SUPREME COURT HOLDS ENTITIES ENGAGED IN NONJUDICIAL FORECLOSURE ARE GENERALLY EXEMPT FROM THE FDCPA

Yesterday, the United States Supreme Court held that the Fair Debt Collection Practices Act ("FDCPA") generally exempts entities that merely engage in nonjudicial foreclosure proceedings, in accordance with state law. In *Obduskey* v. *McCarthy & Holthus LLP*,[1] the Court ruled in favor of law firm McCarthy & Holthus LLP,[2] holding that the language of the FDCPA's general-purpose definition of "debt collector" does not encompass those who enforce security interests by engaging in nonjudicial foreclosure. In light of this decision, law firms and others that undertake steps required by state law to carry out a nonjudicial foreclosure are not, by virtue of those actions, covered by the FDCPA's main requirements.

Overview of the Statute at Issue

The FDCPA covers the activities of "debt collectors." It broadly prohibits deceptive and abusive practices in connection with the collection of any debts,[3] and imposes an array of other requirements.[4] These requirements include a detailed notice a debt collector must provide in its initial communication with consumers.[5] As was relevant in *Obduskey*, the Act requires a debt collector to cease collection of a debt upon receiving a verification request from a consumer until the collector provides the consumer with verification of the debt.[6]

The FDCPA defines "debt" as an actual or alleged "obligation of a consumer to pay money."[7] The Act contains a general-purpose definition of "debt collector," which includes an entity that engages in "any business the principal purpose of which is the collection of any debts," or that "regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another"—*i.e.*, an entity whose overall practices involve sufficiently frequent debt collection.[8] It also includes a limited-purpose definition, which provides that, "[f]or the purpose of" a particular provision of the FDCPA that prohibits threatening or taking actions to effect dispossession or disablement of property in certain circumstances,[9] the term "debt collector" "also" includes an entity that engages in "any business the principal purpose of which is the enforcement of security interests."[10]

Obduskey concerned how the limited-purpose definition of "debt collector" relates to the primary definition of the same term. The presence of the limited-purpose definition could, on one hand, imply that entities principally involved in "the enforcement of security interests"—such as those that commence foreclosure proceedings—are *not* debt collectors for general purposes under the FDCPA. On the other hand, the limited-purpose definition could simply emphasize the fact that such entities are subject to § 1692f(6) in addition to the rest of the FDCPA. Lower courts had gone both ways on this question, with a majority holding that an entity engaging in the enforcement of security interests *is* a debt collector for purposes of all of the Act's requirements.[11]

Background and Procedural History

Foreclosure is a common means of enforcing a security interest under state law. All States provide for some form of *judicial* foreclosure, a legal action in which a court supervises notice of the foreclosure process, the sale of the property, and the distribution of the proceeds from that sale. More than half the States also provide for *nonjudicial* foreclosure, in which the foreclosure process is not supervised by a court.[12]

Petitioner Dennis Obduskey obtained a loan to buy a residential property in Colorado. The loan was secured by the property and serviced by Wells Fargo Bank, N.A. Obduskey defaulted on the loan and stopped making payments to Wells Fargo. After repeated attempts to modify the loan, Wells Fargo hired McCarthy & Holthus LLP to pursue a nonjudicial foreclosure under Colorado law.

McCarthy sent Obduskey a letter stating that it had been instructed to commence foreclosure against his property. The letter further stated the amount Obduskey owed to the creditor; noted that McCarthy would assume the amount to be valid unless petitioner disputed it within thirty days; and warned that foreclosure could be commenced before the end of that period. Obduskey alleged that he responded to the letter, asking for verification of the debt, but that he did not receive a response.

McCarthy then took steps necessary to initiate a nonjudicial foreclosure under Colorado law by filing a notice of election and demand for sale with the public trustee. Thereafter, Obduskey filed suit against McCarthy, asserting that McCarthy engaged in debt-collection activity prohibited by the FDCPA by imitating the nonjudicial foreclosure before providing verification of the debt.

The United States District Court for the District of Colorado dismissed the suit on the ground that McCarthy was not a "debt collector" within the meaning of the FDCPA.[13] The United States Court of Appeals for the Tenth Circuit affirmed the dismissal, concluding that the "mere act of enforcing a security interest through a non-judicial foreclosure proceeding does not fall under the FDCPA."[14]

The Supreme Court's Opinion

In a unanimous decision, the Supreme Court held that entities that engage in nonjudicial foreclosure proceedings in accordance with state law, are not thereby subject to the general provisions of the Act.[15] At the outset, the Court assumed that both of the notices sent by McCarthy were "required under state law" for the nonjudicial foreclosure process.[16] Justice Breyer's opinion for the Court then identified three considerations that led it to rule for McCarthy.

First, the Court focused on the text of the definition of "debt collector." The Court noted that the primary definition of "debt collector," by itself, would seem to encompass entities engaged in nonjudicial foreclosure proceedings.[17] But the Court reasoned that the presence of the limited-purpose definition is an "insurmountable" obstacle to "subjecting McCarthy to the main coverage of the Act."[18] The limited-purpose definition, which provides that "[f]or the purpose of" a particular section, the term "debt collector" "*also* includes" an entity like McCarthy, "strongly suggests that **ONE WHO DOES NO MORE THAN ENFORCE SECURITY INTERESTS DOES *NOT* FALL WITHIN THE SCOPE OF THE GENERAL DEFINITION**."[19] In particular, **the Court emphasized that the word "also" suggests that the definition adds something new to the general-purpose definition.**[20] And it reasoned that, on a contrary interpretation, **the limited-purpose definition would be "superfluous, and [the Court] 'generally presum[es] that statutes do not contain surplusage.**' "[21]

Second, the Court relied heavily on the fact that McCarthy's interpretation avoids potential conflicts with state nonjudicial foreclosure schemes, which provide various protections for homeowners. Some of those foreclosure-specific protections are "in tension" with FDCPA requirements.[22] For example, the FDCPA broadly bans communications with third parties by debt collectors "in connection with the collection of any debt."[23] If engaging in foreclosure activity constituted debt collection, simply advertising a foreclosure sale—an essential requirement of all state foreclosure schemes—would often violate the FDCPA.[24] That would "hardly benefit debtors," the Court noted, because a "core purpose" of such advertisement is to "attract bidders, ensure that the sale price is fair, and thereby protect the borrower from further liability."[25]

Third, the Court explained that the legislative history of the FDCPA supported its interpretation. When drafting the Act, Congress considered competing bills. One bill defined "debt collector" to include entities whose principal purpose was enforcing security interests, bringing these entities within the full scope of the FDCPA.[26] A different version of the bill wholly excluded entities that enforced security interests from the definition of "debt collector."[27] The Court concluded that the enacted language, viewed in light of that history, "**has all the earmarks of a compromise," with the result that "[t]he prohibitions contained in § 1692f(6) will cover security-interest enforcers, while the other 'debt collector' provisions of the Act will not.**"[28]

Justice Sotomayor wrote a concurring opinion to make two observations. *First*, she noted that, in her view, this was "a close case,"[29] and that Congress is "free" to amend the FDCPA to "make clear" that the Act fully covers entities pursuing nonjudicial foreclosures.[30] *Second*, she reiterated that an entity that enforces security interests does not have "blanket immunity" from the FDCPA.[31] It would be a different case, she predicted, if an entity "frighten[ed] homeowners with the threat of foreclosure without showing any meaningful intention of actually following through."[32]

Implications

The Supreme Court's decision in *Obduskey* is a substantial limit on FDCPA liability for enforcing security interests through nonjudicial foreclosure, and therefore is significant both for the entities that carry out the nonjudicial foreclosure and the creditors, including financial institutions, that hire law firms and others to enforce their security interests. Entities that undertake nonjudicial foreclosure are not subject to the FDCPA's main provisions, at least to the extent that they hew to the nonjudicial-foreclosure procedures dictated by state law.

The Court's holding in *Obduskey* is especially important because it protects against a conflict between state law and the FDCPA that had been imperiling businesses' ability to use the nonjudicial foreclosure process in certain States. In regions that had followed a contrary rule before *Obduskey*, holders of security interests were often left in a difficult bind: they had to choose between complying with state-law requirements for conducting a foreclosure and complying with potentially incompatible FDCPA requirements. A failure to comply with state law would cast doubt on the validity of a subsequent foreclosure sale, but an FDCPA violation could lead to costly litigation and potential liability. Because of the Supreme Court's decision, businesses will no longer face that dilemma in the nonjudicial foreclosure context, and will be entitled to use that process in the States that have chosen to make it available.

Questions remain after the Court's decision, however. In particular, litigation is likely to determine which actions related to a nonjudicial foreclosure but not required by state law fall outside the Court's reasoning. At least in Justice Sotomayor's view, regularly threatening to undertake a nonjudicial foreclosure that an entity does not in fact intend to initiate, is far enough removed from nonjudicial foreclosure activity that it would bring an entity into the general-purpose definition. What courts will decide about this question and other activities related to nonjudicial foreclosures remains to be seen.

Finally, the Court left open the question whether judicial foreclosure activities are also exempt from the FDCPA. Judicial foreclosures enforce a security interest through a court action, and the activity occurs under a court's supervision. A deficiency judgment against a debtor is available in many judicial foreclosures, although entities do not always pursue the deficiency. Much of the Court's rationale in *Obduskey* would seem to apply to judicial foreclosures, and the decision therefore opens up arguments that undertaking judicial foreclosure activity is similarly insufficient to subject an entity to the FDCPA's main provisions. But because the Court's opinion did not speak to the issue, it is likely to be the subject of future litigation.

To view all formatting for this article (eg, tables, footnotes), please access the original here.