BONA FIDE ERROR DEFENSE APPLYS TO SERVICER & THE TRUSTEE NOT A "DEBT COLLECTOR" UNDER THE FDCPA

The U.S. District Court for the Southern District of Alabama recently granted summary judgment in favor of a mortgage loan servicer and the trustee of a mortgage backed securities trust in a putative class action alleging violations of the federal Fair Debt Collection Practices Act (FDCPA), ruling that the "bona fide error" defense applied to the servicer and that the trustee was not a "debt collector" under the FDCPA.

A copy of the opinion is available at: Link to Opinion.

A borrower defaulted on his mortgage loan and filed a petition under Chapter 7 of the U.S. Bankruptcy Code in June 2012, listing the mortgage loan in his schedules. A few months later, he was granted a discharge.

In January 2013, the loan servicer sent the borrower a letter advising that it would become the servicer of the loan effective Feb. 1, 2013. Between Feb. 1, 2013, when the servicing began performing it duties, and Dec. 1, 2013, the borrower did not receive any written communications from the servicer.

In September 2013, the borrower received another letter from the servicer advising that the loan had been transferred to a new owner, a bank acting as trustee of a mortgage backed securities trust.

The mortgage on the borrower's home was foreclosed and the loan servicer purchased the property for $238,800 at the foreclosure sale in November 2013.

After the foreclosure sale, the borrower received two monthly billing statements from the servicer dated Dec. 2, 2013 and Dec. 16, 2013. These statements reflected the total outstanding principal on the loan without mentioning either the foreclosure sale or the borrower's bankruptcy discharge. They did, however, contain a disclaimer that stated to the extent the borrower's obligations under the loan had been discharged, the statement was for informational purposes only and was not an attempt to collect the debt.

The borrower filed a putative class action on behalf of himself and similarly situated borrowers against the loan servicer and trustee, alleging that the two December statements violated sections 1692d, 1692e and 1692f(1) of the

FDCPA because the plaintiff's debt had been discharged in bankruptcy and because the statements did not credit the plaintiff with the amount received at the foreclosure sale.

The servicer's investigation during discovery revealed that the loan had been correctly coded as a foreclosure, which prevented the servicer's computerized system it uses from sending out statements automatically. However, sometime later the foreclosure code was inadvertently removed, which caused the system to issue the two statements. The servicer asserted during discovery that this mistake was limited to the borrower and did not happen as to any other loans being serviced.

The defendants raised several affirmative defenses, one of which generally alleged that the plaintiff's claims were barred by the FDCPA's bona fide error defense.

The defendants moved for summary judgment and also filed a motion to seal certain exhibits in support of the motion.

The Court first addressed the motion to seal, in which the defendants sought to exclude from public view four exhibits containing loan codes, describing the functions of the servicer's asset management department, the servicer's internal FDCPA policy and portions of its FDCPA training course for employees because such information is confidential and proprietary.

The Court agreed, finding that the common law presumption in favor of public access to the judicial system was outweighed by the servicer's interest in protecting the privacy of its proprietary business operations and the irreparable harm it would suffer if the information became public.

Turning to the bona fide error defense, the Court explained that it "forestalls FDCPA liability where a defendant's violation was unintentional and resulted from a bona fide error notwithstanding defendant's procedures reasonably adapted to avoid such errors."

In response, the borrower argued that the bona fide error defense is an affirmative defense, and that the servicer did not meet the heightened pleading requirements applicable to affirmative defenses.

Although the Court agreed that “federal courts have required defendants to plead the FDCPA bona fide error defense with particularity” and in order to “satisfy Rule 9(b), the defense must articulate ‘who, what, when, where and how’ the bona fide error occurred,” the Court held that the plaintiff's argument failed because he waited too long to raise it.

Specifically, the Court held that the borrower failed to move to strike the insufficiently pleaded defense within 21 days after service of the answer as required by Rule 12(f)(2). The Court found that the plaintiff “cannot raise this technical pleading defect for the first time on summary judgment as a means of derailing the Rule 56 Motion and excising that defense from the case.”

The Court then addressed the parameters of the bona fide error defense, explaining that FDCPA subsection 1692k(c) provides that “[a] debt collector may not be held liable in any action brought under this subchapter if the debt collector shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error.”

The Court noted that, “[a]s construed by the courts, this defense is unavailable for mistakes of law or misinterpretation of the FDCPA’s requirements, but instead is designed to ‘protect against liability for errors like clerical or factual mistakes.’”

The Court further explained that in order to “prevail on this defense, ‘a debt collector bears a three-part burden of showing that its FDCPA violation (1) was not intentional; (2) was a bona fide error; and (3) occurred despite the maintenance of procedures reasonably adapted to avoid any such error.’ … ‘The failure to meet any one of those three requirements is fatal to the defense.’”

The Court found that the servicer satisfied the first prong, which is a subjective test, and established the error was unintentional because the evidence clearly showed the servicer did not intend to send the December statements while the loan was in foreclosure and only did so due to its employee’s coding error.

As to the second prong, which “serves to impose an objective standard of reasonableness upon the asserted unintentional violation,” the Court explained that “[a] bona fide error is a mistake that occurred in good faith” before finding that the facts supported a “compelling inference that [the servicer’s] mistake in issuing the December 2013 billing statements to [the borrower] was made in good faith and was objectively reasonable (i.e., not a contrived mistake).”

Regarding the third prong, the Court explained that “the debt collector has an affirmative statutory obligation to maintain procedures reasonably adapted to avoid readily discoverable errors.” This is a two-step, “‘fact intensive inquiry’ that proceeds ‘on a case-by-case basis and depend[s] upon the particular acts and circumstances of each case.’”

The Court agreed with the servicer that its “general training procedures and its specific procedures for pre-foreclosure review” taken together, “adequately reflects that [the servicer] has mechanical, orderly processes in place to avoid errors, and that those procedures were reasonably adapted to avoid the specific error that occurred here (i.e., the reactivation of a borrower's loan on pre-foreclosure review, thereby changing the … code on the loan and erroneously ending suppression of monthly billing statements).”

The Court rejected the borrower's argument that the servicer's bona fide error defense failed because it had no procedure to avoid sending statements to borrowers whose debts were discharged in bankruptcy, because the case law is clear that “the bona fide error defense must be examined as to 'the specific error at issue'” which in the case at bar was the mistaken reactivation of the loan by the employee performing the pre-foreclosure review, not the servicer's “general practices concerning borrowers whose debts have been discharged.”

Accordingly, the Court found that the servicer met its burden of establishing that it was entitled to the bona fide defense, that no genuine issue of fact existed as to this defense, and that the servicer was entitled to summary judgment as a matter of law.

The Court then quickly determined that, as a matter of law, the trustee bank was also entitled to summary judgment because the undisputed evidence showed that it was not a debt collector within the meaning of the FDCPA. Instead, the trustee bank was the owner of the subject loan and the other loans in the trust and thus could not be a debt collector because those debts were not “owed or due another at the time of collection.”

The defendants' motion for summary judgment was granted and the plaintiff's claims dismissed with prejudice.