contact consumers, by filing suits, and by obtaining default judgments for the full amount of the debt originally owed. In New York City, approximately 90 percent of these lawsuits result in default judgments.[3] The debt buyers

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[1] *See* MFY Legal Services, 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 (June 2008) (available at http://www.mfy.org/Justice_Disserved.pdf) and Urban Justice Center, Debt Weight: The Consumer Credit Crisis in New York City and its Impact on the Working Poor (Oct. 2007) (available at http://www.urbanjustice.org/pdf/publications/CDP_Debt_Weight.pdf).
[2] *See, e.g.*, Sewell Chan, *An Outcry Rises as Debt Collectors Play Rough*, N.Y. Times, July 5, 2006, at A1.
[3] *See supra* 1.

then satisfy those judgments by garnishing wages and restraining bank accounts, effectively denying people who live check to check access to their money. The actions of debt buyers have real and very tragic effects on people's lives, which is why all of these companies should be regulated, as they would be under the proposed legislation.

MFY represented debtor Robert Druce in *Centurion Capital Corp. v. Druce*[4], the first New York decision to clarify that debt buyers are considered "debt collectors" for purposes of licensing by DCA under the New York City Administrative Code. Since the *Druce* decision, however, many debt buyers have attempted to skirt the DCA licensing requirement by claiming they are so-called "passive debt buyers" because they do not engage in traditional debt collecting methods with consumers, and the DCA itself has issued confusing guidance on this question. While we firmly believe that *all* debt buyers, even so-called "passive debt buyers," are already subject to the licensing requirement, the bill before the City Council would clarify this issue.

The New York City Council recognized that the debt collection industry is rife with abuse and unfairness to the public, which is why it enacted the law to license debt collection agencies and to subject them to regulation by DCA in the first place.[5] With this local law, the Council established a mandate for the licensing of debt collection agencies in order to "protect the interests, reputations and fiscal well-being of the citizens of this city against those agencies that would abuse their privilege of operation."[6] Consistent with this interpretation is the Council's "Legislative declaration," in which the Council makes clear that its intent to impose licensing requirements stems from a desire to protect consumers from "unscrupulous" collectors.[7]

Notably, the law as written contains no exception for a "passive debt buyer" or for a debt collection agency that does not have direct contact with the public.[8] These companies have thus created a new exception that was not provided for by the City Council, the legislative body that enacted the law. Further, while passive debt buyers may not engage in traditional debt collection activities because they purchase debts and hire others to contact and sue consumers on their behalf, the filing of a lawsuit is a "debt collection activity" under the Fair Debt Collection Practices Act, and there is no reason why such activity should not come under the purview of the City.[9]

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[4] 14 Misc. 3d 564, 828 N.Y.S.2d 851 (Civ. Ct. N.Y. Cty 2006).
[5] N.Y.C. Admin. Code § 20-488, *et seq.*
[6] N.Y.C. Admin. Code § 20-488.
[7] N.Y.C. Admin. Code § 20-488 ("Due to the sensitive nature of the information used in the course of such agency's everyday business, and the vulnerable position consumers find themselves in when dealing with these agencies, it is incumbent upon this council to protect the interests, reputations and fiscal well-being of the citizens of this city against those agencies who would abuse their privilege of operation.").
[8] N.Y.C. Admin. Code § 20-489(a)(1)-(9).
[9] 15 U.S.C.S. § 1692g(b).

Also, New York City's licensing law specifically states that licensees are responsible for the acts of their agents.[10] Thus, there can be no question that the City Council sought to license all business entities that are covered by the law, as well as sought to hold such entities responsible for the activities or abuses of their agents. As the owners of alleged debts, debt-buyers have the most at stake in attempting to collect on these accounts and are in the best position to ensure that entities collecting the debts for them do not engage in abusive practices.

Finally, MFY knows from first-hand experience, by representing people sued by debt buyers, that most debt buyer lawsuits lack merit. In fact, over the past three years, not one consumer credit case handled by the Consumer Rights Project at MFY has gone to trial, chiefly because the debt buyer could not prove its case against the defendant or could not prove that it actually owned the debt in question.

For all these reasons, MFY encourages the Council to pass this important clarifying legislation and is committed to working with the City Council to better protect the consumers of New York City. Thank you for holding today's hearing and for considering this important bill.

[10] N.Y.C. Admin. Code § 20-493(d) ("[L]icensees may be held responsible for statements, representations, promises or acts of their employees *or their agents* within the scope of their authority." (emphasis added)).

COMMERCIAL LAWYERS CONFERENCE OF NEW YORK
New York's Creditors Bar Association

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COMMITTEE OF CONSUMER AFFAIRS
Of The
COUNCIL OF THE CITY OF NEW YORK

TESTIMONY OF

ERIC M. BERMAN., ESQ.
PRESIDENT

THE COMMERCIAL LAWYERS CONFERENCE OF NEW YORK

In Opposition To

Introduction No. 660 - A Local Law to amend the administrative code of the city of New York, in relation to buyers of consumer debt.

February 25, 2009

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February 25, 2009

Chairperson, Leroy G. Comrie, Jr.
Committee Member Charles Barron
Committee Member James F. Gennaro
Committee Member G. Oliver Koppell
Committee Member John C. Liu
Committee on Consumer Affairs
The Council of the City of New York
City Hall
New York, NY 10007

Re: Testimony **in Opposition** to Introduction No. 660 - A Local Law to amend the administrative code of the city of New York, in relation to buyers of consumer debt.

Mr. Chairperson Comrie, Committee Members Barron, Gennaro, Koppell and Liu, and Members of the City Council, thank you for the opportunity to testify this morning in regard to Introduction No. 660 - A Local Law to amend the administrative code of the city of New York, in relation to buyers of consumer debt.

Introduction No. 660 violates Federal and State Law and cannot be passed. Section 1 is an invasion of the federal government's right and responsibility to regulate interstate commerce. Section 2 violates the doctrine of separation of powers as set forth in the New York and United States Constitutions and is an improper extension of powers delegated to the Commissioner of the Department of Consumer Affairs in Chapter 64 of the Administrative Code of the City of New York.

Even if these amendments were legal, their effect would be to increase the difficulties consumers have in obtaining loans and paying their debts, and drive lenders and other financial institutions from doing business in New York City.

I would like to introduce myself to the Committee and then discuss Section 2 as it affects attorneys-at-law admitted to the practice of law in the State of New York, followed by Section 1 which seeks to extended the authority of the Department of Consumer Affairs to regulate debt buyers in addition to debt collection agencies.

I am President of the Commercial Lawyers Conference of New York ("CLC") and a Director the National Association of Retail Collection Attorneys (NARCA). The CLC is a New York State Bar Association whose members represent creditors seeking the recovery of consumer and commercial debts in the State of New York. The members of the CLC are law firms whose attorneys are licensed to practice law in the State of New York and whose practice is regulated by and under the supervision of the Appellate Division of the Supreme Court of the State of New York. The CLC has represented creditors' attorneys in standard-setting proceedings involving New York State and City legislation, and in the development of Court Rules and civil practice. We look forward to continuing these discussions in the hope that we can achieve meaningful changes that will benefit consumers while protecting the rights of creditors.

I am an attorney admitted to the practice of law in the State of New York, but I started my professional career as a musician and then became a public school teacher. This helped me pay my way through night law school. In my post-college years, I, like many others, waited on lines at the New York State Unemployment Office and had trouble paying my bills. I know how it feels to get dunning letters and collection calls, and I use that experience in my law practice to try to minimize the stress debtors experience when contacted about a bill they owe, but cannot pay.

To understand debt collection, you first have to acknowledge that many people owe debts. Attorney General Andrew M. Cuomo states on his website that, "It is important for you to understand that companies do have a right to try to collect money owed to them."[1] In its Economic Report for 2009, the New York State Assembly Ways and Means Committee noted that:

> As banks are unable to raise capital, they will be unable to raise money. In addition, lending standards have been tightened for some time, and have become even tighter despite actions by the federal government and the Federal Reserve.[2]

Without the ability to raise funds and collect the debts that they are owed, banks will be unable to lend money, driving us down in an ever-increasing spiral of recession, though hopefully, not into a full-fledged depression. Many banks sell all or part of their delinquent accounts to raise money and meet capital reserve guidelines set by the Federal government. The more difficult debt collection becomes, the lower the price banks can expect, adding to their financial woes.

As the economy sank into an economic morass, the media spotlighted debt collection as an area of financial and social abuse. Their stories incorporate anecdotes about the poor and disabled being assailed by debt collectors. Consumer advocacy publications do the same.

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[1] http://www.oag.state.ny.us/bureaus/consumer_frauds/tips/debt_collectors.html. Last accessed 2/21/2009.

[2] http://assembly.state.ny.us/comm/WAM/2009EcRep/2009EcRep.pdf, p.24.

Consumer complaints are up. The portrayal of debt collectors is down. The Federal Trade Commission ("FTC") which enforces the Federal Fair Debt Collection Practices Act ("FDCPA")[3] issues an annual report which includes the number of complaints lodged against debt collectors. However, no analysis of the complaints is provided. What is left unsaid in all of these publications is that the number of debt collection complaints is infinitesimal in comparison to the number of contacts debt collectors have with consumers.

There is another side to debt collection that is rarely discussed. Debt avoidance is flourishing. Professional debtors have sprung up, using false claims of identity theft and the courts to avoid payment of their outstanding debts. The Civil Courts have provided debtors with check-off forms to use as answers and discovery demands which go beyond legal entitlement. Court Clerks fill out the forms and tell the debtors where to sign. Judges decide cases on the merits and then, at the request of debtors, sign Orders vacating their own judgments. A segment of the consumer bar uses frivolous allegations of improper debt collection practices to extort payment from collection agencies who are forced to make business decisions to pay rather than incur the costs of fighting baseless lawsuits. The New York State Legislature has changed New York's garnishment laws to severely handicap creditors in recovering the amounts they are owed. And now, the City seeks to require licenses they cannot, by law, administer.

Introduction 660 raises several questions, the answers to which doom its passage. First. Does the City has the legal authority to amend the Administrative Code of the City of New York, as proposed. Second. How will the proposed amendments change current law; and third, what will be the real world impact of those changes?

The short answers are that this body does not have the authority nor the power to amend the Code as proposed; that these amendments are unconstitutional; that the net effect of the amendments would be to add another layer of administration to processes that are already in place and duplicate powers rightfully held by other branches of government; and lastly, these amendments will not help consumers.

Point I. <u>Section 2. Attorney Licensing</u>

A. The proposed amendment to Paragraph 5 of subdivision a of section 489 of title 20 of the administrative code of the City of New York, violates the doctrine of separation of powers under the Constitutions of the State of New York and the United States of America.

§2. Paragraph 5 of subdivision a of section 489 of title 20 of the administrative code of the City of New York is amended to read as follows:

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[3] 15 U.S.C. § 1692 *et. seq.*

(5) Any attorney-at-law or law firm collecting a debt [as an attorney] in such capacity on behalf of and in the name of a client [;] through legal activities such as the filing and prosecution of lawsuits to reduce debts to judgments, but not any attorney-at-law or law firm who regularly engages in activities traditionally associated with debt collection, including but not limited to, sending or making collection telephone calls;

New York has a unified court system.[4] New York's Constitution provides that the chief judge of the court of appeals is the chief judge of the State of New York and the chief judicial officer of the unified court system. . .[5] The chief judge . . . establishes standards and administrative policies for general application throughout the state. . .[6] The power to admit, regulate and disbar attorneys is held by the Appellate Division of the New York State Supreme Court.[7] The power to license and regulate New York Attorneys cannot be placed with the New York City Department of Consumer Affairs ("DCA") which is a department of the Executive Branch, as this authority is exclusive and inviolate, and its transfer would create a constitutional conflict whose final determination has only one possible resolution, the status quo.

> The practice of law is so intimately connected with the exercise of judicial power in the administration of justice that the right to define and regulate the practice naturally and logically belongs to the judicial department of the state government. Under the doctrine of separation of powers the courts have inherent power to regulate admission to the practice of law, to oversee the conduct of attorneys as officers of the court, and to control and supervise the practice of law generally, whether in or out of court. It is the prerogative of the judicial department to regulate the practice of law.[8]

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[4]Constitution of the State of New York, Article 6 § 1.

[5]Constitution of the State of New York, Article 6 § 28. a.

[6]Constitution of the State of New York, Article 6 § 28. c.

[7]Judiciary Law, Article 4 - Appellate Division, § 90. Admission to and removal from practice by appellate division; 2. The supreme court shall have power and control over attorneys and counsellors-at-law and all persons practicing or assuming to practice law, and the appellate division of the supreme court in each department is authorized to censure, suspend from practice or remove from office any attorney and counsellor-at-law admitted to practice who is guilty of professional misconduct, malpractice, fraud, deceit, crime or misdemeanor, or any conduct prejudicial to the administration of justice; and the appellate division of the supreme court is hereby authorized to revoke such admission for any misrepresentation or suppression of any information in connection with the application for admission to practice.

[8]*Washington State Bar Assn. v. State*, 125 Wn.2d 901, 907-908, 890 P.2d 1047 (1995).

In another case of Executive Branch overreaching,[9] the New York and American Bar Associations sought a declaratory judgment that the FTC's regulation mandating ". . . attorneys engaged in certain 'financial activities' as part of their legal practices would be subject to the GLBA [Gramm-Leach-Bliley Act],"[10] and that this regulation exceeded the statutory authority of the FTC, was arbitrary and capricious and invalid as a matter of law. The Court agreed, holding that "the Commission's attempt to regulate the practice of law under the Act fell outside its statutory authority.[11] The CLC believes that the same outcome would result should the amendments before us become law.

In his concurring opinion in *William J. Clinton, President of the United States v. City of New York et al,*[12] Associate Supreme Court Justice Kennedy expressed his concerns regarding modifications to the separation of powers:

> Separation of powers was designed to implement a fundamental insight: concentration of power in the hands of a single branch is a threat to liberty. The Federalist states the axiom in these explicit terms: "The accumulation of all powers, legislative, executive, and judiciary, in the same hands . . . may justly be pronounced the very definition of tyranny." [*citations omitted*] So convinced were the Framers [of the Constitution] that liberty of the person inheres in structure that at first they did not consider a Bill of Rights necessary. . . [*citations omitted*]
>
> They used the principles of separation of powers and federalism to secure liberty in the fundamental political sense of the term, quite in addition to the idea of freedom from intrusive governmental acts. The idea and the promise were that when the people delegate some degree of control to a remote central authority, one branch of government ought not possess the power to shape their destiny without a sufficient check from the other two. In this vision, liberty demands limits on the ability of any one branch to influence basic political decisions. Quoting Montesquieu, the Federalist Papers made the point in the following manner:
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> > "'When the legislative and executive powers are united in the same person or body,'says he, 'there can be no liberty, because apprehensions may arise lest the same monarch or senate should enact tyrannical laws to execute them in a tyrannical manner.' Again: 'Were the power of judging joined with the legislative, the

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[9] *New York State Bar Association and American Bar Association v. Federal Trade Commission* (430 F.3d 457, D.C. Cir. 2005).

[10] Safeguarding Rule, 14 C.F.R. Part 314.

[11] *New York State and American Bar Association v. Federal Trade Commission*, Ibid.

[12] 524 U.S. 417, 449-452 (1998) (No. 97-1374).

> life and liberty of the subject would be exposed to arbitrary control, for the *judge* would then be the *legislator*. Were it joined to the *executive* power, the *judge* might behave with all the violence of an *oppressor*.'" [*citation omitted*]
>
> **The principal object of the statute, it is true, was not to enhance the President's power to reward one group and punish another, to help one set of taxpayers and hurt another, to favor one State and ignore another. Yet these are its undeniable effects. The law establishes a new mechanism which gives the President the sole ability to hurt a group that is a visible target, in order to disfavor the group or to extract further concessions . . .** [emphasis added]
>
> . . . Separation of powers helps to ensure the ability of each branch to be vigorous in asserting its proper authority. . . By increasing the power of the President beyond what the Framers envisioned, the statute compromises the political liberty of our citizens, liberty which the separation of powers seeks to secure.

Transplanting the regulation of attorneys-at-law from the Judiciary to the Executive in the form of the DCA, violates the separation of powers and is a cause for concern as discussed by Justice Kennedy. And, the proposed amendment violates the Charter of the City of New York.

B. The proposed amendment to Paragraph 5 of subdivision a of section 489 of title 20 of the administrative code of the City of New York violates Chapter 64 of the Charter of the City of New York.

The intent of this amendment is to require the licensing of attorneys who collect debts, but who are not actively litigating debt collection cases in New York City Courts. This distinction is disingenuous at best, as the FDCPA requires that every person attempting to collect a consumer debt must send a debt collection letter or other document containing the Federal Validation Notice to every debtor from whom they seek to collect. Therefore, all attorneys who do even a minimum amount of debt collection would be subject to licensing by the DCA.

Chapter 64 of the Charter of the City of New York governs the Department of Consumer Affairs[13] and limits the powers of its commissioner from assuming "any of said powers [which] are conferred on other persons or agencies by laws."[14]

As described above, the power to admit, regulate and disbar attorneys resides within the Appellate Division of the New York State Supreme Court and cannot be delegated to the DCA.

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[13] § 2201.

[14] § 2203(c).

Attorneys must practice law in compliance with the Code of Professional Responsibility and Disciplinary Rules.[15] The Rules clearly provide that the practice of law encompasses disciplines and practices that do not involve litigation. The "practice of law" means the giving of legal advice or counsel to, or providing legal representation for, a particular body or individual in a particular situation in either the public or private sector in the State of New York or elsewhere, it shall include the appearance as an attorney before any court or administrative body agency.[16]

A lawyer can serve as an Advisor to a client (Rule 2.1) or as an advocate in non-adjudicative matters. (Rule 3.9) Lawyers have responsibility for the conduct of subordinate lawyers (Rule 5.1) and the conduct of nonlawyers they employ. (Rule 5.3) Lawyers can provide nonlegal services (Rule 5.7) which are defined as being those services that lawyers may lawfully provide and that are not prohibited as an unauthorized practice of law by a nonlawyer. (Rule 5.7 c) Lawyers may not engage in misconduct (Rule 8.4) and are subject to the disciplinary authority of this state. (Rule 8.5)

Many legal disciplines do not require litigation and do use nonlawyers. Law firms which practice in other fields of the law regularly use nonlawyers to take input information from new clients, prepare documents, close real estate sales, notarize documents, investigate accidents and crimes, interview clients and witnesses, and perform a host of other tasks. Lawyers who collect debts owed their clients use nonlawyers for many of these same or similar tasks. All lawyers, debt collectors or not, must supervise the nonlawyers they employ or they are in violation of the Code.

Attorneys who regularly engage in debt collection are also bound by the provisions of the FDCPA and the New York Debt Collection Practices Act ("NYDCPA").[17] The FDCPA governs debt collectors including attorneys who regularly engage in consumer debt collection activity, even when that activity consists of litigation,[18] and gives enforcement powers to the United States Attorney General. The NYDCPA is a penal statute and gives the power of investigation to the New York Attorney General.

Even if these powers were available to the DCA, they would only duplicate the powers held by other government agencies, thereby increasing costs and expense and providing no additional benefit to consumers.

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[15]Rules of the Supreme Court: Appellate Divisions, First Department, Part 603 *et seq*. The Rules governing attorneys admitted in the Second Department are at §691 *et. seq*. New Rules of Professional Conduct take effect on April 1, 2009, but are similar to the Disciplinary Rules in the current Code of Professional Responsibility.

[16]New York Rules of Court, Standards and administrative policies, rules of the Chief Administrator of the Courts, Part 118 Registration of Attorneys, §118.1(g).

[17]N.Y. Gen.Bus. § 600 *et. seq*.

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

Other States have recognized that lawyers admitted to practice law in their states are not required to be licensed as debt collectors if their practice includes debt collection. On October 13, 2006, the Massachusetts Division of Banks issued an opinion pertaining to attorneys at law ("attorneys") who engage in the collection of consumer debt in Massachusetts and the applicability of Massachusetts' debt collection laws[19] and regulations (collectively the "Debt Collection Law").[20]

> [Massachusetts'] Debt Collection Law defines a "debt collector" as "any person who uses an instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of a debt, or who regularly collects or attempts to collect, directly or indirectly, a debt owed or due or asserted to be owed or due another." Within the same definitional provision is a list of exclusions from the "debt collector" definition including in clause (g) "attorneys-at-law collecting a debt on behalf of a client". The Division has been requested to opine on the scope of this attorney-at-law exclusion and applicability of the Debt Collection Law to attorneys.
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> It is the position of the Division that the "attorney-at-law" exclusion applies solely to attorneys licensed to practice law in the Commonwealth since, unlike attorneys licensed in other jurisdictions, they are in fact authorized to practice law and utilize the court system in the Commonwealth. Attorneys licensed to practice law in the Commonwealth are subject to the Supreme Judicial Court's Rules of Professional Conduct and the disciplinary oversight of the Board of Bar Overseers.
>
> This position is consistent with the Division's longstanding practice relative to the licensing of attorneys as debt collectors. Attorneys, licensed to practice law in the Commonwealth, are also subject to the requirements and restrictions of the FDCPA and the debt collection regulations of the Massachusetts Attorney General, 209 CMR 7.00 et seq. The Debt Collection Law contains substantially similar requirements and restrictions as the FDCPA.

Massachusetts' policy exempting attorneys from licensing as debt collectors is echoed by

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[19] General Laws chapter 93, sections 24-28, inclusive.

[20] 209 CMR 18.00 *et. seq.*

many other States including, but not limited to, California,[21] Connecticut,.[22] Florida,[23] Illinois,[24] New Jersey,[25] North Carolina,[26] and Pennsylvania.[27]

The proposed amendment to Paragraph 5 of subdivision a of section 489 of title 20 of the administrative code of the City of New York, is counter to the practice of these and other states, violates Federal and State Law, and for the reasons presented, must be withdrawn from consideration.

Point II. **Section 1. Licensing of Debt Buyers. The proposed amendment to Subdivision a of section 489 of title 20 of the administrative code of the city of New York violates the Federal Government's right to regulate interstate commerce[28] and Chapter 64 of the Charter of the City of New York.**

a. "Debt collection agency" shall mean a person engaged in business the principal purpose of which is to regularly collect or attempt to collect debts owed or due or asserted to be owed or due to another[.] and shall also include a buyer of debt who refers such debt to another for collection or to an attorney-at-law for litigation in order to collect such debt.

The CLC contends that the intent of this amendment is to require licensing of debt buyers to generate revenue for the City despite the City's lack of legal authority to do so. Only the

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[21]The *Rosenthal Fair Debt Collection Practices Act* (RFDCPA), Cal. Civ. Code § 1788.1 *et seq.*, governs the collections of debts in California. Attorneys are expressly exempted from the RFDCPA's definition of debt collectors. Cal. Civ. Code § 1788.2 c.

[22]The *Connecticut Consumer Collection Agencies Act* (CCAA), Conn. Gen. Stat. §§ 36a-800, *et. seq.*, is a regulatory statute providing for licensing and bonding of collection agencies. The CCAA exempts from collection agency status "any member of the bar of this state."

[23]Florida Statutes. Title XXXIII, Chapter 559.553 *Registration of consumer collection agencies required; exemptions.*-- (4) This section shall not apply to: (b) Any member of The Florida Bar.

[24]Debt collection in Illinois is regulated by the *Illinois Collection Agency Act* (ICAA), 225 ILCS 425/1, *et seq.* "Licensed attorneys at law" are not subject to the act. 225 ILCS 425/2.03(5).

[25]The New Jersey *Collection Agencies Act* regulates collection agencies operating in New Jersey. The Act exempts any attorney at law "duly authorized to practice in this state." NJ Rev. Stat. § 45:18-6.

[26]The *North Carolina Collection Agencies Act*, (NCCAA), N.C. Gen. Stat. §§ 58-70-1, *et seq.*, exempts attorneys from licensing as collection agencies if they are handling claims and collections in their own name. N.C. Gen. Stat. § 58-70-15(c)(8).

[27]The *Pennsylvania Unlawful Collection Agency Practices Act*, 18 Pa. Cons. Stat. Ann., § 7311, exempts attorneys at law duly admitted to practice in any court of record in the Commonwealth of Pennsylvania, and the *Debt Pooling Act*, Pa. Cons. Stat. Ann., § 7312(b)(1), exempts any person who is admitted to practice before the Supreme Court of Pennsylvania or any court of common pleas of the Commonwealth.

[28]Commerce Clause, U.S. Constitution art. I, § 8, cl. 3.

federal government can regulate interstate commerce. Business licensing within the State is a power held by the Secretary and Department of State. Neither is available to the City in regard to Debt Buyers who do not collect their own debts in New York City. As enunciated by the Counsel's Office of the New York State Department of State:

> The ability of a state to require a foreign corporation to apply for authority (or "to take out a license" or "to qualify") traces to *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1868). It holds that only natural persons are "citizens" within the meaning of the Privileges and Immunities Clause. U.S. Constitution art. IV, § 2. From this it follows that a state has the power to exclude a foreign corporation from doing intrastate business within its borders. However, no state may exclude or condition admission of a foreign corporation that engages solely in interstate or foreign commerce. The Commerce Clause, U.S. Constitution art. I, § 8, cl. 3, commits to Congress, and impliedly withholds from states, the power to regulate interstate and foreign commerce. Holding that a corporation engaged in interstate commerce need not comply with a foreign corporation statute, the U.S. Supreme Court said, "A corporation of one state may go into another, without obtaining the leave or license of the latter, for all the legitimate purposes of [interstate] commerce; and any statute of the latter state which obstructs or lays a burden on the exercise of this privilege is void under the commerce clause." *Dahnke-Warner Milling Co. v. Bondurant,* 257 U.S. 282, 290 (1921). See also, *International Textbook Company v. Tone,* 220 N.Y. 313, 115 N.E. 914 (1917) ("We have steadily upheld the right of foreign corporations, without aid of any license, to engage in activities incidental to commerce between the states." 220 N.Y. at 318)
>
> A foreign corporation may transact some kinds of business within the State without procuring a certificate or submitting to control. If its business be interstate, it is beyond State interference. "A corporation of one State may go into another, without obtaining the leave or license of the latter, for all the legitimate purposes of such commerce; and any statute of the latter State which obstructs or lays a burden on the exercise of this privilege is void under the commerce clause." *Dahnke-Walker Co. v. Bondurant*, 257 U. S. 282, 291.[29]

Debt Buyers are business entities that purchase or take assignments of portfolios of debt instruments from debt sellers who may be the originating creditor such as a bank, or from a debt buyer who originally purchased the debt from an originating creditor and then decides to re-sell it. The assignment of rights under the debt sale contract is the complete transfer of the right to receive the benefits accruing to one of the parties to that contract. The Debt Buyer, through the assignment, owns and holds all title and interest formerly held by the assignor.

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[29] *"Doing Business" in New York: An Introduction to Qualification*, NYS Department of State, Counsel's Office, Legal Memorandum CO01 (2000)

Many Debt Buyers are foreign corporations (or other business entities) which are formed strictly and solely for the purposes of buying and holding portfolios of debt instruments. They have no other existence and engage other companies to service their needs. They do not venture into New York and are not required to be licensed by New York State or New York City. These entities are considered to be "passive" debt buyers.

A Debt Buyer which collect its own debt is considered to be an "active" debt buyer and is subject to licensing as a debt collection agency, but not as a Debt Buyer.[30] Only the act of debt collection requires a license.[31] A debt collection agency is currently defined in § 20-489 as being "a person engaged in business the principal purpose of which is to regularly collect or attempt to collect debts owed or due or asserted to be owed or due to another." The amendment before us seeks to extend the DCA's authority to Debt Buyers, whether or not they actually collect or attempt to collect the debts owed them.

On January 5, 2009, the Tennessee Collection Service Board issued a *Clarification Statement Regarding Debt/judgment Purchasers and "Passive" Debt Buyers,* in which it explained that:

> It is currently the opinion of the Tennessee Collection Service Board that entities who purchase judgments or other forms of indebtedness will be deemed a "collection service" if they collect or attempt to collect the debt or judgment subsequent to their purchase of the debt or judgment. However, entities who purchase debt or judgments in the manner described above but who do not collect or attempt to collect the purchased debt or judgment, but rather assign collection activity relative to the purchased debt to a licensed collection agency or a licensed attorney or law firm shall not be deemed to be a "collection service".[32]

On October 13, 2006, the Massachusetts Division of Banks addressed the passive Debt Buyer issue when it issued Opinion 006060 entitled *Passive Debt Buyer Exemption from Debt Collector License*:

> It is the position of the Division that a debt buyer who purchases debt in default but is not directly engaged in the collection of these purchased debts is not required to obtain a debt collector license provided that all collection activity performed on behalf of such Debt Buyer is done by a properly licensed debt collector in the

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[30] *Letter from Marla Tepper, General Counsel, New York City Department of Consumer Affairs to Dennis Malen, Esq.*, March 7, 2007.

[31] New York City Administrative Code § 20-489.

[32] http://www.tennessee.gov/commerce/boards/collect/documents/CSBCLARIFICATIONSTATEMENTREGARDINGDEBT.pdf . Accessed 2/23/2009.

Commonwealth.[33]

In 2007, the DCA concurred with the opinion of the Massachusetts Division of Banks.[34]

> The Department of Consumer Affairs was recently asked to address an inquiry as to whether "debt buyers" that do not themselves engage in collection activities must be licensed by the Department. "Debt buyer" is a term commonly used to describe a purchaser or assignee of defaulted debt. The Department responded as follows:
>
> In addressing this question, the Department first confirms its position that a purchaser or assignee of defaulted debt whose principal purpose is the collection of that debt, whether for itself or others, is a "debt collection agency" under New York City Administrative Code § 20-489 (a). Debt buyers that engage in debt collection activities must therefore be licensed by the Department in order to collect debts in New York City. New York City Administrative Code § 20-490.
>
> **A debt buyer that merely purchases or acquires defaulted debt but does not engage in collection activities itself does not require a license from the Department.** [*emphasis added*]

There is no need to change that opinion and amend a regulation that requires no amendment.

Conclusion **For all the reasons cited above, the Commercial Lawyers Conference of New York respectfully requests that Int. No. 660 - A Local Law to amend the administrative code of the city of New York, in relation to buyers of consumer debt, be withdrawn from consideration.**

Respectfully submitted,

Commercial Lawyers Conference of New York

Dr. Eric M. Berman, Esq.
President

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[33] *Selected Opinion 06-060,* Deputy Commissioner of Banks, State of Massachusetts, June 16, 2006.

[34] *New York City Department of Consumer Affairs Clarifies Collection Services Licensing Requirements and Establishes Amnesty Period,* Notice from the City of New York Department of Consumer Affairs, 2007.

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Testimony of Thu Tuyen T. To and Claudia Wilner
on behalf of the Neighborhood Economic Development Advocacy Project

Before the Committee on Consumer Affairs
of the Council of the City of New York

Hearing on Debt Buyers in New York City

February 25, 2009

Thank you for the opportunity to testify today regarding the amending of New York City's administrative code to license all debt buyers. NEDAP supports the City Council's amending NYC's Administrative Code to require licensing for all buyers of consumer debt that directly or indirectly engage in debt collection activities in New York City.

NEDAP is a nonprofit resource and advocacy center that provides legal, technical and policy support to community groups and individuals in New York City's low income neighborhoods and communities of color. Founded in 1995, NEDAP promotes economic justice and works to eliminate discriminatory economic practices that harm communities and perpetuate inequality and poverty. NEDAP operates the NYC Financial Justice Hotline, which provides legal information and referrals to low-income New York City residents. We have helped thousands of consumers since launching the Hotline in September 2005. The majority of our callers are seeking assistance with debt collection matters, particularly debt buyer and creditor lawsuits.

NEDAP agrees with and endorses the analysis and conclusions of the New York City Bar Association in support of this legislation. Claudia Wilner, NEDAP's Senior Staff Attorney, is a member of the Bar Association's Civil Court Committee.

In addition, we wish to share some of our own observations with regard to debt buyers, particularly unlicensed debt buyers, and the manner in which these entities abuse our civil courts and take advantage of low income New Yorkers.

In 2008, NEDAP's Hotline staff assisted 466 people who had been sued in the NYC Civil court. Within this group, 52% of clients were sued by debt buyers, and 40% of those cases were brought by unlicensed debt buyers.

Our reviews of recent annual reports filed by publicly traded debt buying companies, including Encore Capital Group, Inc. (one of the largest debt buyers nationally) show significant annual increases in the percentage of operational funds devoted to litigation. That is no surprise to us. A lawsuit allows a debt collector to turn a seemingly uncollectible debt into a powerful judgment that it can use to freeze a person's bank account or garnish her wages. Judgments are collectible for twenty years, counted from the date of last payment, so the statute of limitations on a judgment

almost never expires. And judgments appear on credit reports, where they harm consumers in myriad ways.

Debt buyers file lawsuits en masse to collect on debts cheaply. Larger debt buyers file tens of thousands of cases against New York City residents every year. Debt buyers rarely effect proper service of these lawsuits, and the majority of defendants never get any notice that they have been sued. Without notice, defendants do not come to court to defend themselves. Thus, it is no surprise that 90% of consumer credit filings result in default judgments. These judgments harm low income New Yorkers, damaging their credit reports, making it difficult for them to find housing and employment, and rendering it impossible for them to build the savings necessary to withstand economic shocks.

At the same time, many of these cases have no merit because the debt is not actually owed by the consumer, or the statute of limitations has passed, or the debt has been previously discharged in bankruptcy. If challenged, debt buyers are often unable to come up with any admissible evidence that the defendant owes any money at all. Even in cases where the consumer does owe some money, debt buyers often sue for grossly inflated amounts.

For example, our client Lillian M. was sued in 2007 by Palisades Collection, then an unlicensed debt buyer. The underlying debt related to an unauthorized charge that appeared on Lillian's credit card, which the original creditor refused to remove. By the time Palisades Collection sued Lillian in 2007, the original creditor was out of business, and the statute of limitations had expired on the debt. Lillian went to court in response to the lawsuit and proved that the debt was past the statute of limitations. The case was discontinued. Recently, Palisades Collection hired a different law firm to sue Lillian again **for the same debt.** Even though Lillian already proved two years ago that this debt is uncollectible, she has to appear in court to defend herself all over again. In this second case, Palisades is taking the position that it is a passive debt buyer that does not require a license from the Department of Consumer Affairs.

Similarly, our client Peter P. was sued by Palisades Acquisition V, an unlicensed debt buyer, in 2006. Peter appeared in court and demanded that Palisades come forward with proof of the debt. Palisades was given many chances, but it was ultimately unable to provide any evidence in support of its claim, and the case against Peter was dismissed with prejudice, meaning that it could never be brought again. One year later, Palisades Acquisition V, still an unlicensed debt buyer, hired a different law firm to sue Peter again **for the same debt.** Even though he had already won his case once, Peter had to appear in court to defend the lawsuit a second time.

Both Peter and Lillian are seniors who rely on exempt income – SSI and Public Assistance – as their sole source of income.

Peter and Lillian are not alone. We recently reviewed our files to see what our clients had to say about the lawsuits brought against them by unlicensed debt buyers. We found that nearly half of the unlicensed debt buyer cases in our records were brought by LR Credit and its affiliate companies. Of clients who were sued by LR Credit, 40% of the cases were clearly meritless because, according to the client, the account was fraudulently obtained, past the statute of limitations, already paid, or previously discharged in bankruptcy. (As a point of comparison, we found that clients could raise these defenses in 35% of cases brought by all debt buyers and only 18% of cases brought by original creditors.) With regard to service, 79% of clients sued by LR Credit reported that they were not properly served with a summons and complaint, although they did receive some notice of the lawsuit, and 60% reported that they never received any notice of the case at all.

Although these issues can be raised and addressed in individual court cases, that is not enough. More oversight is clearly needed. A licensing requirement would give the Department of Consumer

Affairs clear authority to investigate patterns and practices of lawsuit abuse and power to take action to protect NYC residents from abusive, frivolous lawsuits brought by unlicensed debt buyers. In addition, NYC residents would gain an accessible forum in which they could file complaints about abusive litigation practices. DCA could use its subpoena power to conduct investigations, and it could deny licenses to entities that engage in abusive tactics, thus preventing these entities from using our courts to collect debts from NYC residents.

For these reasons, and the reasons cited by the New York City Bar Association, NEDAP supports the proposed legislation to require licensing for all debt buyers. Thank you.

Oral Testimony of Janet Araya on behalf of MFY Legal Services Client Josefina Araya before the New York City Council Committees on Consumer Affairs Public Hearing Local Law No. 660 on February 25, 2009

Good morning. My name is Janet Araya, and I am here to speak on behalf of my mother, who was not able to take the day off from her job in Queens to testify today. My mother is forty-six years old working mother of two; she came to the United States about twenty years from Central America and has lived here ever since.

My mother opened up her very first credit card in 1995; a SEARS card financed by Citibank, which she only ever used at a SEARS store close to our home. After a few years of regular, on-time payments of the full balance, she was upgraded to a SEARS card with a MasterCard logo which would allow her to use the card anywhere MasterCard was accepted. Even so, my mother continued to use the card only to purchase SEARS products in the store nearby, to buy necessities such as clothes or to have our car worked on. That all changed in May of 2005, when my mother discovered charges for three transactions on her credit card statement that she had not made. All of the transactions had apparently been made in Bangkok, Thailand, for jewelry and other luxury goods, amounting to over $10,000. My mother was shocked and immediately contacted Citibank and SEARS to dispute these charges; she also stopped using the card altogether. Despite her continued written disputes, Citibank eventually charged off and sold the account to a debt buyer, and over the course of a couple of years the account was sold from one debt buyer to the next.

For almost two years my mother and our family received harassing phone calls from the debt collection agencies that were hired to collect this debt, with my mother trying to explain that she did not owe the money. When the collectors would call they were very rude and said very

threatening things, such as that if we didn't pay we would lose our belongings and would be living on the streets. My parents were scared of what might happen and even discussed the possibility of selling the house to pay something to the collectors and make the whole thing go away. I even considered raising money of my own in case my parents were forced to pay something, and thought about going to the army rather than enrolling in college. After putting up with these phone calls for a long time, finally, in March of 2008, an unlicensed debt buyer, LVNV Funding, sued my mother for $13,000, which included the $10,000 balance on the credit card plus $3,000 in interest, finance charges and late fees. This lawsuit caused us even more stress and anxiety – we could not believe my mother was being sued for so much money, for a debt that was obviously not hers. Luckily, when we contacted MFY Legal Services, an attorney from their Consumer Rights Project agreed to represent my mother. Eight months later the lawsuit was discontinued because LVNV Funding was unable to provide any documentation to the court to prove that they had bought the account, or that my mother was responsible for the charges on the SEARS card.

After going through this nightmare as a family, we all feel it is important for all debt buyers such as LVNV Funding to be subject to regulation and oversight so that they can be held accountable for abusing New Yorkers, whether through harassing phone calls or abusive, meritless lawsuits. This kind of thing should not happen to any New Yorkers. Thank you for listening to my mother's story, and thank you for the opportunity to speak today.

For more information contact:

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NEW YORK
CITY BAR

Contact: Maria Cilenti - Director of Legislative Affairs - mcilenti@nycbar.org - (212) 382-6655

TESTIMONY OF JANET RAY KALSON, CHAIR OF THE CIVIL COURT COMMITTEE OF THE NEW YORK CITY BAR ASSOCIATION, IN SUPPORT OF INT. 0660-2007

NEW YORK CITY COUNCIL
February 25, 2009

My name is Janet Ray Kalson, and I'm the Chair of the Civil Court Committee of the New York City Bar Association. The New York City Bar supports Int. 0660-2007, which amends the administrative code of the City of New York in relation to buyers of consumer debt. This legislation would clarify that debt buyers, including entities that refer debts to other agencies for collection and/or litigation, are considered "debt collection agencies" under local law and accordingly must be licensed by the New York City Department of Consumer Affairs (DCA) in order to collect debts from New York City residents.

In 1984, the New York City Council passed a law requiring all debt collection agencies to be licensed by DCA before engaging in debt collection activities against New York City residents. The Council's intent was to protect residents from abusive debt collection practices. At that time, most of the abuse emanated from third party agencies, collecting on behalf of original creditors, who engaged in campaigns consisting of harassing letters and phone calls.

In the last twenty years, the debt collection landscape has changed. The industry now includes a growing number of debt buyers – companies that purchase defaulted debts for pennies on the dollar and then seek to collect the full face value of the debts for themselves. While some debt buyers perform their own in-house collections, many outsource the collection work to other entities, and, increasingly, to debt collection law firms. Debt buyers are heavy users of the New York City Civil Court. Some of the larger debt buyers file tens of thousands of debt collection lawsuits each year. The New York City Civil Court saw almost 300,000 consumer credit filings in 2008 alone, with the majority of filings made by debt buyers.

Section 3015(e) of the New York State Civil Practice Laws and Rules ("CPLR") requires that if a plaintiff's cause of action arises from the plaintiff's conduct of a business which is required to be licensed by DCA, "the complaint shall allege, as part of the cause of action, that plaintiff is duly licensed and shall contain the name and number, if any, of such license and the governmental agency which issued such license." This provision applies to debt collection agencies. Therefore, if a debt collection agency files a consumer credit lawsuit against a New York City resident, it must state that it is licensed by DCA, and it must include the license number in the complaint. If the debt collection agency fails to plead its license status and number, the consumer defendant may move to dismiss the case.

In recent years, some debt buyers have argued that they are not "debt collection agencies" and do not have to comply with the licensing requirement because they are "passive," i.e. they engage in no collection activities themselves, but instead hire others to do this work. However, these unlicensed "passive" debt buyers have been among the worst perpetrators of abusive debt collection practices against New York City residents, disproportionately affecting those who are poor, disabled, or elderly. ["Debt Weight: The Consumer Credit Crisis in New York City," Community Development Project, Urban Justice Center, October, 2007.]

Int. 0660-2007 would eliminate the so called "active/passive" distinction and make clear that all debt buyers who are seeking to collect debt from City residents, including those who hire a collection agency or law firm to collect on their behalf, are "debt collection agencies," and must obtain a license from DCA. The City Bar supports this legislation for three reasons.

First, the federal Fair Debt Collection Practices Act ("FDCPA"), on which the New York City statute is based, applies to all debt buyers. Under this law, a debt buyer is considered a "debt collector" if the debt that it is seeking to collect was in default at the time the debt buyer acquired it. This is almost always the case when a debt buyer is involved, because debt buyers, by definition, purchase defaulted debt. The Bar Association believes that if a debt buyer is a "debt collector" for purposes of the FDCPA, then it should also be a "debt collection agency" under local law.

Second, the City Bar believes that the proposed legislation will lead to increased efficiency in the Civil Court and lessen the burden on overworked court clerks and judges. Currently, debt buyers allege in their lawsuits either that they are licensed by the DCA or that they are passive debt buyers and do not require a license. This second allegation raises serious problems with regard to proof. If an unrepresented defendant wishes to raise the lack of a license as a defense, how does the court decide whether a particular debt buyer is "active" or "passive?" Who has the burden of proof, and what kind of evidence should be required? What does the inquest clerk do when presented with a request for a default judgment from a debt buyer that claims to be "passive" and does not include a DCA license number on its complaint? How does the clerk decide whether to issue the judgment? The proposed legislation would eliminate these thorny questions by implementing a bright line rule: All debt buyer plaintiffs must obtain a license and plead their license in the complaint as required by CPLR 3015(e). Then, if an unrepresented defendant raises the defense that the debt buyer plaintiff lacks a license, it will be simple and easy for the court to address this issue. In addition, the non-attorney clerks who review and decide applications for default judgments can apply a clear rule and refuse to issue judgments to entities that have not included their license in their complaint.

Finally, the Association believes that by bringing a debt collection lawsuit, a debt collector is engaging in debt collection that should be subject to licensure and government oversight. It is no secret that some lawsuits brought by debt buyers raise substantial questions as to the validity of the lawsuits and even the underlying debts. Problems such as improper service, the attempt to collect time-barred debts, the filing of suits that cannot be proven, and the seizure of exempt income abound in these cases. [*See, e.g.*, "Justice Disserved," Consumer Rights Project, MFY Legal Services, June, 2008; "Debt Weight," *supra*.] While these issues can be raised in individual cases, litigants, almost all of whom are unrepresented, and overworked judges should not be the only enforcers of the law. Moreover, when more than 90% of these

cases result in default judgments – which can produce serious consequences for debtors - it is imperative that some protections be built into the process. Mandatory licensing requirements would make clear that DCA has jurisdiction to conduct investigations and enforce the law against all debt buyers filing cases in the New York City Civil Court to collect consumer debts from New York City residents.

Respectfully submitted,

Janet Ray Kalson
Chair
Civil Court Committee
New York City Bar Association

February 25, 2009

Testimony by The Legal Aid Society Before a Hearing on Proposed Legislation to License Debt Buyers held by the New York City Council Committee on Consumer Affairs February 25, 2009

We want to thank the Committee on Consumer Affairs and Councilmember Comrie for giving The Legal Aid Society the opportunity to testify today in favor of Intro 660, and we want to thank Councilmember Garodnick for introducing this much needed legislation. Debt buyers have siphoned millions of dollars out of the poorest residents of our City through illegal means. They have used our overworked courts as their private collection agency, forcing working families with children, senior citizens and the disabled to fall short when the time comes to pay their rent, utilities and even their grocery bills. Many people who receive a summons from a debt buyer believe they will face imprisonment if they do not pay. It is the right time to put some reasonable controls on this unregulated part of collection industry so debt buyers cannot operate unchecked to prey on our communities.

Our Experience

As part of its civil practice, The Legal Aid Society represents low income clients who have been sued by various debt buyers for credit card debts they allegedly owed at one time in the past. We have been part of the planning committees which advanced the CLARO1 pro bono advice projects now operating in the boroughs of Brooklyn, Manhattan and Queens, and organized the first citywide Consumer Debt Conference held at Fordham law School in June, 2008, at which Councilmember Garodnick spoke about the Debt Buyer Licensing Bill.

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1 Cicl Legal Advice and Referral Office

We have assisted hundreds of clients sued by debt buyers and observed that in the vast majority of cases, the amount of the debt being sued on was under $3000.00, but the claimed default interest rates and the fees associated with these old credit card debts doubled or tripled the original sum the debt buyer alleged was owed. Debt buyers typically purchase bundles of discharged debt for less than five cents on the dollar, and together with this potential interest and fee multiplier, and the fact that a large percentage of debtors default, the investment in litigation becomes highly profitable.

In several years of representing clients against debt buyers in the Civil Court, we have never lost a case against a debt buyer—why? Because when put to the test, most debt buyers cannot prove their case. They have no true evidence of the debt, and most often, they do not have the legal right to collect the debt. When challenged by our attorneys, they have either asked to discontinue the case, made a favorable settlement for our clients, or at our request the case was dismissed by the court. The problem is that The Legal Aid Society and other civil legal services programs can only represent an extremely small fraction of the debt buyers' targets. The Civil Court is clogged with 300,000 cases, most of which are brought by debt buyers against unrepresented ("pro se") defendants without the resources to hire attorneys. In general, Legal Aid is forced to turn away seven clients for every one we can assist. In the consumer debt area, the problem is magnified and only stands to worsen given the present state of the economy.

Without the oversight that the licensing process would afford, debt buyers use the court system to their own advantage. They serve legal papers at old addresses and obtain default judgments against the alleged debtors before the defendants know they are being sued. If a debtor does answer the summons, the debt buyers' courthouse-savvy lawyers aggressively pursue them to make one-sided payout settlements, using crowded court hallways to pressure

defendants into agreeing to pay more than they can possibly afford. The settlements provide that when they miss a payment, the entire sum becomes due and their wages can be garnished or their bank accounts restrained.

Another abusive tactic debt buyers use is to utilize out-of court discovery to interrogate defendants about their entire debt history and their credit card accounts to find out facts about their claims which they do not have from the original creditors. Debt buyers serve defendants with "notices to admit" facts which would prove their case, because if the unsophisticated defendant does not answer the notice, or does not answer in time, he or she is deemed to have admitted the debt buyers' claims. When the debtors do file answers, the debt buyers' counsel may slap together a motion for summary judgment, using evidence which could not prove their claim at trial but which forces the unrepresented defendants to respond in writing to unfamiliar legal terms. Debt buyers know that the overburdened Civil Court is ill-equipped to police these kinds of practices despite the best efforts of some judges and the Civil Court administration.

Our clients

For example, Ms. S was sued last year by a debt buyer based on alleged credit card debt of $7000.00. Approximately half of this amount was the alleged debt, the remainder consisted of default interest charges and late charges. Ms. S only found out about the case against her when her employer received an income execution notice. Ms. S obtained representation from The Legal Aid Society and challenged the jurisdiction of the court because she had not been served with the Summons and was unaware of the debt. The process server's affidavit contained so many errors that it was virtually false, including stating that Ms. S lived in a private, two family house when in fact she resides in a large apartment building. In opposition to our motion, the

plaintiff did not even submit an opposing affidavit by the process server and the case was dismissed.

Even for debt buyers which purchase valid claims, there is a great need for licensing and the oversight that the licensing agency could exercise. Debt buying is a high volume business which we have observed is prone to mistakes as well as outright abuse. More than the monetary burden if our clients choose to use their subsistence income or savings to pay back a debt, there are the added unseen costs of their needless frustration and worry, and the time away from work and family commitments. Ms. D's case perfectly illustrates why this is so. In 2007, Ms. D was sued by an unlicensed debt buyer for $2440.00 in payments allegedly due on a credit card dating back to 2001. Ms. D remembered owing a balance of under $1000.00 when she could no longer afford to make payments on this card. During 2006, while Ms. D was recovering from an illness at home, she started receiving frequent calls from a debt buyer representative regarding the alleged balance. Finally, Ms. D agreed to settle the disputed debt for $1500.00. She promptly sent the funds and received confirmation of receipt from the debt buyer's attorneys. She was shocked when despite her payment the Summons for the same claim arrived in the mail. Many other clients have been re-sued for the same debts when their court cases have been dismissed or discontinued.

A licensing requirement would shine a light on debt buyers and allow the Department of Consumer Affairs the power to sanction the abusers. The last time City Council addressed the issue of licensing and regulation of debt collection agencies was in 1984, prior to the growth of third party debt buyers as collectors of consumer debt. When requiring licensing of debt collectors, the City Council did not intend to relieve a debt collection agency of its obligation to obtain a license simply because it engaged a licensed debt collection law firm as its counsel. The

same reasoning should apply to debt buyers. No meaningful distinction between companies whose only business is to buy the discharged debts of others and try to obtain payment through the courts to generate their revenue, and companies calling themselves debt collectors who take others' debts and use collection tactics to generate revenue.

The City Council can make a critical contribution toward curtailing abusive debt buyer practices by enacting the licensing bill. If not all debt buyers abuse the court system, the Department of Consumer Affairs will prove that by monitoring and prosecuting only those which do not operate legally. We also urge the City Council to consider providing more resources for legal representation and advocacy so we do not have to turn away so many clients whose economic situation is threatened by the burden of debts they may not owe but which compound and follow them for years. In addition, we urge that the City agencies along with elected officials and the advocacy community coordinate resources so that together we may better serve distressed consumers.

Thank you again for the opportunity to testify before the Committee on Consumer Affairs.

Respectfully submitted by

Oda Friedheim, Staff Attorney
The Legal Aid Society
199 Water Street
New York, New York 10038
Tel. 212 577 3930

CAMBA
Legal Services

TESTIMONY IN SUPPORT

February 24, 2009

BILL NUMBER: # 4293

SPONSORS: Garodnick, Comrie, Mendez, Viverito, and Barron

TITLE OF BILL: Debt Buyer Licensing Bill # 4293

PURPOSE: The bill would clarify that debt buyers who refer their debts for collection and/or litigation are debt collection agencies subject to the licensing requirement and government oversight under New York City law.

STATEMENT OF SUPPORT: I would like to begin by thanking the City Council for the opportunity to speak here today, and to specifically thank councilman Garodnick for introducing this bill. My name is Matt Schedler, I am an attorney practicing consumer law at CAMBA Legal Services, a community based non-profit legal service provider located in the Flatbush neighborhood of Brooklyn. CAMBA's consumer law program arose out of its membership in the working poor coalition, a five-member group that includes the Urban Justice Center, Westside SRO, Housing Conservation Coordinators, and the Northern Manhattan Improvement Corporation. The aim of the consumer program is to assist housing clients at the member organizations who also have consumer issues, with a goal of ensuring self-sufficiency for the client after the provider has resolved the initial issue.

The proposed legislation addresses an ambiguity in the definition of debt collection agencies under the New York City Administrative Code, and would ensure New Yorkers additional protections against unscrupulous and abusive debt buyers. The harassment and aggressive collection activity of debt buyers is a rapidly growing problem in New York City, and has a particularly disproportionate effect on the poor, disabled, and elderly.

The City Council last addressed the licensing and regulation of debt buying in 1984. At that time the City Council noted the need for licensing to address the problem of a minority of unscrupulous collection agencies employing abusive collection tactics. Since 1984 the debt collection industry has exploded, particularly in the area of third party debt buyers- companies that purchase debts for literally pennies on the dollar-who then farm out the debt collection activities to other collection agencies, including law firms. The collection activities that these firms engage in is not limited to the traditional practices of sending dunning letters and making phone calls, increasingly the debt collection model has shifted with a much greater focus on filing lawsuits. This new model is extremely

troubling, as majority of the debt buyers in these cases seem unable or unwilling to provide the evidence necessary to support their claim. A 2007 report by the Urban Justice Center entitled, *Debt Weight: The Consumer Credit Crisis and its Impact on the Working Poor*, examined the rise of debt collection actions in New York City Courts. The report found that in 2006 approximately 320,000 consumer debt cases were filed in New York City Civil Courts, and that the vast majority, 89.3%, were brought by debt buyers. The report also found that in 99.0% of third party debt buyer cases reviewed by the study the third party debt buyers submitted facially invalid supporting documents. A copy of this report can be found at http://www.urbanjustice.org/ujc/publications/community.html. Anecdotally my own experience also suggests that debt buyers are generally unable to support the cases they bring. I have never represented a client in a case with a debt buyer plaintiff where the debt buyer was able produce enough evidence to establish a prima facie case, and I have never had a case brought by debt buyer go to trial.

Currently third party debt buyers that engage a collection agency to collect a debt, or law firms to initiate a suit, are allowed to bypass the licensing requirement if the collection agency or law firm they hired is licensed. This places third party debt buyers outside the Department of Consumer Affairs regulatory grasp, and denies New York City residents the important protections regulation provides, and deprives the city of the revenue generated by licensing fees.

Because the mission of CAMBA's consumer program is focused on assisting the working poor I am able to see firsthand the potentially devastating effects that these cases can have on the this population. Even though the vast majority of debt buyer cases can likely never be proven, the cost for a *pro se* defendant to represent himself or herself in a consumer credit action is extraordinarily high. Consumer credit cases are often adjourned numerous times, requiring the defendant to miss multiple days of work to attend court appearances. This causes not only the loss of a day's wages, but also puts the defendant in fear of losing their job due to too many absences. As a result working poor clients often make settlement agreements on invalid debts out of fear that a prolonged court case will put their job at risk. This is not a decision that New York's working poor should be forced to make.

An illustrative example of these issues is the case of Mr. D. With the assistance of Northern Manhattan Improvement Corp. and CAMBA Legal Services Mr. D was able to move out of a homeless shelter and into affordable housing. Mr. D was also offered job search assistance through these organizations and found employment as a security guard. After obtaining employment Mr. D was sued by an unregulated third party debt buyer attempting to collect a debt that Mr. D did not recognize. CAMBA Legal Services agreed to represent Mr. D, and after requesting discovery and after numerous adjournments the debt buyer voluntarily dismissed the case, having never produced any of the supporting documents. Had Mr. D not been represented, like the vast majority of Civil Court defendants, he would have been faced with a decision between defending the

case and missing multiple days of work, putting his new job and his self-sufficiency at risk, or agreeing to pay a debt that he didn't believe he owed, and for which no supporting evidence was ever produced.

In closing I would like to encourage the City Council to support licensing of third party debt buyers, and the important protections that it would offer to New York City residents. I would also like to again thank the City Council for the opportunity to appear here today to offer this testimony.

THE COUNCIL
THE CITY OF NEW YORK

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Name: HaQuyen Pham (Ha-QUIN FOM)

Address: ~~123 William St, 16th Fl~~ 314 E. 19th St

I represent: Urban Justice Center

Address: 123 William St, 16th Fl

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Name: Janet Ray Karson

Address: Himmelstein McConnell Iri Maiden
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I represent: NY City Bar Assoc

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Name: Harley ~~Epstein~~ Epstein

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I represent: Urban Justice Center

Address: 123 William Street

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Name: ROBERT A. MARTIN

Address: DC 37, 125 Barclay Street

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Name: Claudia Wilner

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Name: Oda Friedheim, Esq.

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I represent: The Legal Aid Society

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Name: ERIC M. BERMAN

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I represent: COMMERCIAL LAWYERS CONFERENCE

Address: NY SAME address

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Name: ANDREW EILER

Address: _____

I represent: DCA

Address: _____

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Name: Arthur N. Hirsman

Address: _____

I represent: ACA International

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Name: Janet Araya (On behalf of Josefina Araya)

Address: 86-11 77st Woodhaven, N.Y.

I represent: _____

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Name: Carolyn E. Coffey

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I represent: MFY Legal Services

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Name: Melvin Billings

Address: 917-214-4603

I represent: _____

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Name: Matt Scholer

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I represent: CAMBA Legal Services

Address: _____

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