PURCHASED DEBT CASES

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A growing issue that you will quickly face when you begin to hear civil dockets is the question of sufficiency of evidence required to support a judgment in purchased debt cases. I have included in this outline a copy of an article from the National Judicial College describing a course they designed to address this topic. The article clearly illustrates that this is an important issue with national implications, as judges across the nation struggle to determine the proper method of review.

In your handouts today, you will also find two articles from the Wall Street Journal which I urge you to read. The first one in particular gives an excellent review of the history of the debt-buying industry, and the problems inherent to that industry. Specifically the troubling lack of supporting documentation, also known as "media".

This presentation today invites you to consider two basic principles of law within the context of default judgments in purchased debt filings.

1. Even in a default situation, the plaintiff must establish a prima facie case. Consider a personal injury matter with a request for a $15,000 award. You would not grant that amount without copies of medical bills, and evidence of pain and suffering. It would not be sufficient to receive a sworn statement that the requested amount was simply verified by the suing party or his/her attorney. A default judgment is more than a rubber stamp.

2. The assignee has no greater rights than the assignor, and must present the same level of evidence as would be required of the original creditor.

So what are these issues I keep referring to? The clearest way to illustrate is with an analogy.

Let's say a doctor's office has a patient who hasn't paid her bill. The doctor had her sign a contract at the time of her first visit which allows him to charge her interest on the unpaid balance at the rate of 1.5% per month, then convert the interest to principal each month, and charge interest on the new principal balance (i.e. to compound the interest). The contract also allows him to seek legal fees.

If the doctor files suit to collect on the patient's unpaid bill, the Court should not give him a judgment which includes the compounded interest, or the attorney's fees, unless he establishes his contractual right to receive those amounts. An affidavit from his office merely alleging that he has the right to collect those contractual "extras" would not be sufficient.

What if the doctor sells the debt? The purchaser of that debt will be purchasing the final balance, which INCLUDES all of that compounded interest (which has now become principal on the doctor's books). Will the debt purchaser be allowed to obtain a judgment including all of those extras, i.e. the compounded interest amount, plus attorney's fees, plus the 18% interest rate? Can he do so if he has a copy of the signed contract? What if the debt purchaser wasn't provided with a copy of the signed contract? What if the contract was lost? What if the debt purchaser supplies an affidavit prepared by his office, or from his attorney's office asserting that (a) they have reviewed the records, (b) these amounts are justly due and owing, and (3) they have the contractual right to collect these "extras"?

This is exactly what happens in the credit card industry. When someone opens up a credit card account, they agree to certain terms and conditions, either by endorsing a "check" that has been sent to them, or by actually signing a contract, or merely by use of the card (which is sent with the terms and conditions). Uniformly, these credit card accounts contractually provide for a variety of additional fees known as ancillary charges (e.g. late fees, over-limit fees, etc.) as well as very high interest rates on any unpaid balances. Each month that the entire balance remains unpaid, all of the unpaid amounts (including the ancillary fees) are added together and treated as the new "balance" for the following month, and interest is calculated using that new balance. The following month, the cycle is repeated, many times resulting in a balance that has nothing to do with any purchases.

When a debt purchaser purchases these accounts, the accounts are usually very old, and the original documentation reflecting the original agreement between the credit card company and the consumer has either been lost, or was never maintained. The debt purchaser buys these accounts in bulk, typically without any supporting media. What are they buying? They are merely buying a computer listing of unpaid accounts, and the assignor credit card company's right to sue the account holder for the unpaid balance, which is "charged-off" at the time of sale. Remember that this balance does not just reflect purchases. It also includes all of the ancillary fees, which have been added to the prior balance each month, as well as all of the compounded interest (calculated at 24% or more). The debt purchasers then bring suit in your District Court, and ask for judgments in the amount of the charged-off balances, plus attorney's fees, as well as the right to charge interest on the judgment amount at the high interest rate charged on the original credit card account.

These practices have caused many problems for our courts. Historically, many high-volume courts have, understandably, been reluctant to carefully review each and every default matter that requires a signature, and many believe that in a default matter, they should not have to review the sufficiency of the supporting documentation at all. As a result, these purchased-debt default matters have run into very few impediments in the district courts, and the debt purchasers have come to see it as a matter of right that they be allowed to prevail in a default situation, even though they have no supporting evidence of any contractual agreement. Moreover, there seems to be a universal misunderstanding by the assignee debt-purchasers that the charge-off amount is THEIR balance, and therefore all they have to do is prove that this was the balance at the time they bought the debt.

The matter first came to our attention in Fairfax in 2006-2007 when we began to notice a large influx of these types of default matters. Since we rotate through the Civil Return Docket once a year, it took a while for us to reach a consensus, but over time what we all observed was a consistent failure to identify the original creditor in the Warrant in Debt, and the seemingly universal reliance upon bare-bones affidavits which merely verified that the debt existed. There would be no accompanying bills, no copies of the original terms and conditions, nothing except a word processor document (prepared by the debt-purchaser or the law firm) purporting to be Statements of Account.

Another disturbing trend that we noticed was that if a matter was set for trial, the debt-purchasers were routinely non-suiting at trial. Thus, be it intentional or not, they were filing suits that could not be won at trial. They were either anticipating a default matter (because so many of these are served by posting, or through the Secretary of the Commonwealth), or they were anticipating that they defendant would fail to file the necessary pleadings so they could get a Summary Judgment, or they could hope that the defendant would simply not appear on the trial date. If all else failed, and they actually had to present a case, they would simply non-suit, because they were lacking the necessary documentation or witnesses.

Realizing the situation at hand, we decided to develop a consistent approach to our review of these files. We began by agreeing that any analysis and solution had to apply the two basic premises I mentioned at the beginning of this paper. The first being that the law abhors a default, and the Federal Truth in Lending Act requires that fairness be injected into the process. Thus, even in a default situation, the plaintiff must establish a prima facie case. The second premise is that an assignee has no greater rights than the assignor. Thus, the assignee debt-purchaser had to meet the same evidentiary requirements as would be required of the original assignor credit card company.

The next thing that we did was to set up a meeting for all interested parties At the meeting we heard from everyone, including collections attorneys, representatives from Legal Services, defense attorneys, debt-purchasers, as well as some national representatives of the debt-buying industry. We listened to all points of view, and encouraged the participants to send us any research they felt would help us in our endeavor.

During the course of the meeting, we were directed to the National Banking Act (NBA), and it was suggested that the NBA allowed for the automatic conversion of the charge-off balance into a new principal for the debt-purchaser. That is to say, that the Act allegedly waives any requirement of the assignee debt-purchaser to establish the original contractual terms (which provided for the higher interest rate, the compounding of any interest, and the charging of the ancillary fees) and simply treat the charge-off balance as all principal. In essence, a newly-created debt to the debt-purchaser.

Try as we might, we were unable to find such a provision in the NBA. We were later able to confirm that no such provision exists at this time. We did, however, find two important provisions that gave us direction. Both have been attached to this outline.

As you may know, the National Banking Act was created as a means of strengthening the national banking system, by utilizing the powerful ability of the federal government to pre-empt state law. The core of this power as it relates to credit card companies is found in Section 85 of the NBA which provides that the banks may charge interest at the rates allowed by the laws of the State in which they are located.

Where are credit card companies located? The U.S. Supreme Court defined that term in the case of Marquette v. First Omaha, 439 U.S. 299. Under the Marquette doctrine, a national bank (credit card company) is deemed to be located in the State where it is chartered. As such, it is accountable to the laws of that home State for its commercial activities, and not the laws of the State where litigation may be ongoing. This allows for the exportation of the home State laws to Virginia.

So when determining the law that applies to the issues surrounding the sufficiency of evidence for the default cases, we must first look to the National Banking Act, and if the NBA does not provide the answer, then we must look to the laws of the home State for the original Creditor. If the issue is still not addressed, then we apply Virginia law, looking first to our statutory provisions, and then finally applying common law.

This is why our usury laws do not apply to credit card cases. Most credit card companies have chosen to charter in credit-card-friendly States, such as Delaware or South Dakota, which have no limits on the interest rates that can be charged.

The second provision we considered is 12 CFR 7.4001, which defines the term "interest" as used in Section 85. This definition was drawn from the decision in Smiley v. Citibank, 517 U.S. 735 (1996). In accordance with that decision, and the NBA, interest is deemed to include all of those ancillary charges, such as late fees, NSF fees, over-limit fees, annual fees, membership fees, and so on, ad infinitum.

This is why the credit card companies get~~s~~ to treat all of those ancillary fees the same as they would interest. If the Bank has a contract with the credit card holder debtor allowing the compounding of interest, then each month that there is an outstanding balance, all of those fees get added to the preceding month's unpaid principal, and the new balance becomes the amount upon which the finance charge is determined or computed.

So, let's get back to our question. When the assignee debt-purchaser purchases the old account from the credit card company, is there a law, or federal provision, which provides that the charge-off amount automatically ~~get~~ gets converted into a whole new principal? If it does, then the debt-purchaser doesn't have to establish that it has a contractual right to sue for, and collect, the compounded interest amounts (including the ancillary charges) from the credit card holder-debtor.

Since ~~there is~~ we found no such provision in the National Banking Act, we turned to the Delaware statutes, as the vast majority of the credit card companies which practice before us are chartered in that State. (A copy of the relevant portions of the Delaware Code is attached to this outline). We found no provision in the Delaware Code converting the charged-off

balance into pure principal. Moreover, we discovered that Delaware law, just like Virginia law, does NOT allow for the compounding of interest without a contract, which they refer to as a "plan". This contract requirement also extends to requests for attorney's fees, as well as higher interest rates (i.e. higher than the judgment rate), just like Virginia law.

Once we determined the correct law, and appropriate standards we needed for our analysis, we prepared a Best Practices document for dissemination. We also prepared a checklist for us to follow when reviewing these files. Both of these documents have been attached.

This has not been an easy process to institute. The debt-buyers strenuously objected at first, as you may imagine. It was suggested that our Court was no longer acting as a "gatekeeper", and had taken on the role of defense counsel. It was also argued that these document requirements should not apply to them, or should be set aside, because when they purchase these old accounts, they purchase them in bulk, and they obtain limited information and supporting media. They have also argued that the modern methods of commercial transactions contain appropriate safeguards that the Courts may rely upon.

It is the contention of this writer though, and of the Court on which I sit, that it is not the Court's responsibility to accommodate their business model. It is also inappropriate and unethical for a lawyer to file any lawsuit upon which he knows at the outset he cannot prevail. Until the National Banking Act or other relevant statutes are amended, we will apply the Best Practices document and checklist to our review of these cases.