DBA INTERNATIONAL'S COMMENT AND TESTIMONY RELATING TO PROPOSED AMENDMENTS TO FED.R.BANKR.P. 3001

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DBA International ("DBA") appreciates the opportunity to submit this Comment relating to the proposed amendment to Fed.R.Bankr.P. 3001.

BACKGROUND OF DBA INTERNATIONAL

DBA International (DBA) was formed in 1997 as a trade group for debt buyers and was formerly known as Debt Buyers Association. DBA currently has 405 professional debt buyer members and 140 vendor and affiliate members. DBA was formed to provide networking and educational opportunities for its members, as well as a forum to advance the interests of debt buyers with state and federal legislatures. It has a strict code of conduct which includes compliance with the Fair Debt Collections Practices Act (FDCPA) and other applicable federal and state laws. Many of DBA's members collect their own purchased debts or outsource their collections to collection agencies or attorneys. Debt buyers provide an economic benefit to consumers by substantially discounting debt settlements and offering payment plans.

I. INTRODUCTION

The proposed amendments to Fed.R.Bankr.P. 3001 ("Rule") will dramatically change its current structure and impose new burdens upon creditors and their assignees despite the lack of a pressing need for such changes. The Rule will have the practical effect of discouraging all creditors from pursuing legitimate claims. It will impose a disproportionately heavier chilling effect upon debt buyers. The proposed changes will ultimately also result in the decline of the value of defaulted debt in the market, which in turn

will ultimately reduce the availability of unsecured credit to consumers. In short, as will be discussed below, the changes which are being proposed may very well harm consumers more than it will help them.

II. PROPOSED AMENDMENTS-CATEGORIES

The proposed amendments fall into three categories:

1. **Rule 3001(c)(1).** The proposed amendments to this Rule requires that a proof of claim based on an open-end or revolving consumer credit agreement include a copy of the most recent statement provided to the debtor.

2. **Rule 3001(c)(2)(A)-(C) (new).** The new proposed sections of Rule 3001(c)(2)(A)-(C) require that a claim include specific information, including an itemized statement of the interest, fees, expenses or charges incurred before the petition date, the amount necessary to cure any arrearage on a debt secured by the debtor's principal residence, and a copy of the most recent escrow statement on a debt secured by the debtor's principal residence.

3. **Rule 30001(c)(2)(D.)** This proposed Rule adds an exclusionary Rule prohibiting a creditor from presenting any omitted information in any contested matter or adversary proceeding unless the court determines that the failure was substantially justified or was harmless. It also authorizes "other appropriate relief, including reasonable expenses and attorney's fees."

III. THE PROPOSED AMENDMENTS WILL SUBSTANTIALLY BURDEN CREDITORS AND WILL DISCOURAGE FILING OF LEGITIMATE CLAIMS

The proposed amendments fundamentally alter the balance between debtors and creditors in bankruptcy. Under the current law and Rules, there

is a balance between the rights and responsibilities of creditors and those of debtors.

- Debtors must file sworn schedules of assets and liabilities listing all of their debts.[1]
- Creditors may file a proof of claim subject to fine of up to $500,000.00 or imprisonment for up to five years for submitting a fraudulent claim.[2]
- A claim once filed is allowed absent an objection.[3]
- A proof of claim executed and filed in accordance with the Rules "shall constitute prima facie evidence of the validity and amount of the claim".[4]
- Even if a claim is not entitled to prima facie validity due to a defect in form or substance, a creditor may establish the validity of the claim by presenting competent evidence in court.[5]
- A debtor's listing of a claim in his or her schedules may be sufficient to establish the validity of a filed claim which corresponds to the schedules.[6]

This balance reflects the bankruptcy bargain. Debtor as the party seeking relief from his or her debts has the duty to fully disclose all his or her assets and liabilities. Creditors are entitled to have their claim recognized on a sliding scale if: (a) no party objects; (b) the claim is properly filed and the objecting party does not rebut the prima facie validity of the claim; or (c) the creditor presents competent evidence to prove the claim. This system deters gamesmanship by allowing undisputed claims and giving creditors the option of either taking advantage of the presumption or proving their claim in open

court. Fraudulent behavior by both debtors and creditors is deterred by the threat of a criminal prosecution under Title 18.

The proposed amendments to Rule 3001(c) fundamentally alter the existing balance. By requiring additional information from creditors and penalizing the omission of this additional information, the Rule imposes additional costs on creditors and incentivizes debtors to dispute undisputed claims in their schedules and to object to valid claims. Under 11 U.S.C. §502(b), a claim shall be allowed "except to the extent that" it falls within nine stated grounds. These grounds do not include failure to include documentation.[7] Additionally, many well-reasoned cases hold that even if a claim is not supported by proper documentation, it may be allowed if it corresponds to a claim listed in the debtor's schedules.[8] Finally, even if a claim is not supported by proper documentation, it may be proven at trial through competent evidence.[9] A minority of courts have taken a position analogous to that of the proposed Rule by prohibiting a creditor from amending its claim to add documentation without leave of court once an objection has been filed.[10] However, to DBA's knowledge, no court has adopted an exclusionary Rule prohibiting a creditor from offering evidence which was not attached to the claim form.

The proposed amendments will change existing law by eliminating the opportunity to present documents not attached to the proof of claim at a trial on allowance of the claim. It will encourage debtors to object to claims based

on documentation rather than because of a bona fide dispute. This issue was framed by a court which asked:

> Have the Debtors attempted to disallow claims they truly question or do not owe so that they, in good faith, can pay creditors with allowed claims more under their confirmed plans, or are they just trying to reduce their obligations under their plans and seek earlier discharge?[11]

The proposed amendments will also foster litigation motivated by the hope of recovering sanctions against creditors. These factors will deter creditors from filing legitimate claims.

The federal courts are now beginning to recognize that a 'cottage industry' has been spawned as a result, in part, of the strict liability standard, fee shifting, and exemplary damages provided by FDCPA.[12] These cases involve plaintiffs who attempt to thwart the good intentions that Congress had when it promulgated the FDCPA to protect consumers from abusive practices and instead have used the suit to engender large fee awards for counsel where the recovery to the plaintiff may only be the statutory award of $1,000.00.

The Seventh Circuit in 2004 held that the Bankruptcy Code and the FDCPA were not in conflict and that an independent cause of action could be filed in bankruptcy court by a debtor.[13] While some courts have held that the filing of a proof of claim is *not* actionable under the FDCPA, it is unclear whether the same analysis would apply if with the proposed amendments to Rule 3001(c) are adopted with their increased, more stringent filing requirements and the allowance for "other appropriate relief".[14] The amendments could easily result in a new or renewed area of litigation for

plaintiffs' attorneys 'specializing' in FDCPA litigation: indeed, these attorneys are already looking to expand their client base by attending 341 meetings to record debtors alleged grievances against debt collectors and filing suit in the name of the Trustee and not the consumer).

By way of comparison, the FDCPA requires that a debt collector provide verification of the debt to the debtor if requested in writing within thirty (30) days from the debtors receipt of the validation notice, See 15 USC 1692g(b). Upon the consumer's written request under section 1692g(b) verification must be given in writing and failing to do so is a violation of the Act.[15] Some courts have held that verification of a debt involves nothing more than the debt collector confirming in writing that the amount being demanded is what the creditor is claiming is owed.[16] If enacted, the proposed amendments to Rule 3001 would provide for documentation more burdensome than required by the FDCPA.

IV. THE PROPOSED AMENDMENTS WILL CAUSE AN ADVERSE IMPACT UPON DEBT BUYERS AND CREDIT ORIGINATORS

Debt buying began only forty-five (45) or so years ago, but it has become more widely practiced in the last ten (10) years as more consumer credit originators, especially federal and state chartered banking institutions, took advantage of the opportunity to sell nonperforming assets to willing buyers, who were willing to invest the time and expense to collect the debt. Upon the purchase of a portfolio of charged-off receivables, a debt buyer as assignee takes subject to all the rights, title, and interest of the assignor to the

indebtedness as well as to any applicable defenses of consumers with respect to their debts. Largely unnoticed by the courts and legislatures is the fact that debt buyers offer substantial discounts to resolve the debts to consumers, discounts which creditors largely can't or won't match. Debt sales of accounts other than those originated by banks also have become as commonplace and are as accepted a practice as the sale of mortgages. Examples of the types of charged-off receivables sold to debt buyers include accounts from credit card originators, telecom providers, retail merchants, and utilities. (See *DBA International's Comments Related to Debt Collection for the FTC Debt Collection Workshop filed June 2, 2007 by Barbara A. Sinsley)(herein "DBA Comment").*

While there are hundreds (if not thousands) of entities purchasing debt, there are only five publicly traded debt buying companies.[17] Three of these publicly traded debt buyers[18] collectively reported that they purchased from 1992 to December 13, 2009 (using varying time spans within the annual reports for each of the three companies) a total of $105.7 billion dollars of consumer debt at face value. Publicly traded debt buyers as well as several large privately-owned companies purchase many of the larger portfolios, including large credit card portfolios, directly from the originators. However, there are many smaller debt buyers that are active in the debt buying marketplace as well purchasing a wide variety of debt portfolios.

The advent of debt buying and the growth in the number of debt buyers appears to have preceded consumer comprehension of the debt buying industry. In recent years, however, consumer awareness that a debt may

actually be owned by an entity other than the original creditor has significantly increased. The legal system's understanding of the vital role of debt buying in the operation of financial markets has similarly expanded. As Judge Richard A. Posner, a frequent author of opinions for the United States Court of Appeals for the Seventh Circuit, stated in *Olvera vs. Blitt & Gaines*[19]:

> 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 that 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.[20]

Debt buyers perform an important role in the market. As one court stated:

> It is a basic facet of modern day credit financing that debts are frequently assigned to succeeding creditors. The law generally encourages this, as without it, the capital needed to fund the large amount of financing for which consumers have come to depend would simply not exist.[21]

Debt buyers allow credit originators to monetize the value of a defaulted debt and reinvest their capital elsewhere. Debt buyers assume the risk that a defaulted debt will be uncollectible in return for the possibility of making a profit. As a result, the amount that they are willing to pay will depend upon the level of risk and expense being incurred.

The proposed amendments increase both transaction costs and risk to debt buyers, thus reducing the value of this charge-off debt to them. First, the requirement to include the most recent account statement ignores the market

realities of debt buying (i.e. electronic business records). Court rules require creditors, including debt buyers, to file claims within 90 days of the first date set for creditors meetings and account statements are rarely made available to debt buyers within 90 days of being requested. Second, the exclusionary Rule prevents a debt buyer from using documents not attached to the proof of claim in a hearing on the merits.

Debt buying transactions involve large volumes of accounts. In many cases, debt buyers receive electronic business records from the credit originator. The level of original documentation received varies dramatically from seller to seller. In many cases, copies of specific account media may not be provided at the time of sale, but may be obtained in the event of litigation. The debt buyer has the option to obtain the account media in the event that an objection to claim is filed and either amend the claim or offer the evidence at trial. The proposed amendments would eliminate that opportunity and increase the cost of portfolios to debt buyers by requiring that an account statement be attached to the claim and excluding from evidence any document not attached to the claim thereby increasing costs to debt buyers and creditors.

Generally, a debt buyer is allowed, under the Rules on hearsay exceptions, to submit the electronic files of the creditor. These documents are deemed the business records of the debt buyer and admissible under Rule 803(6), Federal Rules of Evidence. Additionally, the documents evidencing the prior assignments purport to establish an interest in property (i.e., the credit account) and are admissible under Rule 803(15), Federal Rules of Evidence.

The fact that a debt buyer does not create the document that it seeks to introduce as a business record does not preclude admissibility of the documents prepared by the third parties: "if the [debt buyer] 'integrated the document into its records and relied upon it.'"[22] The cases addressing admissibility of documents prepared by third parties as business records stress two factors: "[t]he first factor is that the incorporating business relied upon the accuracy of the document incorporated and the second is that there are other circumstances indicating the trustworthiness of the document."[23] The debt buyer's business is premised upon the integration of the business records of the original creditor into its own records and the debt buyer must primarily rely upon the accuracy of the documents in pursuing collection of the account thereby satisfying the first factor for admissibility. However, debt buyers cannot and should not be held to a higher standard than that of a creditor. For example, a national bank subject to the National Bank Act is allowed to compound interest on a credit card into "principal" to date of charge-off.[24] A debt buyer cannot breakdown the "principal" purchased from the creditor when the creditor was not legally required to provide such a breakdown.

The amendments would require debt buyers to obtain account statements in every transaction despite the fact that most cases will yield little or no distribution to unsecured creditors. During the fiscal year ending September 30, 2009, there were 1,402,816 bankruptcy cases filed. Of these, 989,227 cases were chapter 7 filings. Approximately 95-97% of chapter 7 filings were no-asset cases.[25] Of the remaining 33% of cases in which there

could be a distribution to unsecured creditors, the amount actually paid to unsecured creditors is relatively low. In Fiscal Year 2001, unsecured creditors received just 21.4% of the distributions in chapter 13 asset cases and 23.3% of the distributions in chapter 7 cases.[26] In the same year, the average distribution to unsecured creditors in chapter 13 cases was $2,444.85 per case while the average distribution to unsecured creditors was $370.89 (although this included all chapter 7 cases and not just asset cases).[27]

V. THE PROPOSED AMENDMENTS DO NOT MEET A PRESSING NEED

The proposed amendments to Rule 3001(c) do not meet a pressing need. Taken together, the amendments require that creditors submit additional information and documentation and provide for the imposition of penalties for failing to do so. The Report of the Advisory Committee does not appear to address the fundamental need for these changes, although, it appears that the catalyst for the rule was concern about mortgage claims.[28] However, even though these same concerns do not apply to unsecured creditors, these creditors would be subject to the new requirements.

The requirement of proposed Rule 3001(c)(1) to attach the most recent statement from a credit card account would appear to be aimed at identifying the debt for purposes of determining whether the debt is actually owed. However, this is information which should already be in the possession of the debtor and would be used in preparation of the debtor's schedules. Because the debtor is required to file sworn schedules of liabilities, a claim based upon a credit card can be matched to an entry on the debtor's schedules in most

cases. It is only in the instance where the schedules and the claim do not correlate that the additional documentation would be necessary. Since the account statement should only be necessary in a small percentage of cases it would seem overly burdensome and broad to require the effort necessary to comply on 100% of the filers.

VI. CONCLUSION

The proposed amendments to Rule 3001(c) would negatively impact unsecured creditors and their assignees. The return to unsecured creditors in bankruptcy is already so low that imposing additional burdens and the potential of sanctions will deter creditors from asserting legitimate claims and add to a growing industry of debtors claiming FDCPA violations against debt collectors. Rather than imposing Rules which require additional documentation and breakdowns of information and which exclude evidence, the Rules Committee should look for ways to facilitate the allowance of legitimate claims.

The function of a proof of claim is to provide sufficient information to debtors and trustees to determine whether a claim is owed and whether the amount is correct. In the case of a credit card account, the most useful information to answer these questions will be:

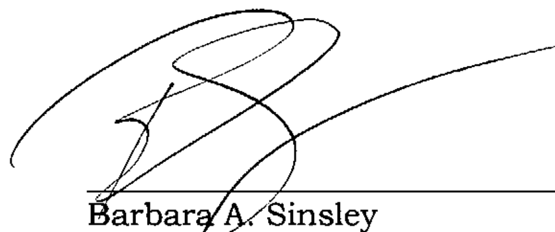
1) the name of the current creditor;
2) the amount of the claim;
3) the last four digits of the account number; and
4) the name of the original creditor if the account has been sold.

All of this information except for the name of the original creditor is already provided on the current proof of claim form.

This basic information will allow the filed claim to be compared to the debtor's schedules to determine whether there is a discrepancy. If the filed claim can be matched to a claim listed in the debtor's schedules and multiple claims are not filed on the same account, there should not be any reason to dispute the claim.

The rule should reflect a policy of providing relevant information rather than additional documentation for the sake of documentation. The rule should encourage allowance of legitimate claims rather than creating opportunities to deny claims based on form or lack of documentation.

DBA International appreciates this opportunity to respond and would respectfully request full consideration of its Comment.



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[1] 11 U.S.C. §521(a)(1). Fed.R.Bankr.P. 1007.

[2] 18 U.S.C. §152 and 3571.

[3] 11 U.S.C. §502(a).

[4] Fed.R.Bankr.P. 3001(f).

[5] *Caplan v. B-Line, LLC*, 572 F.3d 838 (10th Cir. 2009); *eCast Settlement Corp. v. Tran*, 369 B.R. 312 (S.D. Tex. 2007).

[6] *In re Samson*, 392 B.R. 724 (Bankr. N.D. Ohio 2008); *In re Kincaid*, 388 B.R. 610 (Bankr. E.D. Pa. 2008); *In re Cox*, 2007 Bankr. LEXIS 4048 (Bankr. W.D. Tex. 2007); *In re Kemmer*, 315 B.R. 706 (Bankr. E.D. Tenn. 2004).

[7] *In re Heath*, 331 B.R. 424 (9th Cir. BAP 2005); *In re Dove-Nation*, 318 B.R. 147 (8th Cir. BAP 2004).

[8] *In re Samson*, 392 B.R. 724 (Bankr. N.D. Ohio 2008); *In re Kincaid*, 388 B.R. 610 (Bankr. E.D. Pa. 2008); *In re Cox*, 2007 Bankr. LEXIS 4048 (Bankr. W.D. Tex. 2007); *In re Kemmer*, 315 B.R. 706 (Bankr. E.D. Tenn. 2004).

[9] *Caplan v. B-Line, LLC*, 572 F.3d 838 (10th Cir. 2009); *eCast Settlement Corp. v. Tran*, 369 B.R. 312 (S.D. Tex. 2007).

[10] *In re DePugh*, 409 B.R. 84 (Bankr. S.D. Tex. 2009); *In re Gilbreath*, 395 B.R. 356 (Bankr. S.D. Tex. 2008).

[11] *In re Cluff*, 313 B.R. 323, 342 (Bankr. D. Utah 2004), *aff'd*, 2006 U.S. Dist. LEXIS 71904 (D. Utah 2006).

[12] *See Turner v Asset Acceptance, LLC*, 302 F. Supp 2d 56, (D.N.Y. 2004); *Jacobson v. Healthcare Fin. Servs.*, 434 F. Supp. 2d 133 (D.N.Y. 2006).

[13] *Randolph v. IMBS, Inc.*, 368 F.3d 726, 729-33 (7th Cir. 2004) (recognizing FDCPA claim for violation of Bankruptcy Code's automatic stay provision).

[14] See *Baldwin v. McCalla*, 1999 U.S. Dist Lexis 6933 (N.D. Ill. April 19, 1999).

[15] *Johnson v. Statewide Collections, Inc.*, 778 P2d 93 (Wyo. 1989).

[16] *Chaudhry v. Gallerizzo*, 174 F3d 394, 406 (4th Cir. 1999); *Clark v. Capital Credit & Collection Services, Inc.*, 460 F. 3d 1162 (9th Cir. 2006), *Anderson v. Frederick J. Hanna & Associates*, 361 F. Supp. 2d 1379 (ND Ga. 2005).

[17] Asset Acceptance Capital Corp., Portfolio Recovery Associates, Inc., Encore Capital Group Inc., Asta Funding Inc. and First City Financial Corp.

[18] Asset Acceptance Capital Corp. ("AACC"), Portfolio Recovery Associates, Inc. ("PRAA") and Encore Capital Group, Inc. ("ECPG")

[19] 431 F.3d 285 (7th Cir. 2005)

[20] *Id. at 288.*

[21] *In re Samson*, at 729.

[22] *Air Land.Forwarders Inc. v. U.S.*, 172 F.3d 1338, 1342 (Fed. Cir. 1999).

[23] Id. at 1343.

[24] Act of June 3, 1864, c. 106, 13 Stat. 99 (codified as amended at *12 U.S.C. 1*, 2, 3, 4, 8, 11, 12, 13, 14, 21, 22, 23, 24, 26, 27, 29, 35, 39, 52, 53, 56, 57, 59, 60, 61, 62, 66, 71, 72, 73, 74, 75, 76, 81, 84, 85, 86, 90, 91, 93, 94, 141, 142, 143, 144, 161, 165, 181, 182, 192, 193, 194, 196, 481, 482, 483, 484, 485, 541, 548; *19 U.S.C. 197; 31 U.S.C. 543*.38). See, e.g., *Marquette Nat'l Bank of Minn. v. First Omaha Serv. Corp.*, 439 U.S. 299, 318-19 (1978) (finding NBA preempts state credit card interest rate ceiling); *Greenwood Trust Co. v. Mass., 971 F.2d 818, 831 (1st Cir. 1992)* (finding NBA preempts state credit card late fee restriction); *Am. Bankers Ass'n v. Lockyer*, 239 F. Supp. 2d 1000, 1022 (E.D. Cal. 2002*)* (finding NBA preempts state credit card disclosure law).

[25] United States Trustee Program, Preliminary Report on chapter 7 Asset Cases 1994 to 2000 (June 2001), p. 7.

[26] Ed Flynn, et al, "A Tale of Two Chapters: Financial Data," American Bankruptcy Institute Journal (Oct. 2002). During Fiscal Year 2008, distributions to unsecured creditors in chapter 13 cases were just 22.7% of the total amount distributed.

[27] Id. Since unsecured creditors in bankruptcy are chasing pennies, any increased burden or risk to them will fundamentally change the economics of collection.

[28] Memorandum to Advisory Committee on Rules from Subcommittee on Consumer Issues dated August 27, 2008.