Payback: Lawyers on Both Sides of Collection are Feeling Debt's Sting

(Photo by Jim Newberry)

Adam Krohn sues debt collectors for unfair practices, but he found himself in a role reversal last year when calling a fellow California lawyer who owed him money on a judgment.

"He told me, 'Come get it. I want you to know what it's like to try to collect a debt,' " recalls Krohn. So he had a writ of execution served on Scott Carruthers, who Krohn says picked up another $90 in costs for the pleasure of teasing his adversary before paying up on a consumer's Fair Debt Collection Practices Act claim.

Carruthers did not respond to interview requests.

Their tangle, ongoing with new cases in which Krohn says Carruthers is avoiding service altogether, offers a humorous glimpse into a decidedly unfunny area of the law: debt collection.

With the nation so awash in debt—the Federal Reserve pegs "consumer credit outstanding" at more than $2.4 trillion—getting payment from those who owe money has become a huge business. And a big mess, with plenty of opportunities for lawyers to find work—and get into trouble.

A Federal Trade Commission report released in July said the system for resolving debt disputes needs fixing. No other industry generates as many complaints to the agency. Much of the report, titled Repairing a Broken System: Protecting Consumers in Debt Collection Litigation and Arbitration, jabs a finger at debt collectors, including law firms. A chorus of consumer advocacy groups, too, has been turning out damningly critical studies with more granular specificity.

They point to the perfect storm of sheer numbers, with debt buyers picking up portfolios of receivables for cents on the dollar, computerized automation with little human involvement and courts accepting the word of lawyers bearing scant proof.

And there are the inevitable mistakes where some folks who don't owe a penny still see their bank accounts frozen or wages garnisheed. They might be victims of identity theft. The debts may be past the statute of limitations or discharged through bankruptcy. Perhaps their name is similar to that of the actual debtor, or the money might have been paid in full.

Still, someone tries to collect on it.

COLLECTORS COURT

"Collection lawyers are considered second-class citizens among lawyers." —Tomio Narita (Photo by Melissa Barnes)

"It got to the point where debt-collection lawyers were running the court," says Kings County Civil Court Judge Noach Dear, who has taken such strict control of his pro se courtroom in Brooklyn, N.Y., that he forbids lawyers to speak with or otherwise try to negotiate with debtors outside the room. The judge also demands that lawyers show up with witnesses and sufficient evidence—testimony and affidavits aren't enough—or their cases are dismissed with prejudice.

The increased legal work has been a boon for lawyers working both sides of debt's fence. A lot of them came from other practice areas that have grown idle, bringing, for example, commercial litigators to the collection side and lemon-law specialists to work filing collection act cases. What some might lack in experience, or knowledge of practice-area custom and ethics, they make up for with aggressiveness.

One almost silent but salient fact remains constantly in the background: The person being hounded by debt collectors almost always owes money. But collection lawyers, whatever side they are on in what has become the worst economy in generations, enjoy a reputation that would have made Rodney Dangerfield cringe.

"Collection lawyers are considered second-class citizens among lawyers. They're not seen as being real lawyers," says Tomio Narita, a partner in San Francisco's Simmonds & Narita who represents debt-collection companies and lawyers who are sued by the other side. "As we suffer through the Great Recession, I think it is very politically popular to demonize debt collectors and collection attorneys."

But many a lawyer who gets stiffed on a bill quickly becomes a zealous debt collector, sometimes calling on Narita's clients for help.

Several longtime debt-collection lawyers interviewed for this story, some with leadership positions in the organized bar, are reluctant to speak of abuses by others, even in general. Criticism of fellow collection lawyers has to be teased out of Eric M. Berman, a member of the board of directors of the Washington, D.C.-based National Association of Retail Collection Attorneys, which has a code of ethics and has "disinvited" some members over the years for unprofessional practices.

"I will tell you that some brethren do awful things, and by God they should be sued," says Berman, whose eponymous firm is based in Babylon, N.Y. "I'm not an apologist for everyone, and if my people screwed up, we settle it quickly; if they didn't, then we fight it all the way. Otherwise you make an easy target."

Indeed, debt collectors have become big targets. There is a fast-growing cottage industry of lawyers suing debt collectors, including other lawyers, under the Fair Debt Collection Practices Act of 1978. According to Jack Gordon, a former debt collector who sells litigation data through his WebRecon site, the number of cases nationwide more than doubled to 9,365 in 2009 from 4,372 in 2007. He projects the 2010 tally will reach 11,394, a 22 percent increase. (His statistics reflect a count of plaintiffs in each claim, and a small number of suits have more than one.)

Krohn, who changed his firm's practice in 2008 after his lemon-law niche went sour, now files about 15 percent of the FDCPA cases around the country. He doesn't pursue underlying actual damages, as some FDCPA lawyers do, instead going for settlements: The statute calls for $1,000 for the plaintiff plus legal fees, which often dwarf the client's award.

He soon began asking for separate checks: “Even though we’re up front about it in our contract, saying our fees will be higher than what you receive, a lot of clients would say, ‘This is crazy. You’re getting the lion’s share and I’m the victim.’ ”

About 90 percent of his cases settle successfully, Krohn says, and many debt collectors would rather pay his fees than change their collection practices. “It’s cheaper to pay us than to play by the rules,” he says.

Far more cases are brought against nonlawyer debt-collection companies, Krohn says, though plenty go after lawyers.

A TOOL TURNS

Debt-collection lawyers note the FDCPA was created to stem abuses by debt collectors, such as harassing phone calls and deceptive letters, but argue it has been turned on its head over the years and now is used abusively against them. For example, they say, a single plaintiff brought 41 lawsuits under the act in 2008. But consumer-side lawyers say that is simply private enforcement at work. They point out that the FTC, which wields the FDCPA, brought just 62 enforcement actions in 30 years.

“That’s two a year, which is like a lion catching a wildebeest,” says Richard J. Rubin, a Santa Fe, N.M., lawyer. “It gets one from the herd, but there’s no threat to the others.”

Rubin used to litigate consumer complaints, but since 1995 he has mostly been teaching and handling FDCPA appeals for other consumer lawyers around the country.

Consumer lawyers say the broad statute needs even sharper teeth, particularly an increase in the paltry $1,000 award for the plaintiff. Debt-collection lawyers believe the statute is out of date.

“It’s death by a thousand cuts,” says Robert Markoff, a name partner in Chicago’s Markoff & Krasny. He has been a debt-collection lawyer for 34 years and is a former president of the National Association of Retail Collection Attorneys. “We’re being extorted by this litigation, much of it based on judicial decisions about nuance.”

The first FDCPA suit against Markoff years ago, for example, concerned his use of “v.” between the names of his client and the debtor at the top of a letter, along the lines of *Acme v. Jones*, a typical beginning for many lawyerly missives. But judges have ruled that implies a lawsuit has been filed or one is imminent—a deceptive practice if untrue.

The act is a strict liability statute, and thus courts do not concern themselves with whether money is owed. The law goes after abusive tactics and methods. Lawyers had been exempt from the 1978 statute until 1995, when the U.S. Supreme Court ruled in *Heintz v. Jenkins* that they are debt collectors under the act when engaged in consumer debt-collection litigation.

While debt collectors complain the statute is both broad and vague, courts have usually found its wording to be specific enough, and common law has made it more so. In January, for example, a federal judge in the Eastern District of New York ruled in a summary judgment motion in *Ehrich v. I.C. System Inc.* that a debt-collection letter giving otherwise proper notice was deceptive to Hispanic recipients because it contained a single sentence in Spanish that said to call a certain telephone number with any questions.

The statute is geared to the "least sophisticated" person and says the communication "may not overshadow" the right to dispute the debt or request information about the original creditor.

The collection side lost another FDCPA case earlier this year when the Supreme Court ruled in *Jerman v. Carlisle* that a law firm's letter telling an alleged debtor she must dispute a debt "in writing" violated the act, which does not specify any particular form of communication. The court said the statute's "bona fide error defense" does not extend to an error of law—making it clear that ignorance of the law is not an excuse. (Though not pertinent to the case, the law firm was in error trying to foreclose on a home after the debt had been paid. The homeowner brought a class action under the act.)

In dissent, Justice Anthony M. Kennedy, joined by Justice Samuel A. Alito Jr., apparently acknowledged the significant uptick in FDCPA litigation, writing that the majority opinion "aligns the judicial system with those who would use litigation to enrich themselves at the expense of attorneys who strictly follow and adhere to professional and ethical standards." Notably, however, several ordinarily business-friendly justices were in the 7-2 majority that didn't buy arguments about an abusive cottage industry bringing FDCPA cases against lawyers who are doing nothing wrong.

NOT ENOUGH DATA

"The system's incentive are out of whack. Meaningful review is uneconomical." —Daniel Schlanger (Photo by Sara Stathas)

More recently, debt litigation itself has come under increased scrutiny. The FTC and other critics say too many suits are filed without sufficient proof of debt—who owns it, who owes it and a breakdown of principal, costs, fees and interest as those amounts grow while debt passes from one collector to another.

In 2009 North Carolina amended its debt-collection statute, stating that debt buyers who file suit must include copies of the original contract and other pertinent proof of debt. Debt buyers there have virtually disappeared.

"I don't know that they've left the state, but they're not using our court system to collect on debts where they can't prove that they own them or can't prove how much the borrower owes," says Carlene McNulty, who helped draft the law and is a staff attorney with the North Carolina Justice Center in Raleigh, which advocates on behalf of low-income residents.

In some ways, consumer debt collection has begun to mirror the mortgage crisis, where revelations about automation, haste and questionable documentation in making mortgages recently ground foreclosure processes to a near halt. Like mortgages, some debt has been bought and sold so many times that collectors have been known to file suit based on little more than a name, account number and dollar amount printed out from a computer record. When pressed for proof, which happens infrequently because of the high number of default judgments on no-shows, the collectors can sound like early Greek philosophers contemplating the substance of the shadow of smoke.

Even the arbitration side of debt collection took a big hit last year when Minnesota Attorney General Lori Swanson filed suit. Swanson alleged that a group of investors with corporate and financial ties to a major debt-collection law firm, Mann Bracken, had taken control of the Minneapolis-based National Arbitration Forum; the forum, among other matters, handled the lion's share of credit card collection claims.

Consumer advocates had long argued that NAF was biased against consumers. Its arbitrators found for businesses 94 percent of the time in consumer cases.

In 2006, said the complaint filed in July 2009, Mann Bracken handled more than half of NAF's 214,000 consumer arbitration claims. The arbitration company's staffers even drafted complaints for creditors, it said. The complaint included copies of damning internal e-mails from NAF, including one saying, "We should certainly plan for unwinding any deal in the event shared ownership becomes an acute issue."

Several days later NAF agreed to stop arbitrating any credit card cases, a devastating hit to its business model. Mann Bracken, which had grown dominant by merging with major debt-collection firms Wolpoff & Abramson of Rockville, Md., and Eskanos & Adler of Concord, Calif., quietly closed its offices around the country. The firm entered receivership in February.

Critics say the deck has been stacked in litigation, too, mostly with help from the judicial system as well as from shady operators.

After a spate of shocking studies and reports by consumer advocacy groups looking at debt-collection abuses in New York City, the City Council and courts there tightened restrictions on debt collectors, calling for more proof when filing suit and for more accountability on the part of process servers.

In June, 35 debt-collection law firms entered a consent order in a suit brought by New York Attorney General Andrew Cuomo. Agreeing to unscramble a rotten egg, they are now, in effect, walking back or redoing as many as 100,000 default judgments against alleged debtors in which a corrupt process service company engaged in “sewer service,” claiming to have served complaints when it did not.

BANKING ON DEFAULT

There has been a mountain of papers to be served as the courts helped speed the pace of high-volume litigation. In New York City, for example, before a recent tightening of laws and administrative rules, debt collectors could make bulk purchases of index numbers (docket entries for cases) from the court clerk’s office and file suits based on a skimpy set of documents and affidavits, and then obtain default judgments without any of it ever entering a courtroom.

In New York City Civil Court, 26 debt buyers were awarded about $1.1 billion in judgments and settlements from January 2006 through July 2008, according to a study by MFY Legal Services, which provides legal aid to the poor. The debt buyers got default judgments in nearly 87 percent of the matters and prevailed more than 94 percent of the time.

About 71 percent of the alleged debtors were not served, or served improperly, according to the study.

“In recent years they’ve started skipping the traditional collection tools of calls and letters, and more and more go straight to court and sue,” says Carolyn Coffey, an MFY staff attorney. “And when someone does show up with an attorney, they drop the case because it’s not worth the effort. It’s easier to move on to the next one.”

District Council 37 Municipal Employees Legal Services, an arm of New York City’s largest public employee union, reported in December 2009 that when its lawyers represented members sued by debt buyers, the plaintiffs walked away from all but 5.5 percent of the cases. And in those remaining, the debt collectors failed to prove money was owed in 95 percent of the matters they litigated.

Had they not been represented by lawyers, those alleged debtors likely would have had default judgments entered against them. Many would know nothing of it until their bank accounts were frozen or wages garnisheed because they were never served with complaints.

Investigators for New York's attorney general found that American Legal Process, used by many New York debt buyers and debt-collection firms, routinely claimed to have served papers when it had not. Among many outlandish examples: One processor noted being in four locations at the same moment, and another would have driven 10,000 miles in a single day to have done what he claimed. ALP's owner is now serving a year in jail for fraud.

One debt-collection law firm that signed the consent order without admitting wrongdoing was Cohen & Slamowitz in Woodbury, which filed more than 300,000 suits in the four years from 2005 through 2008. The firm has 14 lawyers. Those numbers—14 lawyers filing 80,000 suits per year—got a lot of second looks and rolling eyes. Cohen & Slamowitz, through a lawyer representing the firm, declined comment.

With that kind of volume "you see a significant number of people, though a minority of the cases, who are sued on debts already paid or who otherwise don't owe it," says Daniel Schlanger, a consumer lawyer at Schlanger & Schlanger in White Plains.

"I think for most of the firms if you're talking about the bigger players, those [errors] are not typically intentional," he says. "But if you're talking about service on bad addresses, the problem is they have no incentive to get it right. Their business model is based on defaults. They only have that incentive after getting the default, when they want to collect. Then they are fantastic at finding a good address."

"The system's incentives are out of whack," Schlanger says. "The volume players have determined that meaningful review is uneconomical."

But high volume is not necessarily bad, says Fred Blitt, a collections lawyer in Wheeling, Ill. The current president of the National Association of Retail Collection Attorneys believes 14 lawyers and their staff can competently handle 80,000 cases a year.

"Would it be any better if 10 law firms got 8,000 files apiece and all flew under the radar?" Blitt asks. "Why is it bad that we have a computerized system? It's very simple work. You either owe the money or you don't."

DEBT DRAMA DOUBTED

Blitt's exasperation is undisguised. He has been the go-to guy for quotes in news stories over the past year about abuses in debt collection. Like fellow NARCA board member Berman, Blitt believes many of the criticisms are exaggerated and many sad-song anecdotes overplayed. He is even more reluctant than Berman to criticize errant debt collectors.

A couple of years ago Blitt's firm was about to be sanctioned as much as $7,000 for suing the wrong "John Smith" in a Chicago suburb. The man had not responded to phone calls and letters, so litigation was the only alternative, according to Blitt.

He admits, though, that one of his staff attorneys “could have been more aggressive in shutting the file down as we do when it’s the wrong person, but the other side wasn’t being good about it either.

“I rarely go to court anymore and was sort of upset and went off, figuring that for $5,000 to $7,000 I was going to get my money’s worth.” Maintaining the defendant had not responded to calls and letters, Blitt recalls, “I said to the judge, ‘I don’t care if 25 nuns came in my office with this file and said it was kosher; I would never have known this was not the right person.’ The judge sanctioned me $5,000.

“That’s adequate remedy, I guess.”