

## **DBA INTERNATIONAL'S PAPER ON THE COLLECTION OF PAST STATUTE DEBTS**

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### **INTRODUCTION**

DBA International ("DBA") is pleased to submit to the Federal Trade Commission this paper on the collection of debts on which the creditor can no longer sue because of the time the debts have been in default ("Past Statute Debt"). DBA recognizes and applauds the Commission's desire to increase its understanding of the debt buying industry in its ongoing efforts to ensure full compliance with the Fair Debt Collection Practices Act ("FDCPA") by all those who may be subject to the statute. DBA hopes that the information provided herein will assist the Commission in doing so as part of its Fall Workshop.

### **DEBT BUYING**

Selling debt is a financial management tool which major credit originators have been utilizing to manage their receivables more and more in the last ten (10) years. The portfolios of debt being sold range in age from recently charged-off debt to debt which has aged for a period of years with no final resolution. The outstanding balances on the debts being sold can range from less than \$100 per claim to thousands of dollars per claim. The debts being sold can range from the overcollateralized to those which are completely unsecured. Debt buyers purchase these debts with all the rights, title, and interest of the assignor to the indebtedness and therefore have the same rights as the assignor to

pursue the debt. With the recent “collapse” of the sub-prime market, debt buying has become newsworthy and the process subjected to a great deal of scrutiny. The public policy reasons for recognizing and working with (if not encouraging) the practice, however, was discussed at some length by Judge Posner in the Seventh Circuit Court of Appeals case styled *Olvera v. Blitt & Gaines, P.C.*, wherein he stated

*Borrowers would not benefit on average, because creditors, being deprived of the assignment option as a practical matter (the statutory rates being far below the market interest rates for delinquent borrowers), would face higher costs of collection and would pass much of the higher expense on to their customers in the form of even higher interest rates....*

...

*There is an innocent reason that creditors assign collection to other firms rather than doing it themselves. It is the same reason that most manufacturers sell to consumers through independent distributors and dealers rather than doing their own distribution. Outsourcing phases of the total production process facilitates specialization, with resulting economies. Specialists in debt collection are likely to be better at it than specialists in creating credit card debt in the first place.<sup>1</sup>*

Additionally, debt buying has measurable economic benefits to those other than the sellers and purchasers of debt. The practice also contributes to the economy as a whole and to individual consumers as well by making more credit available, lowering interest rates, and increasing purchasing ability. One study has estimated that the benefit to each American household resulting from third party debt collection is

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<sup>1</sup> 431 F.3d 285, 288 (7th Cir. 2005).

\$351.00 per year.<sup>2</sup> Added to that number is the additional benefit made to the economy by debt buyers.

Ultimately, even the sale and collection of Past Statute Debt adds to the economic benefit to consumers.

## **STATUTES OF LIMITATIONS**

State law governs the period of time during which a creditor or its assignee can file a lawsuit to recover on a debt. This length of time is established in each state by a statute or statutes of limitations. However, the expiration of limitations does not as either a legal matter or as a matter of general public policy extinguish a debt with the exception of Mississippi and Wisconsin (which will be discussed herein). Rather, statutes of limitations are intended to help assure that matters brought before the courts of a state are "fresh" matters.

The statutory time in which one may file suit on a debt is an issue addressed by the legislature of each state and varies by state. For example, in Arkansas, the time period to sue on a written contract is five (5) years whereas the time period to sue on a verbal debt is three (3) years.<sup>3</sup> In contrast, the time period to sue on a written contract in Kentucky is fifteen (15) years and the time period to sue on a verbal contract is five (5) years.<sup>4</sup> In many states such as Texas, procedural law

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<sup>2</sup> *The Value of Third-Party Debt Collection to the U.S. Economy: Survey and Analysis*, prepared for ACA International by Pricewaterhouse Coopers, June 27, 2006.

<sup>3</sup> Arkansas Code Ann., TIT. 16, SUBTIT. 5, CH. 56. SUBCH. 1.

<sup>4</sup> Kentucky Rev. Stat. § 413.090 et seq.

regarding the residency of the consumer will determine the applicable limitations period applied to its residents notwithstanding that the choice of law for substantive contractual interpretations with respect to the debt may be governed by a different state law.<sup>5</sup>

Other factors, however, may contribute to a consumer's willingness to pay a debt even if he or she cannot be sued on that debt. In some cases, if a state's statute of limitations is relatively short as it is in Arkansas, the debt may be reported on the consumer's credit bureau report as a trade line for a time period which actually exceeds the statute of limitations period as the Fair Credit Reporting Act ("FCRA") allows for a trade line to be reported for seven (7) years.<sup>6</sup> Additionally, some consumers may also desire to pay a debt past the statute of limitations or the reporting date on a trade line out of a sense of financial or moral obligation.

### **FAIR DEBT CONSIDERATIONS**

"[A]busive, deceptive, and unfair debt collection practices" by debt collectors prompted the adoption of the FDCPA.<sup>7</sup> Its enactment was intended to: (a) eliminate abusive debt collection practices by debt collectors; (b) insure that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged; and

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<sup>5</sup> *Hill v. Perel*, 923 S.W.2d 636, 639 (Tex. App.—Houston [1<sup>st</sup> Dist.] 1996, no writ).

<sup>6</sup> 15 U.S.C. 1681c(c). See also 15 U.S.C. 1681c(d) as the expiration of the trade line to be reported ("fall off date") is not a required disclosure.

<sup>7</sup> 15 U.S.C. § 1692(a).

(c) promote consistent State action to protect debtors against debt collection abuses.<sup>8</sup> However, the FDCPA was never intended to protect a debtor from the ordinary annoyance and inconvenience occasioned by lawful collection efforts.<sup>9</sup> The mere fact that collection efforts distress or inconvenience a debtor does not automatically make such efforts unlawful.

The FDCPA prohibits a debt collector from using any false, misleading representation or means in connection with the collection of a debt including the false representation of the character, amount, or legal status of the debt<sup>10</sup> or any unfair or unconscionable means to collect a debt.<sup>11</sup> The cases addressing the issue of the collection of Past Statute Debt discuss certain limitations on the type of information that debt collectors may convey when collecting on these debts based on these provisions of the FDCPA.

One of the initial cases examining the collection of Past Statute Debt is the 1987 case of *Kimber v. Federal Financial Corp.* out of the United States District Court for the Middle District of Alabama.<sup>12</sup> In *Kimber*, the collection efforts complained of included both threats to sue and the filing of suits on debts that the defendant knew to be beyond the

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<sup>8</sup> 15 U.S.C. § 1692(e).

<sup>9</sup> See, e.g., *Lewis v. ACB Business Services, Inc.*, 911 F.Supp. 290 (S.D. Ohio 1996), *aff'd* 135 F.3d 389 (6th Cir. 1998).

<sup>10</sup> 15 U.S.C. § 1692e(2)(A).

<sup>11</sup> 15 U.S.C. § 1692f.

<sup>12</sup> 668 F.Supp 1480 (M.D.Ala. 1987).

statute of limitations. The *Kimber* Court concluded that the filing of a lawsuit to collect on a debt that appears time-barred, without a reasonable inquiry as to whether some portion of the limitations period had been tolled, constituted an unfair and unconscionable practice in violation of 15 U.S.C. § 1692f. This determination was based upon the Court's conclusion that "time-barred lawsuits are, absent tolling, unjust and unfair as a matter of public policy."<sup>13</sup>

However, the Eighth Circuit Court of Appeals in *Freyermuth v. Credit Bureau Services, Inc.*<sup>14</sup> refused to find violations of the FDCPA with respect to the collection of a Past Statute Debt where there were no threats of suit, holding that the expiration of the statute of limitations limited the judicial remedies available by precluding the filing of a court action but it did not mean that the debt itself was extinguished.<sup>15</sup> While the *Freyermuth* case has been widely followed by other courts,<sup>16</sup> it should be noted that at least one court has held that a threat of "further collection action" on a time-barred debt is enough to constitute a violation of the FDCPA.<sup>17</sup>

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<sup>13</sup> *Id.* at 1487.

<sup>14</sup> 248 F.3d 767 (8th Cir. 2001).

<sup>15</sup> *Id.* at 771.

<sup>16</sup> See, e.g., *Walker v. Cash Flow Consultants, Inc.*, 200 F.R.D. 613, 616 (N.D. Ill. 2001); *Wallace v. Capital One Bank*, 168 F. Supp. 2d 526, 528 (D. Md. 2001); *Shorty v. Capital One Bank*, 90 F. Supp. 2d 1330, 1332 (D.N.M. 2000); *Johnson v. Capital One Bank*, 2000 U.S. Dist. LEXIS 13311 \*6, (W.D. Tex. May 19, 2000); *Dawe v. Capital One Bank*, 456 F. Supp. 2d 236; ( D. Mass. 2006).

<sup>17</sup> *Stepney v. Outsourcing Solutions, Inc.*, 1997 U.S. Dist. Lexis 18264 (ND Ill. 1997) (Not reported in F. Supp.). See also *Perretta v. Capital Acquisitions & Mgmt. Co.*, 2003 U.S. Dist. LEXIS 10070 (N.D. Cal. 2003.)

Proscriptions on the collection of Past Statute Debt also arise under state law in several states. Debt buyers and debt collectors need to consider whether the states in which they may be attempting to collect this type of debt have such statutory bars. The limitations provisions of at least two states, Wisconsin and Mississippi, contain language effectively eliminating not only the right to sue on a debt after the expiration of limitations but the debt itself.<sup>18</sup> Any attempt to collect Past Statute Debt in states with this type of statute will create a cause of action under state law as well as under the FDCPA because the collection efforts misrepresent the legal status of the debt.<sup>19</sup>

Yet another consideration with respect to Past Statute Debt is who is going to be engaged in its collection. Letters and other communications from a debt collector who is an attorney may arguably be perceived as pre-cursors to suit, whether or not the debt is past statute or suit is ever mentioned in the communications. In the 2007 Connecticut case of *Gervais v. Riddle & Assocs.*<sup>20</sup>, the United States District Court held that the following constituted false threats of litigation in violation of the FDCPA:

- (i) the collection letter was sent on letterhead identifying defendant as "Attorneys & Counselors at Law";

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<sup>18</sup> "When the period within which an action may be commenced on a Wisconsin cause of action has expired, the right is extinguished along with the remedy." Wis. Stat. § 893.05. "The completion of the period of limitation prescribed to bar any action shall defeat and extinguish the right as well as the remedy." Miss. Code Ann. § 15-1-3.

<sup>19</sup> *Klewer v. Cavalry Invs., LLC*, 2002 U.S. Dist. LEXIS 1778 \*7 (W.D. Wis. 2002).

<sup>20</sup> *Gervais v. Riddle Associates, ,* 479 F. Supp. 2d 270 (D. Conn. 2007).

(ii) the collection letter contained the language "[o]ur law firm has been retained to collect from you," "[o]ur client has agreed to," and "[i]f you want to resolve this matter, you must either pay the Total Amount Due . . . or call our law firm . . . and work out arrangements for payment...."; and

(iii) telephone messages from the debt collector stated: "This is the law firm of ... calling you about an important legal matter."<sup>21</sup>

Interestingly the *Gervais* Court qualified its statements by stating:

*[T]his Court does not hold that every collection letter from an attorney carries an implied threat of legal action. However, debt collectors cannot exploit the naiveté of consumers through vague and unnecessary legal references. While all communications from Defendant were honest in fact, the least-sophisticated-consumer standard clearly contemplates that debtors shall be protected from nonfeasance as well as malfeasance.*<sup>22</sup>

The Courts addressing Past Statute Debt have not required that debt buyers and debt collectors actually inform the consumer that his/her debt is past statute.<sup>23</sup> The United States District Court for the District of Maryland has explicitly held that, unless it is alleged that a debt collector has engaged in a course of conduct that tricks a debtor into waiving his/her legal right to assert a limitations defense, no violation of the FDCPA occurs solely because a debt validation notice

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<sup>21</sup> *Id* at 273.

<sup>22</sup> *Id* at 275.

<sup>23</sup> Indeed, the cases with respect to disclosure in other areas also seem to hold that disclosure under the FDCPA does not require disclosure by the debt collector in communication of all the ramifications of payment. See *Mebane vs. GC. Services Limited Partnership*, 481 F.Supp.2d 249 (S.D. N.Y. 2007) where the District Court held that the failure to provide a consumer every possible payment option is not a violation of the FDCPA.

silent on the time-bar issue is sent to a debtor.<sup>24</sup> The United States District Court of New Mexico has reached a similar conclusion.<sup>25</sup> However, it should be noted that on August 28, 2007, suit was filed by the New Mexico Attorney General and is currently pending in New Mexico state court which asserts that the legal status of a debt is material and therefore the failure to disclose that it is past statute is a deceptive trade practice.<sup>26</sup>

Adding to the complexity of the issue of what must be disclosed is the disciplinary rules to which attorneys are subject. While the issue of the disciplinary and ethical rules governing attorneys and the giving of legal advice to non-represented parties has not been a discussion in the cases on Past Statute Debt, attorneys are generally prohibited from giving a non-represented person legal advice. While the bar of each state establishes its own disciplinary rules, most follow in substantial part the ABA Model Rules of Professional Conduct 4.3 "Dealing With Unrepresented Person" which states:

In dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested. When the lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer's role in the matter, the lawyer shall make reasonable efforts to correct the

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<sup>24</sup> *Wallace v. Capital One Bank*, 168 F. Supp. 2d 526, 529 (D. Md. 2001).

<sup>25</sup> *Shorty v. Capital One Bank*, 90 F. Supp. 2d 1330 (D.N.M. 2000) wherein the Court held that it was not false, deceptive, or misleading to fail to disclose the time-barred status of the debt.

<sup>26</sup> *State of New Mexico v. Merchants Credit Guide Company*, Case No D1314 CV 07930 filed in the Thirteenth Judicial District, County of Valencia, New Mexico.

misunderstanding. The lawyer shall not give legal advice to an unrepresented person, other than the advice to secure counsel, if the lawyer knows or reasonably should know that the interests of such a person are or have a reasonable possibility of being in conflict with the interests of the client.

Finally, the Commission also has considered the issue of the collection of Past Statute Debts and has issued a "FTC Consumer Alert-Time Barred Debts" which concurs that past statute debt may be collected as long as there is no threat of legal action.<sup>27</sup> As stated by the Commission in its Alert:

*There's no doubt about it: you are responsible for your debts. If you fall behind in paying your creditors — or if you dispute the legitimacy of a debt — a debt collector may contact you.*

...

*Most courts that have addressed the issue have ruled that the FDCPA does not prohibit debt collectors from trying to collect time-barred debts, as long as they do not sue or threaten to sue you for the debt. If a debt collector sues you to collect a time-barred debt, you can have the suit dismissed by letting the court or judge, know the debt is, indeed, time-barred."<sup>28</sup>*

## **CONCLUSION**

The purchase and collection of past statute debt provides additional savings to consumers in areas such as the cost of credit by enabling creditors to recover a portion of an investment that has "gone bad." Under existing case law and the FTC's Consumer Alert, debt buyers and third party debt collectors may continue to collect on debts which are outside the statute of limitation if no threats of suit are made.

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<sup>27</sup> October 2004 Federal Trade Commission - Consumer Alert Time Barred Debt.

<sup>28</sup> *Id.*

DBA looks forward to working with the Commission on these matters at the upcoming workshop.

Respectfully submitted,  
Barbara A. Sinsley  
General Counsel  
DBA International  
2901 W. Busch Boulevard, No. 703  
Tampa, Fl. 33618  
(813)500-3636  
(813)963-7172 fax  
bsinsley@bnswlaw.com