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Client Alert: Supreme Court Holds Businesses Engaged in Nonjudicial Foreclosures Are Not “Debt Collectors” Under the FDCPA

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CLIENT ALERT | 3.26.2019

On March 20, 2019, the U.S. Supreme Court decided *Obduskey v. McCarthy & Holthus LLP*, unanimously holding that a business engaged in nonjudicial foreclosure proceedings is not a “debt collector” under the Fair Debt Collection Practices Act (the “FDCPA”), except for the limited purpose of one section.

The decision was in response to a circuit split regarding application of the FDCPA to nonjudicial foreclosure proceedings. Prior to *Obduskey*, both the Fifth and Sixth Circuits held that businesses whose sole role was the enforcement of security interests were debt collectors subject to the entirety of the FDCPA.

The Court’s ruling is limited to nonjudicial foreclosures. A nonjudicial foreclosure is where notice to the parties and sale of the property occur outside court supervision, whereas a judicial foreclosure is a legal action initiated by a creditor in which a court supervises the sale of property and the distribution of proceeds. Nonjudicial foreclosures, including foreclosures under “deed of trust” mortgages, are the normal method of foreclosures in thirty-two states, including Texas.

In *Obduskey*, the law firm McCarthy & Holthus LLP (“McCarthy”) was hired to carry out a nonjudicial foreclosure on Obduskey’s property. McCarthy initiated the nonjudicial foreclosure by mailing correspondence required by state law, and Obduskey responded with a letter invoking section 1692g(b) of the FDCPA, which requires a debt collector to cease any collection efforts until it obtains verification of the debt. When McCarthy did not cease collection efforts or verify the debt, Obduskey initiated an action alleging that McCarthy violated the FDCPA by, among other things, failing to comply with the debt verification procedure.

Three considerations led the Court to conclude that a business engaged in nonjudicial foreclosure proceedings is not a “debt collector” subject to the FDCPA.

First, the Court examined the definition of “debt collector” found in section 1692a(6) of the FDCPA, and identified two subparts of the definition: the *primary definition* and the *limited-purpose definition*. The primary definition includes “any person . . . in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect, directly or indirectly, debts owed or asserted to be owed or due another.” The third sentence of the definition, what the Court calls the limited-purpose definition, states, “For the purpose of section 1692f(6) [the] term [debt collector] also includes any person . . . in any business the principal purpose of which is the enforcement of security interest.” The Court held that “giving effect to every word of the limited purpose definition narrows the primary definition, so that the debt-collector-related prohibitions of the FDCPA (with the exception of §1692f(6)) do *not* apply to those who . . . are engaged in no more than security-interest enforcement.”

Section 1692f(6) of the FDCPA prohibits debt collectors from taking or threatening to take nonjudicial action to effect disposition of property if there is no present right to possession, there is no present intention to take possession of the property, or the property is exempt by law from such disposition.

Second, the Court understood Congress to have chosen to “treat security-interest enforcement differently from ordinary debt collection in order to avoid conflicts with state nonjudicial foreclosure schemes.” State nonjudicial foreclosure laws “provide various protections designed to prevent sharp collection practices and to protect homeowners.” To apply the FDCPA to these laws “might run afoul of the FDCPA.”

Third, the Court examined the legislative history of the FDCPA and noted that Congress considered, but ultimately chose not to include, language that would have defined debt collector as “any person who engages in any business the principal purpose of which is the collection of any debt *or the enforcement of security interests*.”

The Court noted, however, that “pursuing nonjudicial foreclosure is [not] a license to engage in abusive debt collection practices” and that “enforcing a security interest does not grant an actor blanket immunity from the [FDCPA].” Because McCarthy did no more than take the necessary steps required under state law to enforce a security interest, the Court did not consider “what *other* conduct (related to, but not required for, enforcement of a security interest) might transform a security-interest enforcer into a debt collector subject to the main coverage of the Act.”

Justice Sotomayor, in a concurring opinion, emphasized that a different set of facts could subject a business enforcing a security interest to the entirety of the FDCPA: “I would see as a different case one in which the defendant went around frightening homeowners with the threat of foreclosure without showing any meaningful intention of ever actually following through. There would be a question, in such a case, whether such an entity was in fact a ‘business the principal purpose of which is the enforcement of security interest,’ . . . or whether it was simply using that label as a stalking horse for something else.”

The Court’s decision has two immediate practical effects. First, the decision clarifies the persons that are subject to the full ambit of the FDCPA. Businesses engaged in nonjudicial foreclosures are subject only to the proscriptions of the FDCPA found in section 1692f(6). The Court overrules the circuits subjecting these businesses to the entirety of the FDCPA, and resolves uncertainty in those jurisdictions that had yet to decide the issue. Second, the decision removes a number of potential impediments to nonjudicial foreclosures. Debtors will have greater difficulty opposing nonjudicial foreclosures, for example, by using verification letters to stop foreclosures. Additionally, businesses that strictly adhere to state nonjudicial

foreclosure laws can better combat FDCPA claims. While the Court's holding makes it more difficult for borrowers facing nonjudicial foreclosures to raise FDCPA claims, it is not impossible. Businesses taking steps not required under state nonjudicial foreclosure laws may still subject themselves to such claims.

The Supreme Court's opinion can be found [here](#).