July 23, 2018 12:00 AM

Debt-collection lawsuits are roaring back, along with an old ruse that victimizes borrowers

AARON ELSTEIN

Buck Ennis

Esther Roman, a 60-year-old grandmother in Brooklyn, was alarmed when she noticed in January that her $300 weekly paycheck was $27.99 short. She called her employer, a home health care agency, which said her wages were being garnished after someone sued her, claiming she'd failed to pay an old credit-card bill.

Roman was blindsided. She had never been served with a lawsuit.

It turned out that more than 10 years earlier, a process server had delivered the legal papers to the wrong address and falsely stated they were accepted by a "Mr. Roman—Relative" between 51 and 65 years old. But Esther Roman actually lived half a mile away and only with her children, then ages 15 to 32.

A few days after finding out she'd been a defendant for better than a decade, Roman got a letter from a city marshal saying she was on the hook for $2,078.50, half of which was accumulated interest.

"I said, 'Oh my God, how am I going to pay?'" she recalled. "I couldn't sleep. I was desperate."

Roman was the victim of an old game in the debt-collecting business known as sewer service. The ruse works like this: A debt collector buys defaulted debt from a bank, then sues the debtor without notification and falsely states the lawsuit was properly served. When the debtor does not show up in court, a default judgment is routinely entered, and the collector is free to start garnishing wages.

Not long ago, the tactic was remarkably common. In 2009 the New York attorney general's office said it found more than 100,000 judgments improperly obtained via sewer service.

A crackdown followed. In 2010 the city began requiring all process servers to record delivery attempts using a GPS device. Four years later, state officials subjected debt collectors to tough new regulations while the new federal Consumer Financial Protection Bureau made the industry a top priority. In 2015 Encore Capital Group, the firm that sued Roman, was fined $10 million, ordered to pay up to $42 million in refunds and forced to stop collection on $125 million worth of debts after the consumer bureau found the company had pressured debtors with false statements and churned out lawsuits using robo-signed documents.

The rollback and the comeback

The crackdown sent the number of debt-collection suits filed in New York City plummeting, from 300,000 in 2008 to fewer than 47,000 eight years later. But now they are making a comeback as the Trump administration rolls back financial regulations of all kinds. Last year the number of debt-collection suits in the five boroughs jumped by 61%, to nearly 76,000, according to figures from the New York State Unified Court System.

Data for this year is not available, but if the scene on the 11th floor of the Civil Courthouse in Downtown Brooklyn is any gauge, this year should see a bumper crop. On a recent Monday morning, the pews were filled with about 40 alleged debtors waiting to plead their case before the judge. Some left the room after being approached by attorneys for debt collectors, asking if they would strike a last-minute settlement. According to the state, 98% of defendants in these cases do not have a lawyer, so Sidney Cherubin, director of legal services at the Brooklyn Bar Association Volunteer Lawyer Project, shows up four days a week with a small team to help them.

"Sometimes the judge will call me over after telling the defendant, 'Maybe you should talk to an attorney before you agree to settle,'" Cherubin said.

One explanation for the surge in cases is that consumers—perhaps inspired by the strong economy—are taking on record amounts of debt through credit-card, car and other loans, totaling $13.2 trillion, according to data from the Federal Reserve Bank of New York. Invariably some people bite off more than they can comfortably chew.

"There's an industry saying: 'You sue the won't pays, not the can't pays,'" said Jan Stieger, executive director of the Receivables Management Association, a trade group for debt collectors.

But the defanging of the Consumer Financial Protection Bureau, whose creation was a key part of 2010's Dodd-Frank Wall Street Reform and Consumer Protection Act, has likely emboldened collectors. President Donald Trump has called the agency a "total disaster" and its acting director, Mick Mulvaney, earlier this year asked for a quarterly budget of zero dollars while warning staffers to do their jobs with "humility" and not to "push the envelope." One example of the change in approach: On July 13 the bureau, which had originally sought $60 million in restitution and debt forgiveness from a Kansas collection firm, instead fined it just $800,000. The agency would not comment.

"The bureau continues to be much more of a balanced regulator, balancing the needs of industries and consumers," Encore Capital Chief Executive Ashish Masih said in a May conference call, according to a transcript on financial analysis website Seeking Alpha. In 2016 the CFPB began a process to regulate debt collectors on a national basis, but experts say that project is now on the back burner.

Debt collectors aren't the only ones enjoying a regulation rollback. Goldman Sachs and Morgan Stanley were on the brink of failing their annual stress tests in the spring, which would have limited their stock buybacks and dividend payouts, until Federal Reserve officials instructed them how to get a passing grade. The Commodity Futures Trading Commission last year ordered 80% fewer fines and penalties than in 2015. The business of packaging subprime mortgages or other consumer loans and selling them to investors—a hallmark of the last decade's housing bubble—is picking up again.

Maria Vullo, superintendent of the state Department of Financial Services, noted that for the first time since the financial crisis, Wall Street professionals are feeling bold enough to cook up deals that test the boundaries of what's legal.

"People are trying to skirt regulations by structuring things in a certain way," she said. "It's happening again. We are back."

Vullo said she and her staff of 1,400 are doing their best to fill the void left by federal regulators. "I must protect New Yorkers because the CFPB is not going to do it," she said. "Unfortunately I can't do it for the rest of the country."

"Scientific process"

In 2014 state regulators took steps to protect consumers from debt collectors. They required collectors to share significantly more information with debtors, such as identifying the original creditor while also clearly spelling out the amount of the debt plus any interest and fees added. Collectors also must explain that they cannot legally sue to collect a debt after a certain amount of time has passed, but the constraint disappears if someone promises to pay or even acknowledges an old debt.

While New York authorities cracked the whip, the debt-collection business experienced a consolidation wave. Encore Capital emerged as the biggest player, and today the San Diego–based firm has 8,500 employees, a $1 billion market capitalization, a Nasdaq listing and such high-profile shareholders as BlackRock and T. Rowe Price.

Earlier this year the company acquired control of large British debt collector Cabot Credit Management for $238 million from private-equity firm J.C. Flowers & Co. Encore's business is buying written-off loans for pennies on the dollar from banks, health care providers, cellphone carriers and the like, and nudging people to pay up. Over time the firm collects around twice as much as it paid, analysts say.

"They use a very scientific process and have analytics showing the best time to call people," said Eric Hagen, an analyst at brokerage firm Keefe Bruyette & Woods. "They also text."

Sarah Ludwig, founder of the New Economy Project, a nonprofit that for years has fought debt-collection abuses, describes Encore's process differently. "They use demographic data and target people who typically don't have counsel," she said. "It's a real bottom-feeding approach."

In recent years, analysts say, it was difficult for outfits like Encore to buy as much defaulted debt as they wanted because fewer dud loans were being sold, in part because the industry feared even more regulation was looming. But now the debt marketplace is reviving again.

"Our forward flow commitments for 2018 remain well above historic levels," Encore's Masih said in May.

The shortage of fresh debts a year or two ago may help explain why Encore tried to collect on Roman's old bill. An Encore unit, Midland Funding, sued her in 2007 and quickly secured a default judgment after a court date passed without her knowledge. But the company didn't enforce the judgment until it garnished $6.06 from Roman's paycheck in December 2015 and $20.29 in September 2016, court records show. Then came the $27.99 that she flagged in January; $26.60 was scheduled for July 2019. At that pace it would have taken more than 76 years to collect all the money Encore sought.

Encore would not comment on the case, but in a statement, Sheryl Wright, senior vice president for corporate and government affairs, said litigation is always a last resort and "only pursued when we've already determined that the debt is valid and the consumer has the ability to pay."

Roman, who didn't recognize the debt Encore pursued, found the legal-assistance program Claro and got advice from lawyers at the New Economy Project. After she took time off to go to court, her debt was vacated by a judge last month. Roman was able to prove the process server filed a false affidavit by showing the judge leases and utility bills listing her actual address at the time.

"It's a good thing I never threw those things out," she said.

A few weeks later, at a Midtown hotel, New Economy Project lawyers showed up at Encore's annual stockholders meeting and played a recording of Roman giving her account for the CEO and his board. An employee of the nonprofit, which owns shares in Encore, served officials with a mock-summons declaring: "Plaintiffs demand that defendants immediately vacate all fraudulently obtained default judgments and provide redress for defendants' systematic extraction of wealth from New York's low-income communities and communities of color."

Encore has returned some of the money it garnished from Roman. Her lawyers are seeking the remainder as well as compensation for lost wages and stress, but the company has refused those demands and is unwilling to discuss the use of false affidavits to collect payments, said Susan Shin, New Economy Project's legal director.

"They say that's in the past," Shin said. "Clearly, it's not."

RELATED ARTICLES

Tales from Toy Land: 'Flat is the new up'

Making Cooper Union free again

Tackling the scourge of sidewalk sheds

Clothing retailer for short men taps into $7 billion opportunity

Touching hearts and minds through the lens

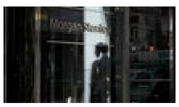
Queens entrepreneur is looking to link his cryptocurrency to a sure thing

Medical residents can now practice virtual operations before they ever touch a ...

RECOMMENDED FOR YOU

Morgan Stanley's long romance of Palantir pays off as IPO nears

Musk's bid to take Tesla private looks like top of frothy market



Morgan Stanley's long romance of Palantir pays off as IPO nears

RightToFreeSpeech • 4 months ago

The lions are feeding in the lion pit.

SIGN UP

JOIN CRAIN'S

As a loyal print subscriber you are eligible for FREE full digital access to the best business coverage in New York.

SUBSCRIBE

ALL ACCESS

Our Mission

Crain’s New York Business is the trusted voice of the New York business community—connecting businesses across the five boroughs by providing analysis and opinion on how to navigate New York’s complex business and political landscape.

CRAIN'S NEW YORK BUSINESS

CONTACT US

685 Third Avenue
New York, NY 10017
(212) 210-0100

Email

Staff Directory

RESOURCES

Current Issue

Newsletters

Reprints

Newsstands

AdChoices

Sitemap

Corrections and Clarifications

ADVERTISE

2019 Editorial Calendar

Media Kit

LEGAL

Terms and Conditions