



Neighborhood Economic Development Advocacy Project

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Thank you for the opportunity to comment on debt collection practices in New York. My name is Claudia Wilner, and I am Senior Staff Attorney at the Neighborhood Economic Development Advocacy Project (NEDAP) where I direct the Consumer Law Project. NEDAP is a nonprofit resource and advocacy center that provides legal, technical and policy support to community groups in New York City's low income neighborhoods and communities of color. NEDAP promotes economic justice and works to eliminate discriminatory economic practices that harm communities and perpetuate inequality and poverty.

NEDAP runs the NYC Financial Justice Hotline, a consumer hotline that provides free legal information and advice to low and moderate income New Yorkers who are aggrieved by abusive and discriminatory financial services practices. We have helped thousands of people since launching the Hotline in September 2005. In 2008, 80% of our callers were seeking assistance with debt collection matters, particularly debt buyer and creditor lawsuits.

1. Debt Collection Lawsuit Abuse

By far, the most common problem that we see is abusive debt collection lawsuits, or what we call "lawsuit abuse," a practice mostly perpetrated by debt buyers and debt collection law firms. Debt buyers are companies that buy portfolios of old, defaulted debts from original creditors for pennies on the dollar, and then engage in aggressive efforts to collect these debts. Increasingly, debt buyers are using the courts to try to collect on these debts by suing the consumer.

The volume of debt collection litigation is growing exponentially. In 2008, nearly 300,000 debt collection lawsuits were filed in New York City alone. These cases are overwhelmingly brought against low- and moderate- income New Yorkers, many of whom are elderly or disabled, and nearly all of whom are unrepresented by attorneys. Approximately 80% of these cases result in "default" judgments – automatic wins for the debt collector because the defendant fails to appear in court. The consequences of these judgments can be devastating, impeding low- and moderate-income New Yorkers' ability to support their families, secure housing, and obtain employment.

These cases present many problems for our low income clients. First, many defendants never receive notice of lawsuits filed against them. This problem has grown so pervasive that the New York State Attorney General recently sued a local process serving agency, American Legal Process, and threatened action against a local debt collection law firm, Forster & Garbus, for engaging in “sewer service” – the act of failing to deliver notice to individuals of lawsuits pending against them, thereby denying them the chance to respond. Sadly, we have observed that the practices employed by American Legal Process and Forster & Garbus are not unique but, in fact, are standard practice throughout the industry. See Robert E. Kessler, “Cuomo: Lynbrook process servers committed fraud,” *Newsday* (Apr. 14, 2009); MFY Legal Services, *Justice Disserved* (June 2008) (available at http://www.mfy.org/Justice_Disserved.pdf).

Second, when our clients do receive notice of lawsuits and appear in court, most of them must appear and defend themselves *pro se* (without a lawyer). While all plaintiffs in consumer credit actions are represented by counsel, 99% of defendants are not. See, e.g., Urban Justice Center, *Debt Weight* (Oct. 2007). Unrepresented debtor-defendants are at a significant disadvantage. Unknowingly, these defendants routinely waive important defenses such as the absence of personal jurisdiction, the plaintiff’s lack of standing to bring the claim, or the statute of limitations. Meanwhile, debt buyer plaintiffs are able to manipulate complicated rules of civil procedure and lax pleading requirements to their advantage.

Third, most debt buyers file and complete their debt collection lawsuits without producing actual proof of the debts in court. . Unrepresented defendants often have significant questions about the debt for which they are being sued, but do not know that they have the right to ask the plaintiff for proof of its claims. Many of the debts are invalid to begin with because they are too old to be sued on, have already been paid or discharged in bankruptcy, or result from identity theft or mistaken identity. The invalid nature of many of the debts undoubtedly accounts for some of the debt buyers’ failure to produce actual proof. But even where a defendant may have incurred a legitimate debt to an original creditor, debt buyers rarely produce any actual proof, such as a sworn statement from someone with personal knowledge of the debt.

The problem may lie in the debt buyer’s business model. A debt buyer pays an average of five cents or less on the dollar for a portfolio of old, defaulted debts. In exchange, the debt buyer usually obtains an electronic spreadsheet containing some information about the debts, but none of the documents—such as credit applications, agreements, or statements, often referred to by debt buyers as “media”—that the debt buyer would need to prove the debts in court. Under many of the agreements that govern the purchase and sale of debt portfolios, debt buyers are permitted to obtain such media for only a limited percentage of the debts in the portfolio and/or for a limited period of time. Some purchase-and-sale agreements preclude debt buyers from obtaining media for any of the debts in the portfolio.

This bad faith business model ensures not only that debt buyers generally possess little to no proof of the debts when they file lawsuits, but also that they are unlikely to be able to prove the debts at trial. Yet debt buyers readily obtain default judgments on debts that are invalid and/or cannot be substantiated. The problem is exacerbated by the fact that state law permits clerks, and does not require judges, to assess the sufficiency of default judgment applications and enter default judgments. When defendants do appear in court to defend against a lawsuit, debt buyers will often simply drop the lawsuit, especially if the defendant can afford an attorney or find a free legal

services attorney. In other words, the success of the debt buyer's business model is predicated on the defendant not appearing in the lawsuit.

Once a debt buyer has a judgment, it wields tremendous power over a debtor. Debt buyers use judgments to freeze bank accounts and garnish wages. They threaten to seize personal property and place liens on people's homes. Judgments are reported on credit reports, where they prevent people from obtaining housing, employment, or from refinancing out of a predatory mortgage.

The combination of these factors leads to a shocking result. The vast majority of cases filed by debt buyers could not stand up in court if challenged. Many of the debts are not owed at all. Yet debt buyers win the vast majority of these cases easily, because most defendants do not get notice and therefore do not appear in court. In New York City, applications for default judgments rarely go to a judge, but are simply stamped by clerks who process hundreds of thousands of judgments a year. As a result our courts have become unwitting collection mills, turning outstanding debts of dubious merit into powerful judgments that can be collected for 20 years.

New York needs reform to end lawsuit abuse by debt buyers. Specifically, we call upon the New York State legislature to enact the Consumer Credit Fairness Act (A.7558/S.4398). This legislation will restore fairness and due process to the adjudication of debt collection lawsuits.

- By adopting statewide an additional notice requirement already in place in New York City, it ensures that more New Yorkers will receive notice that they have been sued in a debt collection lawsuit.
- By requiring court papers to include basic information about a debt, it ensures that New Yorkers will be better able to identify the debt or account on which they are being sued.
- By providing that default judgment applications in debt collection lawsuits will be evaluated by judges, it better protects New Yorkers against default judgments on debts for which the plaintiff does not possess legitimate proof.
- By reducing the statute of limitations on debt collection lawsuits from six years to two years, the act encourages creditors to file claims in a timely manner and better protects low- and moderate-income New Yorkers from the unfair and excessive accumulation of interest and fees.
- The proposed legislation also protects unrepresented defendants from unintentionally waiving the defense that a debt is past the statute of limitations or that they were improperly served.

2. Debt Settlement and Debt Protection Scams

Another rising consumer scam affecting low and moderate income New Yorkers is debt settlement. Debt settlement is marketed as an alternative to bankruptcy that will allow consumers to repay their debts at 50 cents on the dollar and be debt free in just a few years. The idea behind debt settlement is that the consumer stops paying her credit card bills, and instead pays the debt settlement company. The debt settlement company does not disburse payments to creditors, but instead allows the settlement money to accumulate in a bank account. Theoretically, when enough money has accumulated to satisfy the creditor, the debt settlement company negotiates a lump sum settlement on the consumer's behalf, thus eliminating the debt.

The scheme virtually never works. First, most major credit card issuers refuse to negotiate with debt settlement companies. Second, debt settlement companies charge large upfront fees, which the consumer must pay before she can start to accumulate settlement funds. In our experience, it takes the consumer about six months to pay the debt settlement fees and accumulate a small amount of money in the account. During this time, their debts double because of penalty interest rates and fees, and their credit scores take a huge hit. The credit card companies will not deal with the debt settlement companies, and they tend to file lawsuits against the consumers at about the six month mark. The debt settlement company abandons the consumer to deal with the lawsuits alone. And, although they fail to provide services, debt settlement companies usually refuse to return their fees.

A related problem has to do with companies that claim to offer protective services to seniors and people with disabilities. These companies have great-sounding names like “Debt Counsel for Seniors and the Disabled” and “Legal Advocates for Seniors and People with Disabilities.” These companies charge their clients an upfront fee of \$200, followed by a monthly fee of \$20-\$35, in order to write “cease communication” letters to debt collectors and credit card companies. Of course, the clients could write these letters themselves, with the same effect, for free. The real harm occurs when the senior or disabled person receives actual legal process – an arbitration notice or court summons. Although these companies bill themselves as providing legal representation to clients, they have no attorneys licensed to practice in New York State, and they do not appear in New York courts. These companies instruct their clients to forward all legal papers to them. They then respond to the notices of legal action by sending a letter to the creditor indicating that the client’s income is exempt from collection. Of course, the inevitable result is that the creditors enter default judgments against the clients, who then must deal with frozen bank accounts, negative credit reporting, and other types of judgment enforcement, such as threats of property execution. These companies are engaging in the unauthorized practice of law in the State of New York.

Debt settlement is currently illegal in New York State. Debt settlement companies act as unlicensed budget planners. Pursuant to § 455 of the General Business Law, budget planning is defined as the making of a contract in which (1) a consumer pays a sum of money, and (2) the budget planning entity distributes, supervises, or coordinates the distribution of the sum to creditors in accordance with an agreed upon plan, (3) in exchange for consideration. Debt settlement falls squarely within this definition. Budget planners must be licensed by the New York State Banking Department in order to operate in this state. Unlicensed budget planning is illegal and may give rise to criminal prosecution. *See* N.Y. Gen. Bus. Law §§ 456-457.

Unfortunately, when we have reported problems with debt settlement companies to the authorities, we have had difficulties getting the authorities to take action. We are heartened by the Attorney General’s recent launching of a nationwide investigation against debt settlement companies. Historically, however, the NYC Department of Consumer Affairs and the Attorney General have not handled our complaints about debt settlement companies, but instead have referred us to the Banking Department. Meanwhile, the Banking Department claims that it has no jurisdiction over unlicensed entities, and it has also refused to take our complaints. The result is that little relief has been available for New Yorkers who have been victimized by these scams. New York law already prohibits for-profit debt settlement. However, legislative reform could help to clarify that for-profit debt settlement is illegal. Legislative change could also provide for enhanced penalties, injunctive relief, and a private right of action, which would aid enforcement.

Any legislation addressing debt settlement must have certain essential characteristics in order to protect consumers.

- First, the law must provide that debt settlement services may only be provided by legitimate, not-for-profit entities.
- Second, the law must limit fees that debt settlement companies can charge
- Third, the law must make clear that the agency in charge of enforcement has both the jurisdiction and the duty to go after unlicensed entities.
- Fourth, the law must provide a private right of action and significant penalties, including actual, statutory, and punitive damages, injunctive relief, and a mandatory award of reasonable attorney's fees.

The Uniform Debt Management Services Act, proposed in Assembly bill A.7268, has many good aspects, but it does not go far enough to protect consumers. Specifically, **the fees are too high**. No legitimate not-for-profit organization needs to charge a \$400 set up fee, a \$50 monthly service fee, plus a settlement fee. It is also unclear why debt settlement should cost more than a debt management plan. These high fees are guaranteed to attract scammers and profiteers to our state to make money by fleecing low income New Yorkers desperate to resolve their debts. Therefore, we recommend that the legislature adopt the following amendments, which are based on legislation recently adopted in Minnesota:

- Cap fees at a reasonable level, set as low as possible to allow legitimate not-for-profit entities to cover their costs while discouraging profiteering.
- Explicitly prohibit debt settlement companies from telling consumers to default on their debts or stop paying existing accounts.
- Require providers of debt management plans and debt settlement services to get preapproval of the plans from creditors before the consumer signs the contract.

3. Answers to Specific Questions Posed by the Committees

Should New York State license third party debt collectors and debt buyers, as proposed in Assembly bill A.3926-A?

Should consumers have a private right of action to remedy improper debt collection practices under state law, as proposed in A.3532?

Yes. New York City residents are lucky in that the New York City Department of Consumer Affairs licenses and regulates debt collection agencies, including debt buyers, who collect debts within the five boroughs of New York City. Accordingly, when New York City residents face debt collection abuse, they can file a complaint with DCA, who investigates, provides mediation services, and can take larger enforcement action. New York City residents can also find out on DCA's website whether a particular debt collection agency is licensed. New York State residents should have this same opportunity.

A.3926 provides a good framework for licensing debt collection activities, but it can be improved in several key respects. First, New York City recently passed legislation updating the definition of a debt collector and providing for several important new protections, like the right to verify a debt at any time and the right to written confirmation of settlement agreements made over the phone. These rights and definitions should be incorporated statewide so that uniform rules prevail throughout the

state. Second, the bonding requirements in the proposed legislation are currently set too low. Bonds should be set high enough so that if multiple consumers are injured by a single collection agency, they would all be able to collect from the bond. Raising bond limits will protect consumers without significantly altering the price of the bond. Third, any licensing requirement should make clear that compliance with state, federal, and local law, particularly those laws related to debt collection, is a nonnegotiable condition for obtaining, maintaining, and renewing a license.

Finally, a private right of action, coupled with appropriate remedies, is indispensable to adequate enforcement of debt collection laws. Both the Federal Trade Commission and the New York City Department of Consumer Affairs receive more complaints about debt collection abuse than about any other industry. There are far more collection agencies, consumer complaints, and debt collection contacts per year than any agency can possibly investigate and enforce on its own. Government agencies need the assistance of private attorneys general – private and legal services attorneys who can sue directly on behalf of aggrieved individuals. Any enforcement scheme must provide for the following: (1) actual damages; (2) statutory damages to be assessed *per violation*; (3) punitive damages; (4) injunctive relief; and (5) attorneys fees and costs. Only a full complement of remedies can provide an adequate level of deterrence so that illegal, abusive conduct will stop.

Should New York State require debt collectors seeking to collect a time-barred debt to disclose such fact to the consumer?

Should New York State ban the practice of collecting time barred debts where the statute of limitations has expired? Should the statute of limitations be shortened in consumer debt cases?

New York's statute of limitations for consumer debt lawsuits is too long and should be shortened. New Yorkers desperately need protection from the usurious interest rates and fees charged by credit card companies and debt buyers. In our experience, in the rare cases that we get to see our clients' account statements, we usually find that the principle amount of the debt is dwarfed by interest and fees. Often our low income clients make payments for years and never make a dent in their debt. Even after default and charge-off, interest rate continues to accrue at contract rates, which can be as high as 29%. Many of our clients have actually paid back what they charged many times over, and they would not have a debt at all if interest rates and fees were assessed fairly. Unfortunately, New York cannot directly regulate the amount of interest and fees that most credit cards can charge. We can, however, set a time limit for filing lawsuits. A shorter time limit will cap the amount of interest and fees that can be assessed against an account and save struggling New Yorkers millions of dollars.

Reducing the statute of limitations will also provide for a more fair and efficient resolution of cases. Under current law, debt buyers and creditors routinely bring actions on debts that are quite old but still within New York's six year statute of limitations. In many of these cases, the debt buyer no longer has accurate contact information for the consumer. Court notices are routinely sent to old, incorrect addresses. The six year statute of limitations undoubtedly contributes to the high default rate in consumer debt cases. Furthermore, when the consumer does get notice and appears in court on one of these old debts, documents are no longer available because both consumer and original creditor have already discarded the statements. These cases clog the court system, as cases are adjourned multiple times for debt buyer plaintiffs that claim they need more time to obtain documents that in fact no longer exist. Consumers lose time and money each time they have to

come to court. If the statute of limitations is shortened, then creditors and debt buyers will be more likely to have the consumer's correct contact information and access to account documents. Consumers will be more likely to get notice of the cases against them, and they will be better prepared to settle cases if information about the accounts is available.

Finally, reducing the statute of limitations will clarify an unsettled area of the law. Under existing section 202 of the CPLR, when a foreign plaintiff sues a New York resident, and the cause of action accrued outside of New York, the cause of action must be timely under both New York law and the law of the foreign jurisdiction. *See GML, Inc. v. Cinque & Cinque*, 9 N.Y.3d 949, 951 (2008) *Global Financial Corp. v. Triarc Corp.*, 93 N.Y.2d 525, 528 (1999). In the case of a credit card debt, the cause of action accrues in the original creditor's home state. *Id.* New York courts are actually required to apply the law of the foreign jurisdiction if doing so would bar the claim. *Id.* Many creditors are located in states, such as Delaware, that have a much shorter statute of limitations than New York's. Cases are routinely filed during the window after the applicable foreign statute of limitations has expired but before New York's statute has run. These cases should be thrown out of court on statute of limitations grounds. Unfortunately, many judges and nearly all *pro se* defendants are unaware of CPLR 202, and so judgments are routinely awarded on cases on which the statute of limitations has expired.

In addition, debt collectors should be barred from seeking to collect a debt on which the statute of limitations has expired. Many of our clients want to pay their debts and feel extremely guilty that they are unable to do so. Debt collectors and debt buyers call and harass them on very old debts, long past the statute of limitations, hounding them until they agree to make a "good faith payment" of \$20 or \$25. Our elderly and disabled clients are particularly vulnerable to these tactics. Of course, the debt collector's primary objective is not to get that token payment, but to reset the statute of limitations so that the debt buyer can file a lawsuit for the original amount of the debt, plus all the accumulated interest. In order to protect our clients from involuntarily waiving the statute of limitations on very old debts, we urge that debt collectors be barred from collecting debts on which the statute of limitations has expired. (Creditors would still be allowed to report debts on a consumer's credit report for the full time period allowed under the Fair Credit Reporting Act, so consumers who are concerned about their credit record will still have a healthy incentive to repay their old debts). In the alternative, we believe that New York state law should at the very least adopt the same provisions as those already incorporated into New York City law, which provides: "[A] debt collection agency shall not... [c]ontact a consumer about or seek to collect a debt on which the statute of limitations for initiating legal action has expired unless such agency first provides the consumer such information about the consumer's legal rights as the commissioner prescribes by rule." N.Y.C. Admin. Code 20-493.2 (b).

Again, thank you for the opportunity to testify at today's hearing.