DOES THE NON-JUDICIAL FORECLOSURE PROCESS CONSTITUTE "DEBT COLLECTION" UNDER THE FDCPA?

U.S. SUPREME COURT TO DECIDE!

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In a decision that will be felt throughout the mortgage servicing world, the U.S. Supreme Court will decide whether the non-judicial foreclosure process and the act of conducting a trustee's sale qualify as "debt collection" under the Fair Debt Collection Practices Act ("FDCPA" or the "Act"). *Obduskey v. Wells Fargo* is fully briefed, with amicus efforts on both sides, including briefs by the NAACon, the consumer side, and collaborative efforts by industry firms, including Wright, Finlay & Zak, on the servicer side. With the oral argument set for January 7, 2019, the servicing industry anxiously awaits the Court's ruling, since a finding that the non-judicial foreclosure process – consisting of the issuance, recording, posting, and mailing of foreclosure notices and the conducting of trustee's sale – amounts to debt collection will have a drastic impact on the mortgage industry, as well as on the State law.

Before addressing the potential impact of an adverse decision on the industry, the reader should understand the facts of the case, why the Supreme Court agreed to review the Tenth Circuit's decision, and analyze the likelihood of the adverse ruling by the Supreme Court.

Background. In *Oduskey*, having defaulted on his mortgage loan obligation, the borrower sued his loan servicer, Wells Fargo Bank, N.A., and the law firm of McCarthy and Holthus, LLP ("McCarthy") – who was retained by Wells Fargo to conduct the non-judicial foreclosure process – for, among other things, violation of the FDCPA. *Obduskey v. Wells Fargo*, 879 F.3d 1216, 1218-19 (10th Cir.) As relevant herein, the Tenth Circuit found that McCarthy did not violate the FDCPA because the Act did not apply to non-judicial foreclosures. *Id*. at 1222-23.The Supreme Court granted Obduskey's Petition for writ of certiorari (138 S.Ct. 2710) in order to finally address the issue, which has thus far split the circuits, resulting in two different legal interpretations of the issue. Compare *Vien-Phuong Thi Ho v. ReconTrust Co., NA*, 858 F.3d 568 (9th Cir., 2017) ("*Ho*") [finding that non-judicial foreclosure proceedings are not covered under the FDCPA] with Wilso*n v. Draper & Goldberg, P.L.L.C.*, 443 F.3d 373 (4th Cir. 2006); *Kaltenbach v. Richards*, 464 F.3d 524 (5th Cir. 2006); *Glazer v. Chase Home Fin. LLC*, 704 F.3d 453 (6th Cir. 2013) [finding that the process is covered by the Act].

Language of the FDCPA supports finding that non-judicial foreclosure does not constitute debt collection. Analyzing the purpose of the FDCPA and the Act's pertinent language suggests that the Supreme Court should uphold the Tenth Circuit's decision.

The Act was enacted in 1977 to eliminate abusive debt collection practices by unscrupulous debt collectors while, at the same time, protecting ethical debt collectors from unnecessary restrictions. Senate Report No. 95-382, p.p. *1-2 (Aug. 2, 1977) ("Report"); 15 U.S.C. § 1692(a) and (e).[1] The Act prohibits "'abusive, deceptive, and unfair debt collection practices,' such as late-night phone calls or falsely representing to a consumer the amount of debt owed." *Obduskey*, 879 F.3d 1216, 1219 (10th Cir.) [citing 15 U.S.C. §§ 1692(a), 1692c, and 1692e]. Congress found the legislation was necessary because the existing laws and procedures were inadequate to protect individual consumers from the above-referenced practices. 15 U.S.C. § 1692(b) and (c); Report, p.p. 2-3. These concerns do not apply to non-judicial foreclosure proceedings, as the process does not involve the type of abusive debt collection practices that the Congress sought to curtail. Unlike the above-articulated collection practices, non-judicial foreclosure notices are merely informational in nature, do not demand payment from the consumer borrowers, and are not the type of harassing or abusive communication the FDCPA was designed to protect against. Indeed, they "were designed to *protect* the debtor." *Ho*, at 574 [emphasis in original]. While the issuance of non-judicial foreclosure

[1] The Act reasoned that the legislation was necessary because the abusive debt collection practices – such as "[d]isruptive dinnertime calls, downright deceit, and more", including "obscene or profane language, threats of violence, … misrepresentation of a consumer's legal rights, disclosing a consumer's personal affairs to friends, neighbors, or an employer, obtaining information about a consumer through false pretense, impersonating public officials and attorneys, and simulating legal process…" – all contributed to "personal bankruptcies, to marital instability, to the loss of jobs, and to invasions of individual privacy." *Henson v. Santander Consumer USA Inc.*, 137 S.Ct. 1718, 1720, 198 L.Ed.2d (2017); Senate Report No. 95-382, *supra*, p.2; 15 U.S.C. § 1692(a).

notices may, of course, induce the defaulted consumer borrower to either cure the deficiency or even pay off the loan completely, that possibility, in and of itself, does not transform a regular non-judicial foreclosure process into "debt collection": "[t]he prospect of having property repossessed may, of course, be an inducement to pay off a debt. But that inducement exists by virtue of the lien, regardless of whether foreclosure proceedings actually commence. The fear of having your car impounded may induce you to pay off a stack of accumulated parking tickets, but that doesn't make the guy with the tow truck a debt collector." *Ho*, at 572.

On its face, the Act does not apply to non-judicial foreclosures. The Act applies only to "debt collectors" who "collect" "debt". *Obduskey*, at 1219. To come within the provisions of the FDCPA, all three prongs must be satisfied. The non-judicial foreclosure activity does not fall squarely within these definitions. First and foremost, the issue of whether mortgage indebtedness falls squarely within the Act's definition of "debt" is not a foregone conclusion. For instance, in Section 1692a(6)(F), Congress excluded from the definition of "debt collector" persons who are foreclosing (whether judicially or non-judicially) on mortgage debt that was not in default when they obtained it, whether it be for purposes of servicing the loan or its collection. *Henson v. Santander Consumer USA Inc.*, 137 S.Ct. 1718, 1723-24 (2017) 1723-24. As a result, a non-judicial foreclosure of a previously performing loan would not fall within the purview of the Act. Moreover, in limiting Section 1692i's venue provision to judicial foreclosures only (*Obduskey*, at 1222 – recognizing that the term "action" applies to a judicial proceeding), Congress – while being well aware of the fact that more than half of the states have laws governing non-judicial foreclosures – appears to have made a conscious decision to exempt or otherwise exclude the non-judicial foreclosure process from the Act's provisions.

Second, non-judicial foreclosure activities do not qualify as "debt collection". While the Act did not define the term "debt collection", case law interpreted it to mean the "activity undertaken for the general purpose of inducing payment". *McLaughlin v. Phelan Hallinan & Schmieg, LLP*, 756 F.3d 240, 245 (3d Cir. 2014). There is a caveat to this definition however. When reviewing Section 1692a(5)'s definition of "debt", it stands out that Congress has elected to limit it to an "obligation … of a consumer to pay money", which limitation is significant. Based on this limitation, in order for the activity to fall within the definition of "debt collection", it must be aimed or directed at collecting money from the consumer and not from *any* other person. *Ho*, at 572 ["debt collection" necessarily involves collection of money from the consumer, as "debt" is "synonymous with 'money'". *Id.* at 571]; *Molina v. F.D.I.C.*, 870 F.Supp.2d 123, 133 (D.D.C. 2012), aff'd in part sub nom. *Molina v. Ocwen Loan Servicing*, 545 F.App'x 1 (D.C. Cir. 2013) [holding that the plaintiff failed to state a claim for violation of FDCPA where he failed to allege that the defendant attempted to collect money from him].

The non-judicial foreclosure activity does not involve collection of money from the consumer. The Ninth Circuit, which is the first Circuit that has thus far recognized that the "debt collection" is limited to activity designed to induce payment from the consumer (and construed this limitation in the context of a non-judicial foreclosure), explained that, while different courts have come to different conclusions regarding the purpose of a non-judicial foreclosure sale,[2] the undeniable effect of the non-judicial foreclosure sale is collection of money from the purchaser of the property and not from the delinquent consumer/borrower. *Ho*, at 572. In *Obduskey*, the Tenth Circuit agreed with the Ninth Circuit's reasoning, explaining that, unlike judicial foreclosure, which permits recovery of deficiency judgments from the defaulted borrowers, non-judicial foreclosure activity does not provide for recovery of such deficiency. *Obduskey*, at 1221-22 ["non-judicial foreclosure proceeding … only allows 'the trustee to obtain proceeds from the sale of the foreclosed property, and no more.'"]; *see also*, *Ho*, at 571 [under California law, non-judicial foreclosure sale extinguishes the entire debt and the borrower is not subjected to a deficiency judgment].

Third and finally, the provisions of 15 U.S.C. § 1692f(6) do not in any way alter the conclusion reached in *Ho* and *Obduskey*. While the Circuits disagree as to whether the non-judicial foreclosure process and the entities involved in it are subject to the provisions of Section 1692(f)(6),[3] that divergence does not affect the determination of the

[2] *See*, *Ho*, at 572 [citing to *Burnett* v. *Mortg. Elec. Registration Sys., Inc.*, 706 F.3d 1231, 1239 (10th Cir. 2013) and *Alaska Tr., LLC* v. *Ambridge*, 372 P.3d 207, 228 (Alaska 2016) (Winfree, J., dissenting) for the proposition that non-judicial foreclosure does not involve collection of money but merely sale or real estate and *Glazer* v. *Chase Home Fin. LLC*, 704 F.3d 453, 463 (6th Cir. 2013) for the proposition that "the ultimate purpose of foreclosure is the payment of money".]

[3] *See, e.g.*, *Obduskey*, at 1221, fn. 4 [holding that non-judicial foreclosure actions do not fall within the provisions of Section 1692f(6)]; and *Ho*, at 572-73 [finding that a foreclosure trustee falls under the definition of "debt collector" under the provisions of Section 1692f(6).]

underlying issue of whether non-judicial foreclosure activities amount to "debt collection". Even if the provisions of Section 1692f(6) were applicable to the non-judicial foreclosure process, they would only impose limits on the activities prohibited thereunder, *i.e.*, commencing or threatening the non-judicial foreclosure "to effect dispossession… of property if - (A) there is no present right to possession of the property claimed as collateral through an enforceable security interest; (B) there is no present intention to take possession of the property; or (C) the property is exempt by law from such dispossession or disablement." *Ho*, at 573; 15 U.S.C. § 1692f(6). They have no impact on the general classification of the non-judicial foreclosure activity as "debt collection".

The potential impact of an adverse ruling on the mortgage industry and State laws. If the Supreme Court agrees with Mr. Obduskey, finding that the non-judicial foreclosure process falls within the provisions of the Act, that ruling will have drastic effect on State laws and the mortgage industry. Such ruling would interfere with State foreclosure laws, requiring States to re-write their foreclosure statutes.

For example, 15 U.S.C. § 1692g, requires that the initial communication between a debt collector and a consumer (or subsequent communication made within five days thereafter) include notice of the consumer's right to request the debt collector to obtain validation of the debt. The form Notice of Default currently prescribed by California *Civil Code* § 2924c, as well as the additional "Summary of Key Information" now required by California *Civil Code* § 2923.3, both refer the consumer directly to the trust deed beneficiary or loan servicer. The Notice of Default forms, which must be mailed to the consumer at the inception of the foreclosure, and which would constitute the initial communication to the consumer, could be attacked in many respects as "overshadowing" the verification notice, which is a violation of FDCPA section 1692g.

15 U.S.C. § 1692g also requires that if the consumer contacts the debt collector, requesting verification of the debt, all collection activities must cease until such verification is provided. However, during the thirty day period following the recording of the Notice of Default, trustees are required under California *Civil Code* § 2924b(b)(1) and 2924b(c)(1) to make two separate mailings. Should a notice of dispute be received during that initial thirty day period, the trustee *could* be prevented from complying with the State's foreclosure requirements. The validity of the foreclosure would thus be called into question, requiring the entire process to be started anew, including the purchase of a new title report (called the "trustee's sale guaranty") and new recording and mailing expenses, with no guidance as to who would be responsible to pay these expenses.

15 U.S.C. § 1692c(b) generally prohibits a debt collector from communicating with third parties concerning the subject debt. Yet, the trustee is required by California statute to record notices in the public records, mail them to junior lienholders and others, and finally to post them on the property and publish them in the newspaper. These third party communications are vital to advertise the foreclosure, in part for the benefit of the consumer, as well as to provide a warning, consistent with the requirements of due process, to those whose junior liens would be extinguished by the foreclosure. All of these communications *could* become illegal if the FDCPA were applied to non-judicial foreclosures in California.[4]

In conclusion, most loan servicers, their foreclosure trustees and law firms, have historically treated the non-judicial foreclosure process, consisting of the issuance, recording, posting, and mailing of foreclosure notices and the conducting of trustee's sale, as falling outside of the Act. But, with recent conflicting decisions between the 4th,6th, 9th and 10th Circuits, the U.S. Supreme Court will attempt to resolve the issue once and for all, in the *Obduskey* case. While the industry is optimistic that the Supreme Court will agree with the 9th and 10th Circuits, a negative decision could have significant impacts on the servicing and non-judicial foreclosure industries.[5]

Wright, Finlay & Zak, LLP specializes in mortgage-related litigation, compliance and regulatory matters for its clients throughout the Western United States, including California, Nevada, Arizona, Washington, Utah and Oregon. If you have any questions regarding this issue or any other matter, please contact Robert Finlay at rfinlay@wrightlegal.net or Luke Wozniak at lwozniak@wrightlegal.net.

[4] A negative ruling could also create conflict with Nevada, Washington and Oregon's mandatory non-judicial foreclosure mediation programs, e.g., Washington's RCW 61.24.163 and Oregon's ORS 86.726.

[5] For copies of Wright, Finlay & Zak's amicus brief or, for any of the other briefs, please feel free to contact Luke Wozniak or Robert Finlay.

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