

8.3: Consumer Protection Laws and Debt Collection Practices

Learning Objectives

By the end of this section, you will be able to:

- Understand that consumers have the right to cancel some purchases made on credit.
- Know how billing mistakes may be corrected.
- Recognize that professional debt collectors are governed by some laws restricting certain practices.

Cancellation Rights

Ordinarily, a contract is binding when signed. But consumer protection laws sometimes provide an escape valve. For example, a Federal Trade Commission (FTC) regulation gives consumers three days to cancel contracts made with door-to-door salespersons. Under this cooling-off provision, the cancellation is effective if made by midnight of the third business day after the date of the purchase agreement. The salesperson must notify consumers of this right and supply them with two copies of a cancellation form, and the sales agreement must contain a statement explaining the right. The purchaser cancels by returning one copy of the cancellation form to the seller, who is obligated either to pick up the goods or to pay shipping costs. The three-day cancellation privilege applies only to sales of twenty-five dollars or more made either in the home or away from the seller's place of business; it does not apply to sales made by mail or telephone, to emergency repairs and certain other home repairs, or to real estate, insurance, or securities sales.

The Truth in Lending Act (TILA) protects consumers in a similar way. For certain big-ticket purchases (such as installations made in the course of major home improvements), sellers sometimes require a mortgage (which is subordinate to any preexisting mortgages) on the home. The law gives such customers three days to rescind the contract. Many states have laws similar to the FTC's three-day cooling-off period, and these may apply to transactions not covered by the federal rule (e.g., to purchases of less than twenty-five dollars and even to certain contracts made at the seller's place of business).

Correcting Billing Mistakes

Billing Mistakes

In 1975, Congress enacted the Fair Credit Billing Act as an amendment to the Consumer Credit Protection Act. It was intended to put to an end the phenomenon, by then a standard part of any comedian's repertoire, of the many ways a computer could insist that you pay a bill, despite errors and despite letters you might have written to complain. The act, which applies only to open-end credit and not to installment sales, sets out a procedure that creditors and customers must follow to rectify claimed errors. The customer has sixty days to notify the creditor of the nature of the error and the amount. Errors can include charges not incurred or those billed with the wrong description, charges for goods never delivered, accounting or arithmetic errors, failure to credit payments or returns, and even charges for which you simply request additional information, including proof of sale. During the time the creditor is replying, you need not pay the questioned item or any finance charge on the disputed amount.

The creditor has thirty days to respond and ninety days to correct your account or explain why your belief that an error has been committed is incorrect. If you do turn out to be wrong, the creditor is entitled to all back finance charges and to prompt payment of the disputed amount. If you persist in disagreeing and notify the creditor within ten days, it is obligated to tell all credit bureaus to whom it sends notices of delinquency that the bill continues to be disputed and to tell you to whom such reports have been sent; when the dispute has been settled, the creditor must notify the credit bureaus of this fact. Failure of the creditor to follow the rules, an explanation of which must be provided to each customer every six months and when a dispute arises, bars it from collecting the first fifty dollars in dispute, plus finance charges, even if the creditor turns out to be correct.

Disputes about the Quality of Goods or Services Purchased

While disputes over the quality of goods are not "billing errors," the act does apply to unsatisfactory goods or services purchased by credit card (except for store credit cards); the customer may assert against the credit card company any claims or defenses he or she may have against the seller. This means that under certain circumstances, the customer may withhold payments without incurring additional finance charges. However, this right is subject to three limitations: (1) the value of the goods or services charged must be in excess of fifty dollars, (2) the goods or services must have been purchased either in the home state or within one hundred miles of the customer's current mailing address, and (3) the consumer must make a good-faith effort to resolve the dispute

before refusing to pay. If the consumer does refuse to pay, the credit card company would acquiesce: it would credit her account for the disputed amount, pass the loss down to the merchant's bank, and that bank would debit the merchant's account. The merchant would then have to deal with the consumer directly.

Debt Collection Practices

Banks, financial institutions, and retailers have different incentives for extending credit—for some, a loan is simply a means of making money, and for others, it is an inducement to buyers. But in either case, credit is a risk because the consumer may default; the creditor needs a means of collecting when the customer fails to pay. Open-end credit is usually given without collateral. The creditor can, of course, sue, but if the consumer has no assets, collection can be troublesome. Historically, three different means of recovering the debt have evolved: garnishment, wage assignment, and confession of judgment.

Garnishment

Garnishment is a legal process by which a creditor obtains a court order directing the debtor's employer (or any party who owes money to the debtor) to pay directly to the creditor a certain portion of the employee's wages until the debt is paid. Until 1970, garnishment was regulated by state law, and its effects could be devastating—in some cases, even leading to suicide. In 1970, Title III of the Consumer Credit Protection Act asserted federal control over garnishment proceedings for the first time. The federal wage-garnishment law limits the amount of employee earnings that may be withheld in any one pay date to the lesser of 25 percent of disposable (after-tax) earnings or the amount by which disposable weekly earnings exceed thirty times the highest current federal minimum wage. The federal law covers everyone who receives personal earnings, including wages, salaries, commissions, bonuses, and retirement income (though not tips), but it allows courts to garnish above the federal maximum in cases involving support payments (e.g., alimony), in personal bankruptcy cases, and in cases where the debt owed is for state or federal tax.

The federal wage-garnishment law also prohibits an employer from firing any worker solely because the worker's pay has been garnished for one debt (multiple garnishments may be grounds for discharge). The penalty for violating this provision is a \$1,000 fine, one-year imprisonment, or both. But the law does not say that an employee fired for having one debt garnished may sue the employer for damages. In a 1980 case, the Fifth Circuit Court of Appeals denied an employee the right to sue, holding that the statute places enforcement exclusively in the hands of the federal secretary of labor. *Smith v. Cotton Brothers Baking Co., Inc.*, 609 F.2d 738 (5th Cir. 1980).

The 1970 federal statute is not the only limitation on the garnishment process. Note that the states can also still regulate garnishment so long as the state regulation is not in conflict with federal law: North Carolina, Pennsylvania, South Carolina, and Texas prohibit most garnishments, unless it is the government doing the garnishment. And there is an important constitutional limitation as well. Many states once permitted a creditor to garnish the employee's wage even before the case came to court: a simple form from the clerk of the court was enough to freeze a debtor's wages, often before the debtor knew a suit had been brought. In 1969, the US Supreme Court held that this prejudgment garnishment procedure was unconstitutional. *Snidach v. Family Finance Corp.*, 395 U.S. 337 (1969).

Wage Assignment

A wage assignment is an agreement by an employee that a creditor may take future wages as security for a loan or to pay an existing debt. With a wage assignment, the creditor can collect directly from the employer. However, in some states, wage assignments are unlawful, and an employer need not honor the agreement (indeed, it would be liable to the employee if it did). Other states regulate wage assignments in various ways—for example, by requiring that the assignment be a separate instrument, not part of the loan agreement, and by specifying that no wage assignment is valid beyond a certain period of time (two or three years).

Confession of Judgment

Because suing is at best nettlesome, many creditors have developed forms that allow them to sidestep the courthouse when debtors have defaulted. As part of the original credit agreement, the consumer or borrower waives his right to defend himself in court by signing a confession of judgment. This written instrument recites the debtor's agreement that a court order be automatically entered against him in the event of default. The creditor's lawyer simply takes the confession of judgment to the clerk of the court, who enters it in the judgment book of the court without ever consulting a judge. Entry of the judgment entitles the creditor to attach the debtor's assets to satisfy the debt. Like prejudgment garnishment, a confession of judgment gives the consumer no right to be heard, and it has been banned by statute or court decisions in many states.

Fair Debt Collection Practices Act of 1977

Many stores, hospitals, and other organizations attempt on their own to collect unpaid bills, but thousands of merchants, professionals, and small businesses rely on collection agencies to recover accounts receivable. The debt collection business employed some 216,000 people in 2007 and collected over \$40 billion in debt. PricewaterhouseCoopers LLP, *Value of Third-Party Debt Collection to the U.S. Economy in 2007: Survey And Analysis*, June 2008, www.acainternational.org/files.aspx?p=/images/12546/pwc2007-final.pdf. For decades, some of these collectors used harassing tactics: posing as government agents or attorneys, calling at the debtor's workplace, threatening physical harm or loss of property or imprisonment, using abusive language, publishing a deadbeats list, misrepresenting the size of the debt, and telling friends and neighbors about the debt. To provide a remedy for these abuses, Congress enacted, as part of the Consumer Credit Protection Act, the Fair Debt Collection Practices Act (FDCPA) in 1977.

This law regulates the manner by which third-party collection agencies conduct their business. It covers collection of all personal, family, and household debts by collection agencies. It does not deal with collection by creditors themselves; the consumer's remedy for abusive debt collection by the creditor is in tort law.

Under the FDCPA, the third-party collector may contact the debtor only during reasonable hours and not at work if the debtor's employer prohibits it. The debtor may write the collector to cease contact, in which case the agency is prohibited from further contact (except to confirm that there will be no further contact). A written denial that money is owed stops the bill collector for thirty days, and he can resume again only after the debtor is sent proof of the debt. Collectors may no longer file suit in remote places, hoping for default judgments; any suit must be filed in a court where the debtor lives or where the underlying contract was signed. The use of harassing and abusive tactics, including false and misleading representations to the debtor and others (e.g., claiming that the collector is an attorney or that the debtor is about to be sued when that is not true), is prohibited. Unless the debtor has given the creditor her cell phone number, calls to cell phones (but not to landlines) are not allowed. Federal Communications Commission, "In the Matter of Rules and Regulations Implementing the Telephone Consumer Protection Act of 1991," http://fjallfoss.fcc.gov/edocs_public/attachmatch/FCC-07-232A1.txt. (This document shows up best with Adobe Acrobat.) In any mailings sent to the debtor, the return address cannot indicate that it is from a debt collection agency (so as to avoid embarrassment from a conspicuous name on the envelope that might be read by third parties).

Communication with third parties about the debt is not allowed, except when the collector may need to talk to others to trace the debtor's whereabouts (though the collector may not tell them that the inquiry concerns a debt) or when the collector contacts a debtor's attorney, if the debtor has an attorney. The federal statute gives debtors the right to sue the collector for damages for violating the statute and for causing such injuries as job loss or harm to reputation.

Key Takeaway

Several laws regulate practices after consumer credit transactions. The FTC provides consumers with a three-day cooling-off period for some in-home sales, during which time the consumer-purchaser may cancel the sale. The TILA and some state laws also have some cancellation provisions. Billing errors are addressed by the Fair Credit Billing Act, which gives consumers certain rights. Debt collection practices such as garnishment, wage assignments, and confessions of judgment are regulated (and in some states prohibited) by federal and state law. Debt collection practices for third-party debt collectors are constrained by the Fair Debt Collection Practices Act.

Exercises

1. Under what circumstances may a consumer have three days to avoid a contract?
2. How does the Fair Credit Billing Act resolve the problem that occurs when a consumer disputes a bill and "argues" with a computer about it?
3. What is the constitutional problem with garnishment as it was often practiced before 1969?
4. If Joe of Joe's Garage wants to collect on his own the debts he is owed, he is not constrained by the FDCPA. What limits are there on his debt collection practices?

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