Consumer & Class Action Litigation Newsletter - March 2011

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Seventh Circuit Rejects Debtor's Argument That a Student Loan Is Dischargeable in Bankruptcy

Hinshaw & Culbertson LLP recently won a case on behalf of a lender in the U.S. Court of Appeals for the Seventh Circuit. The case involved a student/debtor who argued that his student loan was dischargeable in bankruptcy. The debtor had obtained the $3,000 loan from a university/lender. The debtor defaulted on the loan and the lender obtained a judgment against him. The debtor then filed for bankruptcy and argued that his loan was dischargeable because the lender had refunded excess money in the debtor's student account to his mother.

The Seventh Circuit found that the loan was nondischargeable under 11 U.S.C. § 532(a)(8). The Court adopted the approach taken by the U.S. Court of Appeals for the Fifth Circuit in *In Re: Murphy,* 282 F.3d 868 (5th Cir. 2002), that it is the purpose of the loan which determines whether it is educational. This approach aligns with the broader goal of protecting lenders against debtors who divert educational funds toward other uses. The five factors the Court considered were: (1) the lender is a school; (2) the loan was part of a financial aid package; (3) the promissory note was signed while the debtor was a student; (4) the debtor had to be a student to be eligible for the loan; and (5) the loan money was deposited into his student account.

In addition, the Seventh Circuit held that the bankruptcy court properly awarded the lender its costs and fees incurred in litigating this issue in the bankruptcy court pursuant to the terms of the promissory note, in which the debtor had agreed to pay attorney's fees necessary for the collection of any amount not paid when due.

Busson-Sokolik v. Milwaukee School of Engineering, Nos. 08-4317, 09-4009 & 10-1456 (7th Cir. 2011)

For more information, please contact John P. Ryan or your regular Hinshaw attorney.

Eleventh Circuit Addresses What Is a "Reasonable Procedure" Under Bona Fide Error Defense

In *Owen v. I.C. System, Inc.,* plaintiff debtor claimed that defendant debt collector impermissibly sought payment of unearned interest, improperly charged a 33 percent collection fee, falsely stated that additional charges might

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be added, and incorrectly reported the amount of the debt to credit reporting agencies. The U.S. Court of Appeals for the Eleventh Circuit held that the debt collector's application of improper compound interest and improper fees was a clerical or factual, not legal, error. Therefore, the U.S. Supreme Court's *Jerman v. Carlisle* decision did not preclude the bona fide error defense.

The Court then held that the debt collector did not meet the third element of the bona fide error defense: the maintenance of procedures reasonably adapted to avoid the alleged error. The debt collector asserted that it had three procedures to avoid the error at issue: (1) the contract with the creditor obligated this creditor to provide only accurate information on debts, including amounts due and owing; (2) upon receipt of the debtor's request for verification, the debt collector ceased collection efforts, obtained verification documents, and the forwarded those documents to the debtor; and (3) when it provided these documents to the debtor, the debt collector requested that the debtor contact it if she continued to dispute the debt.

The Court reasoned that: (1) blindly relying on the debtor's creditor pursuant to a one-time form contract dating back four years prior was not a reasonable procedure; (2) ceasing collection was a statutory requirement, not a procedure meeting the bona fide error defense; and (3) informing the debtor to contact the debt collector again was an after-the-fact procedure, not one to avoid the error which had already occurred. Further, the Court focused on the fact that the debt collector had not presented evidence of any internal, error-correction procedures to avoid miscalculations of debt amounts, interest and fees, such as training to examine principal and interest, to avoid compound interest, or to segregate principal and interest to avoid error. Last, the Court noted that although the debt collector might not have had additional information other than the amount of the debt when the creditor forwarded the account, it indisputably obtained copies of the underlying agreement and account statement upon the debtor's request, and these documents demonstrated a readily discoverable error regarding the accurate amount of the debt, interest and fees. Therefore, the Eleventh Circuit reversed the lower court's holding and entered summary judgment in favor of the debtor on the debt collector's bona fide error defense.

Owen v. I.C. System, Inc., No. 09-15464, 2011 WL 43525 (11th Cir. Jan. 7, 2011).

For more information, please contact your regular Hinshaw attorney.

FDCPA Victory: Seventh Circuit Agrees That a Cease Request Under Section 1692c Is Limited to Consumers

In a case that Hinshaw & Culbertson LLP defended, *Tinsley v. Integrity Financial Partners, Inc.,* plaintiff debtor alleged that defendant debt collector violated Section 1692c(c) of the Fair Debt Collection Practices Act (FDCPA) by calling a nonprofit legal services program after the debt collector received a fax from the legal services program which stated: (1) the legal services program represented the debtor; (2) the debtor was not going to pay his debt; and (3) the debt collector should cease communications with their client; and which instructed that "all future communications" should be made to the legal services program's office. Many of these types of cases had been filed in the last year alleging similar facts, legal theories and plaintiffs (i.e. seniors represented by the legal services program), and the same plaintiff's counsel.

The debt collector moved to dismiss the Complaint pursuant to Fed. R. Civ. P. 12(b)(6) on several grounds, one of which was that it did not violate Section 1692c(c) of the FDCPA because it communicated with the legal services program, not the debtor. The District Court agreed and the debtor appealed.

The U.S. Court of Appeals for the Seventh Circuit affirmed, using strong language to agree with the debt collector's argument that Section 1692c of the FDCPA is limited to consumers and that attorneys cannot assert the cease rights. In its decision, the Seventh Circuit recognized its decision in *Evory v. RJM Acquisitions,* LLC, 505 F. 3d 769 (7th Cir. 2007) and the Third Circuit's opinion in *Allen v. Checkredi of Ky., LLC,* No. 09-103, 2010 WL 4791947 (3rd Cir. Nov. 17, 2010), which state that communications to attorneys may violate the FDCPA. However, the Tinsley Court held that those cases are not applicable in the context of a Section 1692c case due to the unique language of that provision.

Tinsley v. Integrity Financial Partners, Inc., No. 10-2045, -- F.3d -- , 2011 WL477486 (7th Cir. Feb. 11, 2011).

For more information, please contact John P. Ryan or your regular Hinshaw attorney.

Hinshaw Obtains Dismissal of Plaintiff's Loan Origination, Rescission and Servicing Claims

The U.S. District Court for the District of Massachusetts recently dismissed a plaintiff debtor's Truth in Lending Act (TILA), Real Estate Settlement Procedures Act (RESPA), Credit Repair Organizations Act (CROA), fraud/misrepresentation, and Racketeer Influenced and Corrupt Organization Act (RICO) claims brought against defendants, a loan originator, current mortgage holder, and loan servicer. The Court found that the TILA, RESPA and fraud/misrepresentation claims were all barred by the doctrine of *res judicata* due to the dismissal with prejudice of a state court action brought by the debtor regarding the same loan. The Court's decision also affirmed that rescission claims pursuant to TILA must be brought within three years of the loan closing date, and noted, "[t]his three-year period is a rigid deadline."

The Court dismissed the RESPA claims against the mortgage holder on the further basis that they were barred by the applicable statute of limitations. The Court interpreted Section 2605 of RESPA, which requires mortgage loan servicers who receive a "qualified written request" to respond and address written requests within specific time limits, to require that a plaintiff ". . . assert to whom the request was made, when the request was made, how the defendant failed to respond to the request, whether the statutory period for responding has elapsed, and whether the defendant meets the statutory definition of a servicer."

Because the debtor failed to plead "sufficient facts to support his claim under Section 2605 of RESPA" the Court granted defendants' motion to dismiss the RESPA claim against the loan servicer. The Court dismissed the CROA claims because the CROA only governs actions of "credit repair organizations," and none of the defendants met this definition. Finally, the RICO claim was dismissed because the debtor failed to properly plead a violation of the statute.

Mantz v. Wells Fargo Bank, N.A., et al., 2011 WL 196915 (D. Mass. Jan. 19, 2011).

For more information, please contact Maura K. McKelvey or your regular Hinshaw attorney.

Eleventh Circuit Holds That Prerecorded Messages to Unintended Recipient's Residential Line Do Not Violate the TCPA

Plaintiff, the mother of a debtor, received approximately 300 calls to her residential phone line in regard to a debt owed by her daughter and by the family that previously owned plaintiff's telephone number. The debt collector used an automatic telephone dialing system to deliver prerecorded messages when it called plaintiff's number. As a result, plaintiff sued under two provisions of the Telephone Consumer Protection Act (TCPA). First, she alleged that the debt collector had violated 47 U.S.C. § 227(b)(1)(B) (TCPA), by unlawfully initiating a telephone call to a residential telephone line using an artificial or prerecorded voice without plaintiff's prior express consent; and secondly, that it violated 47 U.S.C. § 227(c)(5) for allegedly making more than one "telephone solicitation" within a 12-month period. The District Court granted summary judgment in favor of the debt collector on the TCPA claim, and plaintiff appealed.

The U.S. Court of Appeals for the Eleventh Circuit affirmed the District Court's decision finding that the debt collector did not violate the TCPA because its prerecorded debt-collection calls to plaintiff's residence were exempt from the TCPA as the debt collector had an existing business relationship with the intended recipient of its calls. The Court rejected plaintiff's argument that the debt-collection exemptions did not apply to her because she was not the debtor, and as such, could not have had an established business relationship with the debt collector. Further, the Eleventh Circuit found that the debt collector did not violate Section 227(c)(5) because the debt collector's calls were not "telephone solicitations" as defined by the Federal Communications Commission, and therefore, such calls did not violate the TCPA.

Meadows v. Franklin Collection Service, Inc., Case No. 10-13474 (11th Cir. Feb. 11, 2011).

For more information, please contact Barbara Fernandez or your regular Hinshaw attorney.

Chain of Title Requirements for Collection Complaint Under the Illinois Collection Agency Act

The Illinois Appellate Court recently held that a collection agency has standing to sue even if the account was assigned "for collection purposes only." Thus it is acceptable to sue if the agency has legal title only and does not own the debt. Additionally, the Court held that a collection agency can use multiple documents/contracts to establish that it has standing under Section 8b of the Illinois Collection Agency Act.

However, the Court also ruled that an affidavit cannot be used to establish chain of title as is required under Section 8b. Therefore, the collection agency must produce every assignment contract for the account. To make this point the Court stated: "we reiterate, however, that Section 8b requires each contract of assignment in the chain of title for the account, beginning with the original creditor and ending with the plaintiff, to specifically state and include the effective date of assignment, the consideration paid, and the identifying information for the account transferred." Thereafter, the Court held that under Section 8b "a collection agency can establish an assignment of accounts receivable for collection purposes through documents attached as exhibits to the Plaintiff's complaint where the identification of the accounts transferred, the consideration paid, and the effective date of the transfer of particular accounts are in multiple incorporated documents. However, such documents must be in the form of contracts of assignments or documents that are incorporated by reference into those contracts, rather than in the form of an affidavit."

The opinion seems to be limited to those situations in which one entity holds beneficial/equitable title (i.e., owns the debt) and assigns legal title to another agency so that the second agency can sue in its name. However, it should be expected that opposing counsel will attempt to expand this holding in future cases so as to make it apply to debt collectors even if they own all rights and title to the debt.

Unifund CCR Partners v. Shah, Case No. 1-10-0855 (Ill. App. Feb. 1, 2011).

For more information, please contact John P. Ryan or your regular Hinshaw attorney.

The National Arbitration Forum Is Gone: Where Do You Go? Illinois Supreme Court Decides

Plaintiff buyer purchased a computer from defendant seller. Subsequently, the buyer filed suit, alleging that the seller misrepresented the speed of the computer's processor. The seller sought to dismiss the suit and compel arbitration in accordance with the terms of the sales contract. The Circuit Court denied the motion, holding that there was no valid arbitration agreement between the parties. The seller appealed. While the case was on appeal, the arbitration forum designated in the arbitration agreement, the National Arbitration Forum (NAF), stopped accepting arbitrations. Thereafter, the Appellate Court affirmed the Circuit Court's decision, holding that the arbitration agreement failed due to the unavailability of the arbitral forum.

The seller then appealed to the Illinois Supreme Court. It argued that Section 5 of the Federal Arbitration Act allows for the substitution of an arbitration forum where the parties' designated arbitration forum is unavailable. The Court noted that this section applies unless the designation of a specific arbitrator was "integral" to the agreement. The Court held that, "the mere fact that parties name an arbitral service to handle arbitrations and specify rules to be applied, does not, standing alone, make that designation integral to the agreement." However, the Court held that because the arbitration clause, drafted by the seller, contained a penalty for bringing claims in any other forum, the use of NAF was integral to the agreement, and the substitution of the arbitrator under Section 5 was not proper. The Court further held that because NAF was unavailable to hear the claim, the seller's motion to compel arbitration failed.

Parties drafting arbitration agreements should reflect on language used to select an arbitral forum. If the arbitration clause contains a specified arbitration service, parties should consider adding specific language noting that the use of a designated arbitration service is not integral to the agreement, and specifically allowing for use of alternate services if the designated arbitration service is unavailable.

Carr v. Gateway, Inc., Docket No. 109485 (Ill. Sup. Ct. Feb. 3, 2011).

For more information, please contact your regular Hinshaw attorney.