4th Cir Decision on the Definition of Debt Collector Under the Fair Debt Collection Practices Act Offers Opportunities for Loan Servicers

In a March 23, 2016 opinion, the Fourth Circuit Court of Appeals rejected the acquired-in-default test for debt collector liability under the Fair Debt Collection Practices Act ("FDCPA") when it affirmed a dismissal under Rule 12(b)(6). *See Henson v. Santander Consumer USA, Inc.*, ___ F.3d ___, Op. No. 15-1187 (4th Cir. Mar. 23, 2016). The *Henson* decision is a victory for owners of consumer loans facing allegations of harassing debt collection practices, and by extension, for assignees and servicers of debt.

According to the opinion, plaintiffs alleged in their complaint that the loans at issue were subprime retail installment sales contracts originated by CitiFinancial Auto to finance vehicle purchases. After the plaintiffs defaulted on their loans, CitiFinancial Auto repossessed the vehicles, accelerated the debts, and sought deficiencies on the outstanding balances. As plaintiffs alleged, CitiFinancial Auto hired Santander to service the defaulted loans and subsequently sold the outstanding balances to Santander as part of an investment bundle of receivables.

The *Henson* plaintiffs filed a class action against Santander, alleging that it violated the FDCPA by engaging in abusive, harassing, and deceptive attempts to collect the defaulted debts. Plaintiffs alleged that Santander was a consumer finance company that acquires defaulted debt for a "few cents on the dollar" and therefore was a "debt collector" under the FDCPA. Santander moved to dismiss the plaintiffs' complaint on the basis that Santander did not meet the definition of "debt collector" under the FDCPA. The District Court for the District of Maryland granted Santander's motion, concluding that Santander was collecting the debts on its own behalf and therefore was a "creditor" under the FDCPA. The Fourth Circuit affirmed, holding that plaintiffs had not alleged that Santander was acting as a debt collector under the FDCPA. Because plaintiffs alleged that Santander purchased and thus owned the debt, Santander was not collecting on behalf of another, and ***THE FDCPA DOES NOT APPLY TO CREDITORS WHO COLLECT DEBTS ON THEIR OWN ACCOUNTS.***

The Fourth Circuit rejected the acquired-in-default test, which has been accepted by the Third, Sixth, and Seventh Circuit Courts of Appeal and was advanced by the *Henson* plaintiffs. Under that analysis, the definitions of "creditor" and "debt collector" under the FDCPA are treated as mutually

exclusive, and liability turns on whether the entity acquired the debt before or after the borrower defaulted. The FDCPA defines a creditor as an entity to whom a debt is owed, unless the entity was assigned the debt while it was in default to collect it for another. On the other hand, **any entity whose principal purpose is debt collection or who regularly collects debts owed to another is a debt collector, unless the debt was *not* in default when acquired.** Based on their interpretations of the definitions, the plaintiffs argued that entities who acquire a debt in default, including Santander, must be debt collectors since the default status excludes them from being creditors and they fail to meet the "not in default" exclusion to the definition of debt collector.

While the default status test advanced by the *Henson* plaintiffs neatly characterizes every entity as either a creditor or debt collector, it ignores the contours of the statute. As noted by the Fourth Circuit, Santander is not necessarily a debt collector merely because it cannot meet the exclusion to the definition. Instead, the exclusions to the definition of debt collector can only apply if the entity qualifies as a debt collector under the threshold definition. The Fourth Circuit found that the plaintiffs had not alleged that Santander did not have the principal purpose of debt collection and did not regularly collect debts due another, so it was not a debt collector—even though the plaintiffs' loans were acquired in default. The Fourth Circuit ultimately concluded that dismissal was appropriate because the plaintiffs alleged that Santander owned the debts at issue and thus was collecting debts owed to it.

Santander owned the debts, but the Fourth Circuit's rejection of the acquired-in-default test could have important ramifications for non-owner servicers too. **Servicers collecting debts where the debtor is obligated to make payments directly to the servicer rather than the owner of the debt may be protected from liability under *Henson* depending on the circumstances of the transfer and the servicer's activities with respect to the transferred loan and other loans**. Redirecting the inquiry on the principal purpose of the entity's business rather than the default status of the debt benefits servicers, who regularly engage in activities other than debt collection, such as administering escrow accounts, offering loan modification options, collecting regular payments, originating loans, responding to borrower inquiries, and maintaining insurance.

With *Henson*, the Fourth Circuit joins the growing number of jurisdictions rejecting the acquired-in-default test, including the Eleventh Circuit. For loan servicers who collect regular payments as part of a broader relationship with the borrower and an investor, the *Henson* decision could be a useful resource in FDCPA litigation, especially within the Fourth Circuit.