<u>PITFALLS OF PURSUING POST-CHARGE-OFF INTEREST</u>

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If you decide to collect post-charge-off interest your business practices must be reviewed to ensure you are not attempting to collect monies which have been legally waived (with or without the knowledge of the debt collector). Key things to do are:

1) Obtain written permission/direction from your client to pursue or waive post-charge-off interest. Many companies have made business decisions to waive post charge off interest. A court could determine that a company's internal business practices act as a waiver as to interest. You need to confirm in writing what the original creditor and prior creditors business practices were at the time they acquired the loan. By trying to obtain interest that has been waived, you are exposing yourself to a FDCPA lawsuit

2) <u>Look for indicia of waiver</u>:
   (1) The sale agreement defines the debt in an indirect manner that indicates that post-charge-off interest was waived.
   (2) The client stops reporting to the credit bureaus that the balance is increasing, e.g.: balance does not change for 6 months.
   (3) Client's computer screens/printouts show the interest rate set at 0%.
   (4) The creditor stopped sending monthly statements to the customer.

3) If you decide to use the legal/statutory rate of interest, **<u>determine if the interest is discretionary or mandatory under state law. If the law is silent, the court may argue it is discretionary and can only be requested in the complaint in a prayer for relief clause, wherefore clause or equivalent.</u>**
   a. Is the statutory rate higher or lower than the contract rate? If the statutory rate is higher than the contract rate, it may invite a lawsuit.
   b. What is the interest start date? If a forbearance occurred, you may not be able to collect interest during the forbearance period. Researching your state law on this issue is recommended.
   c. What does the agreement say about calculating interest? Is the agreement clearly identifiable to the specific debtor (e.g.: generic form credit card agreement)? Is it the correct version? Is it signed? Check your state law and your local case law. Will the court treat the generic agreement as binding on the debtor based on limited documentation?

There has been an uptick in lawsuits against debt buyers by Plaintiff's attorneys alleging that the original creditor waived interest after charge-off. Three common elements they cite to are: (1) The balance on a credit report remaining the same; (2) The creditor stopped sending statements to the customer; (3) The purchase/sale agreement appears to exclude the sale of post-charge-off interest.

Under general assignment law, when a debt buyer purchases a debt they step into the shoes of their retrospective assignors and the debt bought is subject to any existing waivers or defenses. The leading case is <u>Terech v. First Resolution Mgmt. Corp.</u>, 854 F.

Supp. 2d 537 (N.D. Ill. 2012). If a creditor expressly or implicitly waives post charge-off interest, the debt buyer has waived it as well. Unfortunately, most collection agencies and debt buyers do not have first-hand access to this information.

Recent case law demonstrates that debt buyers, collection agencies, and law firms are being sued for FDCPA class action violations for pursuing post-charge-off interest that a creditor has allegedly waived. New York has not yet ruled on this issue, but suits have been filed in New York, and courts nationwide are beginning to rule, showing a trend of favorable decisions for debtors. *Best Practice: Obtain an affidavit from the client if you decide to pursue post-charge-off interest and send it with the initial 1692g demand letter.*

The law of New York has long held that a waiver is the voluntary relinquishment of a right. Cowenhoven v. Ball, 118 N.Y. 231 (N.Y. 1890) Waiver can be express or implied. An express waiver will be written or oral. An implied waiver is more difficult to prove. An implied waiver may be done "by acts from which an intention to waive may be inferred or from which a waiver follows as a legal result." Titus v. Glens Falls Ins. Co., 81 N.Y. 410 (N.Y. 1880).

Black's Law Dictionary (9th ed) defines implied waiver as a "…waiver of contractual rights…where the conduct or acts of the party charged with waiver have either: (1) clearly manifested an intention to waive the contract provision or term allegedly waived *or* (2) reasonably induced the non-waiving party to rely upon an apparent waiver or such term or provision".

In one of the most recent and damaging decisions for debt buyers, debt collectors, and law firms, McDonald v. Asset Acceptance LLC, 2013 U.S. Dist. LEXIS 110829 (E.D. Mich. Aug. 7, 2013), the court granted Plaintiffs' Renewed Motion for Class Certification and Plaintiffs' Motion for Summary Judgment as to Liability, and denied Defendant's Motion for Summary Judgment. In this case the Plaintiffs alleged Defendant violated the FDCPA through its practice of retroactively imposing post-charge-off interest on consumer debts it purchased from various financial institutions.

In the decision, the court stated that "[w]hen deciding whether or not the Defendant violated the FDCPA, the court focused on the agreement between Asset Acceptance LLC and WFNB which stated in part:

> "[t]here has been no post charge off interest or fees added to the Unpaid Balance. . .The definition of 'Unpaid Balance' explicitly states that it is the total outstanding unpaid balance . . . excluding post charge-off interest." Id.

The agreement between Asset and Chase similarly excluded post charge-off interest from the definition of "Unpaid Balance." Id. Further, it provided that:

> "[e]ach charged-off Account is enforceable for the full Unpaid Balance . . .and is the legal, valid and binding obligation of the Cardholder, enforceable in accordance with its terms and not subject to offsets or defenses." Id.

The purchase agreements explicitly stated that the accounts do not include post-charge-off interest and are only enforceable up to the unpaid balance. The court held "it was clear from the evidence that Chase and WFNB intended to waive the right to collect interest on Plaintiffs' accounts and the creditors knowingly and intentionally waived their right to interest and sold the accounts to take advantage of favorable accounting practices". Id.

The accounting practices the court's decision refers to is one commonly used throughout the banking industry. Instead of amassing interest on a worthless account, creditors will sell accounts to shift the risk of nonpayment to a third party for a nominal fee. This practice permitted Chase and WFNB in the McDonald case to remove the account from their financial records and receive a bad debt tax deduction. The court took the position that this tradeoff leads to the reasonable inference that the original creditors intended to waive interest on Plaintiffs' accounts and Defendant Asset could not lawfully re-impose waived interest.

Even more damaging was the testimony of the bank's witnesses. The court stated:

"Likewise, Thomas Henry, director of recovery management and strategy for Chase Card Services, testified that Chase does not add interest to accounts once they are charged-off. (Id. at Ex. 7, p. 15). Henry explained that this is a business decision that alleviates Chase's expense of sending periodic statements to account holders. Henry also testified that Chase believed it was good economics and considered it a "good customer practice." (Id. at Ex. 7, p. 16). In addition, in his experience, other credit card companies such as American Express chose not to impose interest once it charged-off an account. (Id. at Ex. 7, p. 18-19). Plaintiffs also provided evidence of agreements between Asset and CitiFinancial, Wachovia Bank Nevada, HSBC Bank, Wells Fargo Bank, Huntington National Bank of Ohio, Worlds' Foremost Bank of Nebraska, and PREMIER Bankcard LLC, all of which expressly excluded post charge-off interest from the definition of "current balance" of "unpaid balance" in the agreement. Asset does not dispute any portions of the above referenced agreements."

In summary the court held "It is clear from the evidence above that Chase and WFNB intended to waive the right to collect interest on Plaintiffs' accounts. Indeed, at least one court has held that such conduct "create[s] more than a 'sheer possibility' that any interest was waived."

In another recent action out of Rhode Island, McDonald v. Richard J. Boudreau & Assocs., 2013 U.S. Dist. LEXIS 96252 (D.R.I. July 10, 2013), the Plaintiff debtor sought a class action against a law firm collecting a debt on behalf of its client for statutory damages, injunctive and declaratory relief and attorney's fees and asserts the firm

violated sections 1692e3 and 1692f4 of the FDCPA which prohibits a debt collector from using "any false, deceptive, or misleading representation or means in connection with the collection of any debt" and prohibits a debt collector from using "unfair or unconscionable means to collect or attempt to collect any debt," respectively. The Plaintiff alleged that the Defendant attempted to collect a debt by threatening to add an unauthorized amount of money by pursuing post charge off interest despite the creditor discontinuing to send periodic statements to the Plaintiff after the account had charged off.

The Plaintiff-debtor asserted that if a credit card account has been charged off, the credit card issuer must send periodic statements on all accounts "for any period during which fees and/or interest are added to the debt" Id. A periodic statement need not be sent if the creditor has charged off the account "and will not charge additional fees or interest on the account". Id. Plaintiff indicates to the court that by discontinuing sending periodic statement after his account was charged off, the firm waived future interest payments

Plaintiff alleged the lack of periodic statements evidenced the creditor's express waiver of its right to charge interest. However, Plaintiff cited statue 612 C.F.R. section 226.5(b)(2)(i) which deals with implied waiver and provides:

> "The creditor shall mail or deliver a periodic statement as required by § 226.7 for each billing cycle at the end of which an account has a debit or credit balance of more than $1 or on which a finance charge has been imposed. A periodic statement need not be sent for an account if the creditor deems it uncollectible, if delinquency collection proceedings have been instituted, if the creditor has charged off the account in accordance with loan-loss provisions and will not charge any additional fees or interest on the account, or if furnishing the statement would violate federal law."

The court denied the Defendant's motion to dismiss the complaint. A ruling has not yet been published.

In a 2012 U.S. District case from the northern District of Illinois, Simkus v. Cavalry Portfolio Servs., LLC., 2012 U.S. Dist. LEXIS 70931 (N.D. Ill. May 22, 2012), the original holder of a debt, Bank 1, charged off Plaintiff's debt in the amount of $7,077.76. Almost two years later, Bank 1 sought to collect that same amount, $7,077.76. Five months after that, Bank 1 reported the debt to Trans Union as $7,077.00. Shortly thereafter Bank 1 sold the debt to a debt buyer and the debt was reported by the debt buyer to Trans Union as $11,192.00 due to the addition of post-charge-off interest. Bank 1 did not send the debtor any further billing statements post-charge-off.

The Defendant, a collection agency, continued to pursue post-charge-off interest on the account. Plaintiff alleged Defendant violated sections §1692e and §1692f of the

FDCPA for falsely representing the amount of the debt, using unfair and unconscionable means to collect the debt, and for threatening to take action which cannot legally be taken. Defendant filed a motion to dismiss.

The court held that these factual allegations supported the Plaintiff's claim that Bank 1:

> "evinced its intention to waive the right to charge interest post charge-off." Id.

The court further stated:

> [I]t is reasonable to infer that CPS, the assignee violated FDCPA and ICAA by charging unauthorized interest after Bank of America, the assignor, had already waived its right to do so." Id.

In Simkus, the court denied Defendant's motion to dismiss and stated in its decision:

> "At this stage, we find that Simkus's factual allegations are sufficient to support a claim that Bank of America waived its right to charge interest after charge-off of Simkus's debt, which therefore prevents CPS from retroactively charging this interest upon assignment." Id.

The court noted that the agreement between Bank of America and Simkus was not included with the complaint nor Defendant's reply. Because of this, the court would not hear or rule on Defendant's argument that the agreement states that Bank of America's failure to exercise its rights will not waive any of its rights in the future.

In Simkus, the court focused on 612 C.F.R.§ 226.5(b)(2)(i) which provides "[t]he creditor shall mail or deliver a periodic statement as required by § 226.7 for each billing cycle at the end of which an account has a debit or credit balance of more than $1 or on which a finance charge has been imposed. A periodic statement need not be sent for an account if the creditor deems it uncollectible, if delinquency collection proceedings have been instituted, if the creditor has charged off the account in accordance with loan-loss provisions and will not charge any additional fees or interest on the account, or if furnishing the statement would violate federal law.

As mentioned earlier, one of the leading cases in this area is Terech v. First Resolution Mgmt. Corp., 854 F. Supp. 2d 537 (N.D. Ill. 2012), a 2012 action out of Illinois. In Terech, the Plaintiff debtor claimed FDCPA and TILA violations against a debt collector for pursuing interest the creditor had implicitly waived. Plaintiff alleged that the interest was waived because (1) the face value of the debt each time it was sold

was the same as the amount at charge-off and (2) that plaintiff received no periodic statements after charge-off.

Aside from bringing a FDCPA claim, the Plaintiff in this matter brought an action under the Truth in Lending Act (TILA). TILA requires banks to send billing statements for (1) any billing cycle which an account has a balance of more than one dollar and finance charges such as interest are being added, or (2) until the account is deemed uncollectible at which point it would no longer be adding interest, or (3) if delinquency collection proceedings have begun. Id. The 2010 amendments to TILA state that a creditor deems an account uncollectible when it stops trying to collect on it.

The court granted Defendant's motion to dismiss the counts regarding the Illinois Collection Agency Act but denied Defendant's motion to dismiss Count I of the complaint alleging that the retroactive addition of interest violated the federal Fair Debt Collection Practices Act.

These cases set a new precedent for law firms, debt collectors, and debt buyers who pursue post-charge-off interest. The dangers of pursuing post-charge-off interest is amidst us and becoming a hot topic within the courts. Buyer beware.

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