The FDCPA After Henson v. Santander: The Evolving Principal Purpose Test

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In June of 2017, the U.S. Supreme Court decided *Henson v. Santander*, a landmark Fair Debt Collection Practices Act ("FDCPA") case.[1] In *Henson*, the Supreme Court held that a person who collects debt that it owns is not "collecting debt owed or due another," which is one prong of the FDCPA's definition of "debt collector." Although important, the holding is not surprising. In fact, the case is more important for what it did not decide under the other prong of the FDCPA's definition of debt collector. The undecided issue is whether an entity that purchases debt and services that debt in its own name is a "debt collector" because it is engaged in a business with the "principal purpose" of collecting debts. While *Henson* may have narrowed the scope of the "collecting debt owed or due another" prong, it left open the question of what exactly it means for someone to have a business with the "principal purpose" of collecting debts.

Now that the "principal purpose" definition of debt collector is the primary battleground for suing debt buyers and other debt holders under the FDCPA, creditors would be wise to follow "principal purpose" caselaw to see how this legal issue evolves. Sooner rather than later, a debtor will argue that a full-service financial services company has the "principal purpose" of collecting debt. In this article, we provide a brief discussion of where the caselaw has been since *Henson*, where it could go, and the ways in which the FDCPA risk calculation might be changing for creditors.

The "Most Important or Influential Purpose" Test

At least one federal district court in the Ninth Circuit applied a test based on the dictionary definition of "principal." In *McAdory v. M.N.S. & Associates, LLC*,[2] the U.S. District Court for the District of Oregon considered the defendant's motion to dismiss, and held as a matter of law that a debt buyer that purchases delinquent accounts, hires a sub-servicer to collect the accounts, and has no interaction with debtors "simply do[es] not have the principal purpose of collecting debts."[3] The court in *McAdory* noted that one stated purpose of the FDCPA is to eliminate abusive debt collection practices by debt collectors.[4] From that purpose, the court reasoned that the FDCPA is meant to regulate the interaction between debt collectors and debtors.[5] The court then relied on, in part, the dictionary definition of "principal" which is "most important, consequential, or influential," to decide that purchasing debt and hiring a third party to collect the debt does not satisfy the statutory requirement that *collection* be the company's most important or influential purpose.[6]

"Principal Purpose" is a Question of Fact

In contrast, two federal district courts in the Seventh Circuit have reserved for factfinders the question of whether the defendants' "principal purpose" is debt collection. In *Mitchell v. LVNV Funding, LLC*,[7] the U.S. District Court for the Northern District of Indiana reconsidered the parties' cross-motions for summary judgment after *Henson*. The debtor submitted evidence that the defendant itself had described its business's general character as "consumer debt collection," that another court had determined that at least 99% of the defendant's gross revenue was derived from collecting on unpaid consumer debts it owned, and that a state supreme court had held the defendant was subject to the state debt collection statute.[8] In addition, unlike in *McAdory*, the plaintiff asserted that the defendant had interacted with debtors by filing lawsuits against them. Reasoning that the defendant's interaction with debtors by suing them distinguished the case from *McAdory*, the court found that the debtor submitted sufficient evidence to establish that debt collection was *one of* the defendant's purposes.[9] However, neither party had submitted sufficient evidence to resolve on summary judgment whether the defendant's *principal* purpose was the collection of debt.[10]

In *McMahon v. LVNV Funding, LLC*, the U.S. District Court for the Northern District of Illinois also concluded that the issue of the defendant's principal purpose was an issue of fact for a factfinder.[11] The defendant asked the court to consider whether *Henson* meant that it was not subject to the FDCPA because it was not collecting debt "owed or due another."[12] The debtor argued that *Henson* did not apply because the defendant was a debt collector under the "principal purpose" prong and *Henson* only addressed the "collecting debt owed or due another" prong.[13]

The *McMahon* court agreed with the debtor in part, explaining that the defendant would not be a "debt collector" under the "collecting debt owed or due another" prong because it owned the debt it was collecting, but could be a "debt collector" under the "principal purpose" prong.[14] The court found that the plain language of the "principal purpose" prong does *not* require that a debt buyer interact with debtors to be a debt collector.[15] The *McMahon* court additionally noted that if "all or an overwhelming majority of a business's revenue is derived from acquiring distressed debt and collecting it, then surely that business's principal purpose is the collection of any debts."[16] Because a reasonable jury could conclude, based on the evidence, that the principal purpose of the defendant's business was debt collection, the court denied both parties' motions for summary judgment.[17]

Pending Appeals in the Third Circuit

There are two appeals of cases from the U.S. District Court for the Eastern District of Pennsylvania pending in the U.S. Court of Appeals for the Third Circuit that could shed more light on how appellate courts will interpret the "principal purpose" prong after *Henson*.

In *Barbato v. Greystone Alliance LLC*,[18] the federal district court held (and affirmed on reconsideration after the *Henson* case) that the defendant was a "principal purpose" debt collector.[19] The defendant had unsuccessfully argued that it could not be a debt collector under *Henson* because it was a creditor that owned the plaintiff's debt and did not directly collect debt from the plaintiff.

In a similar vein, in *Tepper v. Amos Financial, LLC*,[20] the federal district court found in a bench trial that the defendant, which purchased and serviced defaulted debts, was a debt collector under the "principal purpose" definition.[21] In its ruling, the court explained that the "principal purpose" definition of debt collector is not limited to debts owed another, but rather applies to "any

debts."[22]

The defendants' arguments in these cases hinge, at least in part, on a pre-*Henson* line of cases holding that a person cannot be a creditor and a debt collector with respect to the same debt because those terms are mutually exclusive.[23] When analyzing whether a debt holder was a "debt collector," those pre-*Henson* cases relied on the status of a specific debt at the time a debt holder acquired it. In short, a debt holder that acquired a debt after default was a "debt collector," not a creditor, with respect to that particular debt.[24] In those cases, courts typically found that the debt holder was a debt collector under the "collecting debt owed or due another" definition, rather than the "principal purpose" definition, and analyzed whether a person was a debt collector on a debt-by-debt basis.

Uncertainty for Debt Holders

Open questions remain for debt holders as the "principal purpose" definition becomes the battleground for FDCPA litigation over whether a debt holder is a "debt collector."

First, clearly, after *Henson*, a debt holder can only be a "debt collector" under the "principal purpose" definition. Whether courts will continue to consider the default status of the account at the time of acquisition when analyzing whether a debt holder has a "principal purpose" of collecting debt is an open question. There is no statutory support for analyzing the default status of the debt at the time of acquisition under the "principal purpose" definition. The text of the FDCPA expressly excludes from the "collecting debt owed or due another" definition a person who acquires the debt prior to default.[25] But, there is no similar exclusion from the "principal purpose" definition. And, the "principal purpose" definition seems focused on the overall business of the alleged debt collector, rather than the status of each individual debt at the time the alleged debt collector acquires it.[26]

Indeed, it will likely be the case that traditional debt buyers will remain within the scope of the FDCPA notwithstanding that they may, at times, acquire mixed portfolios of defaulted and non-defaulted accounts because the principal purpose of their business is acquiring defaulted debts and collecting them, or hiring a third party to collect them. Less clear is whether a full-service financial services company can have a "principal purpose" of collecting debt when it acquires mixed portfolios that include some current accounts and some defaulted accounts.

Once a court determines that a debt holder that acquires a mixed portfolio is a "principal purpose" debt collector, a whole new issue arises: Must the debt holder comply with the FDCPA with respect to all of its debts, or just the ones it acquired after default? In the years before *Henson*, conservative debt holders would comply with the FDCPA with respect to only those debts they purchased after default. Now, if a court finds that a debt holder has a principal purpose of collecting debts, the plain text of the statute suggests that the debt holder will likely be a "debt collector" for all of its accounts, not just those it acquired after default.

Keep a Weather Eye

It would be unwise for a creditor or debt holder to proceed as if the Supreme Court's holding in *Henson* limited its exposure. It is not yet clear from the case law what strategies creditors and debt holders can use to mitigate their risk at the federal level (and, state creditor collection statutes with private rights of action are still an option for plaintiffs suing debt holders). The risk of having to defend an FDCPA lawsuit remains, and litigating the fact-intensive "principal purpose" prong of

the definition of debt collector under the approach in *McAdory* and *McMahon* will be expensive, particularly with so many metrics that could factor into "principal purpose" (e.g., revenue from collections, employees dedicated to collections, resource allocation). The court's language in *McMahon*, which suggested that courts could consider a company's revenue as a factor in the "principal purpose" determination, may be a clue to where other courts are headed. But, it is easy to see how a revenue-based analysis can balloon into something more complicated, particularly for large and complex enterprises where the servicing unit is an affiliate of a much larger organization.

Even if there is less risk after *Henson* for debt holders, plaintiffs will continue to test the boundaries of the FDCPA's scope in litigation, and could win at least some favorable holdings under the "principal purpose" prong against debt holders that originated the debt or that acquired it at some point after origination. Once that happens, debt holders will have to grapple with whether the FDCPA applies to all their accounts or just those they acquired after default. And, in states like California and Texas, which have collection practices statutes with private rights of action that apply to creditors collecting their own debts, the fact that a creditor might not have a "principal purpose" of collecting debts is irrelevant to whether it can be liable under those state statutes.[27]

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[1] *Henson v. Santander*, 137 S. Ct. 1718 (U.S. 2017).
[2] *Slip copy*, 2017 WL 5071263 (Dist. Or. Nov. 3, 2017).
[3] *Id.* at *3.
[4] *Id.*
[5] *Id.*
[6] *Id.*
[7] *Slip copy*, 2017 WL 6406594, *6 (N.D. Indiana Dec. 15, 2017).
[8] *Id.*
[9] *Id.*
[10] *Id.*
[11] 2018 WL 1316736, *13-14 (N.D. Ill. March 14, 2018). The case might sound familiar because the district court was hearing the case on remand, and for the third time, after the Seventh Circuit had already ruled on the debtor's claim that an offer to settle a time-barred debt could violate the FDCPA, and on certain class certification issues. This iteration of *McMahon*, however, came after *Henson*.
[12] *Id.* at *12.
[13] *Id.*
[14] *Id.* at 13-14.
[15] *Id.*
[16]*Id.* at 13.
[17] *Id.* at 14.
[18] *Slip copy* 2017 WL 1193731 (E.D. Pa. March 30, 2017), affirmed by the district court on reconsideration in 2017 WL 4770719 (E.D. Pa. Oct. 19, 2017), affirmed and superseded by 2017 WL 5496047 (E.D. Pa. November 16, 2017). Appeal filed on January 14, 2018.
[19] *Slip copy* 2017 WL 1193731, *10 (E.D. Pa. March 30, 2017).
[20] *Slip copy* 2017 WL 3446886 (E.D. Pa. Aug. 11, 2017).
[21] *Id.* at *8.
[22] *Id.* In *Tepper*, oral argument before the Third Circuit was held on June 5, 2018.
[23]*Fed. Trade Comm'n v. Check Investors, Inc.*, 502 F.3d 159, 173 (3d Cir. 2007); *Schlosser v. Fairbanks Capital Corp.*, 323 F.3d 534, 536 (7th Cir. 2003).

[24]*See, e.g., F.T.C. v. Check Investors, Inc.* 502 F.3d 159 (2007); *Beard v. Ocwen Loan Servicing, LLC*, 2016 WL 344300 (M.D. Penn. Jan. 28, 2016).
[25]15 U.S.C. § 1692a(6)(F)(iii).
[26]The Third Circuit may get to this issue when it considers *Barbato* because the lower court at least considered the issue of whether the "debts not in default" exception applies to the "principal purpose" definition.
[27]*See* Cal. Civ. Code §§ 1788.2(c), 1788.30; Tex. Fin. Code §§ 392.001(6), 392.403.