MFY LEGAL SERVICES INCORPORATED

New York State Laws on Debt Collection Must Be Amended

Testimony to the New York State Assembly Standing Committees on Consumer Affairs and Protection, and on Judiciary
October 24, 2006

Karuna Patel, Esq.
Consumer Rights Project of MFY Legal Services

Good morning. My name is Karuna Patel and I am a staff attorney in the Consumer Rights Project at MFY Legal Services, Inc. MFY is dedicated to providing legal services to low-income and immigrant populations in New York City. In the last year, I have dedicated my practice to giving advice to and to defending seniors, people who are mentally and physically disabled, and other low-income populations confronted with debt collectors and debt collection. Based on my experience, I urge this Committee to amend New York State law, which now allows debt collectors – whether they are debt buyers, third party debt collectors or attorneys in the practice of debt collection – to regularly take advantage of people receiving federal and state disability and old-age benefits. When a person with limited income has his or her bank account frozen improperly, there is an immediate and dangerous cascading effect, because food cannot be purchased, rent will not be paid, and necessary medicines may not be bought.

MFY Legal Services, Inc. serves more than 2000 clients every year. We are the largest legal services provider for mental health service consumers in New York City and we have a project dedicated to providing legal services to seniors living in Manhattan. We launched our Consumer Rights Project one year ago in response to a growing demand for those services from our clients. Since then, we have found that the need for legal representation in the area of debt and debt collection is largely unmet. We have also partnered with the Volunteer Lawyers Project of the Brooklyn Bar Association in a project called Civil Legal Advice and Resource Office or CLARO. The innovative project is housed in the Brooklyn Courthouse. Once a week, volunteer attorneys provide advice and referrals, when possible, to pro se litigants in debtor/creditor matters.

Both the federal and state governments provide cash assistance in the form of Social Security Retirement, Social Security Disability (SSD), Supplemental Security Income (SSI), and Public Assistance to seniors and people with disabilities to meet their basic needs for food, clothing and shelter. Federal law, 42 U.S.C. § 407(a), and state law, CPLR § 5205, protect these and other assets and income from collection to pay consumer debts. The federal law specifically prohibits the use of the legal system for payment of debts from these resources. This policy is intended to ensure that the funds that government provides to fulfill the basic needs of our most vulnerable members are available for that purpose. With the law as it is currently written, debt collectors are regularly, sometimes purposefully, collecting these exempt funds.

Here are some situations I have encountered in which the letter and spirit of these protections are being violated:

- Mr. R's social worker calls me. She has a 61 year-old HIV+ client whose sole source of income is Social Security Disability. His disability payments are directly deposited into a bank account, as recommended by the Social Security Administration. He had a credit card years ago for which he was no longer able to maintain payments once he fell ill. He never got any court papers, but at the end of July of this year a judgment was entered against him. He walked into the bank in the beginning of August to find his bank account frozen. The only money in the account was Social Security Disability. Mr. R never received a notice, as required by New York Law, CPLR § 5222, from the judgment creditor stating that certain funds are exempt from collection by law. The social worker does her best to get the problem resolved. She speaks with someone at the debt collection attorneys' office. She sends them proof that Mr. R's only source of income is Social Security, with a letter stating that Mr. R can agree to pay $50 per month from this income if his account can be released, as he needs the money in the account for rent, food and utilities. A week later, the account is still frozen. Mr. R desperately needs the money in his account. The social worker calls me. I advise her that Mr. R's SSD is exempt from collection under federal law. This is news to her. Even when she told someone at the debt collection attorneys' office information that should, of course, have stopped the process of collection, nothing was done. I got involved and sent a letter stating the exemption. The account is finally released one week later. Total time Mr. R had no money: 28 days.

- Ms. A's social worker calls me. Ms. A is 66 years old. She had good credit and owned her own condominium until 5 years ago when she had a psychotic breakdown. As she became increasingly ill, she lost everything and ended up homeless. She was institutionalized and then began receiving mental health treatment. As her condition improved, and she moved to assisted living, her social service providers helped her obtain public assistance and SSI. One day, she went to the bank and found that her bank account totaling $800 of public assistance monies was frozen. She had no idea that there was a judgment against her. She had never been served with any court papers. She never received a notice, as required by New York Law, CPLR § 5222, from the debt collector explaining that her funds might be exempt from collection by law. Her social worker scrambled to help her. By the time he reached our offices, the money in the account was gone – it had already been paid to the debt collector. Now Ms. A has stopped using the bank altogether and goes to a check casher instead. To get her money back, we had to go to court. We learned that the original papers were served at an address where Ms. A last lived in about 1983. Fortunately we were able to get most of Ms. A's money back. Unfortunately, the bank charged her with a $125 fee, that will not be returned.

- Mr. C was hospitalized for mental illness and was unable to pay his rent. He was eventually evicted with an outstanding rent balance. He is currently recovering and living in supportive housing. In July, he went to the bank one day to find that his

account was frozen. His caseworker immediately called the Mental Health Law Project at MFY Legal Services. An MFY attorney advised the caseworker to inform the debt collection attorneys that the only funds in the account were exempt. About five days after his account was frozen, Mr. C spoke to the office of the debt collection attorneys and faxed them a Social Security award letter, proving that his only income was exempt. None of this mattered. Days later, the money was gone. All of this happened in a total of about 10 days.

These accounts reveal compounding effects of unfair and deceptive practices used by debt collectors in the execution of judgments and the lack of checks in the current system to safeguard exempt funds. The issues include

1. improper service of court papers that spiral into default judgments and frozen bank accounts;
2. failure to notify consumers of their rights, even when required by law;
3. lack of legal resources to help low-income consumers whose funds are wrongly restrained or taken;
4. bank fees charged to the consumer, regardless of whether restraint of funds was improper; and
5. collection of funds that are unquestionably exempt under the law.

As currently written, New York law gives collectors a structural advantage in the process. There are no checks on their practices, and thus, no accountability. Once a party has a judgment, that party has a right to serve a restraining notice on any financial institution with funds in which the judgment debtor is known to have an interest. CPLR § 5222(a). This means a debt collection attorney with a judgment can freeze a bank account in the judgment debtor's name and social security number by simply serving a piece of paper or even an electronic notice on the bank. The bank is then legally obligated to hold twice the amount due on the judgment. CPLR § 5222(b). The law requires the debt collector to notify debtors that their money or property may be exempt from collection and provides the content of such notice. The debt collector is obligated under the law to send the notice within one year before serving the restraining notice or within four days of serving the restraining notice. CPLR § 5222(d). The collector is not required to report or show any proof that the notice was provided. To finally take the money from the account, the debt collector must obtain the services of a Marshal or Sheriff. CPLR § 5230. Money can be held by the bank for up to one year. CPLR § 5222(b). Money can be executed upon by the Marshal or Sheriff as soon as it is restrained.

In this entire process, the presumption is that debt collectors will self regulate to ensure that they do not collect exempt funds. However, our clients' experiences evidence that exempt funds continue to be collected every day. To that end, we provide the following suggestions for reform to protect consumers from the unfair and sometimes deceptive collection of their exempt funds:

1. Reform Restraint and Execution Procedure. The current restraint and execution procedure gives debt collectors the right to restrain and even take funds regardless of their exempt status. We recommend reform similar to that adopted in Connecticut

and California. In cases where funds deposited into an account in the preceding 30 days are readily identifiable as exempt by a financial institution, a certain amount shall not be restrained or removed from the account. This measure would prevent individuals living on small, fixed incomes from incurring banking fees related to bounced checks and from falling victim to the cascading effects of losing access to the only money they have for basic needs.

2. Reform Notice Procedure. The current notice procedure allows the debt collector to meet its notice obligation by simply sending the notice via first class mail to any known address of the debtor. We recommend that the legislature require notice to be sent with return receipt requested. Furthermore, we recommend that the debt collector be required to present evidence to the Marshal or Sheriff that the consumer received such notice before the Marshal or Sheriff can lawfully execute on the funds.

3. Reform the Content of the Notice Requirement. The current notice provision is inadequate and unclear; it fails to give a consumer any idea about the specific actions he or she must take to protect exempt funds. We recommend that the notice provision include step-by-step instructions on how to claim an exemption in plain language. Moreover, this notice, when served, is often the first time a consumer learns that a judgment has been entered against him or her. The notice should define judgment and include step-by-step instructions on how to vacate a default judgment.

4. Create Penalties for Non-compliance with Notice Requirement under CPLR § 5222. Currently there are no penalties imposed on debt collectors that fail to notify consumers as required by the statute. We recommend that the legislature create a penalty for failure to notify as an incentive.

The goal of the proposed reforms is to enforce laws already in place to protect our most vulnerable populations. Without such reforms, debt collectors will continue to unfairly take funds protected by federal and state law. Without such reforms, debt collectors will continue to deceive consumers into handing over their government benefits. And in the end we as a society are literally paying for those practices to continue. Our Social Security, Supplemental Security Income and Public Assistance dollars are ending up in the pockets of debt collectors at the cost of state taxpayers who support the elderly and the disabled when they can't buy food, can't pay their utilities or can't pay their rent. We believe the New York State legislature is in a unique position to come to the aid of these most vulnerable consumers.

APPENDIX