HUDSON COOK

Massachusetts Supreme Court Rules on Debt Collector Licensing of Passive Debt Buyers

April 30, 2018 | Thomas P. Quinn, Jr.

At least one potential Massachusetts licensing requirement for passive debt buyers appears to have, finally, fallen by the wayside. Or has it?

The recent Massachusetts Supreme Court holding in *Dorrian v. LVNV Funding, LLC*, 2018 Mass. LEXIS 229 (Mass. April 9, 2018) is a good one for the debt buying industry. The case involved a party that acquired consumer debts and loans, but outsourced all collection and servicing responsibilities to a party holding a Massachusetts debt collector license. The Supreme Court concluded that that such a party, commonly referred to as a "passive debt buyer," does not need a debt collector license in Massachusetts. The *Dorrian* opinion is a story of cleaning up unintended legislative consequences. And, upon closer examination, the holding may not be the free pass that it appears.

Like all tales, we should start at the beginning. Massachusetts has had debt collection licensing statutes on its books for decades. Prior to 2003, the parties requiring licensure were referred to as "collection agencies." However, Massachusetts amended its collection statutes in 2003 to harmonize its language with the federal Fair Debt Collection Practices Act (FDCPA). At first blush, this appears to promote compliance efficiency, as parties would now have to worry about one set of rules. Comply with those rules and you're covered from both a Massachusetts and federal perspective. However, the devil is in the details. In this case, the details are the definitions, specifically the change in nomenclature from "collection agency" to "debt collector."

As the *Dorrian* opinion mentions, the 2003 revisions to the Massachusetts debt collection law were modeled after the FDCPA. Both Massachusetts law and the FDCPA define a "debt collector" to be a party who uses any instrumentality of interstate commerce or the mail in any business the principal purpose of which is the collection of debts or who directly or indirectly collects (or attempts to collect) debts that are owed or due to another. The Federal Trade Commission (FTC) had interpreted the FDCPA definition to include parties purchasing and collecting on delinquent accounts.

The Massachusetts Division of Banks initially cross-pollinated this interpretation into its interpretation of the newly revised Massachusetts law. In June 2006, it issued an Industry Guidance Letter Regarding Debt Buyers that concluded debt buyers were covered by the definition of "debt collector" under the Massachusetts statute. The Division of Banks reached this conclusion by relying almost exclusively on the interpretation of the FDCPA

definition of "debt collector" by federal courts and the FTC. There is logic to this approach - the same language should be construed the same way.

The problem with this analysis is that the FDCPA and the Massachusetts debt collection law impose different burdens on debt collectors. If you are a "debt collector" under the FDCPA, you are obligated to follow its conduct-regulating rules that govern how you collect. If you fall into that definition, but do not engage in any of the conduct regulated (for example, because you hire someone else to do it) the impact is minimal to nonexistent. Massachusetts requires more, however, as it not only regulates the conduct of debt collectors but it also requires their licensure. So, if you fell into the Massachusetts definition of "debt collector" under the June 2006 Industry Guidance, you would need a debt collector license. This was so even if all you did was own the debt being collected and even if you hired a duly qualified and licensed debt collector to do all the collections work.

Fortunately, this interpretation did not last long. A mere four months later the Division of Banks reversed course, in part, in the form of Opinion Letter 06-060. Under this opinion, the Division crafted a "passive debt buyer" exception to the licensing requirement. As articulated in that letter, this exception applies when a party purchases defaulted debt, but retains licensed debt collectors or attorneys to perform all the collection work. Since this clarification, the Division of Banks issued several more interpretive opinion letters confirming this position.

Which returns us to *Dorrian*. The Massachusetts Supreme Court parsed the Massachusetts definition of "debt collector" into two separate definitions. In the first, a debt collector is a party who engages in a business the "principal purpose of which is the collection of a debt." In the absence of legislative history regarding the 2003 Massachusetts amendments, the court turned to the legislative history of the FDCPA. The court noted that the legislative history evidenced a focus on improper and high-pressure collection activities, but no evidence supporting application of the "debt collector" definition to parties who, while they may own the debt, have no contact with the debtor. An absence of collection *practices* cuts against application of the definition. The court also gave significant deference to the Division of Banks' interpretations excluding passive debt buyers from the licensing requirement. In sum, so long as a passive debt buyer has no contact with a consumer and relies entirely on licensed third parties to interface with consumers in the collection process, it does not satisfy the first definition of "debt collector" in the Massachusetts statute.

The second definition of "debt collector" parsed by the Supreme Court covers an entity who directly or indirectly collects (or attempts to collect) a debt owed or due or asserted to be owed or due another. The court's analysis of this second definition is much shorter than the first, and relies on the U.S. Supreme Court's holding in *Henson v. Santander Consumer USA, Inc.*, 2017 U.S. LEXIS 3722 (U.S. (4th Cir. (D. Md.)) June 12, 2017). In *Henson*, the U.S. Supreme Court held that direct collection of purchased debts does not render a party a debt collector under the FDCPA because that party is not collecting "for another" but rather for itself. Considering this holding, the Massachusetts Supreme Court reached the same conclusion. It is worth noting, however, that the *Henson* court expressly excluded the first definitional component of "debt collector" from its analysis.

Considering *Dorrian*, exclusion of passive debt buyers from the debt collector licensing requirement seems like a slam dunk - but there are a couple of hanging threads. For example, in *Dorrian*, the Massachusetts Supreme Court reiterates on several occasions that the debt buyer had no contact with debtors and relied *entirely* on duly licensed third parties for collection efforts. Indeed, the October 2006 Division of Banks Opinion Letter clarified that, for the passive debt buyer exception to apply, "*all* collection activity" must be performed by a duly licensed debt collector or attorney. But what if the passive debt buyer retains some degree of oversight of the collection efforts?

This was the question before a Massachusetts Appellate Court last year in *Midland Funding, LLC v. Juba*, 2017 Mass. App. Div. LEXIS 5 (Mass. App. February 15, 2017). In *Midland Funding*, the named plaintiff acted as a purchaser of past-due credit card debt. While it outsourced the "bulk of practical aspects of collection" to a licensed third party, under the terms of its servicing agreement Midland Funding required the licensed collector to act in accordance with reasonable policies, procedures, and instructions it provided to the collector and required Midland Funding to have oversight of the collector's servicing efforts. Midland Funding was also the named plaintiff when collection lawsuits were filed. In the eyes of the appellate court, these activities were sufficient to give Midland Funding a degree of indirect involvement in the collections process to trigger the licensing requirement. In reaching this conclusion, the appellate court gave relatively little deference to the Division of Banks' opinion letters that the Massachusetts Supreme Court held in high esteem in *Dorrian*.

It is worth noting that the question of indirect control in the form of collection vendor oversight and management was not at issue in *Dorrian*, so it is unclear how the Supreme Court would have addressed it. Also, the *Dorrian* decision does discuss an amicus brief submitted by the Division of Banks which noted that its examination practices are not practical for passive debt buyers and, until recently, it would notify passive debt buyers applying for licensure that the application would not be processed because a license was not required. In light of this, it seems like the *Midland Funding* case should generally be considered an outlier post-*Dorrian*. However, it remains on the books and is thus a somewhat troubling precedent. Whether it should be ignored post-*Dorrian* is unclear.

The other issue unaddressed by *Dorrian* is whether other licensing requirements might be triggered by a passive debt buyer. For example, under the Massachusetts Small Loan Act, a party engaged in the business of making a "small loan" requires a license. A "small loan" is a loan of $6,000 or less with interest and expenses at a rate greater than 12% per year. The statute takes an expansive view of the activities considered to be "engaging in the business" of making such loans, and includes a party that purchases such a loan. If a passive debt buyer were to purchase such a loan it may be subject to licensure under this statutory scheme, even if it is exempt from licensure as a debt collector.

Make no mistake, on balance the holding in *Dorrian* is a step in the right direction. However, it is not a licensing panacea and should not be construed as such.

HUDSON
COOK

Hudson Cook, LLP is a national law firm representing the financial services industry in compliance, privacy, litigation, regulatory and enforcement matters.

7037 Ridge Road, Suite 300, Hanover, Maryland 21076
410.684.3200

hudsoncook.com