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Supreme Court,Finance Policy

United States Supreme Court: Foreclosure Law Firms Likely Exempt from Federal Fair Debt Law

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Client Alert

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On March 20, 2019, the United States Supreme Court held that a foreclosure law firm principally involved in conducting nonjudicial foreclosures (such as Colorado's foreclosure process) is ***not*** covered by the federal Fair Debt Collection Practices Act ("FDCPA" or "Act"). Even more—the firm's antecedent communications required by state law are also not covered by the FDCPA. This order provides much needed clarity to an industry burdened by conflicting circuit court rulings regarding the scope and resulting compliance obligations under the FDCPA.

What Was This Case About?

This case turned on the limited definition of "debt collector" under Section 1692f(6) that includes "any person … in any business the principal purpose of which is the enforcement of security interests," e.g., those involved in conducting a nonjudicial foreclosure. 15 U.S.C. § 1692f(6). Foreclosure law firm McCarthy & Holthus LLP sent plaintiff Obduskey a letter regarding his past-due first lien mortgage loan that threatened foreclosure. Obduskey responded by invoking Section 1692g(b) of the FDCPA. This section requires a "debt collector" to "cease collection" until it verifies "the debt" and mails a copy of the debt verification to the borrower *See* 15 U.S.C. § 1692g(b). Instead of complying with this process, the law firm initiated the foreclosure action.

Obduskey sued under FDCPA Sect. 1692g(b) for failure to validate the debt. The McCarthy firm argued that under Section 1692f(6) it need not comply with the debt validation requirements because McCarthy does not fall within the Act's general definition of "debt collector," as the term is used in that section.

The court in ***Henson et al. v. Santander Consumer USA Inc.*** addressed in its 2016 term the two principal categories of "debt collector." The first defines "debt collector" more generally as "any person …in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect, directly or indirectly, debts." 15 U.S.C. § 1692a(6). Parties who fall within the general definition of debt collector must not only comply with Sect. 1692g(b), but also implement a host of policies and procedures ranging from when and how frequent it can make collection calls to what notices it must provide to borrowers.

The Act also provides a more limited definition of "debt collector" under Section 1692f(6) that includes "any person … in any business the principal purpose of which is the enforcement of security interests," e.g., those involved in conducting a nonjudicial foreclosure. 15 U.S.C. § 1692f(6). This provision does not trigger the debt validation process outlined in Sect. 1692g(b), and requires a less stringent standard of care, essentially requiring a debt collector to ensure they have a right to dispossess a borrower of their personal property before doing so.

These two definitions have caused confusion for foreclosure law firms like McCarthy, which must determine whether they fall under the general definition of "debt collector," or the more limited version. At stake are not only the technical requirements under the FDCPA, but also the litigation risk driven by a mandatory attorneys' fee provision that encourages plaintiffs' lawyers to file technical "foot fault" lawsuits against debt collectors.

Supreme Court: Nonjudicial Foreclosure Firms Are Not Subject to the FDCPA's Primary Restrictions and Limitations

Ultimately, the United States Supreme Court (and the lower courts[i]) found the more narrow definition applies, holding that a person that is principally involved in conducting nonjudicial foreclosures is a "debt collector" only for the limited purpose of 1692f(6). This decision resolved a split amongst the federal circuits, whereby the Ninth Circuit held that the general definition of "debt collector" did not include a party that is principally involved in conducting a foreclosure, versus the Third, Fourth, and Sixth Circuits, and certain state courts, which had previously held that such an entity is a "debt collector" for *all* the purposes of the Act[ii].

The Supreme Court based its ruling on three reasons: first, the court found the plain text of the Act supports a more narrow interpretation:

> [T]he limited-purpose definition poses a serious, indeed an insurmountable, obstacle to subjecting McCarthy to the main coverage of the Act. It says that "*for the purpose of section 1692f(6)*" a debt collector "*also* includes" a business, like McCarthy, "the principal purpose of which is the enforcement of security interests. This phrase, particularly the word "also" strongly suggests that one who does no more than enforce security interest does *not* fall within the scope of the general definition. Otherwise why add this sentence at all? Order, 9.

The court also took notice of the fact that states, like Colorado where Mr. Obduskey lived, likely had their own state foreclosure schemes that provide protections to homeowners. Thus, it would make sense that Congress limited the definition of "debt collector" in an effort to avoid conflicts with the states' nonjudicial foreclosure schemes.

Finally, the court also took notice of the legislative history of the Act, which showed that when Congress first drafted the bill, Congress considered a version that would have subjected security-interest enforcers to be debt collectors, and a version that would have exempted them. The court reasoned "[g]iven these conflicting proposals, the Act's present language has all the earmarks of a compromise: The prohibitions contained in §1692f(6) will cover security-interest enforcers, while the other 'debt collector' provisions of the Act will not." Order, 10.

The Court Leaves Some Questions Unresolved

Among the arguments Mr. Obduskey made in support of a broad application of "debt collector" to nonjudicial foreclosure firms, perhaps the most interesting and noteworthy was his argument that even if McCarthy's efforts to enforce a security interest fall outside of the FDCPA's broader definition, McCarthy was also engaged in debt collection by sending notices to homeowners, which had an animating purpose of getting them to pay a debt. The court, adopting the Tenth Circuit's analysis in this case and the Ninth Circuit's analysis in the *Ho v. ReconTrust Co., NA.*, decision, rejected this line of reasoning, finding:

> [W]e assume that the notices sent by McCarthy were antecedent steps required under state law to enforce a security interest … And because he who wills the ends must will the necessary means, we think the Act's (partial) exclusion of "the enforcement of security interests" must also exclude the legal means required to do so. Order, 13.

We interpret this to mean that any letter that is mandated by state foreclosure law to be sent to a borrower before the foreclosure is initiated is exempt from the FDCPA. However, firms must be circumspect on this point; letters and communications made outside of the foreclosure process, including perhaps the initial "Dunning" or "demand letter," could nevertheless fall within the FDCPA's broader definition of "debt collection." Unfortunately, the court does not address whether and when such communications fall within the broader definition of the FDCPA, thus leaving open the question of whether communications that are not required by an official state foreclosure process could transform a security-interest enforcer into a debt collector subject to the main protections and obligations under the Act.

Nor does the decision address whether those principally involved in judicial foreclosures—e.g., parties involved in the *judicial* repossession of a property, which may or may not leave open the possibility of collecting a deficiency judgment—fall within the FDCPA's broader definition. The court notes that such an issue "is a question we can leave for another day." Order, 12.

Firms that have a hybrid practice of both nonjudicial and judicial foreclosures, thus may still fall within the FDCPA's general definition of "debt collector," and its related requirements. We recommend consulting an attorney in this space to develop appropriate policies and procedures. Moreover, we anxiously await the Bureau of Consumer Financial Protection recently announced planned rulemaking on the FDCPA,[iii] which may in turn provide clarity on these issues and ultimately, modernize an Act that effectively regulates an industry as if no change has occurred since the Act was originally adopted more than 40 years ago.

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[i] *See Obduskey v. Wells Fargo*, 2016 WL 45091174, *3 (D. Colo. July 19, 2016); *Obduskey v. Wells Fargo*, 879 F. 3d 1216, 1223 (2018).

[ii] *See e.g., Vien- Phuong Thi Ho v. ReconTrust CO., NA*, 858 F.3d 568, 573 (9th Cir. 2016); *Kaymark v. Bank of America, N.A.*, 738 F.3d 168, 179 (3rd Cir. 2015); *Glazer v. Chase Home Fin. LLC*, 704 F.3d 453, 461 (6th Cir. 2013); *Wilson v. Draper & Goldberg, P.L.L.C.*, 443 F.3d 373, 376 (4th Cir. 2006).

[iii] Bureau of Consumer Financial Protection, "Fair Debt Collection Practices Act: BCFP Annual Report 2019" (March 2019), ("The Bureau will issue a Notice of Proposed Rulemaking relating to debt collection in spring 2019. The Notice of Proposed Rulemaking will address such issues as communication practices and consumer disclosures.") at *3.

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