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Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Via U.S. Mail, Facsimile and Email

RE: Docket Number R-1210

Dear Ms. Johnson:

The stated primary objective of the Electronic Fund Transfer Act ("EFTA") is "the provision of individual consumer rights."[1] As discussed in this comment, certain provisions in Regulation E ("Reg E") and the official staff commentary thwart this goal and, in fact, serve purposes detrimental to consumer rights. Specifically, this comment concerns those provisions of Reg E and the staff commentary that discuss the use of electronic fund transfers to collect "NSF" fees on dishonored checks. Currently, certain debt collectors are misusing the provisions of Reg E and the staff commentary to circumvent protections afforded to consumers under the Fair Debt Collection Practices Act ("FDCPA") and applicable state laws.

Excluded from this comment are concerns related to the conversion of checks to electronic events at the point of sale and the requisite notice to a consumer concerning this conversion. At the time a check is presented for payment, the check is not a "debt" but simply a form of payment. In the event the check is later dishonored by the consumer's bank, only then does the dishonored check become a "debt" for the consumer. Most states allow a merchant or collection agency to also collect from the consumer a service charge in addition to the face amount of the dishonored check.[2] This comment concerns, on the one hand, the provisions of Reg E and the staff commentary and, on the other hand, the provisions of the FDCPA and their relationship to collection of this state-allowed service charge by electronic fund transfer.

As a preliminary matter, the staff commentary refers to the collection of "NSF fees" as covered by the EFTA and Reg E. Generally, the check collection industry defines "NSF fees" as

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[1] 15 U.S.C. § 1693(b).

[2] The charges, referred to as "service charges", "collection charges" or "penalties", vary in amount by state.

those fees charged and deducted by the consumer's financial institution from the consumer's account when the consumer writes a bad check. If the discussion in the staff commentary is intended to cover only "NSF fees" in this narrow context, a point of sale notice to the consumer about collecting this fee electronically is unnecessary. The consumer's financial institution could deduct the "NSF fee" directly from the consumer's account pursuant to the terms of the consumer's account agreement with the financial institution.

Obviously, the staff commentary intends a broader meaning for the phrase "NSF fees". Because the commentary addresses the need to provide the consumer with notice at the point of sale of a possible electronic fund transfer for the "NSF Fee", the staff commentary must intend to include the electronic collection of the state-allowed service charge in the term "NSF Fee". The language of the model clause in the proposed amendments to Reg E supports this broader meaning of "NSF Fees":

> If there is insufficient funds in your account, you authorize us to charge a fee of $**, and collect that amount through an electronic fund transfer from your account.

This comment assumes that the term "NSF Fee" has a meaning broader than the collection of amounts owed by a consumer for bad checks under a bank checking account agreement and includes amounts owed to merchants (or their collection agencies) for state-allowed service charges. To the extent Reg E only includes the former charges and not state-allowed service charges, the language of Reg E (*i.e.*, the proposed model clause) and the staff commentary should be amended to clarify the meaning of "NSF Fees".

CHECK COLLECTION INDUSTRY

FDCPA Consumer Protection

When a check is presented for payment and dishonored by the consumer's bank, the check is considered a "debt" for FDCPA purposes.[3] In addition, the FDCPA governs the collection of other fees and expenses incidental to the principal debt, including, any state-allowed service charge.[4]

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[3] *E.g., Gary v. Goldman & Co.*, 180 F. Supp. 2d 668, 670 (E.D. Penn. 2002), *and* FTC Staff Commentary on the FDCPA (term includes "dishonored check that was tendered in payment for goods or services acquired or used primarily for personal, family, or household purposes").

[4] 15 U.S.C. § 1692f(1).

Many merchants use the services of debt collectors to pursue and collect these debts. Debt collectors must comply with the provisions of the FDCPA in their collection activities.

Under the FDCPA,[5] a debt collector must send a letter to a consumer within five days following the first communication (*i.e.*, attempt to collect the debt) between the debt collector and the consumer.[6] The letter must include the following information: (i) the face amount of the check; (ii) the name of the merchant to whom the check was written; (iii) a statement that the consumer has thirty days in which to dispute the debt; (iv) a statement that, if requested, the collector will obtain verification of the debt; and (v) a statement that, upon request, the collector will provide the consumer with the name and address of the original creditor.[7] The FDCPA requires that the debt collector provide this information "to eliminate abusive debt collection practices by debt collectors, to insure that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged, and to promote consistent State action to protect consumers against debt collection abuses."[8]

If the consumer does not pay the amount owed in response to the first letter, the collector will send a second letter and/or place telephone calls to the consumer, also as governed by the FDCPA. If the consumer continues to refuse to voluntarily pay the amount due, the collector typically either forwards the debt to legal counsel for collection or returns the check to the merchant. The collector typically receives compensation for its services from the state-allowed service charges paid by those consumers that voluntarily satisfy their debt.

The FDCPA prohibits a wide variety of abuses on the part of debt collectors. For example, Section 806 prohibits a debt collector from engaging in "any conduct the natural consequence of which is to ***harass, oppress, or abuse***."[9] Section 807 precludes the use of any ***"false, deceptive, or***

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[5] Congress found that "[t]here is abundant evidence of the use of abusive, deceptive, and unfair debt collection practices by many debt collectors. Abusive debt collection practices contribute to the number of personal bankruptcies, to marital instability, to the loss of jobs, and to invasions of individual privacy." 15 U.S.C. § 1692(a).

[6] 15 U.S.C. § 1692g.

[7] *Id.*

[8] 15 U.S.C. § 1692(e).

[9] 15 U.S.C. § 1692d.

misleading representation or means in connection with the collection of any debt."[10] Section 808 of the FDCPA prohibits the use of ***unfair or unconscionable means*** by a debt collector to collect a debt.[11]

Courts reviewing FDCPA claims use the standard of "the least sophisticated consumer" or "the unsophisticated consumer."[12] This standard asks how "the least sophisticated consumer – one not having the astuteness of a 'Philadelphia lawyer' or even the sophistication of the average, everyday, common consumer" – perceives the action taken by the debt collector.[13] The least sophisticated consumer standard seeks "to protect naive consumers, while 'preserving a quotient of reasonableness and presuming a basic level of understanding.'"[14]

NACHA Rules

Under NACHA rules, a collector may not increase the face amount of a check as part of any RCK debit to allow collection of any State-allowed service charge. Moreover, NACHA rules require the consumer's written authorization to originate an EFT debit entry to the consumer's account.[15] An EFT to collect a service charge based solely on a point-of-sale sign clearly violates NACHA rules *unless the consumer also provides separate written authorization to draft the service charge.*

"Quick Take" Collection Process

A new breed of check collectors uses modern technology and point-of-sale signs as the basis for taking funds from the bank accounts of consumers without obtaining any express authorization or agreement from the consumers or sending the FDCPA-required notice letter. These "Quick Take" Collectors sometimes operate under the label of "processors" in an effort to distinguish themselves from traditional check collectors and to add credibility to their alleged non-regulated status. In fact,

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[10] 15 U.S.C. § 1692e.

[11] 15 U.S.C. § 1692f.

[12] *McKenzie v. E.A. Uffman and Assoc., Inc.,* 119 F.3d 358, 362 (5th Cir. 1997).

[13] *Russell v. Equifax*, 74 F.3d 30, 34 (2d Cir. 1996).

[14] *Chaudhry v. Gallerizzo*, 174 F.3d 394, 408-09 (4th Cir. 1999).

[15] *See* NACHA Operating Rule 2.1.2. Courts have found NACHA operating rules to be enforceable and have, therefore, granted them deference. *See, e.g., Geiger v. Crestar Bank*, 778 A.2d 1085 (D.C. 2001).

many of these "Quick Take" Collectors are not even licensed in the States where they conduct their check collection activities.

"Quick Take" Collectors use a two-step process to collect bad checks. The first step involves collection of the face amount of the bad check. The second step involves the collection of any state-allowed service charges.

RCK - Electronic Check Re-Presentment

To collect the face amount of the check, "Quick Take" Collectors obtain bank routing and customer account information from the returned checks (or their visual images). Using this account information, the Collectors convert the returned checks to electronic transactions for the purpose of clearing the ACH. "Quick Take" Collectors then electronically re-present the checks for payment against the consumer's account. This process is known as Electronic Check Re-presentment ("RCK presentment").

EFT's and Demand Drafts

To collect the applicable state-allowed service charge for returned checks, "Quick Take" Collectors use EFT or create and present demand drafts[16] against the consumer's account, again using the same account and routing information obtained from the returned checks. The service charges are sometimes collected at the same time as (or even regardless of whether) the face amount of the check is collected by RCK presentment. Typically, consumers receive no notice and never consent to collection of the service charges by EFT. To the extent "Quick Take" Collectors provide any information to consumers, the "notice" comes solely in the form of a posted point-of-sale sign. Of course, few if any consumers ever actually see, read or understand the provisions on point-of-sale signs posted among all of the other signs, advertisements and distractions in most retail stores at the point-of-sale. States' laws vary on whether point-of-sale notices are even capable of creating a binding agreement between a consumer and a merchant (or its collection company). Thus, the implication that a simple point-of-sale notice *without the required FDCPA notice* constitutes "adequate notice" of intent to withdraw funds is troubling.

[16] Some collectors also use "demand drafts" or "paper drafts". Reg E and NACHA rules do not govern these drafts, as they must be physically presented to a financial institution for payment.

After taking funds from the consumers, "Quick Take" Collectors remit some of the funds to the merchants or other original holders of the checks. The Collectors retain a portion of the funds collected from the consumers as compensation for their collection services.

This practice has been questioned and roundly criticized by leading experts in the collection industry.[17] In addition, the regulatory authorities of several States have rejected these collection practices under their statutory provisions.[18]

MISUSING REG E AND STAFF COMMENTARY

As support for their activities, the "Quick Take" Collectors cite the language of Reg E and the staff commentary. Specifically, these Collectors argue that Reg E authorizes the collection of the state-allowed service charges without regard to the requirements of the FDCPA or state law. In other words, rather than viewing Reg E as *permitting* the use of the EFT process *when* the substantive right to collect otherwise exists under state law, these Collectors suggest that Reg E *grants* substantive rights to collect the state-allowed service charge *regardless* of the requirements of the FDCPA (concerning debt collection) or state law (concerning creation of the underlying obligation to pay the service charge).

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[17] *Does the FDCPA Apply to Operators Who are Acting as "Check Processors?"*, McCluskey, Glen R., Director, Check Services Program, ACA Legal Counsel (June 21, 2002); *Can NSF Service Fees Be Collected with a Pre-Authorized Demand Draft?*, McCluskey, Glen R., Director, Check Services Program, ACA Legal Counsel (June 14, 2002); "What about Fees? Electronic check presentment leads to questions about collection of NSF service fees.", McCluskey, Glen R., *Collector* (February 2001); "Pre-Authorized Drafts and RCK Service Fees", *Bounce* (June 2001) (Collectively, Exhibit "A").

[18] Arizona and Maryland have specifically questioned the practice of relying on point-of-sale notices to collect service charges. *See* Letter from Craig A. Raby, Assistant Attorney General, State of Arizona (July 16, 2002); and Letter from Michael J. Jackson, Administrator, Department of Labor, Licensing and Regulation, State of Maryland (July 30, 2002). The Louisiana Office of Financial Institutions requires written permission from the check writer to collect a service charge. *See* Letter from Willie D. Maynor, Senior Attorney, Office of Financial Institutions, State of Louisiana (August 29, 2002). The Wisconsin Department of Financial Institutions, Division of Banking, has concluded that the collection of service charges based solely on a point-of-sale notice violates various State banking rules and regulations. *See* Letter from Ray Hellmer, Advanced Examiner, Department of Financial Institutions, State of Wisconsin (July 12, 2002). Utah prevents the collection of a service charge if a check is honored on re-presentment. Utah Code, § 7-15-1(3)(b). Finally, the statutory schemes of some States (*e.g.*, Mississippi (Miss. Code §§ 11-7-12 and 97-19-57(1))), require written notice to the check writer as a prerequisite to the right to collect a service charge. *See* Letter from Anne Marie Turner, Special Assistant Attorney General, Consumer Protection Division, State of Mississippi (August 26, 2002) (Collectively, Exhibit "B").

Not only does this interpretation of Reg E and the staff commentary conflict with the protections of the FDCPA, the NACHA Rules and the stated "primary objective" of the EFTA, the taking of funds in such a manner constitutes an "unauthorized electronic fund transfer" under the EFTA as the transfer is conducted without the "actual authority" of the consumer.[19] A point-of-sale notice does not adequately inform a consumer in a manner sufficient to obtain "actual authority" from that consumer to use the consumer's bank account information on a check for the purpose of deducting funds from that account for a state-allowed service charge.

DETRIMENT TO COLLECTORS AND CONSUMERS

Check collection companies that abide by the FDCPA, NACHA Rules and state law operate at a significant competitive disadvantage when compared to the "Quick Take" Collectors. Collecting the debt created by the returned check and the state-allowed service charge using traditional collection methods is significantly more expensive than simply posting a point-of-sale notice and then electronically debiting funds from a bank account. The "Quick Take" Collectors not only have lower costs but they also achieve faster collections (with quicker payments to their merchant customers). Check collection companies that play by the rules (that were established and have been maintained by Congress or state legislatures with a clear understanding of societal cost and benefit) find themselves with a decreasing share of the check collection market.

The "Quick Take" method also deprives consumers of protections afforded to them under the FDCPA, including the right to dispute the debt, the right to confirm the debt and the right to refuse payment of the debt. The "Quick Take" process also deprives consumers of protections afforded under various state laws (those laws that create the underlying right to the state-allowed service charge) and raises serious doubts about the creation of any contractual right (distinct from the statutory right) to collect a service charge for a dishonored check.

RECOMMENDATIONS

To clear the confusion that currently exists in the check collection industry and to adequately protect the rights and interests of the consumers, please consider adopting the following changes to Reg E:

1. Clarify that the EFTA, Reg E and the staff commentary grant no substantive right to collect a state-allowed service charge related to the collection of a dishonored check;

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[19] 15 U.S.C. § 1693a(11).

2. Clarify that the EFTA, Reg E and the staff commentary do not amend or modify (i) the rights available to consumers under the FDCPA, or (ii) the duties and obligations of collectors under the FDCPA;

3. Clarify that the EFTA, Reg E and the staff commentary do not amend or modify (i) the rights available to consumers under state law as concerns the imposition and collection of state-allowed service charges, or (ii) the duties and obligations of collectors under state law as concerns the collection of state-allowed service charges; and

4. Require the consumer's signature at the point-of-sale as a prerequisite to collecting by electronic fund transfer any service charge or "NSF Fee" otherwise permitted under law.

Thank you for your consideration of these comments. Please contact me if you wish to discuss these issues or if you want any additional information from me concerning these matters.

Very truly yours,

MAYO MALLETTE PLLC

J. Cal Mayo, Jr.

JCMjr./ms
Reg E Comment.wpd
Enclosures