

Introducing Certainty to Debt Buying: Account Chain of Title Verification for Debt

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Introduction

It's not easy being an issuer of credit ("Issuer") or buyer of debt ("Debt Buyer") in today's climate. Once industries that functioned without a lot of coverage or scrutiny, they now find themselves the subject of attention by the judiciary, government and the press. As a result of changes in court rules, regulations and statutes that require Issuers and Debt Buyers to prove ownership of accounts with greater documentation, the once predictable process of collecting charged off debt has now become less predictable and more uncertain.

In uncertain times (like the current economic environment), trust often takes a back seat to verification. Whether it's in the context of a home purchase, business reorganization or employment application, the parties typically verify creditworthiness, financial status or education history prior to moving forward. To ensure impartiality, the party verifying information usually turns to a third party, such as a title company or credit reporting agency. If everything checks out, the value of the home, business, asset or salary increases because the buyer has confidence in the integrity and transparency of the process.

Yet surprisingly enough, in an age of record consumer debt defaults, buyers and sellers of charged off debt rely on trust and hope when verifying what *they* are buying. Billions of dollars are paid annually for accounts that could have already been sold to another Issuer or debt buyer, are the subject of a validated dispute, identity theft, fraud, bankruptcy or simply can't be collected because the debtor is deceased with no estate.

The multiple cases concerning debt buyers Goldberg & Associates, LLC and now—bankrupt debt broker Hudson & Keyse, LLC, illustrate these problems. Hudson & Keyse agreed to sell a portfolio for \$2.4 million to Goldberg & Associates, and despite refusing to pay for the portfolio (and therefore not owning the debt), Goldberg & Associates undertook collection on, and sold, some of the accounts. Hudson & Keyse ultimately sued Goldberg & Associates in federal court in Florida, but not before other debt buyers had purchased debt from Goldberg & Associates that it did not own, and to which the buyer therefore did not take title. Suits were filed against Goldberg & Associates by numerous debt buyers, include Old National Bank, American Acceptance Co. and RMB Holdings, LLC.

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According to the co-chairman and CEO of one of these buyers, NorAm Capital Holdings:

[Goldberg] represented that he was the principal owner and provided an evaluation portfolio, a seller survey, media samples as well as the executed contract from the originator...

But it was later determined that

not only did the seller not have title to the portfolio, but also the evaluation portfolio had been significantly altered in order to entice NorAm into the transaction

“Debt Buyer Sentenced For Fraud Conviction,” Collections & Credit Risk (November 19, 2009) (quoting Dan Cofall of NorAm Capital Holdings). Other problems have included debtors settling with one creditor and then being sued by another who allegedly purchased the debt (Smith v. Mallick, 514 F.3d 48 (D.C.Cir. 2008)), disputes between debt buyers over who owns which account when buyers have purchased partial portfolios (Wood v. M&J Recovery LLC, CV 05-5564, 2007 U.S. Dist. LEXIS 24157 (E.D.N.Y., April 2, 2007) (dispute over who owned the 1/5th of a portfolio that included the debtor’s account), or debt buyers attempting to collect monies in excess of the balance of a previously settled debt (Overcash v. United Abstract Group, Inc., 549 F. Supp. 2d 193 (N.D.N.Y. 2008)). These issues are discussed in length in D. Edelman, “Representing Consumers in Litigation with Debt Buyers,” (Edelman, Combs, Latturmer & Goodwin LLC, 2008) (<http://www.edcombs.com/CM/News/collection%20defense%20debt%20buyer.pdf>).

In a string of cases refusing to grant judgment to debt buyers based on confusion over ownership, the New York courts have succinctly summarized the issue:

Because multiple creditors may make collection efforts for the same underlying debt even after assignment... failure to give notice of an assignment may result in the debtor having to pay the same debt more than once or ignoring a notice because the debtor believes he or she has previously settled the claim.

MBNA Am. Bank v. Nelson, 15 Misc. 3rd 1148, 841 N.Y.S. 2d 846 (N.Y. 2007). The problem of establishing ownership, according to the MBNA court, deals squarely with the core issue of *standing*, i.e., the ability to even bring the case into court:

It is imperative that an assignee establish its standing before a court, since "lack of standing renders the litigation a nullity." It is the "assignee's burden to prove the assignment" and "an assignee must tender proof of assignment of *a particular account* or, if there were an oral assignment, evidence of consideration paid and delivery of the assignment." Such assignment must clearly establish that Respondent's account was included in the assignment. A general assignment of accounts will not satisfy this standard and the full chain of valid assignments must be provided, beginning with the assignor where the debt originated and concluding with the Petitioner. . . .

Id.

This problem has come to the forefront because Issuers, Debt Buyers and the ARM industry face a set of “perfect storm” circumstances. High debt volume, high default and a long economic downturn have resulted in heightened scrutiny of the industries as well as increased regulations and awareness about deficiencies that exist in proving account level ownership. This in turn creates enormous hurdles in proving the fundamental basis of a lawsuit: standing, which in turn leads to substantial enterprise wide regulatory actions and legal action exposure, higher costs, reduced efficiencies, and lower recovery rates.

The response by regulators, judges and lawmakers has been to increase the burden of verification significantly for the debt owner, making the cost and effort to collect on purchased debt inordinately high absent proof of ownership. At least one municipality, five states and one set of local court rules now require additional proof from debt owners to verify their ownership of accounts in collection suits or otherwise subject debt buyers to requirements formerly restricted to collection agencies:

Jurisdiction	Law or Rule	Requirements
New York City Council	Local Rule No. 15 (amending NY Admin. Code 20-489) and implementing rules from Department of Consumer Affairs	Subjects debt buyers to same requirements as collection agencies; requires for purchased debt a record of the name and address of the seller, date of purchase and amount of debt at time of purchase
New York State	Consumer Credit Fairness Act (CCFA)	Proof of debt must include name of original creditor and all assignees
Illinois	Illinois Collection Agency Act Section 8(b) (225 ILCS 425/8b)	Debt buyers added to this Act—requires written agreement evidencing assignment of debt, recording of assignments
Circuit Court of Cook County,	Local rule 10.9	Debt buyer suits shall include “Legally-sufficient documentation for each transfer or assignment of the account, including documents identifying the specific account”
North Carolina	Changes to N.C. G.S. 58-70-150)	Subjects debt buyers to debt collector laws; require debt buyers to provide documents proving ownership of accounts
Minnesota	House Bill No. 2996 (pending)	<u>Debt buyers must attach to complaint a copy of the assignment establishing that the person is the owner of the debt, and “if debt has been assigned more than once, then each assignment or other writing evidencing transfer of ownership must be attached to establish an unbroken chain of ownership”</u>
Tennessee	Changes to Tennessee Code Annotated 60-20-102(3)	Subjects debt buyers to debt collector laws, requiring debt buyers to provide documents proving ownership of accounts <u>under TCA 60-20-127(a)</u>

In addition, numerous courts have ruled that debt buyers lacked standing to proceed with suits or claims against debtors, where the debt buyer was unable to prove a chain of title to the account. See Unifund CCR Partners v. Cavender, 14 Fla. L. Weekly Supp. 975b (Orange County, July 20, 2007); MBNA Am. Bank v. Nelson, 15 Misc. 3rd 1148, 841 N.Y.S. 2d 846 (N.Y. 2007); In re Leverett, 378 B.R. 793, 800 v. 12011

(Bkrcy. E.D.Tex. 2007); Unifund v. Ayhan, 2008 Wash. App. LEXIS 1922 (August 5, 2008); Nyankojo v. North Star Capital Acquisition, 679 S.E.2d 57, 298 Ga. App. 6 (2009); Wirth v. Cach, LLC, 685 S.E.2d 433, 300 Ga. App. 488 (2009).

But lack of standing has been the least of a debt buyer's problems in other cases. Debt buyers have been involved in litigation in situations where a debtor "settled" with a party who had already sold the debt, see Smith v. Mallick, 514 F.3d 48 (D.C. Cir. 2008) (debt buyer sued over debt that previous buyer settled with debtor); Dornhecker v. Ameritech Corp., 99 F. Supp. 2d 918, 923 (N.D.Ill. 2000) (collection against debtor on debt it had already settled); Northwest Diversified, Inc. v. Desai, 353 Ill.App.3d 378, 818 N.E.2d 753 (2004) (debtor levied by debt buyer after settling account with the creditor), where creditors continued to try to collect on debts already sold to a debt buyer); Associates Financial Services Co. v. Bowman, Heintz, Boscia & Vician, P.C., 2004 U.S. Dist. LEXIS 6520, 2004 WL 826088 (S.D. Ind., Mar. 31, 2004). An excellent summary of these and other cases is set forth in D. Edelman, "Representing Consumers in Litigation with Debt Buyers" (cited above).

Most recently, the tide of foreclosure cases has been stemmed by the same problem: Inability to prove chain of title, locating the original note and supporting documentation, and process deficiencies utilized by Issuers' servicing entities to verify data and presence of correct documentation needed to legally foreclose.. See In re Foreclosure Cases, 521 F. Supp. 2d 650 (S.D. Ohio. 2007); Everhome Mtge. Co. v. Rowland, 2008 Ohio 1282 (Ohio App. 2008); Deutsche Bank National Trust Co. v. Castellanos, 18 Misc. 3d 1115A, 239 N.Y.L.J. 16 (Kings Co. Sup. Ct., Jan. 14, 2008). Faced with this avalanche of adverse case law, GMAC, Bank of America and other lenders have begun to institute foreclosure moratoriums, and the Attorneys General of all 50 states have met to consider legal action.

With the pressure on from courts and legislators to verify ownership, debt owners are forced to seek ways to establish ownership—literally, an account level chain of title—to the debts that they own or have acquired. Perhaps the reason that debt owners have historically failed to verify what they are buying or collecting on is that there was no third party to verify it. That has all changed now, and a solution has emerged.

The Need for a Solution—Account Level Chain of Title Verification for Debt

For debt owners, the problem comes down to proving the origin and subsequent transfers of account level ownership. Although this may sound like an original problem, the problem (and its solution) has its roots in a very old and familiar industry—the real estate business. Despite the current problems in the real estate mortgage industry (which occurred due to serious deficiencies in process and lapses in oversight of the entire mortgage origination, securitization, and subsequent servicing and sale of mortgages), the solution created decades ago by the real estate industry to resolve problems with real estate title creates a useful roadmap for solving debt chain of title issues today.

Prior to the advent of the real estate title insurance industry in the mid—nineteenth century, title to real estate was often very difficult to determine. The buyer had to either make its own search of the relevant legal and governmental records, which were often incomplete or incorrect and certainly not centralized, or pay an attorney to do it for the buyer. If the buyer or attorney made an error, the buyer's rights in the property were at stake and he often had to go to court to settle rights in title.

To address this shortcoming in real estate title, the first title company was formed in 1876. The advent of a real estate title industry led to centralized recordkeeping in the form of title plants, a standardized format for verifying chain of title (the title report) and ultimately greater reliability for buyers. It also created a business record, in the form of the title report, which the buyer could use to document ownership in the unfortunate event that recourse to the courts had to be taken. Today, virtually no one would purchase a home without first examining a title report.

Currently, with debt ownership there is no reliable, industry or global standard to verify title to debt, no centralized title tracking system, and the only recourse is often the courts. The solution for the debt buying industry should follow a familiar pattern: centralized recordkeeping for debt sale and purchase, a standardized format for verifying chain of title and generation of a business record which the buyer can use to document account level ownership. In an interesting twist of fate, GDR's solution can be deployed to benefit the same industry which spawned the chain of title process, by supplying a centralized solution for tracking ownership, managing servicing rights, validating placed or traded data, and acting as a repository for all account level documentation.

The Solution--Account Chain of Title Verification

Such a solution exists in the account level chain of title verification services of Global Debt Registry ("GDR"). From registration to sale, this process creates a portfolio wide and account—specific centralized chain of title that can be used by debt owners to legally establish ownership and validity of account level data in a request for validation or collection suit. Each step, and each report generated as an output of the process, is electronically stored on GDR's secure computer systems and is managed and generated in a manner calculated to meet the federal rules of evidence for the business hearsay rule for electronic business records.

Initial Registration

The chain of title process begins when an Issuer registers a portfolio of charged off debt with GDR by depositing electronic records of each such account into a secure database maintained by GDR. This title origination is performed by the Issuer on or around the time of charge off for an internally placed file or when a portfolio is prepped for sale by the Issuer to another Issuer or debt buyer.

GDR then generates an Initial Registration Report that records key account level data attributes utilized for validating traded data in subsequent transactions or requests for current owner validations. GDR assigns a unique Portfolio Certification Number ("PCN") to each registered portfolio, and assigns a unique Registered Account identifier ("Registry ID") to each account which is associated with the account for the remainder of the time it is in GDR's systems.

Data Verification

When a party that has registered (or purchased) debt with GDR wishes to sell all or part of a portfolio, it provides GDR a data file of the current key data elements (for example, Originating Issuer, Original Account Number, Account Holder's Name, Account Holder's Social Security Number, Charge Off Date, Last Paid Date, etc.) for this set of accounts. GDR then assigns a new PCN to the accounts selected for sale, performs a comparison of the seller's data file to the originally registered account data set and provides an exception report to the seller noting any differences between the two data sets. If necessary,

the seller then resubmits a corrected data file to GDR. This process continues until all exceptions are cleared by GDR, and the portfolio is then cleared for sale or placement.

Although a PCN may change, the Registry ID for each account does not change, allowing tracking of a complete account transfer history. As noted below, one of the records created by the process is an account—level Chain of Title Report which shows the history of the account, referencing each previous PCN and transfer, from registration to the current sale or placement.

Transfer of Ownership

When a sale or other transfer of ownership of selected accounts occurs, GDR follows a set of procedures to ensure valid recording of the transfer. GDR authenticates the identity of each participant in the debt sale or transfer and requires them to attest to their authority to transfer (or purchase) the accounts, and to acknowledge the transfer of ownership by electronically signing the Transfer of Ownership Registration Report (this process is performed in compliance with the E-SIGN Act to create a binding digital signature). GDR then records the transfer of ownership within its system for each account transferred. Each total or partial transfer of a portfolio, and all accounts in it, is therefore recorded in GDR's electronic records.

Account History

GDR maintains an Account History Report ("AHR") for each Registered Account which includes the Registered Account data provided by the Issuer and Subsequent Debt Owner(s) as sellers. The Account History Report includes a Chain of Ownership Summary beginning with the Initial Registration and details each successive Transfer of Ownership for the Registered Account. The electronic business records required for the recording of a Transfer of Ownership of a Selected Portfolio and the titling of accounts includes both portfolio level business records and account level business records provided to and managed by GDR.

Output of the Process: A Virtual Title Report and AR Title Plant for the Debt Buying Industry

The output of this process is a set of business records, issued in a standardized format, which debt owners can use to prove up portfolio and account level chain of title as well as data integrity. At the initial registration stage, GDR and the Issuer execute an Initial Registration Report ("IRR") which records and represents the initial registration of a portfolio. Validation data is recorded electronically by GDR to establish baseline data integrity. With each transfer of ownership, GDR electronically generates a Transfer of Ownership Registration Report ("TOR") which is a record of the transfer of ownership of accounts in a portfolio.

As noted above, the Account History Report that GDR generates for each registered account includes a Chain of Ownership Summary. Because each account maintains its unique Registry ID, the Chain of Ownership Summary shows the entire history of that account following the originating Issuer's registration.

Taken together, the IRR, TOR and AHR literally furnish an account level chain of title for charged off accounts which amount to a virtual title report prepared in a manner intended to be legally admissible in court. From initial registration by the Issuer, through all interim transfers, and up to the most recent sale, all transactions are clearly reflected in a manner that debt buyers can use to prove standing and ownership

v. 12011

as well as establish validity of the placed or traded data and improve perfection of ownership in the account.

But Is It Admissible and Persuasive? Use of Account Chain of Title Verification in a Court of Law

This process, and the documents generated by it, are useful for debt buyers performing due diligence. They are also, however, useful for another very important purpose: proving chain of title at the account level to a debt in court.

In the only case in which the process was placed under scrutiny to date, an Ohio court permitted the testimony and introduction of evidence (GDR's, IRR, TOR, and AHR) concerning the GDR process and ruled that it established chain of title for the debt owner, who was pursuing a collection case against the debtor. That case is Symmetric Acquisitions, LLC v. Troyer, No. 09 CVF 7891 (Canton Municipal Court, Stark County, OH) (February 2, 2010), in which President and CIO of GDR, Bruce Gilmore, established chain of title to the debt via testimony concerning the GDR process, and introduction of the documents generated by GDR showing a clear chain of title. Although the debtor vigorously defended the case on the basis that the debt owner could not establish standing or ownership of the debt up until this hearing, it did not pursue an appeal of the judge's ruling that GDR's testimony established title.

Such testimony is one way to prove chain of title to debt, but an easier path exists in the introduction of the GDR document trail for an account (IRR, TOR and AHR) as business records, using affidavits to establish foundation. Although the rules of evidence vary somewhat from state to state, many states (a total of 42, plus Puerto Rico²) largely follow the language of the Federal Rules of Evidence, or FRE.

FRE 803(6) sets forth the "business records exception" to the hearsay rule, which allows certain records to be admitted as evidence. 803(6) requires that a record, to be admitted as a business record, be a:

memorandum, report, record, or data compilation, in any form, of acts, events, conditions, opinions...made at or near the time by, or from information transmitted by, a person with knowledge, if kept in the course of a regularly conducted business activity, and if it was the regular practice of that business activity to make the memorandum, report, record or data compilation....

FRE 803(6). These elements may be established either by "the testimony of the custodian or other qualified witness, or by certification that complies with [Federal Rule of Evidence] 902(11), ...902(12), or a statute permitting certification" (in other words, by submission of a conforming affidavit).

The records kept and the reports generated by GDR meet these criteria. The IRR is generated at the time of initial registration of an account(s), the TOR is generated at the time of transfer of the account(s), and the AHR is generated from GDR's electronic records made at the time of registration or the last relevant transfer. These records are made by persons at GDR having knowledge of the registration or transfer, in the course of GDR's regularly conducted business activity. Last, it is the regular practice of GDR to make these records in the course of its regularly conducted account registration, validation and transfer activity.

² The states which have not adopted their own rules of evidence (i.e., not based on the FRE) are California, Connecticut, the District of Columbia, Georgia, Illinois, Kansas, Massachusetts, Missouri, New York, Virginia, and the Virgin Islands.

As noted above, the foundation for these records can be established either by testimony or by affidavit. Due to time and expense, most debt owners choose to utilize affidavits to prove foundation whenever possible. As part of its normal business practice, GDR makes affidavits available to Issuers and debt buyers which establish a portfolio level chain of title (i.e., demonstrate the registration and transfer history of the group of accounts which includes the account on which the debt buyer is suing). These affidavits are prepared for the purpose of meeting the certification requirements of FRE 902(11), which states:

The original or a duplicate of a domestic record ... that would be admissible under Rule 803(6) [does not require authentication by testimony] if accompanied by a written declaration of its custodian or other qualified person ... certifying that the record:

(A) was made at or near the time of the occurrence of the matters set forth by, or from information transmitted by, a person with knowledge of those matters;

(B) was kept in the course of the regularly conducted activity; and

(C) was made by the regularly conducted activity as a regular practice.

Using these affidavits from GDR, a debt owner can point to the Chain of Ownership Summary in the Account History Report for a specific account and demonstrate a chain of title beginning with the Initial Registration and ending with the last Transfer of Ownership for that account to the debt owner.

The difficulty of Debt Buyers in proving chain of title without such proof was recently illustrated in the Missouri Court of Appeals case styled Asset Acceptance v. Lodge (No. ED 93264, Mo. App. E.D. September 28, 2010). In that case, a representative of the Debt Buyer (Asset Acceptance) testified to establish the foundation for the original loan contract between the debtor and the Issuer. The trial court accepted this testimony and admitted the original loan contract (and the assignment of the account from the Issuer to the Debt Buyer), but on appeal the Missouri Court of Appeals reversed and entered judgment for the debtor on the basis that the Debt Buyer's employee (since he was not an employee of the Issuer) could not have knowledge of the original loan agreement sufficient to establish foundation. The Debt Buyer's counsel has filed a motion for reconsideration or transfer to the Missouri Supreme Court, but had the Debt Buyer been able to present proof of authenticity from the Issuer (such as would exist with an IRR), the result might have been different.

Conclusion: Why Buy Debt Without Proof of Title?

Businesses and individuals would not dream of buying real property, automobiles, or anything else of value without first having its ownership status verified by a third party. If one would not buy a car or house without title confirmation, why would one spend thousands or millions buying debt without the same protection?

Although debt buyers have proceeded without this verification in the past (in part because no solution existed), such verification is increasingly being required by courts, legislatures and others. In addition to satisfying these legal requirements, validation of chain of title has many proven benefits for all of the participants. Higher standards, increased transparency and integrity in the recovery and sales of charged off debt can only benefit the industry. In the same way that the title industry enabled certainty in validation of real estate title, chain of title verification for purchased debt will enable debt owners to ensure that what they are buying is more than a chance of ownership and recovery.