

DC 37 MUNICIPAL EMPLOYEES LEGAL SERVICES

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December 1, 2009

**Federal Trade Commission
Office of the Secretary
600 Pennsylvania Avenue, N. W.
Room H-135 (Annex A)
Washington, D.C. 20580**

Re: Debt Collection Roundtable – Project No. P094806

To the Federal Trade Commission,

Enclosed is the report issued today by DC 37 Municipal Employees Legal Services, “Where’s the Proof?”

Sincerely,

Robert A. Martin

Where's the Proof?

*When Debt Buyers are Asked to Substantiate
Their Claims in Collection Lawsuits Against NYC
Employees and Retirees, They Don't*



**District Council 37
Municipal Employees Legal Services
December 2009**



About DC 37 Municipal Employees Legal Services

DC 37 Municipal Employees Legal Services, or MELS, is a prepaid legal services plan of District Council 37, AFSCME (American Federation of State, County and Municipal Employees), AFL-CIO. Our in-house staff provides benefits in a range of civil legal matters to current and retired employees of the City of New York. MELS' lawyers regularly represent consumers in financial and debt matters.

Acknowledgments

The principal author of this report is Robert Martin, Associate Director. Law Intern Shelby Russ, New York Law School, 2010, and Legal Assistant Faye Robins assisted in the research. Many thanks to Shelby Russ and to others who helped in the preparation and drafting of the report, including Director and Chief Counsel Joan L. Beranbaum, Systems Manager David Boyd, Supervising Attorney Sheldon Barasch, Senior Attorneys Barbara Cass and Salli Barash, and Staff Attorneys Rashana Cain, Kimberly Johnson, Jill Marcus, and Karen Robinson.



Executive Summary

The lawyers of DC 37 Municipal Employees Legal Services have observed that when they appear on behalf of a defendant and submit a discovery demand seeking substantiation of the debt, the plaintiff generally fails to proceed further with the case. We decided to review and compile results in debt buyer cases opened over an 18-month period.

Of the 238 cases in which our office sought substantiation of the debt:

- The debt buyer responded only 5.5% of the time. In 94.5% of the cases, the plaintiff failed to substantiate the debt.
- Even when the debt buyer did respond, rather than showing that the debt was owed, its own documentation often proved the opposite.
- The cases in the study bear a common thread: in many instances debt buyers sued consumers when they clearly had no legitimate claims. Debt buyers sued in cases of identity theft and mistaken identity, when their records did not reflect payments by the defendant, and when the debt was beyond the statute of limitations.
- In 65 of the 238 cases (27%), our clients had only learned of the lawsuit after their salary was garnished or bank account restrained. These clients were typically deprived of the use of funds for 10 days to three weeks until we could lift the garnishment or restraint – on an alleged debt that the debt buyer could not substantiate.

Based on our study, we recommend that the following steps be taken:

- Prohibit a debt collector from filing a collection lawsuit unless it is in possession of enough evidence, in a form admissible in court, to show that its claim is valid.
- Pass legislation in New York requiring a plaintiff in a debt collection action to set forth evidence of its claims when it files the lawsuit.
- Take effective steps to curb the common practice of debt buyers suing on debts that are beyond the statute of limitations.



Introduction

THIS report has been prepared by District Council 37 Municipal Employees Legal Services, known as MELS, based on our recent experiences in litigating cases filed in court by debt buyers.

As debt buying has emerged as a growth industry, the number of debt collection lawsuits has surged. Debt collection filings in the New York City Civil Court have more than doubled since 2000, to around 300,000 annually.¹ The default rate in these cases has continued to hover around 75% or more.²

Debt buyers are companies who purchase debt from an original creditor, usually a credit card issuer, or from another debt buyer, and then pursue collection efforts. Debt buyers typically pay pennies on the dollar or less for the debts they purchase. Technological changes that allow accounts to be sold in bulk through a transfer of computer records have spurred the escalation in debt buying.³

Practices associated with debt buying have drawn increasing attention from consumer advocates nationally and in New York. Those practices include the prevalence of “sewer service” in collections cases; the failure of debt buyers’ records to reflect instances of identity theft and mistaken identity, payments made by debtors, and disputes by a consumer that a debt is owed; and lawsuits on debts that are beyond the statute of limitations.⁴

Genesis of this Report

Lawyers at MELS observe that when they appear on behalf of a client in a collections case brought by a debt buyer, the case normally dies on the vine. Our experience mirrors that of consumer lawyers in New York and across the country, who report that plaintiffs, when confronted with a defendant whose lawyer appears in the court case and requests documentation of the debt, are commonly unable or unwilling to substantiate the debt. In recent months the media, legislative hearings, court decisions and other forums have been filled with stories of consumers, their lawyers and advocates who report that debt buyers sue consumers with flimsy evidence or none at all.

Although various studies have been conducted of cases filed by debt buyers,⁵ to our knowledge no comprehensive data has been compiled of the outcomes in court cases where defendants appear in the case. Because of the volume of cases that MELS handles, we undertook to compile such data over a period of time.



The Study

In conducting the study, we identified and reviewed each case file in our office:

- Opened in an 18-month period, January 1, 2008 – June 30, 2009,
- That was brought by a debt buyer (not an original creditor), and
- In which a MELS lawyer entered a notice of appearance and served a discovery demand seeking substantiation of the plaintiff's claim.

Our discovery demand in a collections case consists of written interrogatories requesting basic information, including the date when the defendant entered into the credit agreement, a breakdown of the sums sought, and the date of the last payment. In a debt buyer case, the interrogatories request the name of the original creditor and any debt buyer(s) who subsequently purchased the debt, and a copy of any assignments giving the plaintiff the right to sue on the claim. Under New York procedural law, the plaintiff is required to serve sworn answers to the interrogatories within 20 days.⁶

We categorized each case according to the following outcomes:

- **No response** by the plaintiff to the discovery demand.
- **Formal response** as required by law.
- **Informal response.** In some cases, the plaintiff did not provide the required formal response, but submitted a partial response by letter from its lawyer.

In addition, we tallied the number of our clients who only became aware that they had been sued when their bank account was restrained or their wages garnished.

Results of the Study

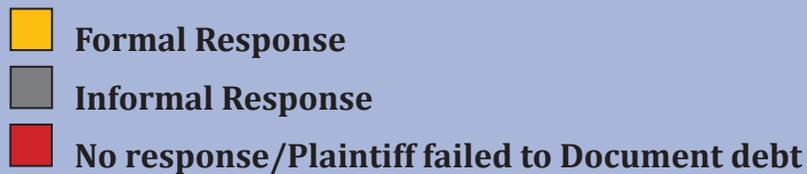
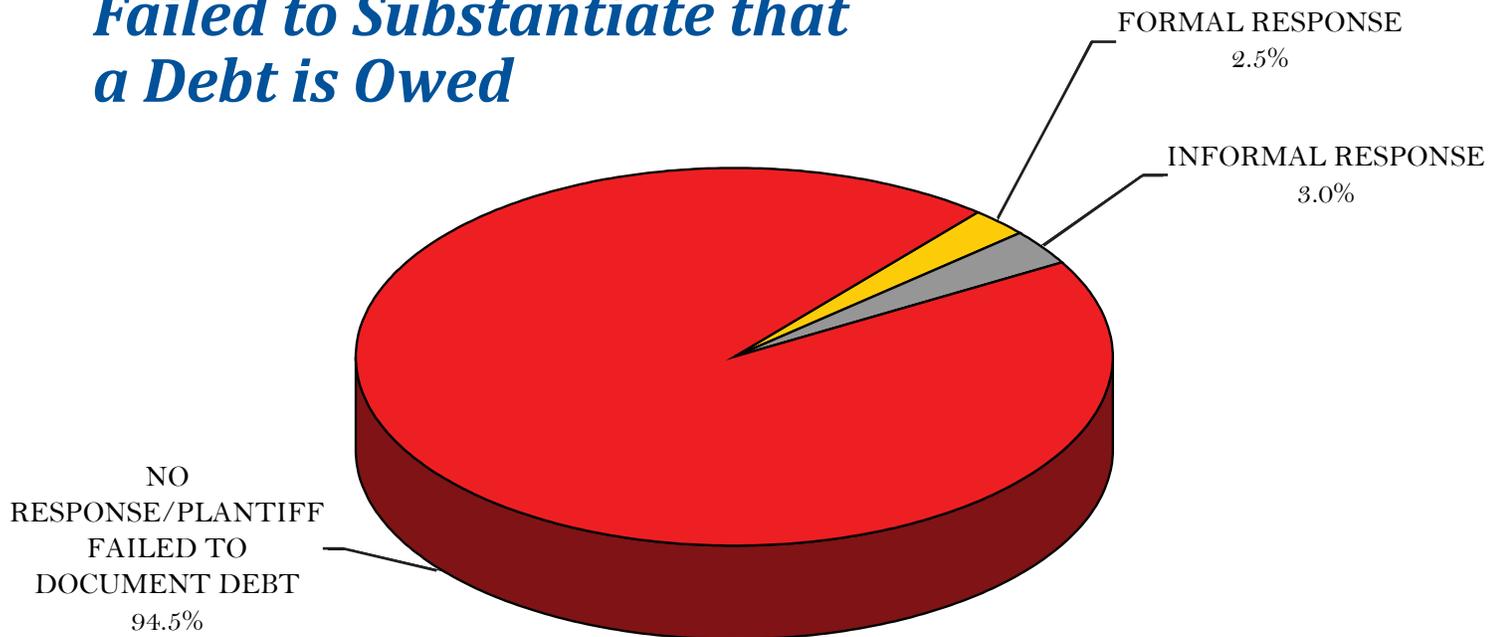
The results can be summed up very succinctly: ***in very few cases did debt buyer plaintiffs provide any documentation at all. Most plaintiffs simply ignored the request to substantiate the debt. In the few cases in which the debt buyer responded, the documentation often showed the defendant did not owe the debt.***

- 238 cases matched the profile of the study – that is, debt buyer cases opened between January 1, 2008 and June 30, 2009, in which our office appeared and served a discovery demand on the plaintiff.
- The plaintiff responded to our interrogatories in only 13, or 5.5%, of the cases – six formal responses as required by law, and seven informal responses.
- In 94.5% of the cases in which debt buyers sued consumers, the plaintiff failed to provide substantiation of the debt. In most instances (194 cases, 86.3%), the plaintiff has taken no further action; although the case is still pending, experience shows that the debt buyer is unlikely ever to proceed. In some cases (31 cases, or 13.7%), the plaintiff discontinued the action, either upon receiving the discovery demand or at a later point.

Thus, in the vast majority of cases, almost 95% of the time, the plaintiff could not or would not substantiate the debt on which it had filed suit. These results are shocking, even though we were already aware that most debt buyer plaintiffs in our cases walk away when put to the test.



Debt Buyer Plaintiffs Failed to Substantiate that a Debt is Owed



The study also tracked the number of our clients who first became aware that they had been sued and a default judgment had been entered when their salary was garnished and/or their bank account was restrained. Those persons then had to contact and retain our office to represent them and file an order to show cause to have the judgment vacated. Once the judgment was vacated and the case restored to the court calendar, it took additional time for the defendant to be restored to full use of the salary and bank account. Typically, this whole process took from 10 days to three weeks.

And for most of these clients, the end result was that the debt buyer plaintiff – having commenced a lawsuit and obtained a default judgment – was unwilling or unable to document that the debt was owed in the first place.

Sixty-five of the clients – or 27% – in the study only became aware they had been sued when their bank account was restrained or salary garnished. Many other clients were not properly served according to the law, but, fortunately, became aware of the lawsuit before entry of a default judgment or before salary garnishment or bank restraint.



Many Consumers First Learned of Lawsuit When Pay Check Was Garnished or Bank Account Restrained

	Number	As Percentage of Cases in Study
Total Number of Cases	238	(100%)
Defendant First Learned of Lawsuit Through Garnishment or Bank Restraint	65	27.3%

Case Studies:

The Human Side of Debt Buyers Filing Lawsuits on Debts They Cannot Substantiate

These case studies from the files reviewed for this report illustrate the pattern of debt buyers filing suit on claimed debts, but then failing to substantiate their claim when MELS' lawyers appear in the legal action and serve a discovery demand. (The names used are fictitious.)

- **Ms. Swift** is a school aide in a public elementary school. She learned of a lawsuit against her by a debt buyer, Palisades Collection, only after she received a restraining notice and judgment for over \$7,000 in August, 2008. ***Although the lawsuit claimed that Ms. Swift had originally owed Fingerhut, she had never done business with Fingerhut; her credit report reveals no Fingerhut account and no other item resembling the account.*** MELS' lawyers succeeded in vacating the default judgment and submitted an answer based on identity theft and mistaken identity. They also served a demand for discovery on the debt buyer's lawyers seeking substantiation of the alleged debt, but more than a year later have received no response.
- **Ms. Ramirez** is a school lunch helper who was sued in 2008 by People First Recoveries. A handwritten notation on the summons and complaint indicated that the original creditor was Bank of America, but Ms. Ramirez had never had a Bank of America credit card and could not identify the debt. The plaintiff has yet to respond to interrogatories or to provide any documentation. Its attorney could only state in a letter, "The original creditor ***appears to be*** Bank of America," but that "it is possible that the credit card was issued by another institution." He claimed to know that the charge-off date was in 2003. In that case – since Bank of America is based in Delaware, which has a three-year statute of limitations – ***the debt is clearly beyond the statute of limitations.***
- **Ms. Sanchez**, a 911 operator in the NY City Police Department, first learned she had been sued when she received notice of a garnishment and bank restraint in March, 2009. She had been sued by a debt buyer, Empire Portfolios, based on an alleged HSBC credit card debt.



The problem with the plaintiff's case, however, was that Ms. Sanchez had paid the debt in full in 2005, and had a cancelled check for \$4,400 to prove it. A MELS lawyer was able to have the judgment vacated, and the plaintiff has yet to produce any documentation in support of its lawsuit.

- **Mr. Chen**, a caseworker, learned of a lawsuit by Laridian Consulting only after receiving a copy of a default judgment for over \$6,000 in November, 2008. The lawsuit claimed that Mr. Chen had originally owed Maryland National Bank. **However, he had never had a credit card from that bank; his credit report shows no Maryland National Bank account and no similar item.** After vacating the default judgment, MELS' lawyers submitted an answer asserting mistaken identity and identity theft, and a demand for discovery seeking substantiation of the alleged debt. A year later, there has been no response.
- **Ms. Brown** is a 67-year-old retired school lunch helper who receives social security and a pension. She switched phone providers in 2004 after receiving an inflated monthly bill from MCI for several hundred dollars that she disputed and which she was unable to resolve with the carrier. In March, 2005, she made a \$300 payment after being badgered by a collection agency. In December, 2007, **Ms. Brown was sued by LR Credit 14 for an amount that did not reflect the payment to the debt collector. MELS served the plaintiff with interrogatories in May, 2008, and never received a response.** In August, 2009, after being confronted by the MELS lawyer with the fact that the debt buyer's case was well outside the statute of limitations for telecommunications matters (two years), the plaintiff's attorney discontinued the legal action.
- **Mr. Davis** is an office worker for the Health and Hospitals Corporation who was sued by North Star Capital Acquisition based on a Capital One credit card account. **From the very face of the plaintiff's Complaint, the lawsuit was beyond the statute of limitations.** The Complaint, which was dated August, 2008, indicated that the default occurred in January, 2002, thus placing the debt outside the limitations statute for written credit card agreements in both Virginia, where Capital One is based (five years), and New York (six years).
- **Ms. Montoya** is a nurse aide in a public hospital. She learned of a lawsuit against her by Midland Funding when her bank account was restrained. She was allegedly served at an address in the Bronx where she had never lived (as documented by lease records). **She also had never had a credit card with HSBC, the original creditor.** Her MELS lawyer was able to have the bank restraint lifted, and filed an answer claiming mistaken identity along with a discovery demand. The plaintiff never provided documentation of the debt, and six months later, it discontinued the case.
- **Ms. Warren** is a Parks Department worker. She was sued by Palisades Acquisition based on an old Spiegel debt. **She had not made any purchases or payments on the account in more than 10 years and the claim was therefore beyond the statute of limitations.** More than a year after a MELS lawyer appeared in the case and served a discovery demand, the plaintiff has yet to provide any documentation. Ms. Warren's case also illustrates the bare bones notice of the lawsuit that our clients typically receive. The only information in the boiler plate summons and complaint which was specific to her case was an indication that Spiegel was the original creditor. There was no account number, date of default, or any other information that would fairly apprise the defendant of the nature of the case.



When Plaintiffs respond to a Discovery Demand: Debt Buyers' Own Documentation Will Likely Prove the Defendant's Case

When the plaintiff responded to a discovery demand, its responses and documents generally did not substantiate the debt on which it had sued. In fact, in numerous instances the documentation demonstrated the opposite – that the plaintiff was not entitled to prevail on its claims. Defects in the documentation typically included a failure to show that the debt buyer possessed a valid assignment establishing that it owned the debt on which it was suing, or that the debt was clearly beyond the applicable statute of limitations.

- In one matter in which MELS received an informal response, the lawyer for the plaintiff, North Star Capital Acquisitions, submitted a one-page computer printout and a copy of a credit card statement ostensibly sent to the defendant by Capital One Bank, the original creditor, at or about the time of default. Rather than support the plaintiff's claim, however, ***the documentation showed that the debt was beyond the statute of limitations.***
- Another case in which our office received an informal response was a suit by a debt buyer based on a debt allegedly owed to Bank America. ***The lawyer for the debt buyer submitted a sworn affidavit attesting to the sale of the debt...to a different debt buyer.*** Upon our pointing out this rather obvious defect in the plaintiff's case, the attorney has taken no further action.
- One matter in which MELS received a formal response to its discovery demand involved a suit by Palisades Collection based on an alleged AT & T wireless account. However, the documents submitted by Palisades indicated an assignment from a different cell phone provider, not AT & T. In addition, the documents showed that the lawsuit had been filed ***more than a year beyond the two-year statute of limitations applicable to wireless services.***
- In another case, the original creditor had supposedly assigned the defendant's account to Debt Buyer 1 (Calvary SPV I), who had then assigned it to Debt Buyer 2 (Calvary Portfolio Services), the plaintiff in the suit. The plaintiff provided a copy of both assignments in response to a discovery demand. Examination of these documents revealed, however, that the assignment to Debt Buyer 2 pre-dated the assignment to Debt Buyer 1 by four years. ***Thus, the plaintiff's documents showed that it did not even own the debt and had no standing to file suit.***



Conclusion:

Where's The Proof? Nowhere To Be Found and Debt Buyers Know It

The sheer weight of the numbers in the study is compelling. Debt buyers are unable to present proof of debts. Why is it that debt buyers responded to our requests for substantiation in only 5.5% of the cases? We can only conclude that one or both of the following are occurring with the full knowledge and design of debt buyers:

- **The debt buyer business model is geared solely toward default judgments. Plaintiffs stop pursuing a lawsuit once a defendant retains a lawyer, and instead devote their resources to obtaining default judgments which do not go before a judge and require minimal if any proof.**
- **Debt buyers do not possess the evidence to prove their claims in the first place.**

Either way, it is simply unfair for consumers to be subjected to such practices. In America, the courts exist to administer justice under fundamental standards of fair play. For debt buyers to use the courts as their collections arm for unsupported claims smacks of unfairness.

Our clients – working persons or retirees who receive a paycheck or whose income consists of a pension and social security – suffer tremendously from having to defend baseless lawsuits. Being sued entails embarrassment and harm to one's credit rating. Being sued means enduring the angst and uncertainty of having to defend oneself in the lawsuit. Being sued involves worrying about the impact on family members. When our clients learn of such lawsuits only after receiving a garnishment or bank restraint notice, the harm is even greater. Those clients – and in our study there were many – went for periods of up to three weeks with a garnishment on their salary and/or being deprived of the use of their bank account to pay rent, buy food and purchase other necessities.

It bears noting that our clients are actually more fortunate than most consumers, who do not have ready access to legal representation. Those persons are forced to hire a private lawyer or try to obtain a legal services attorney, both of which are difficult propositions. Less than one percent of defendants in collection cases in New York City are represented by a lawyer.⁷

The only other option for consumer defendants is to attempt to navigate the judicial system on their own. This is a daunting prospect. If MELS lawyers have difficulty in obtaining substantiation of debts from plaintiffs, it is easy to imagine the near-insurmountable obstacles that prospective defendants face.



Recommendations: Three Steps To Fix the Problem

The following three recommendations would go a long way toward curbing the practices in debt collections cases that this study has identified:

1. Prohibit a debt collector from filing a collection lawsuit unless it is in possession of enough evidence, in a form admissible in court, to show that its claim is valid.

The basic information should include such items as whether the plaintiff is the original creditor; if not, the name of the original creditor and all assignees; original account number (or identifiable portion thereof); date and amount of last payment; and an itemization of the amount sought. If plaintiffs do not have this information, they should not be burdening consumers with litigation.

Ideally, this national problem will end with a national solution. Precluding debt collectors from suing unless they possess the necessary basic information could be accomplished in a number of ways, including new federal legislation or amendments to the Fair Debt Collection Practices Act (FDCPA). Another option would be to define as a deceptive and unfair trade practice, by law or regulation, the filing of a lawsuit without the supporting information.

2. Pass legislation in New York requiring a plaintiff in a debt collection action to plead certain basic information when it files the lawsuit.

In 2009, the New York State Assembly passed legislation that would effectively protect consumers against debt collection lawsuits that have no basis. Under the Consumer Credit Fairness Act (CCFA), plaintiffs in consumer credit collections cases would be required to set forth the basic information described above when they commence the lawsuit. We applaud this bill and urge its adoption by the full legislature in the upcoming session.

The CCFA thus bars the courthouse door to debt buyers who would sue consumers without the evidence to support their claims. That's as it should be.

3. Take effective steps to curb the common practice of debt buyers suing on debts that are beyond the statute of limitations.

Suing on a debt that is beyond the statute of limitations violates the Fair Debt Collection Practices Act. However, consumer advocates nationally report that collectors often sue on time-barred debt. Under New York procedural law, the statute of limitations must be asserted as an affirmative defense in order for a defendant to gain its benefit. When a plaintiff obtains a default judgment on a time-barred debt, or when a defendant appears but does not know to raise the statute of limitations, then the debt collector has effectively circumvented the statute of limitations.

In the study – since so few plaintiffs responded to the demand for discovery – we could not calculate the percentage of cases in which the debt sued on was outside the statute of limitations. Nonetheless, it was clear in many instances that the debt was time-barred.

Our study points out the compelling need for effective legislation to be passed at the federal or state level to prevent debt buyers from suing on debts that are beyond the statute of limitations. The FDCPA should be strengthened to give teeth to the prohibition against creditors suing on time-barred debts. In New York, the Consumer Credit Fairness Act would not only shorten the statute of limitations in consumer credit transactions (to three years), but - by ending the right to sue on debts that are beyond the statute of limitations - would eliminate the problem of defendants having to affirmatively raise the statute of limitations. The CCFA would thus effectively halt the practice of debt collectors circumventing the statute of limitations.

Endnotes

¹Jim Dwyer, *In Civil Court, One Nation Under Debt*, N.Y. Times, Oct. 10, 2008; figure provided by Justice Fern A. Fisher, Deputy Chief Administrative Judge, New York City Civil Courts, March, 2009.

²*Debt Weight: The Consumer Credit Crisis in New York City and Its Impact on the Working Poor*, Urban Justice Center, Oct. 2007, http://www.urbanjustice.org/pdf/publications/CDP_Debt_Weight.pdf.; *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*, MFY Legal Services, June, 2008, http://www.mfy.org/Justice_Disserved.pdf.

³See National Consumer Law Center, *Fair Debt Collection*, p. 7-10 (6th ed., 2008).

⁴*Collecting Consumer Debts: The Challenge of Change – A Workshop Report*, Federal Trade Commission, Feb., 2009, <http://www.ftc.gov/bcp/workshops/debtcollection/dcwr.pdf>; Joel Stashenko, *Service Concerns Prompt Bid to Reopen 100,000 Defaults*, N.Y. Law Journal, July 23, 2009; Debt Weight, Urban Justice Center.

⁵In its 2007 study, for instance, the Urban Justice Center analyzed cases in which the defendant *failed to appear*, due to sewer service or other reasons, and the documentation submitted by the plaintiff when it sought to enter a default judgment.

⁶CPLR Rule 3133.

⁷*Debt Weight*, Urban Justice Center, 16-17.