DREHER TOMKIES LLP

ALERT

FOR CLIENTS AND FRIENDS OF DREHER TOMKIES LLP

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ARKANSAS SUPREME COURT SAYS DEBT BUYER NEEDS LICENSE

The Supreme Court of Arkansas recently held that a debt buyer that purchased delinquent debts and then retained an Arkansas law firm to collect the debts and file lawsuits on its behalf must be licensed under the Arkansas Collection Agencies statute. *Simpson v. Cavalry,* 2014 Ark. 363 (2014). The ruling arose out of two questions certified to the court by the United States District Court for the Eastern District of Arkansas.

Simpson involved a credit card debt that had been charged off by the original creditor and then assigned to the defendant debt buyer. The debt buyer was not licensed as a collection agency in Arkansas. The debt buyer hired an Arkansas law firm to collect the debt on its behalf. The law firm filed suit against the debtor and obtained a default judgment. The debtor brought suit against the debt buyer arguing that it was required to be licensed under Arkansas law. Eventually, the Eastern District certified the following two questions to the Supreme Court of Arkansas: (i) whether an entity that purchases delinquent accounts and then retains a licensed Arkansas lawyer to collect on the delinquent accounts and file lawsuits on its behalf in Arkansas is "attempt[ing] to collect," thus meeting the definition of "collection agency," pursuant to Arkansas Code Section 17-24-101 and (ii) whether an entity that purchases delinquent accounts and files lawsuits on its behalf in Arkansas is "attempt[ing] to collect" and, thus, is required to be licensed by the Arkansas State Board of Collection Agencies (SBCA) pursuant to Section 17-24-301(4).

With respect to the first certified question, Section 17-24-101 provides that a "collection agency" includes any person that purchases and attempts to collect delinquent accounts or bills. The debt buyer argued that this provision did apply to it because it had "assigned" its collection activity to a law firm. Thus, the debt buyer argued, it was not "directly" attempting to collect a debt. The court rejected this argument finding that the debt buyer did not "assign" the debt, but instead "retained" a law firm to act on its behalf in collecting the debt. Also, the court concluded that the Arkansas statute covered both direct and indirect attempts to collect delinquent accounts. Finding the statute to be clear and unambiguous, the court found no need to review the legislative history.

The debt buyer additionally argued that the court should defer to the Arkansas SBCA, which had stated in the minutes of a 2012 meeting that it recognizes as exempt from collection agency licensure in Arkansas any entity that purchases or receives an assignment of ownership of a debt that is in default at the time of assignment provided that the debt buyer (i) does not attempt to collect debts directly either for itself or others, (ii) undertakes collection efforts solely through third-party collection agencies or law firms and (iii) maintains no place of business in Arkansas. While the court found the SBCA's interpretation highly persuasive, because the statute was not ambiguous on this point, the court determined that it could not interpret the statute to mean anything other than what it says.

With respect to the second certified question, Section 17-24-301(4) provides that it is unlawful to purchase and attempt to collect delinquent accounts or bills without being licensed by the SBCA. The court again rejected the debt buyer's arguments, concluding that the statute was, again, clear and unambiguous as to the required license. The fact that the debt buyer retained a law firm to act on its behalf, the court concluded, was irrelevant to whether the debt buyer was attempting to collect on an account (for its own account), and therefore, the debt buyer was required to obtain a license.

A number of state debt collection statutes include specific requirements applicable to debt buyers. Entities purchasing debts for collection should ensure that they have reviewed state statutes for potential applicability even if they employ third parties to collect debts. ❑

✧ *Mike Tomkies and Margaret Stolar*

NEW YORK STATE COURTS ADOPT COMPREHENSIVE DEBT COLLECTION JUDICIAL REFORMS

On September 16, the New York State Unified Court System adopted new rules specifically designed to prevent unwarranted default judgments in consumer credit debt collection cases and to ensure a fair legal process. The rules were subject to a 30-day comment period and the Court System received comments from over 50 representatives of the banking and debt-buying industries, consumer advocacy groups, state and local government agencies,

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The rules are intended to combat default judgments obtained on the basis of insufficient testimony, default judgments granted in cases where the applicable statute of limitations has expired, and the failure to provide consumers with a notice of the lawsuits started against them.

The new rules require any party filing applications for default judgments in consumer credit debt collection cases to submit the following items to the court:

- Affidavits containing detailed proof in support of default judgment applications, including the validity of the debt at issue and the chain of ownership for that debt;
- In actions started by third-party debt buyers, affidavits from the original creditor and all intervening debt buyers, which must be executed by individuals having personal knowledge;
- An affidavit from creditor's counsel affirming that the statute of limitations has not expired; and
- Additional notice of the lawsuit to be mailed by the court to the defendant at the address where process was served.

Copies of key documents must be attached to required creditor and debt buyer affidavits, including the credit agreement, the most recent monthly statement, documents helping to identify the correct defendant, the last four digits of the account at issue, an itemized summary of the balance allegedly due and the complete chain of ownership of the debt. No default judgment will be entered if notice mailed by the court is returned as undeliverable.

The new rules and affidavit requirements for default judgments are effective October 1, 2014. The new requirements apply only prospectively and will not affect consumer credit cases filed prior to the effective date. In debt buyer cases, the new rules will apply to default judgment applications involving debt purchased from an original creditor on or after October 1, 2014. Notwithstanding this initial limitation regarding debt buyer cases, effective July 1, 2015, the new affidavit rules will apply to all debt buyer actions regardless of debt purchase date.

In order to ensure clarity regarding what entities the new rules cover, the rules also contain the following definitions:

- Consumer credit transaction: a revolving or open-end credit transaction wherein credit is extended by a financial institution, which is in the business of extending credit, to an individual primarily for personal, family or household purposes, the terms of which include periodic payment provisions, late charges and interest accrual. A consumer credit transaction does not include debt incurred in connection with, among others, medical services, student loans, auto loans or retail installment contracts.
- Original creditor: the financial institution that owned the consumer credit account at the time the account was charged off, even if that financial institution did not originate the account. Charged-off consumer debt means a consumer debt that has been removed from an original creditor's books as an asset and treated as a loss or expense.
- Debt buyer: a person or entity that is regularly engaged in the business of purchasing charged-off consumer debt for collection purposes, whether it collects the debt itself, hires a third party for collection or hires an attorney for collection litigation.
- Credit agreement: a copy of a contract or other document governing the account provided to the defendant evidencing the defendant's agreement to the debt, the amount due on the account, the name of the original creditor, the account number and the name and address of the defendant. The charge-off statement or the monthly statement recording the most recent purchase transaction, payment or balance transfer shall be deemed sufficient evidence of a credit agreement.

The Court System did respond to industry criticism and adopted a number of recommendations for changes. The reforms reflect continuing scrutiny by state and federal regulators and the courts regarding identified concerns with prevailing collection practices and processes. These reforms affect not only persons actually seeking judgments in New York, but their principals and industry generally under federal regulators' initiatives to hold originating creditors, service providers and debt buyers more accountable under unfair, deceptive or abusive acts and practices principles, as well as vendor management obligations. Some states such as North Carolina have already taken similar steps to address relevant concerns. All industry participants should review their internal policies and procedures and third-party relationships. We would be glad to assist in such review.

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