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Gburek Impact on Housing Counseling Limited; Implications for Servicer Loss Mitigation Efforts

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A recent decision handed down by the Seventh Circuit Court of Appeals in late July is causing confusion among mortgage servicers regarding their ability to refer homeowners to U.S. Department of Housing and Urban Development ("HUD")-approved housing counseling agencies. *Gburek v. Litton Loan Servicing LP*, No. 08-3776 (7th Cir. July 27, 2010) ("*Gburek*") has become important for the mortgage servicing industry because it raises issues regarding the use of third-party agents to directly contact delinquent borrowers and coverage for such practices under the Fair Debt Collection Practices Act ("FDCPA"), 15 U.S.C. §§ 1692 et seq.

In *Gburek*, the Seventh Circuit held that written letters from Litton Loan Servicing ("Litton") and an agent that it retained to perform outreach services on its behalf, Titanium Solutions ("Titanium"), fell within the scope of the FDCPA. As a result, the plaintiff's lawsuit that alleges violations of the FDCPA, including communications that invited the plaintiff to contact Litton and Titanium to discuss foreclosure alternatives, will now proceed.

While some mortgage servicers have suggested that the decision may cause them to reconsider making general referrals to HUD-approved housing counseling agencies, there is nothing in the decision to suggest that such a practice by itself would be prohibited under the FDCPA. Rather, *Gburek* is a classic example of a servicer's use of a third-party agent to contact a delinquent borrower falling under the FDCPA. As a result, the now-common practice of mortgage servicers referring their delinquent borrowers to HUD-approved housing counseling agencies should not be impacted by this decision.

Nonetheless, the *Gburek* decision serves as a reminder of the broad scope of the FDCPA. While not all communications and activities between a servicer or housing counseling agency may fall under the FDCPA, the Seventh Circuit decision illustrates that coordinated outreach by a servicer and a third-party facilitator to delinquent borrowers for which the servicer is not the original lender may be subject to the FDCPA and, thus, would require strict compliance with the requirements of the statute by both the servicer and the third-party facilitator.

I. Background

Under the FDCPA, third-party debt collectors are prohibited from employing deceptive or abusive conduct in the collection of consumer debts incurred for personal, family, or household purposes. A debt collector is someone who regularly collects debts owed to others.

The definition of debt collector includes collection agencies, lawyers, mortgage servicers, and other persons who collect debts on a regular basis and companies that buy delinquent debts and then try to collect them. Debt collectors may not, for example, contact debtors at odd hours, subject them to repeated telephone calls, threaten legal action that is not actually contemplated, or reveal to other persons the existence of debts.

The FDCPA may be enforced by the FTC, state Attorneys General, and private plaintiffs (including in class-action lawsuits). For the FDCPA to apply, however, two threshold criteria must be met: (1) the defendant must qualify as a "debt collector;" and (2) the communication by the debt collector that forms the basis of the suit must have been made "in connection with the collection of any debt."

In *Gburek*, the Seventh Circuit, reversing the district court's decision to dismiss a *putative* class action lawsuit, held that two letters sent by a mortgage servicer to a borrower that was in default had triggered coverage under the FDCPA despite no express demand for payment in either letter. Specifically, the plaintiff alleged that Litton violated the FDCPA by (1) using deceptive means to obtain personal information; (2) communicating directly with the plaintiff even though she had an attorney; and (3) communicating with a for-profit collection agent about her mortgage without her consent.

In holding that the two letters to the borrower and the information-sharing between the Litton and Titanium were made "in connection with an attempt to collect a debt," the Seventh Circuit rejected the assumption that anything less than a demand for payment is not covered by the FDCPA. The Seventh Circuit found that the district court had read "the statutory language too narrowly and ignore[d] the salient facts alleged in the complaint: Gburek's mortgage was in default, and the text of the letters indicates they were sent to induce her to settle her mortgage-loan debt in order to avoid foreclosure."

The Seventh Circuit explained that there is no "bright-line rule for determining whether a communication from a debt collector was made in connection with the collection of any debt." Based on prior decisions, the Seventh Circuit determined that the absence of a demand for payment is just one of several factors that come into play. The Seventh Circuit stated that the evaluation of whether a statement is made "in connection with an attempt to collect a debt" requires a "common sense inquiry" of several factors including: (i) the nature of the relationship of the parties in the communication; (ii) the purpose of the communication; and (iii) the context of the communication.

Applying these factors, the Seventh Circuit found that although the letter from Litton did not explicitly ask for payment, it was an "opening communication" in an attempt to collect on the borrower's defaulted mortgage payments. The Court also found that the letter from Titanium fell under FDCPA because its purpose was to encourage the borrower to discuss "debt-settlement options," and that Titanium was acting on Litton's behalf when sending the letter. Finally, the Court held that the communications of Litton requesting that Titanium contact the borrower "plainly constitute[d] communication in connection with the collection of a debt," since Litton was asking Titanium to collect financial information on its behalf.

The case has been remanded to the trial court to hear the issues regarding the alleged FDCPA violations.

II. Implications for Housing Counseling Services

A. Decision Highlights FDCPA Risks

The need to be mindful of the requirements of the FDCPA is an issue that requires careful monitoring because of the broad reach of the statute, the lack of a blanket exemption for HUD-approved housing counseling agencies,[1] and significant penalties in the event of noncompliance (including the potential for class-action lawsuits).

Any rumors to the contrary, the *Gburek* decision should not portend grave consequences for mortgage servicers who generally refer homeowners to HUD-approved housing counseling agencies for independent housing counseling services. To the extent that the decision found that the FDCPA applies to mortgage servicers and its paid agents, *Gburek* hardly means that servicers cannot refer homeowners to HUD-approved housing counseling agencies.

While a full discussion of the scope of the FDCPA is beyond the scope of this article, an important consideration when considering *Gburek* is with respect to coverage of the FDCPA. Mortgage servicers are not automatically exempt for loss-mitigation activity. Section 803(6) of the FDCPA defines a "debt collector" to mean "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 to another."

Due to the broad coverage of the term "debt collector," it is not surprising that a mortgage servicer that attempts to collect on a debt that was in default at the time the account was obtained would be a "debt collector" with respect to that account, and must comply with the FDCPA – including its affirmative requirements such as the prohibition on disclosing the identity of the debtor to third parties without permission under the statute. This requirement can be triggered by an "initial communication with a consumer" and, as Gburek demonstrated, even in the absence of an explicit demand for payment, communications intending to induce the settlement of a debt can be sufficient to trigger the FDCPA.

B. Referrals to HUD-Approved Housing Counseling Differ from the Servicer's Practices in Gburek

The Seventh Circuit's decision in *Gburek* does not prohibit a servicer from referring homeowners to HUD-approved housing counseling agencies. In our view, any statements to the contrary would represent an overreaction to the decision, which did not at all address the underlying claims. To be clear, referring homeowners to HUD-approved housing counseling agencies is not prohibited under or regulated by the FDCPA.

As noted above, whether a person triggers the FDCPA depends upon all of the facts and circumstances. The now-common practice of a servicer referring a homeowner to a HUD-approved housing counseling agency is clearly distinguishable from the type of actions by Litton that were the basis of the Seventh Circuit's decision in *Gburek*.

While we recognize that housing counseling agencies frequently are the beneficiaries of servicer communications to homeowners in the form of referrals and, thus, sensitive to any concerns that servicers may have in making such referrals, facts such as those that gave rise to the *Gburek* decision – contracting to perform specific outreach on behalf of a specific mortgage servicer to targeted homeowners – are the precise type of activity that many housing counseling agencies have purposefully avoided.

In its discussion of the reasons why the communications to and about the borrower were sufficient to trigger coverage under the FDCPA, the *Gburek* court focused on the substance of the communications to the borrower made by Litton or on its behalf. In stark contrast, commonly provided HUD-approved housing counseling services do not involve soliciting homeowners on behalf of servicers by sending letters or making outbound calls at the request of the servicers. Instead, borrowers initiate contact with the counseling agency, and borrowers then voluntarily provide their financial information to the agency after being provided with a full description of what the counseling services entail and several key disclosures, including privacy and conflict-of-interest disclosures (*e.g.*, regarding creditor funding), pursuant to HUD requirements.

Each homeowner is then counseled generally on their overall financial circumstances and is able to explore all options for their financial situation, whether or not their counseling session results in a servicer-related workout plan. Titanium was not a HUD-approved nonprofit housing counseling agency and was acting solely as the hired agent of Litton. Neither the Litton letter nor Titanium's letter suggested that the borrower contact a HUD-approved housing counseling agency.[2] True HUD-approved housing counseling agencies engage the borrower in a one-on-one counseling session and, unlike Titanium, do not have a pecuniary interest in a particular outcome of a completed counseling session.[3] As noted above, the objective and purpose of a housing counseling session – for the housing counseling agency, at least – is not the repayment of a consumer's delinquent debt.

Therefore, *Gburek* should not pose a direct or immediate threat to the now-typical practice of servicers making referrals to HUD-approved housing counseling agencies. However, the decision may require servicers to closely evaluate their own communications to homeowners, re-examine how they use their own agents to assist with their outreach, and make revisions to their programs in order to ensure compliance with the statute.

C. Other Practices in Light of Gburek

Suggestions that all joint mortgage servicer and HUD-approved housing counseling agency outreach efforts should cease would be an overreaction to *Gburek*. For example, generic "homeownership preservation workshop" outreach activities may be viewed in the same vein as other traditional referrals of borrowers to HUD-approved housing counseling agencies. Although an in-person event may be advertised by a servicer, the counseling that homeowners receive should be substantively the same as the counseling provided over the telephone by HUD-approved counseling agencies. As a result, even under Gburek, counseling provided at these workshops likely is not covered by the FDCPA absent certain facts, *e.g.*, counseling agency communications to delinquent borrowers on behalf of servicers to induce payment.[4]

In contrast, when a servicer that is a debt collector uses a collection agent, the debt collector may be liable for the agent's violations of the FDCPA, and depending upon the circumstances, there may be liability for the agent as well. We understand that some housing counseling agencies are currently involved, or are contemplating being involved, in activities that go outside the housing counseling model that we have discussed above. These activities may include outreach somewhat similar to the facts in *Gburek, e.g.*, making outbound contacts to borrowers at the request of the servicer. In such situations, if the housing counseling agency is acting on behalf of a servicer, like in *Gburek*, then aspects of the services provided may be sufficient to bring its communications within the scope of the FDCPA.

III. Compliance Considerations

Although FDCPA compliance may be unavoidable for some housing counseling agencies, affirmatively triggering FDCPA compliance obligations – either as a result of their activities or out of an abundance of caution – does not appear to be a tenable solution for many HUD-approved nonprofit housing counseling agencies. Compliance with the statute may be difficult in the short-term and have other long-term adverse consequences for counseling agencies, including:

- First, triggering the requirements of the FDCPA would be burdensome and expose the HUD-approved housing counseling agency to additional exposure for allegations of deceptive, misleading, confusing, coercive, and/or unfair practices. Further, falling under the federal statute also would likely mean that state debt collection statutes would be triggered based on the state of the homeowner's residence. These state statutes typically require registration (the federal statute has no such registration requirement).

- Second, the housing counseling agency may not be in a position to know if the homeowner is delinquent, and thus subject to the protections of the law. Indeed, while debt collectors are required to give the earlier-discussed Miranda and "mini"-Miranda disclosures in connection with debt collection communications, these disclosures and other requirements would be inappropriate for housing counseling activities for any number of reasons, and could be considered by critics to be confusing to consumers.[5]

- Third, the FDCPA compliance steps would hamper the collection of information necessary for the counseling process.

- Lastly, while beyond the scope of this memorandum, as with all relationships between creditors and tax-exempt, nonprofit housing counseling agencies, close relationships with mortgage servicers, lenders and/or investors would potentially be problematic for a tax-exempt, nonprofit housing counseling agency if they constitute an "impermissible private benefit" under Section 501(c)(3) of the Internal Revenue Code (the "Code").[6] This has been a point of contention for the Internal Revenue Service ("IRS") and something that the IRS recently cautioned credit counseling agencies about through a Chief Counsel Advice Memorandum on Code Section 501(q) and housing counseling.[7] Visible steps of FDCPA compliance by HUD-approved housing counseling agencies, and the facts that necessitate taking such steps, would surely be used by the IRS as support for a finding of impermissible private benefit to mortgage servicers, lenders and/or investors.

While the above-listed considerations, and others not discussed, do not obviate the need to comply with the requirements of the FDCPA if triggered by a HUD-approved housing counseling agency, they offer good reason for those housing counseling agencies that could potentially trigger the statute to reconsider or restructure their activities.

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Please note that this article is intended to identify and discuss the implications of *Gburek* generally in relation to mortgage servicers and housing counselors, and does not include an analysis of the obligations either of a particular mortgage servicer or housing counseling agency under the FDCPA or state debt collection statutes.

This also is an area that is fraught with difficulties regarding coverage and the making of correct representations to a borrower. As such, housing counseling agencies, along with related foreclosure prevention industry participants, might wish to consider taking careful stock of their current and planned activities in order to identify steps that can be taken to minimize the potential exposure arising from working with homeowners who are or may be in default on their mortgages.

Mortgage servicers and housing counseling agencies involved in communicating with potentially-delinquent borrowers should be mindful of the FDCPA and similar state laws that are often more general in scope. The decision also illustrates the need for housing counseling agencies to carefully evaluate their particular relationships with mortgage servicers on a case-by-case basis. Mortgage servicers and housing counseling agencies should seek the advice of their legal counsel in developing compliance strategies for the FDCPA.

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1. Section 804(6)(E) of the FDCPA states that the definition of "debt collector" does not include "any nonprofit organization which, at the request of consumers, performs bona fide consumer credit counseling and assists consumers in the liquidation of their debts by receiving payments from such consumers and distributing such amounts to creditors." 15 U.S.C. § 1692a(6)(E). The interpretation of this exclusion has been only lightly discussed in court proceedings and by the FTC, including in informal staff letters. A full discussion of the scope and breadth of this exclusion is beyond the scope of this alert.

2. Notably, certain state mortgage foreclosure consultant statues require such a disclosure.

3. Titanium has on its website an FDCPA disclosure "to comply with the FDCPA." *See* **https://www.titaniuminc.com/fdcpa-disclosure.aspx**.

4. *Gburek* at 10 (citing *Horkey v. J.V.D.B. & Associates*, 333 F. 3d 769, 774 (7th Cir. 2003)). The Seventh Circuit in the *Gburek* decision states, "*Horkey* clarifies that a communication need not make an explicit demand for payment in order to fall within the FDCPA's scope; rather, that a communication is made specifically to induce the debtor to settle her debt will be sufficient to trigger the protections of the FDCPA." *Id.*

5. *See, e.g.*, Cranmer, FTC Informal Staff Letter (April 25, 1989) ("Indeed, if a mortgage servicing company were to "over comply" and adhere to, *e.g.*, the affirmative notification requirements of the FDCPA with respect to current accounts, it could be misleading and otherwise counterproductive for the consumer/debtors obligated on those accounts." *emphasis* in original).

6. Section 501(c)(3) of the Internal Revenue Code ("Code") provides that an organization must be organized and operated exclusively for charitable purposes in order to qualify as a tax-exempt organization. *See also*, IRS Reg. 1.501(c)(3)-1(c)(1). It is also understood that an organization will not qualify as tax-exempt if more than an insubstantial part of its activities are not in furtherance of its exempt purpose.

7. *See* IRS Chief Counsel Advice Memorandum POSTS-101470-09, 5 (March 30, 2010) (available at **http://www.irs.gov/pub/irs-tege/pmta_cca.pdf**). The IRS Chief Counsel's office concluded that organizations that provide educational information on financial topics or financial counseling to homeowners at risk of foreclosure are providing "credit counseling services" within the meaning of Code Section 501(q). However, the memo states that to be tax-exempt, an organization that engages in credit counseling services as a substantial purpose must meet all of the requirements of Code Sections 501(c)(3) or 501(c)(4), as well as the applicable requirements of Code Section 501(q). *Id.*