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RE: Addition of Collection Costs to Principal Debt

Dear :

The Executive Director of the Colorado Collection Agency Board referred your letter to me for a response. I apologize for the delay in responding to your inquiry. The office has undergone some employee turnover during the past year, and the transition has created a slight backlog. I am sorry for any inconvenience this may have caused you.

You asked for help interpreting Rule 2.03(3) of the Collection Agency Board Rules. Please refer to the Executive Director's unofficial opinion letter dated January 8, 1991 to determine whether this rule actually applies to the contracts in question. (A copy is enclosed for your convenience.) It appears from what you have stated in your letter that the rule does apply here. However, in order to answer your specific question, an analysis of C.R.S. § 12-14-108(1)(a) is necessary as well.

In your scenario, the collection agency is paid a percentage of the amount it collects on behalf of the creditor. You asked whether the collection agency may increase the amount of the claim to include its commission. The contract between the creditor and the consumer states that the consumer will be liable for the creditor's collection costs upon the consumer's default.

C.R.S. § 12-14-108(1)(a) states:

(1) A . . . collection agency shall not use unfair or unconscionable means to collect or attempt to collect any debt, including, but not limited to, the following conduct: (a) The collection of any amount, including any interest, fee, charge, or expense incidental to the principal obligation, unless such amount is expressly authorized by the agreement creating the debt or permitted by law[.]

(Emphasis added.) The issue here is twofold: First, does the

agreement "expressly authorize" the addition of the collection costs, and second, how much may be added to the debt before the amount becomes unfair or unconscionable?

The federal provision, 15 U.S.C. § 1692(f)(1), is identical to the Colorado provision. The Federal Trade Commission initially interpreted "expressly authorized" to require the contract language which allowed for the addition of collection costs to specify the exact amount of the costs either in dollars or by a percentage. The phrase "reasonable collection fees" was considered too vague. See Schorr, FTC Informal Staff Letter (July 27, 1981) and Callison, FTC Informal Staff Letter (February 27, 1981). However, the FTC subsequently backed away from this position and advised that if the contractual provision for reasonable collection costs was sufficient under state law, it would be sufficient under the Federal Fair Debt Collection Practices Act (the "Federal act"). See Carter, FTC Informal Staff Letter (June 8, 1982). In other words, whether the collection costs are reasonable is to be determined by applicable state law.

In Colorado, the reasonableness of the amount of collection costs is a question for the trier of fact. See Greeley National Bank v. Sloan, 677 P.2d 409 (Colo. Ct. App. 1984) (dealing with attorney fees). The following considerations should come into play in determining reasonableness. Interest rates are already set to compensate the creditor for its collection expenses and losses. Therefore, any separate recovery of collection costs is duplicative. More importantly, consumer credit defaults usually result from the consumer's financial distress. The imposition of collection costs only exacerbates this distress and hinders the consumer's financial recovery.

The collection fees charged to the consumer must closely reflect the actual costs expended in collecting the debt, especially if the debt is substantial. The fee cannot be so large as to constitute a penalty. Carter, FTC Informal Staff Letter (June 8, 1982). A collection charge amounting to fifty percent of the original debt would be considered unconscionable and unfair. "If the charge collected from the debtor is in the form of a percentage collection fee, the amount of that fee should have some relationship to the cost of the collector in collecting or attempting to collect the debt." Schorr, FTC Informal Staff Letter (July 27, 1981). See also, Piscatelli v. Universal Adjustment Services, Inc., [1980-1989 Transfer Binder] Consumer Credit Guide (CCH) ¶ 96,377 (D. Conn. 1985) (twenty-five percent charge was not expressly authorized by the agreement and did not reflect costs actually incurred) and Callison, FTC Informal Staff Letter (February 27, 1981) (proposed charge of one-third was considered contrary to public policy and unconscionable per se). "In any event, a collector should be guided by what it could recover if

suit were instituted, viz., the original amount of the debt plus a reasonable percentage of interest and court costs." *Id.* See Grant Road Lumber Co. v. Wystrach, 682 P.2d 1146, 1148 (Ariz. Ct. App. 1984) (amount charged by the collection agency to the creditor is not prima facie reasonable).

Based upon the foregoing analysis, I would offer the following guidelines to you for the situation you described: If the contract between the creditor and the consumer does not at least use the terminology "reasonable collection costs," you should not add any collection costs onto the principal debt whatsoever. On the other hand, if the amount of collection costs is specified either by a maximum dollar amount, a percentage of the outstanding principal or, at a minimum, the use of the term "reasonable," you must make a determination of what is reasonable under the circumstances. Reasonableness should be determined based upon actual costs of collection expected to be incurred. Please note that by "incurred" I do not refer to the amount of the commission paid to the collection agency but rather the costs of collecting the debt based upon the actual collection efforts that would have been expended by the creditor itself had the account not been turned over for collection. The flat percentages you described which were arbitrarily determined by what it would take for the creditor to recover 100 percent of the debt are clearly unconscionable and against public policy.

Sincerely,



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Enclosure

AG Alpha: LW CB HZGCJ
AG File: CPTC4008