UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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MONIQUE SYKES, et al.

09 cv 8486 (DC)

Plaintiffs,

-against-

MEL S. HARRIS AND ASSOCIATES, LLC., et. al.

Defendants.

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Brett A. Scher, declares under penalty of perjury, pursuant to 28 U.S.C. § 1746:

1. I am a member of the law firm of Wilson, Elser, Moskowitz, Edelman & Dicker LLP, attorneys for defendants Mel Harris and Associates, LLC, Mel Harris, Michael Young, Kerry Lutz, Todd Fabacher, David Waldman, & Mel Harris John/Jane Does (collectively, "Mel Harris defendants").

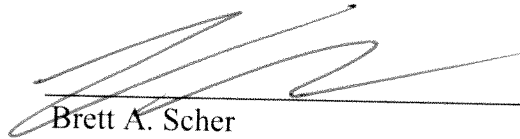
2. I submit this reply declaration in support of the Mel Harris defendants' motion pursuant to Fed. R. Civ. P. 12(b)(6), 12(b)(1) and 9(b), seeking to dismiss the plaintiffs' second amended complaint.

3. Annexed hereto as Exhibit C is a copy of "Comments of Claudia Wilner, Senior Staff Attorney Neighborhood Economic Development Advocacy Project, Federal Trade Commission Roundtable, Debt Collection: Protecting Consumers" dated January 8, 2010. (http://www.nedap.org/resources/documents/FTC1-8-10withexhibits.pdf).

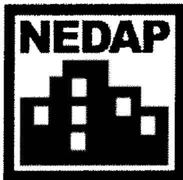
WHEREFORE, the Mel Harris defendants request that the Court enter an Order dismissing the second amended complaint and all causes of action contained therein as against

the Mel Harris Defendants, and any such other and further relief that the Court deems necessary and proper.

Dated: New York, New York
June 10, 2010



Brett A. Scher



Neighborhood Economic Development Advocacy Project
176 Grand Street, Suite 300, New York, NY 10013
Tel: (212) 680-5100 Fax: (212) 680-5104
www.nedap.org

Comments of Claudia Wilner, Senior Staff Attorney
Neighborhood Economic Development Advocacy Project

Federal Trade Commission Roundtable
Debt Collection: Protecting Consumers

January 8, 2010

Thank you for the opportunity to submit written comments regarding the debt buyer industry and its use of the courts to collect debts. I am Senior Staff Attorney at the Neighborhood Economic Development Advocacy Project (NEDAP), where I direct the Consumer Law Project. NEDAP is a nonprofit resource and advocacy center that provides legal, technical and policy support to community groups in New York City's low-income neighborhoods and communities of color. NEDAP's mission is to promote community economic justice and to eliminate discriminatory economic practices that harm communities and perpetuate inequality and poverty.

NEDAP's Consumer Law Project provides free legal information, advice, referrals, and representation to low-income New Yorkers who have problems concerning debt collection, credit reporting, and lending discrimination. We provide services through a legal hotline, a community legal clinic, and direct representation of consumers in state and federal court. We have helped thousands of low-income New Yorkers who are struggling with debt collection issues.

From our position on the front lines, we see directly how individual consumers, and their communities, have been impacted by the rise of the debt buying industry and particularly by debt buyers' use of the courts to extract money from unsophisticated and unrepresented individuals. We routinely see behavior that is extremely troubling. Debt buyers and their attorneys engage in sewer service, file cases on debts that are past the statute of limitations, restrain and seize exempt funds, pressure consumers to make payments on invalid debts, and file false affidavits with the courts, which they use to secure default judgments against unsuspecting individuals. These actions often violate the Fair Debt Collection Practices Act, are unethical, and sometimes rise to the level of criminal fraud. To date, far too little has been done to curb these unlawful and abusive practices.

1. *Sewer Service*

It is no secret that many defendants in debt collection cases fail to appear to defend themselves in court. In New York City, the default judgment rate is approximately 75%, and the answer rate hovers around 10%.

We believe that sewer service – the practice of failing to serve a summons and complaint and then filing a fraudulent affidavit of service – is the primary reason that most defendants do not appear in court. Sewer service deprives people of due process because they do not get notice of the lawsuit and are denied their day in court. We recently completed an in-depth analysis of cases handled by our hotline in 2008. We found that more than 71% of callers who were sued by debt buyers reported improper service, and 56% reported that they never received any notice at all. Only 8% reported service that complied with the law, and, of those, only 3% were personally served. 64% of callers sued by debt buyers learned of the suit only because their bank account was frozen, their wages garnished, or they saw the judgment on their credit report.

In one recent case, we discovered that Ms. V, a single working mother who lives in the Bronx, supports four children, and speaks only Spanish, had seven default judgments against her. All seven judgments were obtained by debt buyers, and Ms. V was not served in any of the cases. Ms. V learned about two of these cases when the debt buyers began garnishing her wages. The other five were discovered by searching court records for any other default judgments entered against Ms. V. Upon further investigation, we found that four of the seven lawsuits had been served at a nonexistent address, and the remaining three alleged substitute service on a fictitious family member. Ms. V had no actual notice in any of the cases.

NEDAP and our partners, MFY Legal Services and Emery Celli Brinckerhoff & Abady, P.C., recently filed a class action lawsuit against a debt collection law firm, a network of related debt buyers, and a process serving agency. The suit alleges that these entities conspired to obtain tens of thousands of default judgments based on fraudulent affidavits of service and affidavits of merit, then used these judgments to extract money from the unsuspecting defendants. A copy of the class action complaint is attached as Exhibit A to this testimony, and a New York Times article describing the lawsuit is attached as Exhibit B.

The New York State Attorney General recently filed a groundbreaking lawsuit against a process serving agency, American Legal Process, and 35 debt collection law firms. The suit seeks to overturn 100,000 default judgments that were obtained as a result of sewer service. The complaint details many examples of faulty service, including numerous instances in which individual process servers claimed to be in two or more places at the same time – a physical impossibility. NEDAP believes that the practices described in this lawsuit are not unique to suits involving American Legal Process, but are standard practice in debt collection cases involving debt buyers. A copy of the complaint and affirmations in that case are attached as Exhibit C to this testimony.

2. *Evidence of Indebtedness*

The sewer service issue is closely connected to the fact that debt buyers generally lack admissible evidence (or any evidence) that the consumer actually owes a debt. Debt buyers are unable to win lawsuits in court in contested cases; therefore, they have a strong interest in obtaining default judgments through sewer service.

As described in the Federal Trade Commission's 2009 report, *Collecting Consumer Debts: The Challenges of Change*, and as confirmed by many participants in the recent series of Roundtable Discussions, debt buyers purchase accounts in bulk, receiving only an electronic spreadsheet with very minimal information about the debt. Debt buyers do not typically purchase the underlying documentation of the debt, including the contract, account statements, detailed payment records, and customer service records that would reflect customer disputes. Some debt buyers may have the ability to go back to the creditor and request documentation of the debt in a limited number of cases. Others are contractually prohibited from ever obtaining this documentation. Attached to this testimony as Exhibits D and E are examples of two purchase and sale agreements. In the first agreement, the debt buyer is allowed to obtain an affidavit from the original creditor in 2% of cases. In the second agreement, the debt buyer is not allowed to obtain any documentation of the accounts at all. What becomes apparent from examining the structure of these agreements is that, for the vast majority of cases filed by debt buyers in court, the debt buyer is contractually prohibited from ever obtaining evidence in support of its case.

Many of the cases filed by debt buyers are, in fact, without merit. In NEDAP's analysis of our case files from 2008, we found that 35% of cases filed by debt buyers against our clients were clearly devoid of merit, meaning that the statute of limitations on the debt had expired, the debt was discharged in bankruptcy, the debt was the result of fraud, or the debt was already paid. The other 65% of cases were not necessarily meritorious. Clients had many questions about those cases as well. For example, clients often could not remember whether they owed the debt, or they recognized the name of the original creditor but the amount for which they were being sued was far in excess of anything they recalled owing.

For example, in the case of Ms. V, described above, most (if not all) of the seven default judgments obtained against her are clearly without merit. Three of the judgments concern a First USA account, but Ms. V never had a First USA account. One of the judgments concerns a Providian account, but Ms. V also never had a Providian account. Two of the judgments concern a Sears account, but Ms. V only ever had one Sears account. The last judgment concerns a Chase account. Ms. V did once have a Chase account, but it appears that she may not have had the particular Chase account at issue in the lawsuit: The lawsuit was served at an address where Ms. V never lived and alleges a different time period from the one during which Ms. V recalls using her account.

In a recent study entitled *Where's the Proof?*, District Council 37 Municipal Employees Legal Services (MELS) conducted an analysis of 238 cases involving debt buyers handled by its office. The study found that in 94.5% of cases, the debt buyer was unable to substantiate the alleged debt. Furthermore, in the few cases that the debt buyer did come up with some kind of documentation, that documentation often showed that the defendant did not, in fact, owe the debt. The report can be found at http://www.dc37.net/benefits/health/pdf/MELS_proof.pdf.

In our own practice, we have never seen a debt buyer come forward with proper, admissible evidence that a consumer owes a debt. We can only conclude that many of the hundreds of thousands of default judgments that have been secured by debt buyers across the country are cases in which the consumer does not, in fact, owe the debt. Debt buyers then work untold harm by using these judgments to collect money from consumers.

3. Statute of Limitations

In our experience, debt buyers frequently file lawsuits on which the statute of limitations has expired. For example, our client Ms. M. was sued in 2007 by Palisades Collection on an alleged debt past the statute of limitations. Ms. M went to court and proved that the debt was past the statute of limitations. The case was discontinued. Two years later, the same debt buyer hired a different law firm to sue Ms. M again for the same debt. By this time, the debt was nearly ten years old. Even though Ms. M had already established two years earlier that this debt was uncollectible, she had to appear in court to defend herself all over again. Incidentally, Ms. M did not owe the underlying debt because the debt arose from a legitimate credit dispute. In the late 1990's, Ms. M was charged hundreds of dollars on her credit card for pornographic magazines that she never ordered or received. Ms. M disputed the charges, but the creditor refused to remove them. By the time Ms. M was sued by a debt buyer many years later, this fraudulent charge had inexplicably ballooned to thousands of dollars.

In addition to filing suits beyond a state's typical statute of limitations for credit card disputes, debt buyers routinely and willfully refuse to apply shorter statutes of limitations that may apply in particular cases. For example, in New York the general statute of limitations for a breach of contract is six years, but contracts for the sale of goods are governed by the Uniform Commercial Code, which has a four year statute of limitations. Yet we see debt buyers suing individuals on debts that fall under the UCC (for example, deficiencies after an automobile repossession) but are between four and six years old.

In one particularly dramatic example that is well worth investigation and pursuit by the Federal Trade Commission, the Federal Telecommunications Act contains a two year statute of limitations for telephone-related debts. 47 U.S.C. § 415 ("All actions at law by carriers for recovery of their lawful charges, or any part thereof, shall be begun within two years from the time the cause of action accrues, and not after."). Certain debt buyers, such as Palisades Collection, have huge portfolios of defaulted AT&T Wireless debts, and have filed tens, if not hundreds, of thousands of lawsuits against individuals to collect these debts. All or nearly all of these debts are more than two years old, and thus time-barred as a matter of federal law. Unfortunately, most consumers are unrepresented and unaware of the two year statute of limitations for this kind of debt.

4. Restraint and seizure of exempt funds

For many years, the problem most often faced by our clients was restraint and seizure of their exempt funds by creditors. At one point, nearly one quarter of my time was spent helping clients to obtain release of their exempt funds, which never should have been restrained in the first place. When my clients' Social Security, Unemployment, or other benefits were frozen by debt collectors, they were unable to pay rent or buy food or medicine. They suffered incredible hardship, as it often took weeks to obtain the release of an account.

Fortunately, in 2008, New York State passed the Exempt Income Protection Act (EIPA) to address this problem. Since this law took effect on January 1, 2009, we no longer have significant problems in this area. Banks are prohibited from restraining accounts that receive directly deposited exempt benefits and contain less than $2,500. Banks likewise must not freeze any account belonging to a natural person that contains less than $1,740, the amount of minimum

wage income that is protected under all circumstances. New York also has a streamlined procedure for claiming an exemption when accounts contain exempt funds in excess of the threshold amounts. EIPA is functioning very well and has made a tremendous difference for low-income New Yorkers. Every state should implement such a law.

In the meantime, we understand that the U.S. Treasury intends to implement a similar rule to protect bank accounts containing federally deposited exempt funds, which would apply nationwide. We wholeheartedly support the Treasury proposal and would like to see it adopted as soon as possible.

5. *Recommendations*

- **The FTC should investigate the debt buyer industry and file more enforcement actions**. As describe above and in the attachments, we believe that debt buyers have been engaging in massive fraud as they routinely secure default judgments on the basis of false affidavits. These practices are harming low-income individuals in New York and across the country, and they cannot be allowed to continue. More investigation and enforcement action is needed to document and stop these unlawful practices.

- **The FDCPA should be amended to prohibit debt buyers from filing lawsuits unless they have admissible evidence that the debt is owed.** As discussed, one of the greatest problems consumers currently face is a rash of debt collection lawsuits filed by debt buyers that cannot provide documentation of the debt. The FDCPA should be amended to outlaw this practice, which is fundamentally unfair and deceptive. Consumers should not be hauled into court unless there is a realistic possibility that the debt buyer can win the case on the merits.

- **The FDCPA should be amended to prohibit debt buyers from filing lawsuits when the statute of limitations to collect a debt has expired.** Case law has already established that it violates the FDPCA to file lawsuits on out-of-statute debt. This law should be incorporated into the statutory language so that the law is clear and applies uniformly across the country.

- **The FDCPA should be amended to prohibit debt collectors from restraining funds that are exempt from collection under federal or state law.** The freezing of bank accounts that contain exempt funds is a huge problem. While we have been able to address this problem in New York State, most states have no such protections. The FDCPA should specifically prohibit the practice of restraining exempt funds, subject to the bona fide error defense. Disabled and elderly consumers would benefit immeasurably from this change, as collection law firms would enact procedures designed to prevent the restraint of exempt funds. Where collection law firms fail to enact such procedures, consumers will gain an effective tool to use to obtain the release of their exempt funds.

- **The FDCPA should be amended to provide for injunctive relief.** The FDCPA does not currently provide for injunctive relief. The lack of an injunctive remedy impairs the ability of legal services providers to advocate for low-income clients. The kinds of violations we see most often do not create significant actual damages for our clients as

individuals, but they are repeated on a large scale and thus cause great harm to communities. An example is the repeated filing of false affidavits in order to obtain thousands of default judgments against low-income New Yorkers. A money judgment in an individual case, or even in a class action (in which the judgment is limited to 1% of the defendant's net worth) simply will not curtail this illegal behavior or prevent it from occurring in the future. It is clear from the tremendous number of FDCPA violations that there is not enough enforcement of the law. Consumers need an injunctive remedy so that they can serve as effective private attorneys general.

- **The FTC should clarify that debt collectors must provide meaningful verification that is specific to the consumer's dispute**. As discussed above, the FDCPA verification requirement has been watered down to the point where it is no longer useful to consumers. Debt collectors should be required to provide verification that is specific to the consumer's dispute. For example, if a consumer raises an identity theft dispute, the debt collector should provide verification that relates to the identity of the cardholder. If the consumer raises a dispute as to the amount, the debt collector should provide verification that relates to the amount. The verification should consist of copies of actual documents, not just a confirmation and renewed demand for the amount.

- **Statutory damages must be raised to a meaningful level.** Statutory damages of $1000 per plaintiff per case are so low as to be meaningless, effectively allowing collection agencies to break the law with impunity. The $1000 statutory penalty is simply a cost of doing business. Statutory damages must be raised to a meaningful level, and they should be available per violation, not per case. Only then can statutory damages serve their intended purpose as an effective deterrent of unlawful behavior.

- **The Internal Revenue Code should be amended to eliminate the unfair tax burden imposed on successful plaintiffs.** The IRS views attorney fee awards to successful plaintiffs as taxable income to the plaintiff. The Supreme Court endorsed this view, at least insofar as contingent fee awards are concerned, in the case of *Commissioner v. Banks*. Following this case, Congress amended the Internal Revenue Code to provide an above-the-line deduction for attorney fees in employment and discrimination cases. This deduction should be extended to apply to consumer cases. Counting attorney fees as taxable income is completely unfair to our low-income clients, as they never see or benefit from that income in any way. In the case of our clients, who are poor enough to qualify for free legal services, the attorney fee award generally exceeds their own recovery, and may even surpass their income for the entire year. Depending on the size of the fee award, counting it as income could prevent our clients from qualifying for the Earned Income Tax Credit, on which they depend for basic survival. Thankfully, that factual scenario has not yet arisen in our practice. Nevertheless, the idea that our low-income clients should have to pay taxes on our attorney fee awards is completely unjust and should be remedied.