
Debt Collection Pitfalls: How to Avoid Adding Insult to Injury

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Rising credit defaults, declining revenues, increased write-offs, record bankruptcy filings. All businesses are feeling the pinch (if not the crush) of our current economic insecurity. As a result, business owners are finding themselves more and more in the unenviable position of being debt collectors. By now, most businesses are generally familiar with the procedures for asserting and documenting a claim in a bankruptcy case. Businesses also are becoming more proficient at seizing and selling collateral on secured loans. Unfortunately, bankruptcy law, the Uniform Commercial Code, and other laws regulating debt collectors are notoriously difficult to navigate, particularly for non-lawyers. Many costly traps await the unwary.

Non-Public Information

Businesses routinely collect non-public information ("NPI") from customers to whom they extend credit. Some examples of NPI include the customer's social security number, taxpayer identification number, driver's license number, financial account numbers, or birth date. The collection of such information is not objectionable so long as the business keeps the information secure and private. Disclosure of NPI can have serious consequences under both federal bankruptcy and North Carolina laws.

Bankruptcy Law. Creditors generally are required to file a proof of claim in connection with each account or claim they may have in a bankruptcy case. Filing a proof of claim generally requires completing a standard form and attaching any relevant documentation evidencing or supporting the claim (such as a credit application). Many businesses, particularly smaller businesses with smaller claims, will file their own proofs of claim rather than turn the matter over to an attorney. These businesses should be aware of Bankruptcy Rule 9037 which requires the redaction of NPI from all filings submitted to the bankruptcy court, including proofs of claim. While there are limited exceptions to the redaction requirement, the safest approach generally is to carefully redact all NPI from every proof of claim, including all attachments, or run the risk of court-imposed sanctions.

North Carolina Law. Disclosure of NPI runs afoul not only of Bankruptcy Rule 9037, but also may violate North Carolina law. The North Carolina Identity Theft Protection Act, enacted in 2005, prohibits businesses from intentionally revealing a person's social security number. Violation of this prohibition subjects the violating party to liability for treble damages and attorneys' fees. If a business reveals a customer's NPI with knowledge of the customer's objection to such disclosure, the customer may be entitled to recover no less than \$500.00 for each unlawful act, even if the customer can prove no loss resulting from the disclosure, as well as attorneys' fees.

The Uniform Commercial Code

The Uniform Commercial Code ("UCC") is set forth in Chapter 25 of the North Carolina General Statutes. Article 9 of the UCC governs the creation and enforcement of security interests in personal property. Article 9 also controls the disposition of collateral in the event of default and imposes certain obligations on secured creditors with respect to consumer debtors.

Debtor Requests for Information. Under the UCC, a debtor is entitled to an accounting of the debtor's unpaid obligations to the creditor and a listing of the collateral securing those obligations. If the debtor submits a proper request for such information, the secured creditor must respond with the information within 14 days. Failure to respond appropriately may

entitle the debtor to actual damages and statutory damages of \$500.00. If the collateral consists of goods used for personal or family purposes and not for business or commercial purposes ("Consumer Goods"), the debtor also may be able to recover additional statutory damages against the offending creditor. In addition, the creditor may forfeit its security interest in the collateral by failing to respond to a proper request from the debtor.

Termination Statements. If you are a creditor that has extended credit to a customer and taken a security interest in collateral to secure the loan, what happens when the loan is paid off? Under the UCC, for loans secured by Consumer Goods, the secured creditor must file a "termination statement" within one month after the loan is paid in full. The "termination statement" effectively cancels the creditor's security interest in the collateral. If the customer sends a demand for cancellation to the creditor, the creditor must file a termination statement within 20 days after receipt of the demand. For non-consumer goods, the secured creditor generally has 20 days following receipt of a demand from the debtor to file a termination statement. The failure to file a termination statement as required may render the secured creditor liable to the debtor for actual damages as well as statutory damages of \$500.00.

Disposition of Collateral. Following a default by a debtor on a secured debt, the secured creditor's rights and obligations with regard to any collateral are determined by the UCC. The secured creditor generally is entitled to dispose of the collateral so long as every aspect of the disposition is commercially reasonable. Prior to disposing of the collateral, the secured creditor must send a notification of disposition to all parties with an interest in the collateral. If the collateral consists of Consumer Goods, the notification must be sent within a reasonable time prior to the disposition. For collateral consisting of non-consumer goods, the notification must be sent at least 10 days prior to the disposition. The secured creditor's failure to send proper, timely notification prior to disposition of the collateral may result in the creditor being held liable for any loss suffered by the debtor as a result of the noncompliance. Where the collateral consists of Consumer Goods, the secured creditor may be liable for additional damages to the debtor.

Conclusion

Businesses routinely make loans by extending credit to customers. Inevitably some customers default on their repayment of the loan, rendering the business an unwitting debt collector. Businesses should be extremely careful in undertaking efforts to collect from customers, as even innocent, technical violations of certain statutes and rules can turn the tables and render the business liable to the customer.

For further information regarding the issues described above, please contact Benjamin E.F.B. Waller.

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