THE REVIEW OF
BANKING & FINANCIAL SERVICES
A PERIODIC REVIEW OF SPECIAL LEGAL DEVELOPMENTS AFFECTING LENDING AND OTHER FINANCIAL INSTITUTIONS

Vol. 35 No. 6 June 2019

DEBT COLLECTION, CONVENIENCE FEES, AND THE FDCPA

Mortgage servicers collecting convenience fees are at significant risk of violating the FDCPA. The authors discuss the limits of the statute and related case law, and explores whether (and how) mortgage servicers may collect such fees without running afoul of the law.

By Jon David D. Langlois and Elizabeth R. Bailey *

In the era of online banking and the Internet of Things, the ability to pay your mortgage in a manner other than sending in a paper check evidences both convenience and complication. Convenience to the borrower, in that there are many avenues to quickly make a payment, even a late payment, to avoid incurring a late charge. But complication to the servicer, who may wish to charge for that convenience, but would do so in the face of significant compliance risk. This article explores whether (and how) mortgage servicers may collect such convenience fees without running afoul of the Federal Debt Collection Protection Act ("FDCPA").[1]

The FDCPA dictates that "[a] debt collector may not use unfair or unconscionable means to collect or attempt to collect any debt," and prohibits a litany of unfair practices, notably including "[t]he collection of any amount (including any interest, fee, charge, or expense incidental to the principal obligation) unless such amount is expressly authorized by the agreement creating the debt or permitted by law."[2] Under the FDCPA, a "debt collector" is "any person who uses any instrumentality of interstate commerce or the mails 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 due or asserted to be owed or due another."[3] However, Section 1692a(6)(F) of the FDCPA provides that an entity that obtains a debt while such debt is not in default is not a debt collector under the Act and, therefore, is not subject to FDCPA liability.

[1] Note that in addition to FDCPA risk, federal and state regulators, enforcement agencies, and plaintiffs have also leveraged prohibitions against unfair, deceptive, and abusive acts and practices ("UDAAP") to attack the marketing, disclosure, and assessment of convenience fees. While this UDAAP risk must be taken into account in developing any strategy to assess convenience fees, this article focuses on the FDCPA compliance risk applicable to convenience fees.

[2] 15 U.S.C. § 1692f(1).

[3] 15 U.S.C. § 1692a(6).

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RSCR Publications LLC Published 12 times a year by RSCR Publications LLC. Executive and Editorial Offices, 2628 Broadway, Suite 29A, New York, NY 10025-5055. Subscription rates: $650 per year in U.S., Canada, and Mexico; $695 elsewhere (air mail delivered). A 15% discount is available for qualified academic libraries and full-time teachers. For subscription information and customer service call (937) 387-0473 or visit our website at www.rscrpubs.com. General Editor: Michael O. Finkelstein; tel. 212-876-1715; e-mail mofinkelstein@gmail.com. Associate Editor: Sarah Strauss Himmelfarb; tel. 301-294-6233; e-mail sarah.s.himmelfarb@gmail.com. To submit a manuscript for publication contact Ms. Himmelfarb. Copyright © 2019 by RSCR Publications LLC. ISSN: 1051-1741. All rights reserved. Reproduction in whole or in part prohibited except by permission. For permission, contact Copyright Clearance Center at www.copyright.com. *The Review of Banking & Financial Services* does not guarantee the accuracy, adequacy, or completeness of any information and is not responsible for any errors or omissions, or for the results obtained from the use of such information.

IS A SERVICER A DEBT COLLECTOR UNDER THE FDCPA AFTER *HENSON*?

The simplest way for a mortgage servicer to avoid liability under the FDCPA for charging convenience fees is to show that it is not a debt collector under the statutory definition. The FDCPA sets out two different tests for determining whether an entity is a debt collector: first, whether an entity's "principal purpose . . . is the collection of any debts" and second, whether an entity "regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another." Under federal case law, these two tests are separately applied; to escape FDCPA liability, an entity must overcome *both* tests. Generally, a mortgage servicer typically is not deemed a debt collector "unless the debt was in default when it was obtained by the servicer."[4] On the other hand, a servicer that does obtain debts in default has a much more limited path to successfully avoid being labeled a debt collector: It must hold the loans for its own account, and the "principal purpose" of its business must not be to collect debt.

Henson v. Santander Consumer USA Inc.

In 2017, the U.S. Supreme Court ruled in *Henson v. Santander Consumer USA Inc.* that entities that purchase defaulted loans and then collect on those loans for its own account are not debt collectors under the "regularly collects or attempts to collect" test.[5] The Court's analysis focuses on the "debts . . . owed or due another" language in the definition of debt collector, and held that a debt owner collecting on loans that it has purchased and held in its own portfolio is not collecting for *another*.

Henson does not address what happens to entities that possess servicing rights for a loan, but do not own the loan outright. At least one federal court has since confirmed that acquiring servicing rights of a defaulted loan, or even being the "holder" of such a loan, is not enough to trigger protection under *Henson*; a servicer must actually *own* the defaulted loan to take advantage of *Henson*.[6] Of course, if a servicer acquires servicing rights — or ownership of the loan — before default, the servicer escapes FDCPA liability under the Section 1692a(6)(F) exception for non-defaulted loans.[7]

The Principal Purpose Test — Henson *Applied*

Even if a servicer owns a defaulted loan outright, it is still not out of the woods. The *Henson* decision expressly limited its holding to the "regularly collects" test, and declined to address the "principal purpose" test. Federal courts have since confirmed that servicers collecting on their own debts therefore must also overcome the question of whether their business's principal purpose is the collection of any debts, to avoid liability.[8] The principal purpose test implicates an "entity that has the collection of any debts as its most important aim"; "[a]s long as a business's *raison d'etre* is obtaining payment on the debts that it acquires, it is a

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[4] *Beard v. Ocwen Loan Servicing, LLC*, 2018 WL 638455 at *3 (M.D. Pa. Jan. 31, 2018) (internal quotation and citation omitted). *See also Perry v. Stewart Title Co.*, 756 F.2d 1197, 1208 (5th Cir. 1985) ("The legislative history of section 1692a(6) indicates conclusively that a debt collector does not include . . . a mortgage servicing company . . . as long as the debt was not in default at the time it was assigned.").

[5] 137 S. Ct. 1718 (2017).

[6] *See, e.g.*, *Beard v. Ocwen Loan Servicing, LLC*, 2018 WL 638455 at *5 (M.D. Pa. Jan. 31, 2018) (distinguishing between being "a servicer or 'holder'" of a mortgage and being an "actual owner" for the purposes of *Henson* protection). *Cf.*, *Swango v. Nationstar Sub1, LLC*, 292 F. Supp. 3d 1134 (D. Or. 2018) (the assignment to a servicer of "'all rights and benefits whatsoever accrued or to accrue under' the Trust Deed . . . ." suffices to avoid debt collector liability under the definition addressed in *Henson*).

[7] *Thomas v. Ocwen Loan Servicing*, 2018 WL 3608398 at *4 (W.D. Wash. July 26, 2018) (a servicer that acquires servicing rights prior to default is not a debt collector).

[8] *See, e.g.*, *Norman v. Allied Interstate, LLC*, 310 F. Supp. 3d 509, 514 (E.D. Pa. 2018) ("join[ing] the majority of courts within the Third Circuit in holding that *Henson* applies only to FDCPA claims brought under the 'regularly collects' definition of debt collector, and not to claims brought under the 'principal purpose' definition"); *Barbato v. Greystone All., LLC*, 2017 WL 5496047 at *8 (M.D. Pa. Nov. 16, 2017) (while an entity could avoid being called a debt collector under *Henson*, that only reaches one of "two possible paths" to being defined as a debt collector under the FDCPA) (citing *Tepper v. Amos Fin., LLC*, 2017 WL 3446886 at *8 (E.D. Pa. Aug. 11, 2017)).

debt collector."[9] "Collection" even reaches servicers that subcontract collection to third-party debt collectors, confirming that a servicer need not be the actual entity doing the collecting to be considered a debt collector.[10]

That said, it is unlikely that mortgage servicers that provide the full scope of servicing a mortgage from loan boarding to liquidation would be ensnared by the "principal purpose" prong. A January 2019 federal case provides recent evidence. In *Green Tree Servicing v. Cargille*, a mortgage servicer escaped liability under the FDCPA by overcoming both parts of the definition of debt collector.[11] Green Tree defeated the "regularly collects" test with the fact that it purchased the loan after default, and defeated liability under the principal purposes analysis despite allegedly "self-identif[ying] as a 'debt collector' on correspondence," and despite allegations that "'servicing' a mortgage account is just another name for collecting a debt." Green Tree countered that its business instead involved "managing the mortgage loan account on a daily basis, including collecting and crediting periodic loan payments, managing escrow accounts, or enforcing the terms of the mortgage or note," a reference to the New Jersey definition of "servicing" at NJ St. 2A:50-55. The court held that the plaintiffs failed to support their claim that "'loan servicer' is synonymous with 'debt collector.'"[12] *Cargille* is joined by other cases that support the notion that debt collection is not the principal purpose of full scope mortgage servicers collecting on defaulted loans.[13]

As a result, in the current landscape of federal case law, it is possible, but still difficult, for a mortgage servicer that is servicing loans for others to avoid FDCPA liability by ducking the debt collector label. While it's unlikely that a court would find that a mortgage servicer offering the full range of services was a debt collector under the "principal purpose" test, any mortgage servicer not servicing loans for its own account would still get caught up by the "regularly collects or attempts to collect" test. Therefore, servicers wishing to charge convenience fees still will likely find themselves grappling with the FDCPA's provision prohibiting "unfair practices."

LIABILITY FOR UNFAIR PRACTICES UNDER SECTION 1692F(1)

Section 1692f(1) prohibits "[t]he collection of any amount (including any interest, fee, charge, or expense incidental to the principal obligation) unless such amount is expressly authorized by the agreement creating the debt or permitted by law." If a servicer is a debt collector under the FDCPA, then any convenience fees the servicer wishes to require will face scrutiny under Section 1692f(1) because such fees have consistently been considered by courts to be "incidental to the principal obligation."[14] A single outlier case,

[9] *Barbato v. Greystone All., LLC*, 2019 WL 847920 at *6 (3rd Cir. Feb. 22, 2019) (internal quotation marks omitted).

[10] *Id.* at *7 ("The existence of a middleman does not change the essential nature – the 'principal purpose' of [defendant's] business . . . the record reflects that [defendant's] only business is the purchasing of debts for the purpose of collecting on those debts. . . .").

[11] 2019 WL 316750 at *3-4 (D.N.J. Jan. 24, 2019).

[12] *Id.* at *3-4.

[13] *See also Davidson v. Capital One Bank (USA), N.A.*, 797 F.3d 1309, 1317 (11th Cir. 2015) (the allegation that Capital One "has attempted to collect . . . delinquent or defaulted debts in the regular course of its business, using the mails and telephone system in doing so" is insufficient to satisfy the principal purpose test, because while it permits the inference "that *some* part of Capital One's business is debt collection, . . . it fails to provide any basis from which we could plausibly infer that the 'principal purpose' of Capital One's business is debt collection."); *Schlegel v. Wells Fargo Bank, NA*, 720 F.3d 1204, 1209 (9th Cir. 2013) (rejecting that plaintiff has adequately alleged that Wells Fargo satisfies the principal

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purpose test because the complaint "establishes only that debt collection is some part of Wells Fargo's business, which is insufficient to state a claim under the FDCPA."); *Rashied v. Ditech Fin., LLC*, 2018 WL 6720501, at *5–6 (N.D. Ga. Oct. 10, 2018), *report and recommendation adopted sub nom. Rashied v. Ditech Fin., LLC*, 2018 WL 6720490 (N.D. Ga. Nov. 13, 2018) ("To plausibly infer, because Defendant regularly files collection actions and claims in bankruptcy actions or uses the telephone to call debtors, that collecting on delinquent mortgage debts is its 'principal purpose' – out of all of the services provided as part of mortgage servicing – would require the Court to infer that most, if not all, mortgagees are delinquent in the payment of their loans."); *Collins v. BSI Fin. Servs.*, 2017 WL 1045062, at *4 (M.D. Ala. Mar. 17, 2017) (the conclusory allegations that defendants "attempted to collect the debt" and "are in the mortgage servicing business and one of their principal business purposes is the collection of debts" . . . "fail to plausibly allege that the 'principal purpose' of CitiMortgage or BSI's business is debt collection.").

[14] *See, e.g., Quinteros v. MBI Assocs., Inc.*, 999 F. Supp. 2d 434, 439-40 (E.D.N.Y. 2014) (pay-by-phone processing fee listed in a debt collection notice is "incidental" to the underlying debt, triggering 15 U.S.C. § 1692f(1)). *Cf. Lindblom v. Santander Consumer USA, Inc.*, 2016 WL 2841495 at *5-6 (E.D. Cal. May 9, 2016) (15 U.S.C. § 1692f(1 liability is not defeated by

Flores v. Collection Consultants of California, disagrees and holds that because these fees are neither unfair or unconscionable, nor incidental to the debt, section 1692f(1) does not apply.[15] But *Flores* presents a minority view among federal courts and does not provide sufficient protection for servicers hoping to avoid a Section 1692f(1) analysis.[16] Therefore, in order to charge a convenience fee, the fee must either be expressly authorized by the underlying debt agreement, or be permitted by state law.[17]

The Tuttle *Standard*

The first option for satisfying Section 1692f(1) — that the fee be expressly authorized by the underlying agreement — is generally unavailable to any mortgage servicer servicing loans primarily originated on the Fannie Mae and Freddie Mac uniform instruments common to most first-lien mortgages today; these instruments do not expressly permit such fees.[18] This is not to say that the drafters of the uniform instruments did not contemplate the possibility of charging other fees. For example, paragraph 14 of the California Single Family Fannie Mae / Freddie Mac Uniform Instrument states that "the absence of express authority in this Security Instrument to charge a specific fee to Borrower shall not be construed as a prohibition on the charging of such fee." The statutory standard, however, requires that a fee be *expressly* permitted.[19] Given the unlikelihood of express permission in the underlying agreement on a systemic basis, a mortgage servicer typically must rely on the second clause: "permitted by law." Under the Second Circuit's 1999 opinion, *Tuttle v. Equifax Check*,[20] this clause yields a three-part standard for Section 1692(f)(1) compliance:

1. *If state law expressly permits service charges,* a service charge may be imposed even if the contract is silent on the matter;

2. *If state law expressly prohibits service charges,* a service charge cannot be imposed even if the contract allows it;

3. *If state law neither affirmatively permits nor expressly prohibits service charges,* a service charge can be imposed only if the customer expressly agrees to it in the contract.[21]

This standard, cited by a line of federal decisions from across the country, requires state law to expressly permit convenience fees, not just remain silent on the issue.[22] Charging a convenience fee as a mortgage servicer without violating Section 1692f(1) would, therefore, require a complex state-by-state analysis of state laws, regulations, and guidance from other state-level authorities.

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the argument that a charge is not "incidental"; merely being any "amount" not expressly authorized by the underlying agreement or permitted by law is sufficient to trigger § 1692f(1)) (citing *Campbell v. MBI Assocs., Inc.*, 98 F. Supp. 3d 568, 582 (E.D.N.Y. 2015)).

[15] 2015 WL 4254032 (C.D. Cal. Mar. 20, 2015).

[16] *See, e.g.*, *Fuentes v. AR Res., Inc.*, 2017 WL 1197814 (D. N.J. Mar. 31, 2017) (*Flores* is distinguishable and in the minority); *Johnson-Morris v. Santander Consumer USA, Inc.*, 194 F. Supp. 3d 757, 764-65 (N.D. Ill. 2016) (same); *Lindblom v. Santander Consumer USA, Inc.*, 2016 WL 2841495 at *5-6 (E.D. Cal. May 9, 2016) (same); *Wittman v. CB1, Inc.*, 2016 WL 1411348 at *4-5 (D. Mont. Apr. 8, 2016) (same).

[17] It is worth noting that a convenience fee that violates Section 1692f(1) will automatically also violate Section 1692e(2) (prohibiting a debt collector from using "any false, deceptive, or misleading representation or means in connection with the collection of any debt" including "the false representation of [ ] (A) the character, amount or legal status of any debt or (B) any services rendered or compensation which may be lawfully received by any debt collector for the collection of a debt") because a notice of such a fee would imply the lawfulness of the fee. *See, e.g.*, *Quinteros v. MBI Assocs., Inc.*, 999 F. Supp. 2d 434, 439-40 (E.D.N.Y. 2014).

[18] While subordinate lien or home equity line of credit agreements are less uniform and may in fact expressly provide for the ability to charge convenience fees, that same lack of uniformity presents a significant challenge to implement, requiring a loan-by-loan analysis to determine whether each agreement expressly permits convenience fees.

[19] For example, certain fees are expressly enumerated in the Uniform Instruments; Paragraph 14 also states that "Lender may charge Borrower fees for services performed in connection with Borrower's default . . . including . . . property inspection and valuation fees."

[20] 190 F.3d 9 (2d Cir. 1999).

[21] *Id.* at 13 (emphasis in original).

[22] *See, e.g.*, *Fuentes v. AR Res., Inc.*, 2017 WL 1197814 (D.N.J. Mar. 31, 2017); *Weast v. Rockport Fin. LLC*, 115 F. Supp. 3d 1018 (E.D. Mo. 2015); *Acosta v. Credit Bureau of Napa County*, 2015 WL 1943244 (N.D. Ill. Apr. 29, 2015); *Quinteros v. MBI Assocs., Inc.*, 999 F. Supp. 2d 434 (E.D.N.Y. 2014); *Shami v. Nat'l Enter. Sys.*, 2010 WL 3824151 (E.D.N.Y. Sept. 23, 2010).

The Pass-Through Model: Some Solace

Several recent cases have indicated that a debt collector charging convenience fees may be able to avoid Section 1692f(1) liability by demonstrating that the amount of the fees matches the actual cost of collection, and that the debt collector is merely passing along that amount to a third-party vendor.[23] An example of a "pass-through fee" would be if "a credit card company such as Visa charges the debt collector $14.95 to process credit card payments and, in turn, the debt collector charges debtors the same amount if they pay by credit card."[24] The Sixth Circuit encountered such a pass-through structure in *Lee v. Main Accounts, Inc.*[25] In *Lee*, the court affirmed a summary judgment ruling in favor of an FDCPA defendant in part because of the district court's holding that a 5% fee imposed on the defendant by its vendor, and in turn passed on to the debtor in exchange for the debtor paying by a credit card, "is not a fee collected by [defendant], but a third-party charge triggered when the debtor chose the option of paying by credit card," and that defendant "would not have received any additional compensation from the credit card fee." The Northern District of Illinois court explained in *Acosta v. Credit Bureau of Napa County* that if a defendant can show that a "processing fee was a "pass-through fee . . . then there is no 'collection,' as that term is used by Section 1692f(1)."[26]

A pass-through model is not without its own administrative difficulties, however; in *Campbell v. MBI Associates*, the defendant admitted that the actual amounts of fees it pays to its credit card payment vendor can vary consumer-to-consumer based on the "kind of credit card a consumer charges and the consumer's contract terms with his credit card company," meaning that in charging a set fee, the defendant "would realize a profit on at least some credit card transactions[.]"[27]

The critical concern is whether the debt collector is profiting from the fee or just covering the costs of a third-party processor. In passing through the cost charged by a third party (such as in a pay-by-phone service), at the very least a servicer can avoid having to outlay the cost of using that third-party vendor from its own pocket, even if the servicer cannot utilize convenience fees as a fee-generating strategy.

How Does it End?

Taking all of this into account, it's evident that charging convenience fees as a mortgage servicer involves significant risk — at least in the absence of very strong compliance management infrastructure. Under *Henson*, a servicer that purchases loans or debt for its own account should be able to charge convenience fees without running afoul of the FDCPA so long as they are not in danger of failing the "principal purpose" test. The path is tougher for a company whose principal purpose is to collect on "debt," or even on a servicer or subservicer in the business of transferring in large pools of loans, some of which may be delinquent, where the servicer does not own the loan. Their alternative is to conduct a manual loan-by-loan review to determine whether any of the loan documents expressly permit convenience fees, and a state-by-state analysis to determine which states expressly permit such fees. Assuming, however, that a company does not have limitless time or financial resources, the simpler approach may be to pass through the cost of any third-party charge without adding a premium to that charge. At least, that is, until Fannie Mae and Freddie Mac see fit to revise the underlying uniform instrument, or defense counsel successfully shifts the tide of FDCPA litigation. ■

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[23] *See, e.g.*, *Fuentes v. AR Res., Inc.*, 2017 WL 1197814 (D.N.J. Mar. 31, 2017); *Johnson-Morris v. Santander Consumer USA, Inc.*, 194 F. Supp. 3d 757, 764-65 (N.D. Ill. 2016); *Lindblom v. Santander Consumer USA, Inc.*, 2016 WL 2841495 at *7 (E.D. Cal. May 9, 2016); *Wittman v. CB1, Inc.*, 2016 WL 1411348 at *4-5 (D. Mont. Apr. 8, 2016); *Acosta v. Credit Bureau of Napa County*, 2015 WL 1943244 at *2 (N.D. Ill. Apr. 29, 2015); *Quinteros v. MBI Assocs., Inc.*, 999 F. Supp. 2d 434 (E.D.N.Y. 2014); *Shami v. Nat'l Enter. Sys.*, 2010 WL 3824151 at *4 (E.D.N.Y. Sept. 23, 2010).

[24] *Acosta v. Credit Bureau of Napa County*, 2015 WL 1943244 at *2 (N.D. Ill. Apr. 29, 2015).

[25] 125 F.3d 855 (6th Cir. 1997).

[26] *Acosta v. Credit Bureau of Napa County*, 2015 WL 1943244 at *2 (N.D. Ill. Apr. 29, 2015).

[27] *Campbell v. MBI Assocs., Inc.*, 98 F. Supp. 3d 568, 582, n.4 (E.D.N.Y. 2015).