Date of Hearing: July 6, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Matthew Dababneh, Chair
SB 641 (Wieckowski) – As Introduced February 27, 2015

SENATE VOTE: 29-10

SUBJECT: Debt buying: default judgment.

SUMMARY: Adds a new provision to the California Fair Debt Buying Practices Act (FDBPA). Specifically, **this bill**:

1) Provides if a service of summons has not resulted in actual notice to a debtor in time to defend an action brought by a third party debt buyer and a default or default judgment has been entered against the debtor, the debtor may serve and file a notice of motion and motion to set aside the default or default judgment and for leave to defend the action within 180 days of the first actual notice of the action.

2) Provides that a notice of motion to set aside a default or default judgment and for leave to defend the action shall designate as the time for making the motion a date prescribed under existing law, and it shall be accompanied by an affidavit showing under oath that the party's lack of actual notice in time to defend the action was not caused by his or her avoidance of service or inexcusable neglect. The party shall serve and file with the notice a copy of the answer, motion, or other pleading proposed to be filed in the action.

3) Provides upon a finding by the court that the motion was made within the period permitted by subdivision (a) and that debtor's lack of actual notice in time to defend the action was not caused by his or her avoidance of service or inexcusable neglect, the court may set aside the default or default judgment on whatever terms as may be just and allow the party to defend the action.

4) Specifies that these provisions shall not be limited by the time period in Civil Code, Section 1788.50 (which limits the applicability of the FDBPA to debt buyers with respect to all consumer debt sold or resold on or after January 1, 2014) and shall be applied to debt buyers with respect to all consumer debt, regardless of the date it was sold.

EXISTING STATE LAW:

1) Establishes the FDBPA which regulates the activities of a person or entity that has bought charged-off consumer loans for collection purposes. The FDBPA is limited to debt buyers with respect to all consumer debt sold or resold on or after January 1, 2014. (Civil Code, Sections 1788.50 et seq.)

2) Provides that a debt buyer shall not bring suit or initiate an arbitration or other legal proceeding to collect a consumer debt if the applicable statute of limitations on the debt buyer's claim has expired.

3) Requires that in an action brought by a debt buyer on consumer debt, certain facts must be alleged in the complaint, including, among others:

a) The date of default or the date of the last payment;

b) The name and an address of the charge-off creditor at the time of charge off and the charge-off creditor's account number associated with the debt. The charge-off creditor's name and address shall be in sufficient form so as to reasonably identify the charge-off creditor;

c) The name and last known address of the debtor as they appeared in the charge-off creditor's records prior to the sale of the debt. If the debt was sold prior to January 1, 2014, the debtor's name and last known address as they appeared in the debt owner's records on December 31, 2013, shall be sufficient; and,

d) The names and addresses of all persons or entities that purchased the debt after charge off, including the plaintiff debt buyer. The names and addresses shall be in sufficient form so as to reasonably identify each such purchaser.

4) Provides that in an action initiated by a debt buyer, no default or other judgment may be entered against a debtor unless business records, authenticated through a sworn declaration, are submitted by the debt buyer to the court to establish the specific facts required to be alleged, above. Existing law further provides that no default or other judgment may be entered against a debtor unless a copy of the contract or other document described, as specified, authenticated through a sworn declaration, has been submitted by the debt buyer to the court.

5) Provides that in any action on a consumer debt, if a debt buyer plaintiff seeks a default judgment and has not complied with the requirements of the FDBPA, the court shall not enter a default judgment for the plaintiff and may, in its discretion, dismiss the action.

6) Provides that, except as provided in the FDBPA, the above default judgment provisions are not intended to modify or otherwise amend existing procedures established under Section 585 of the Code of Civil Procedure (which provides a procedure for judgment to be had if a defendant fails to answer or otherwise respond to a complaint).

7) Provides that when service of a summons has not resulted in actual notice to a party in time to defend the action and a default or default judgment has been entered against him or her in the action, he or she may serve and file a notice of motion to set aside the default or default judgment and for leave to defend the action. Existing law requires that the notice of motion be served and filed within a reasonable time, but in no event exceeding the earlier of: (1) two years after entry of a default judgment against him or her; or (2) 180 days after service on him or her of a written notice that the default or default judgment has been entered. (Code of Civil Procedure, Section 473.5 et. seq.)

8) Requires that a notice of motion to set aside a default or default judgment and for leave to defend the action designate as the time for making the motion a date prescribed under a specified provision (which sets forth the statutory timelines for filing and serving specified noticed motions, opposing papers, and reply papers), and that the notice be accompanied by an affidavit showing under oath that the party's lack of actual notice in time to defend the

action was not caused by his or her avoidance of service or inexcusable neglect. The party shall serve and file with the notice a copy of the answer, motion, or other pleading proposed to be filed in the action.

9) Provides that upon a finding by the court that the motion was made within the period permitted by subdivision (a), above, and that his or her lack of actual notice in time to defend the action was not caused by his or her avoidance of service or inexcusable neglect, it may set aside the default or default judgment on whatever terms as may be just and allow the party to defend the action.

10) Provides the Rosenthal Fair Debt Collection Practices Act, generally prohibits deceptive, dishonest, unfair and unreasonable debt collection practices by debt collectors, and regulates the form and content of communications by debt collectors to debtors and others. (Title 1.6C of Part 4 of Division 3 of the Civil Code, commencing with Section 1788.)

EXISTING FEDERAL LAW regulates the collection of debt through, among other things, the Fair Debt Collection Practices Act; Fair Credit Reporting Act; and the Gramm-Leach-Bliley Act.

FISCAL EFFECT: Unknown

COMMENTS:

SB 641 would allow a consumer, in limited circumstances, to file a motion to set aside a default judgment that is more than 2 years old so the consumer may challenge the validity of the debt in court and try the case on the merits. The measure is limited to cases brought by debt buyers.

Simply stated, debt buyers are companies that purchase delinquent charged-off debts from a creditor for a fraction of the face value of the debt.

FDBPA

The FDBPA was established through legislation SB 233 (Leno) which went into effect on January 1, 2014. The FDBPA regulates the practice of buying charged-off consumer debt, sold or resold on or after January 1, 2014 for collection purposes and prescribes the circumstances pursuant to which the debt buyer may bring suit. The FDBPA prohibits a court from entering a default or other judgment in an action initiated by a debt buyer against a debtor unless business records, authenticated through a sworn declaration are submitted by the debt buyer to the court to establish the facts.

The California Code of Civil Procedure, section 473.5 permits a party to ask a court to set aside a default judgment that has been entered against him or her so that he or she may defend the case on the merits only if:

1) The original service of summons did not result in actual notice to the party in time to defend the action;

2) The default judgment is not more than two years old; and,

3) 180 days has not passed since the party was served with actual written notice of the default judgment.

Need for the bill:

According to the author:

> *"There are far more default judgments in collection cases brought by debt buyers against consumers than there are in any other type of case. Yet despite increased education and media attention around this issue, the number of default judgments in collection cases remains very high in California. For example, in Sacramento County Superior Court, collections cases resulted in default judgments in 74% of cases filed in 2013 and 79.3% for cases filed in the first 5 months of 2014.*
>
> *The Federal Trade Commission, among others, has called for state legislation to deal with the frequency of default judgments and lack of notice provided to defendants in debt collection lawsuits brought by debt buyers.*
>
> *Prior to the passage of FDBPA in 2013, debt buyers were not required to provide the Court with any evidence that the Defendant being sued actually owed the debt. The now famous story of Senator Lou Correa receiving a notice of wage garnishment for a debt owed by a different person is not an anomaly. For many consumers with default judgments entered against them, the first time they are made aware they have been sued on a debt is when they are served post-judgment with a notice of wage garnishment.*
>
> *Although the FDBPA has made great strides in reforming debt collection litigation, it has no effect on default judgments entered before January 1, 2014. It's these default judgments—ones obtained before the FDBPA was signed into law—that SB 641 will affect.*
>
> *Currently, it is enormously difficult to set aside a default judgment that is more than two years old, and like Senator Correa, most Californians who have faced unjust wage garnishment cannot make use of the current exceptions.*
>
> *Moreover, it now appears that at least certain debt buyers are purposely waiting for the two-year mark to pass after having obtained a default judgment and only then seeking a garnishment order, leaving consumers no recourse to challenge the validity of the debt."*

A consumer example provided by the author (name has been changed to preserve confidentiality):

> *"Ms. Rivera came to East Bay Community Law Center with a notice of wage garnishment based on a default judgment obtained in 2002 by a debt buyer for a credit card she had never applied for or received. She had never lived at the address on the credit card statements, and was allegedly "personally served" with the lawsuit at an address she had vacated 6 months earlier. The first she heard of the default judgment was when her wages were garnished 12 years later. The proceeding was disastrous for Ms. Rivers; she fell behind in her rent and risks being evicted because 25% of her wages are being garnished for a debt that is not and never was hers."*

Background:

Existing law requires that a defendant to an action against whom a default judgment has been entered bring any motion to set aside the default judgment within the shorter of two time periods: (1) two years after the date of entry of a default judgment against him or her; or (2) 180 days after service on him or her of a written notice that the default or default judgment has been entered. This remedy is available only where service of a summons has not resulted in actual notice to the defendant in time to defend the action and the defendant's lack of actual notice was not caused by his or her avoidance of service or inexcusable neglect.

SB 641 creates a separate default judgment rule that potentially extends the amount of time a consumer defendant in a debt buying action has to bring a motion to set aside a default judgment. Specifically, the bill would permit a debtor to serve and file a notice of motion and motion to set aside the default or default judgment and for leave to defend the action within 180 days of the first actual notice of the action. This 180-day time limit could fall after the two year limit otherwise prescribed under existing law. The bill does not, however, alter the limited availability of this remedy (to set aside a default judgment) to only those situations where: (1) service of a summons has not resulted in actual notice to the defendant in time to defend the action; and (2) the defendant's lack of actual notice was not caused by his or her avoidance of service or inexcusable neglect. As with existing law, the notice must be accompanied with an affidavit showing under oath that the defendant's (here, the debtor) lack of actual notice in time to defend the action was not caused by his or her avoidance of service or inexcusable neglect. Likewise, as with existing law, the court would not be permitted to set aside the default judgment unless it finds that the motion was made within the appropriate time limit and that the defendant's lack of notice in time to defend the action was not caused by his or her avoidance of service or inexcusable neglect.

Process of a Debt Buyer for nonpayment of debt:

- Debt buyers sue for the nonpayment of debt- the lawsuit starts with a complaint

The lawsuit starts when the debt buyer, files a "complaint" (sometimes called a "petition") with the court. The complaint will list consumer as a defendant, and perhaps someone else too (like a spouse or someone who cosigned the loan or account). It will also state why the debt buyer is suing, and what the debt buyer wants – usually, the debt buyer wants reimbursement for the money consumer owes, plus interest, and sometimes attorneys' fees and court costs.

- Service of the Summons and Complaint

The debt buyer must "serve" the consumer with a copy of the complaint, along with a "summons." The summons notifies the consumer that the consumer is being sued, and usually provides additional information such as when the consumer needs to file a formal response in court.

Most courts require the debt buyer to "serve" the documents by handing them to the consumer personally. Debt buyers most often hire a professional process server or a local sheriff to "serve" the consumer. If the server can't find the consumer, often he or she can leave the summons and complaint with another adult at the consumer's house or business and then mail a copy to the consumer.

Often, courts allow debt buyers to mail the consumer the summons and complaint, along with a form for the consumer to sign acknowledging that the consumer received the papers. If the consumer signs and returns the form, the consumer will have been deemed "served."

- Where Will the Creditor File the Lawsuit?

The debt buyer may sue the consumer in state civil court (these courts can have many types of names: municipal court, superior court, justice court, county court, to name just a few), or, if the consumer owes money to the federal government, in federal court.

- Responding to the Lawsuit

Usually, a consumer has about 20 to 30 days to file a written response to the lawsuit. The document filed is often called the "answer." A consumer prepares the answer and determines whether or not to hire an attorney.

- What happens if a consumer does not respond?

If a consumer does not meet the filing deadline, the debt buyer will likely ask the court to enter a default judgment. Sometimes, the court will award the amount the debt buyer requests in the default judgment, some courts will review the papers carefully to make sure the amount is justified, and still others might require the debt buyer to present evidence before awarding any money.

California Courts:

California courts have a long standing policy of trying cases on the merits when at all possible. "The policy of law is to have every litigated case tried on its merits and court looks with disfavor on party attempting to take advantage of his adversary's mistake, surprise, inadvertence or neglect by procuring default judgment, regardless of merits of such party's case." *Denke v. Bowes* (App. 1947) 77 Cal. App. 2d 642.

Federal Trade Commission (FTC)

In January 2013, the FTC released a study titled, "The Structures and Practices of the Debt Buying Industry." The study found the following:

- This was the most extensive empirical study of the debt buying industry. The FTC examined 90 million consumer accounts purchased by nine of the largest debt buyers. The accounts had a face value of $143 billion and the debt buyers spend nearly $6.5 billion to acquire them.

- Debt buyers received documentation for accounts purchased for a small percentage of the debts. Only 12% of the sample accounts studied by the FTC of accounts purchased by debt buyers came with any account documents. When considering all of the accounts purchased during the study period, an estimated 6% of accounts debt buyers purchased came with any sorts of documentation.

- Debt buyers rarely obtained information about collection history or dispute history for the accounts they purchase-information that the FTC concluded is very relevant to debt buyers in assisting them in determining whether consumer actually owe the debts, whether they are attempting to collect from the right person, and whether the amounts are accurate.

- Debt buyers have some information about the account but fail to share it with the consumer. Information that would help the consumer understand the origins of the debt, including the name of the original creditor, account number and date of last payment is available to the debt buyer but generally not included in validation letters.

- Debt buyers verified disputed debts aged 6 years or more only 36% of the time compared with a 58% verification rate for debts 3 or fewer years old. It makes sense that for older accounts, debt buyers did not verify disputed debt as frequently- the information necessary to verify a debt is less likely to be available, particularly if the debt has been sold and resold many times. In Oregon, the statute of limitations for cases like one brought by debt buyers is 6 years.

- The Commission reiterated its concern over the risk of default judgments on debt beyond the statute of limitations- " As the Commission has noted, because 90% or more of the consumers sued in these actions do not appear in court to defend, filing these actions creates a risk that consumers will be subject to a default judgment on a time-barred debt."

- These findings raise serious concerns about lawsuits brought by debt buyers to collect on the accounts they purchase. Debt buyers are bringing suits and obtaining default judgments in state court at an alarmingly high rate. However, based on some of the findings from this 2013 report, there are valid questions as to whether debt buyers can prove ownership of the debt, the alleged debtor, and the accuracy of the amount claimed to be owed.

- The FTC reiterated its findings from its 2010 report that "debt collection complaints often do not contain sufficient information to allow consumers to admit or deny the allegation and assert affirmative defenses." This finding, among others, led the FTC to conclude in 2010 that "the system for resolving consumer debt disputes through litigation is seriously flawed." In its most recent report, the FTC did not let debt buyers off the hook as they claim- "the sufficiently and accuracy of the information used in the collection of debts remains a significant consumer protection concern."

Consumer Financial Protection Bureau (CFPB)

On October 24, 2012, the CFPB published a rule to allow the agency to federally supervise the larger consumer debt collectors. (CFPB, Consumer Financial Protection Bureau to Oversee Debt Collectors (Oct. 24, 2012) <http://www.consumerfinance.gov/newsroom/consumer-financial-protection-bureau-to-oversee-debt-collectors/> [as of Apr. 9, 2015].) The CFPB noted that, “[a]pproximately 30 million Americans have, on average, $1,500 of debt subject to collection. Debt collectors often report consumers’ collection status to the credit bureaus. If they get the information wrong, this can be the difference between getting approved or denied for such financial products as a mortgage or a car loan.”

Arguments in support:

- SB 641 puts important due process protections in place by permitting consumers to move to set aside default judgments obtained by debt buyers within 180 days after the first actual notice of lawsuit. This important protection would ensure that consumers can defend themselves in situations where they received no initial notice of a lawsuit through no fault of their own. SB 641, like section 473.5 of the Code of Civil Procedure, requires a consumer to swear, under penalty of perjury, that her lack of actual notice in time to defend the action was not caused by avoidance of service or inexcusable neglect.

- The reforms in SB 641 are sorely needed. Many Californians are not aware that a debt buyer has filed a lawsuit against them until their wages are garnished or their bank accounts are levied. Under the current law, if more than two years have passed since the entry of a default judgment, a consumer may have no way to stop a garnishment or levy short of bringing an entirely new action- even if she never knew about the lawsuit or the supposed debt in question.

- Default judgments entered against consumers by debt buyers come at a great cost to consumers, courts, and county sheriffs' offices. Numerous reports have documents the rise in the use of litigation by debt buyers as a mechanism to collect debt from consumers. With this increased litigation has come a concomitant rise in certain debt buyers engaging in unfair practices that echo the worst excesses of the debt collection industry, such as hiring process servers known to falsify proofs of service in order to obtain default judgments against consumers without providing notice.

- Only consumers who lack actual knowledge of debt buyer suits will have recourse under the new law. They will have to act within a reasonable time after learning about the lawsuit. In addition, they will have to submit an affidavit sworn under penalty of perjury that their lack of notice did not result from avoidance of service or inexcusable neglect, and then will have to defend the action on the merits. This new bill is no free ticket out of debt.

Arguments in opposition:

- No time limitation- the bill could conceivably allow a consumer to claim they did not receive "actual notice" at any point in time in the future. This would require companies to maintain documents, including those containing personally identifiable information in perpetuity, despite public policy to destroy such information at the earliest possible date.

- Retroactive application-The bill would ask those who successfully argued their case before a court to reproduce evidence already provided and folded into the judgment. Depending on the age of the judgment, many of the supporting documents and evidence may have been legally destroyed pursuant to corporate and government mandated document retention and destruction policies. If a policy change of this significance is adopted, it should only be applied prospectively so as to allow for compliance.

- The stated problem and the bill's proposed resolution are misaligned- the stated problem involves the process serving profession whereas the bill's solution focuses on the client- but only for one industry. Since debt buying company's contract with the same process services used by other companies, industries, government agencies, and members of the public, any

failure to process would be systematic in nature and not limited to one industry. The Judicial Council's Form POS-010 requires a process server to swear under the penalty of perjury that they have served the correct individual. SB 641 requires the individual seeking to vacate a judgment to submit an affidavit indicating under oath that they lacked actual notice of service. Both individuals are swearing they are telling the truth and yet the facts would suggest otherwise. What is notable is that neither individual is a debt buying company.

- The legislation would restrict the availability of affordable credit. Research by the Federal Reserve Bank of Philadelphia has established that laws making it harder to collect on delinquent debt lead to higher interest rates and less credit available to consumers in the state.

Previous Legislation:

SB 233 (Leno, Chapter 64, Statutes of 2013) Enacted the FDBPA imposing various requirements on practices that may be used to collect on purchased consumer debt.

SB 890 (Leno, 2012 Legislative Session) Failed passage in Assembly Banking Committee. That bill contained provisions substantially similar to this bill and was the author's attempt last year to enact the Fair Debt Buying Practices Act. One notable difference was the change of the definition of “debt buyer.” SB 233 has removed language that would have included parent, subsidiary, and other affiliates in the definition.

AB 350 (Lieu, 2009 Legislative Session) Failed passage in Senate Judiciary. This bill would have enacted the Debt Settlement Service Act for the purpose of licensing debt settlement service providers.

Double-referral:

Should this measure pass out of the Assembly Banking and Finance Committee it will move on to the Assembly Judiciary Committee.

Recommended Amendments:

After a number of meetings and discussions with the opposition and supporters of the measure, the committee believes a number of issues need to be addressed.

1) Retroactive application

The committee is recommending that the measure not be retroactive indefinitely and proposes a date of January 1, 2010. Therefore all judgments entered on or after this date would fall under the measure.

2) 2 Year Period to Set Aside

The committee believes the 2 year period for a consumer to set aside a default judgment should be extended to 6 years for actions brought by debt buyers.

Technical Amendment:

On page 2, line 5, delete "third party"

REGISTERED SUPPORT / OPPOSITION:

Support

East Bay Community Law Center (EBCLC) – Sponsor
American Civil Liberties Union (ACLU)
Bay Area Legal Aid (BayLegal)
California Reinvestment Coalition (CRC)
Center for Responsible Lending (CRL)
Consumer Federation of California (CFC)
Consumers for Auto Reliability and Safety (CARS)
Consumers Union
National Employment Law Project (NELP)
Public Counsel
Western Center on Law and Proverty
1 Individual

Opposition

California Association of Collectors (CAC)
California Bankers Association (CBA)
California Creditors Bar Association (CCBA)
DBA International (DBA)
Encore Capitol Group

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