Proceeding with Caution: Collecting Time-Barred Debts

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I. Introduction

Debt collectors must proceed with caution when attempting to collect time-barred debts. The federal Fair Debt Collection Practices Act (FDCPA)[1] and many state statutes contain provisions that prohibit collectors from making actual or implied false or misleading statements or engaging in unfair or unconscionable conduct in connection with the collection of a debt.[2] Depending upon the circumstances, such prohibitions may be invoked to limit or entirely prohibit a debt collector from attempting to collect a time-barred debt. And applicable state statutes of limitation may operate to extinguish a debt[3] and not merely limit access to the courts, even for federally chartered depository institutions.[4] Consequently, it is essential that collectors be aware of not only the periods specified in state statutes of limitation that may be applicable, but also the full effect of the running of such periods on the collectibility of the debt. This article will discuss: (1) provisions of the FDCPA and state law that may regulate the collection of time-barred debts, in Part II below; (2) recent cases addressing this issue, in Parts III through V; and (3) the applicability of statutes of limitation, in Part VI.

II. Relevant Statutory Prohibitions

The primary federal statute governing consumer debt collection activities is the FDCPA. The FDCPA contains statutory provisions that generally prohibit "debt collectors"[5] (principally third-party collectors) from: (1) engaging in unfair or unconscionable means to collect or attempt to collect any debt; and (2) using any false, deceptive or misleading representations or means in connection with the collection of any debt.[6] Debtors may rely on these general prohibitions as the basis for liability in connection with a lawsuit against a debt collector for attempting to collect a time-barred debt.

The Federal Trade Commission Act (FTC Act) and similar state statutes also contain broad prohibitions against unfair or unconscionable acts similar to those under the FDCPA. Sections of the FTC Act generally prohibit persons, partnerships and corporations from engaging in unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce.[7] The Federal Trade Commission (FTC) has on numerous occasions charged creditors under its jurisdiction with unfair or deceptive debt collection practices under section 5, asserting standards of conduct substantially similar to those set forth in debt collection statutes.[8]

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1. 15 U.S.C. §§ 1692 *et seq.*

2. *See, e.g.*, 15 U.S.C. §§ 1692e(2)(A), 1692f (prohibiting debt collectors from falsely representing the character, amount, or legal status of a debt or using unfair or unconscionable means to collect or attempt to collect any debt); Wis. Stat. Ann. § 427.104(1)(j) (prohibiting debt collectors from claiming, or attempting or threatening to enforce a right with knowledge or reason to know the right does not exist).

3. *See, e.g.*, Klewer v. Cavalry Investments LLC, [New Developments] Consumer Credit Guide (CCH) ¶ 51,690, at 76,155-56 (W.D. Wis. Jan. 30, 2002) (finding that the expiration of the applicable statute of limitations extinguished the underlying debt pursuant to § 893.05 of the Wisconsin Statutes).

4. Some federally chartered financial institutions enjoy special preemption privileges. For example, national banks are exempt from state licensing, supervision and examination requirements, except for state unclaimed property and escheat laws. *See, e.g.*, 12 U.S.C. § 484; OCC Interpretive Letter from William B. Glidden, Ass't. Dir., Legal Advisory Services Div. (Sept. 5, 1989) (state licensing statutes and "any significant regulatory condition" placed on exercise of national bank's powers by state law are preempted by the "comprehensive regulatory scheme" of the National Bank Act, except where the National Bank Act specifically defers to state law as to certain issues). However, as indicated above, such preemption is not absolute. Consequently, such entities generally remain subject to state laws governing contract enforcement and fair debt collection.

5. "Debt collectors" generally include persons who use any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of any debts, or who regularly collect or attempt to collect, directly or indirectly, debts owed or due or asserted to be owed or due another. 15 U.S.C. § 1692(a)(6).

6. 15 U.S.C. §§ 1692e, 1692f.

7. 15 U.S.C. § 45(a)(1), (6).

8. *See, e.g.*, Federal Trade Commission, Annual Report: Fair Debt Collection Practices Act (June 2002) <http://www.ftc.gov/os/

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Many states also have statutory provisions similar to the FTC Act that generally prohibit unfair or deceptive acts or practices.[9] These so-called "mini-FTC Act" statutes may be construed in accordance with interpretations of the FTC Act. Consequently, a debtor may argue that a debt collector has violated the general prohibitions under the FTC Act or a mini-FTC Act by attempting to collect a time-barred debt, and the debt collector's conduct may be judged according to specific standards established under the FDCPA and other debt collection statutes, even if the collector would not otherwise fall within the scope of such statutes.

Debtors may argue that an attempt to collect a time-barred debt also violates specific statutory provisions of the FDCPA in addition to the broad statutory prohibitions described above. Section 1692e of the FDCPA has often been cited by debtors' counsel as a particular basis for liability. Section 1692e provides, in pertinent part, that:

> A debt collector may not use any false, deceptive, or misleading representation or means in connection with the collection of any debt. Without limiting the general application of the foregoing, the following conduct is a violation of this section:
>
> (2) The false representation of—
>
> (A) the character, amount, or legal status of any debt; or
>
> ...
>
> (5) The threat to take any action that cannot legally be taken or that is not intended to be taken.
>
> ...
>
> (10) The use of any false representation or deceptive means to collect or attempt to collect any debt or to obtain information concerning a consumer.[10]

In addition to section 1692e, debtors often argue that attempts to collect time-barred debts violate section 1692f of the FDCPA, which provides, in pertinent part, that:

> A debt collector may not use unfair or unconscionable means to collect or attempt to collect any debt. Without limiting the general application of the foregoing, the following conduct is a violation of this section:
>
> (1) The collection of any amount (including any interest, fee, charge, or expense incidental to the principal obligation) unless such amount is expressly authorized by the agreement creating the debt or permitted by law.
>
> ...
>
> (6) Taking or threatening to take any nonjudicial action to effect dispossession or disablement of property if—
>
> (A) there is no present right to possession of the property claimed as collateral through an enforceable security interest;
>
> (B) there is no present intention to take possession of the property; or
>
> (C) the property is exempt by law from such dispossession or disablement.[11]

Debtors often claim that attempts to collect time-barred debts violate similar state statutory provisions in addition to the specific provisions of the FDCPA set forth above.[12] Such statutes generally are not preempted by the FDCPA unless they are inconsistent with the FDCPA.[13]

The general provisions cited above have been used to challenge time-barred debts in several specific ways, as discussed below.

III. Liability for Threatening Legal Action

One way that a debt collector may violate the FDCPA or state law is by initiating legal action or otherwise directly or indirectly threatening a debtor with legal action in an attempt to collect a time-barred debt. The decision of the United States District Court for the Northern District of Illinois in *Walker v. Cash Flow Consultants, Inc.*[14] illustrates the position taken by a majority of courts on this issue. In *Walker*, a debt collector sent a collection letter to a debtor in an attempt to collect on a bad check that had been issued over four years earlier.[15] The letter requested that the debtor pay the amount of the check along with a service charge. In response to this letter, the debtor filed a class action against the collector, alleging that the letter was misleading and deceptive in violation of sections 1692e, 1692e(2)(A) and 1692e(10) of the FDCPA.[16] The debtor argued that the collector violated these provisions because it was aware when it sent the collection letter that the statute of limitations to bring a legal action on

8. *(Continued from previous page)*

2002/06/fdcpaar2002.htm> (expressing the FTC's willingness to enforce the FDCPA against creditors who are not subject to the FDCPA pursuant to the FTC's authority under the FTC Act).

9. *See, e.g.*, Alaska Stat. § 45.50.471.

10. 15 U.S.C. § 1692e(2)(A), (5), (10).

11. 15 U.S.C. § 1692f(1), (6).

12. *See, e.g.*, Wis. Stat. Ann. § 427.104(1)(j).

13. Section 1692n of the FDCPA provides that state laws are not preempted unless they are inconsistent with the FDCPA and then only to the extent of the inconsistency. Furthermore, state law is not considered inconsistent with the FDCPA if the protection afforded by the state law is greater than that provided by the FDCPA.

14. 200 F.R.D. 613 (N.D. Ill. 2001).

15. *See id.* at 614.

16. *See id.* at 614, 615.

the underlying debt had expired.[17] The collector moved to dismiss the complaint.

The court agreed with the debtor that the collection letter in question was sent after the expiration of Illinois' three-year statute of limitations, which is applicable to dishonored checks. However, the court indicated that under Illinois law, the running of the statute of limitations does not extinguish the underlying debt, but rather, only limits the judicial remedies that are available.[18] Therefore, the court held that "in order [for the plaintiff's allegation] to survive a motion to dismiss, a defendant's attempt to collect on a time-barred debt must be accompanied by actual litigation or a threat, either explicit or implicit, of future litigation."[19] The court indicated that the debt collector's request for payment was not an explicit or implicit threat of future collection action, legal or otherwise, and therefore, found that the debt collector could not have violated the FDCPA under the facts presented by the debtor. Consequently, the court granted the collector's motion to dismiss.[20]

The *Walker* case illustrates that a debt collector generally will not be held liable under the FDCPA for attempting to collect a time-barred debt as long as the debt collector does not actually file suit or threaten future legal action. Notably, however, the *Walker* court stated that threats of future legal action need not be express. Mere implicit threats, in a broader contextual inquiry, may be enough to constitute a violation of the statute.[21]

IV. Liability for Making Implicit Threats of Legal Action

In *Canterbury v. Columbia Gas of Ohio,*[22] the United States District Court for the Southern District of Ohio addressed the type of implicit threats that could trigger liability under the FDCPA. The debtor filed suit against a number of debt collectors that attempted to collect time-barred debts.[23] The debtor argued that the debt collectors violated sections 1692e(2) and 1692f of the FDCPA by attempting to collect, through deceptive practices, debts that they knew or should have known were not legally enforceable.[24] The debt collectors filed a motion to dismiss the debtor's claims.

The court found that the debtor had stated a cause of action under the FDCPA.[25] In coming to this conclusion, the court indicated that the key issue was whether the representations allegedly made by the debt collectors could be viewed by a "least sophisticated consumer" as a threat of legal action.[26] The court explained that the "least sophisticated consumer" is a person "of below-average sophistication or intelligence who is especially vulnerable to fraudulent schemes."[27] The court also explained that this standard protects those who may be uninformed, naive, or trusting, but includes an objective element of reasonableness in order to protect debt collectors from liability for unrealistic or peculiar interpretations of collection letters.[28]

The *Canterbury* court pointed to a number of representations made by the debt collectors in that case that could be considered threats of future legal action to the least sophisticated consumer.[29] These representations included: (1) informing the debtor in telephone conversations that she was liable for the outstanding amount and that the debt collector could legally demand the balance owed; (2) sending a letter stating that "[i]f this bill is not paid promptly, Columbia Gas of Ohio intends to pursue available legal means for collecting this debt, including referral of the matter to an attorney, if necessary"; and (3) sending a letter stating, "[w]e are offering you this final opportunity to reestablish your credit standing with our client by remitting the past due amount today. Failure to respond to this final offering will leave our client no alternative but to take firm collection action."[30] The court indicated that these representations, when taken as a whole, could be interpreted by the least sophisticated consumer as threats of future legal action. Consequently, the court held that the debt collectors might have engaged in a deceptive collection practice under the FDCPA by making such representations in an attempt to collect a debt that was time-barred, and therefore, denied their motion to dismiss.[31]

The *Canterbury* case illustrates that representations about legal means or remedies, including reference to an attorney, might be considered implicit threats of future legal action to a "least sophisticated consumer," even if the statements individually could not be considered threats of legal action, as long as the statements taken as a whole could so be interpreted. Obviously this is a vague and subjective standard, despite the court's stated efforts to avoid such.

However, no court appears to require that a debt collector make an affirmative statement regarding the time-barred nature of a debt (*e.g.*, a statement indicating that the statute of limitations has in fact expired or a statement regarding the consequences of paying or acknowledging a time-barred debt) in order to avoid liability under the FDCPA.[32]

17. 200 F.R.D. at 614.
18. *See id.* at 616.
19. *Id.*
20. *See id.* at 617.
21. *See id.* at 616.
22. No. C2-99-1212, 2001 WL 1681132 (S.D. Ohio Sept. 25, 2001).
23. *See id.* at *2, *4.
24. *See id.* at *2.
25. *See id.* at *8.
26. *See id.* at *6.
27. *Id.*
28. *See id.*
29. *See id.* at *7.
30. *Id.*
31. *See id.* at *7, *15. *But cf.* Peters v. General Service Bureau, Inc., 277 F.3d 1051 (8th Cir. 2002) (language in collection letter indicating that the creditor's "only alternative," if payment was not made, would be to request personal service of process was not misleading or confusing because it was not literally false).
32. *See* Reese v. Arrow Fin. Servs., LLC, 202 F.R.D. 83, 92 (D. Conn. 2001) (indicating that failure to advise debtors about the statute of limitations or the consequences of paying a time-barred debt is not itself an FDCPA violation).

V. Liability for Merely Attempting to Collect a Time-Barred Debt

A. Statutes of Limitation May Extinguish Underlying Debts

In *Klewer v. Cavalry Investments, LLC*,[33] a debt collector sent a debtor two collection letters in 2001 in an attempt to collect credit card debt that had been incurred before 1993.[34] The first letter informed the debtor that she could reduce her outstanding balance by half and no additional interest would be charged on the balance. The second letter contained instructions for the debtor to follow in order to receive a voice message on a system operated by the debt collector. Neither letter apparently threatened any further collection action, whether by suit or otherwise.[35] The debtor filed suit against the debt collector, arguing that the debt was extinguished by the applicable Wisconsin statute of limitations, and therefore, the debt collector's collection letters violated sections 1692e(2)(A), (5), and (10) and 1692f of the FDCPA along with section 427.104(1)(j) of the Wisconsin Statutes. The debtor and debt collector both filed motions for summary judgment on the issues of liability.[36]

The court found that the debt collector had not violated section 1692e(5) of the FDCPA because the collection letters did not threaten any further collection activity.[37] However, the court found that the collection letters violated section 1692e(2)(A), which prohibits a debt collector from making any false representations of the character, amount or legal status of a debt.[38] The court pointed to section 893.05 of the Wisconsin Statutes, which provides that "when the period within which an action may be commenced on a Wisconsin cause of action has expired, the right is extinguished as well as the remedy."[39] The court indicated that this statute, unlike the laws within the majority of states, eliminates the right to collect a debt as well as any available legal remedies.[40] Thus, the court found that the debt collector violated section 1692e(2)(A) of the FDCPA because the running of the statute of limitations caused statements in the collection letter regarding the validity of the debt to be false representations as to the legal status of the debt.

In addition to the FDCPA violation, the court found that the debt collector violated section 427.104(1)(j) of the Wisconsin Consumer Act, which generally prohibits a debt collector from attempting to collect debts if it has knowledge or reason to know the right does not exist. The court indicated that the attempts to collect the time-barred debt were clearly attempts to collect a right that the debt collector should have known did not exist. Consequently, the court found that the debt collector violated Wisconsin law, and granted the debtor's motion for summary judgment.[41]

B. Liability When the Statute of Limitations Does Not Extinguish the Underlying Debt

A few courts have suggested that a debt collector may violate the FDCPA by merely attempting to collect a time-barred debt, even if (1) the collector does not initiate legal action or implicitly or explicitly threaten future legal action, and (2) the running of the applicable statute of limitations does not extinguish the underlying debt. In *Stepney v. Outsourcing Solutions, Inc.*,[42] debt collectors attempted to collect a time-barred credit card debt by sending the debtor a collection notice that demanded payment and stated: "THIS IS AN OPPORTUNITY TO RESOLVE YOUR ACCOUNT WITH NO FURTHER COLLECTION ACTION BEING TAKEN AGAINST YOU."[43] The debtor brought a class action against the debt collectors, arguing that their communications violated the FDCPA and sections of the Illinois Collection Agency Act (evidently meaning sections of the Act with similar effect to sections 1692e and 1692f of the FDCPA). The debt collectors filed a motion to dismiss, arguing that the underlying obligation was not extinguished by the running of the statute of limitations, and therefore, they could not have violated the statutes unless they actually filed a lawsuit to collect the debt or threatened future legal action.[44]

The court was not persuaded by the debt collectors' argument and found that the debtor had stated a claim for relief under sections 1692e and 1692f of the FDCPA and the Illinois Collection Agency Act.[45] In support of this conclusion, the court stated:

> Stepney alleges the violation of the FDCPA based on defendant's knowing attempt to collect time-barred debts with threats of "further collection action." *Kimber* [*v. Federal Financial Corporation*] and its progeny establish the viability of claims premised on a debt collector's knowing attempts to collect timebarred debts. Stepney's complaint sufficiently outlines a deceptive practices claim based on [defendants'] knowing collection of time-barred debts.[46]

Consequently, the court denied the debt collectors' motion to dismiss the debtor's claims under the FDCPA and Illinois law.

One might argue that, based upon the statements set forth above, the *Stepney*

33. [New Developments] Consumer Credit Guide (CCH) ¶ 51,690, at 76,156 (W.D. Wis. Jan. 30, 2002).

34. *See id.* at 76,154, 76,155.

35. *See id.* at 76,155.

36. *See id.* at 76,154.

37. *See id.* at 76,155.

38. *See id.* at 76,155, 76,156.

39. *Id.*

40. *See id.* at 76,156.

41. *See id.*

42. No. 97 C 5288, 1997 WL 722972 (N.D. Ill. Nov. 13, 1997).

43. *Id.* at *1.

44. *See id.* at *4, *5.

45. *See id.* at *5.

46. *Id.* (citing Kimber v. Federal Fin. Corp., 668 F. Supp. 1480 (M.D. Ala. 1987)).

decision supports the proposition that a debt collector may violate sections 1692e and 1692f of the FDCPA by merely attempting to collect a time-barred debt. However, the better argument appears to be that *Stepney* does not stand for such a proposition because the *Stepney* court poorly cites *Kimber* in support of its conclusion. In *Kimber*, a debt collector was found to have violated the FDCPA because it threatened future legal action and filed suit in order to collect a time-barred debt, not because it merely attempted to collect the debt.[47] For this reason, the *Stepney* decision does not persuasively stand for the proposition that a debt collector may violate the FDCPA by merely attempting to collect a time-barred debt. Indeed, other courts addressing the permissibility of collecting time-barred debts have read *Stepney*, to permit the collection of time-barred debts.[48]

A few other cases have implied that debtors may have a cause of action against debt collectors under the FDCPA for merely attempting to collect time-barred debts.[49] However, the precedential value of such decisions is unclear because they (1) often erroneously cite *Kimber* in support of this proposition,[50] and (2) have not been followed by the majority of courts addressing the issue.[51] Therefore, a court should not be expected to find that a debt collector has violated the FDCPA by merely attempting to collect a time-barred debt if the running of the applicable statute of limitations only extinguished the judicial remedies available and not the underlying debt.

VI. Determining Which Statute of Limitations Is Applicable

Because a debt collector may be subject to liability for engaging in certain activities when collecting a time-barred debt, the collector must know whether the debt is time-barred before proceeding with his or her collection efforts. Unfortunately, in some situations multiple statutes of limitation could apply, thus making it difficult to determine whether or not the debt is actually time-barred. For example, a debtor may have incurred credit card debt in a state that has one statute of limitations that is applicable to the sale of goods and another limitation period that is applicable to actions upon a contract. Credit card debts arguably involve the sale of goods and are incurred pursuant to a contract between the parties, thus either of these statutes of limitations arguably could apply. In such a situation, the debt collector may need to look to relevant case law interpreting the various statutes, to determine which one is likely to apply.

The United States District Court for the Northern District of Illinois addressed such an issue in *Hamid v. Blatt*.[52] In *Hamid*, a debt collector sued a debtor to collect a credit card debt, but later dismissed the suit.[53] The debtor filed a class action against the debt collector alleging violations of sections 1692e, 1692e(2), 1692f and 1692f(1) of the FDCPA. The debtor claimed that the debt collector was liable because it filed a lawsuit against the debtor even though it should have known such lawsuit was time-barred by the applicable statute of limitations. The debt collector filed a motion to dismiss on the grounds that the lawsuit was not time-barred, or in the alternative, that there was a good faith argument that the lawsuit was not time-barred.

In order to resolve the issue of liability, the court needed to determine which statute of limitations was applicable. The court indicated that the debt might be subject to either Illinois' four-year statute of limitations for debts arising from the sale of goods or the ten-year statute of limitations for breach of a written contract. According to the court, the critical issue in determining which statute applied was to determine who provided the financing for the credit card debt.[54] If the merchant provided the financing, then the four-year statute of limitations would apply because the transaction would be primarily a transaction for the sale of goods. However, if the financing were provided by a third party, then the transaction would be primarily an extension of credit subject to the ten-year statute of limitations.

The court found that the debtor introduced a number of facts indicating that the merchant provided the financing. First, the debtor alleged that he obtained the credit card from the merchant and used it to finance purchases from the merchant. Second, facts were introduced that indicated that the credit card was issued by the merchant or by a corporation closely related to the merchant. Based upon these facts, the court determined that the shorter four-year statute of limitations for the sale of goods should apply.[55] Consequently, the court denied the debt collector's motion to dismiss because the debt in question was time-barred under Illinois law. In denying this motion, the court was not persuaded by the debt collector's argument that it did not act knowingly and intentionally in violation of section 1692e of the FDCPA because the question of which statute of limitations was applicable was difficult to determine. The court indicated that the debt collector was a law firm in the business of representing collectors, and the precedent underlying the distinction between the two statutes of limitation was well established. Thus, it was possible that the debt collector may have filed the suit in question knowing that

47. *See id.* at 1488, 1489.

48. *See, e.g., Walker*, 200 F.R.D. at 616.

49. *See, e.g.*, Martinez v. Albuquerque Collection Servs., 867 F. Supp. 1495, 1506 (D. N.M. 1994); *Canterbury*, 2001 WL 1681132 at *6.

50. *See, e.g., Martinez*, 867 F. Supp. at 1506 (citing to *Kimber* in support of the proposition that a collection agency's attempts to collect time-barred debts may violate the FDCPA).

51. *See, e.g.*, Shorty v. Capital One Bank, 90 F. Supp.2d 1330, 1332 (D. N.M. 2000) (refusing to follow an earlier decision, which apparently held that a debt collector may engage in fraudulent misrepresentation by merely attempting to collect at time-barred debt, for a number of reasons, including the fact the running of the applicable statute of limitations only extinguished judicial remedies available to the debt collector and not the underlying debt).

52. No. 00 C 4511, 2001 WL 1035726 (N.D. Ill. Sept. 4, 2001).

53. *See id.* at *1.

54. *See id.* at *2.

55. *See id.*

it was barred by the four-year statute of limitations.[56]

VII. Summary and Conclusion

The above cases illustrate that debt collectors may be found liable under the FDCPA and state law if they file suit or threaten legal action to collect time-barred debts. However, courts generally have not found debt collectors liable for merely attempting to collect time-barred debts. In the majority of cases, the running of the statute of limitations does not extinguish the underlying debt, but does extinguish the judicial remedies available to the debt collector. If the underlying debt has not been extinguished, attempts to collect such debts should not be considered misleading or unconscionable because the debt collector is not prohibited under state law from seeking voluntary payment of the debt. In some states, however, the running of the statute of limitations does extinguish the underlying debt in addition to barring judicial remedies.

To avoid violating the state and federal laws described above, a debt collector should determine what statute of limitations applies to the debt to be collected and whether the statute of limitations has expired. In some situations, multiple statutes of limitations may appear to apply and a review of case law may be necessary. If the underlying debt has not been extinguished, it may be permissible to collect the debt as long as any communications with the debtor could not be interpreted by a "least sophisticated consumer" to include explicit or implicit threats of future legal action that may not be taken. Thus, careful analysis is advisable and, in cases of doubt, a conservative approach when communicating with debtors may be appropriate.