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Inf. Adv. # 84  
Hospital Coverage /  
25% Collection Fee

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## Department of Justice

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Dear

Please forgive me for the delay in responding to your letter of March 25, 1997, which was referred to me. Please be assured that we try to be far more prompt than this, as I explained on the phone.

You asked for assistance in evaluating whether a health care provider's plan to assess a surcharge of 25% on accounts that are being assigned for collection was proper under Iowa law.

The letter is not clear as to precisely how this would work. It appears as though what is envisioned is a one-time surcharge of 25% assessed as a collection fee. For example, if the consumer's obligation were \$1000, a one-time \$250 collection fee surcharge would be imposed, with the \$250 payable to the collection agency.<sup>1</sup> This response assumes that this one-time, flat fee is the charge at issue, and that it is a "default charge" or "collection fee," as opposed to a "delinquency fee," or "finance charge" which might be waived in the event of prompt payment.<sup>2</sup>

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<sup>1</sup> Your letter does not appear to suggest that the 25% would be a recurring charge applied to the outstanding balance on a periodic basis until paid. If the 25% surcharge were an APR applied to the debt, it would accrue interest at 2.083% per month - the monthly periodic rate which corresponds to a 25% APR. Were that the form it would take, the consumer would be charged, for example, \$20.83 per month on a \$1000 balance.

<sup>2</sup> Cf. Iowa Code § 535.11, governing finance charges on "accounts receivable," defined as "a debt arising from the retail sale of goods or services or both on credit." Iowa Code §

The underlying premise of your letter is that the hospital does not extend "credit" as that term is defined in Iowa Code § 537.1301(15), but you also state that the admission agreement contemplates a reference to a collection agency only if the entire bill is not paid "in a reasonable time." In light of that practice, the question of whether the hospital may in fact extend "credit" warrants attention.

Extending "Credit" as Defined by the ICCC and the Truth in Lending Act

The definition of "credit" under the ICCC is similar to that under federal credit regulatory statutes, including the Truth in Lending Act and the Equal Credit Opportunity Act (ECOA), so interpretations of those statutes may be relevant.

The ICCC defines credit broadly, as the right to purchase property or services and defer payment for them. Iowa Code 537.1301(15). The Truth in Lending Act defines "credit" as the right to defer payment of debt or to incur debt and defer its payment.<sup>3</sup> The ECOA defines credit as the right to defer payment of debt, incur debt and defer its payment, or purchase property or services and defer payment therefor.<sup>4</sup>

The Iowa Supreme Court apparently has addressed this issue directly only with reference to the dues provision of a membership agreement. In *State of Iowa ex rel Miller v. NFO*, 278 N.W.2d 905 (Iowa 1979), the court held that the organization's membership agreement did not allow deferment of dues, and hence the agreement was not a "credit" transaction within the meaning of the ICCC. Other "pay-as-you-go" arrangements have similarly been viewed as outside the scope of a "credit" transaction, under both the ICCC, Truth in Lending and the ECOA.<sup>5</sup>

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535.11(5).

<sup>3</sup> Reg. Z, § 226.2(a)(14). See also 15 U.S.C. § 1602(e).

<sup>4</sup> Reg. B, § 202.2(j). See also 15 U.S.C. § 1691a(d).

<sup>5</sup> *Muchmore Equipment, Inc. v. Grover*, 315 N.W.2d 92 (Iowa 1982) (construction contract calling for balance in full upon completion is not "credit" under ICCC). Cf *Shaumyan v. Sidetex Co.*, 900 F.2d 16 (2d Cir. 1990) (construction contract calling for progress payments as work is done is not credit under ECOA); *Hahn v. Hank's Ambulance Service*, 787 F.2d 543 (11th Cir. 1986) (no "credit" for TIL purposes where \$5 charge was imposed for failure to pay at time services were performed); See also *Iberlin v. TCI Cablevision of Wyoming*, 855 P.2d 716 (Wyo. 1993) (billing for cable

However, with a service provider such as a hospital, the billing practice may in fact constitute a deferred payment arrangement. If payment is indeed due upon discharge, that might well be considered a "pay-as-you-go" transaction. However, if a patient is allowed a "reasonable" time to either pay or to make arrangements to pay for the services subsequent to discharge, that would appear to constitute "deferred" payment, as that word is ordinarily understood.<sup>6</sup> That, in turn, would constitute the "extension of credit."<sup>7</sup>

Should the extension of credit be involved, it is then necessary to determine whether the accounts would constitute "consumer credit transactions" subject to the ICCC. This is critical, as the collection surcharge would be prohibited if these are consumer credit sales. Iowa Code § 537.3402 prohibits any charges imposed as a result of default by the consumer other than those authorized by the ICCC, except for reasonable repossession expenses.<sup>8</sup>

#### Consumer Credit Transactions

The ICCC governs "consumer credit sales." Under the ICCC,

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services in advance is not credit under Wyoming Consumer Credit Code).

<sup>6</sup> To "defer" is defined as to delay, put off, postpone to a future time, Black's Law Dictionary (6th Ed. 1990)

<sup>7</sup> See, e.g. Bright v. Ball Memorial Hospital Association, 616 F.2d 328, 335-336 (7th Cir. 1980), rev'g in relevant part 463 F. Supp. 152. (NB. One case relied upon by the Iberlin court, supra [Rogers Mortuary v. White, 594 P.2d 351 (N.M. 1979)] relied upon the later reversed district court decision in Bright. Rogers should therefore not be considered sound precedent.)

<sup>8</sup> Default is defined by Iowa Code § 537.5109 as failure to make a payment within ten days of the time required by agreement, or failure to observe any other covenant which materially impairs the consumer's prospect to pay amounts due under the transaction, or materially impairs the creditor's rights in any collateral.

Delinquency charges are permissible within the limits prescribed in Iowa Code § 537.2502.

a "consumer credit sale" of services<sup>9</sup> must meet five elements.

(1) Credit is granted by a seller regularly engaging in credit transactions of the same kind;<sup>10</sup>

(2) The buyer is a person other than an organization;

(3) The services are primarily for personal, family or household purposes;

(4) Either the debt is payable in installments, or a finance charge is made;

(5) The amount financed is \$25,000 or less.

The second and third elements would typically be present when the sale of medical services is involved, and the fifth, of course, would vary.

The fourth element has been examined by the courts in both the context of the Uniform Consumer Credit Code, and in relation to the analogous trigger under Truth in Lending.<sup>11</sup> As with the question of "credit," whether this prong is met is dependent upon the hospital's actual practices.

Payable in installments -- Under the ICCC, whether a transaction is "payable in installments" is a question of fact, which may be found by implication through a course of dealing or course of performance, as well as overt agreement.<sup>12</sup> Therefore, if

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<sup>9</sup> Furnishing medical services for consideration would constitute the "sale of services" as that term is defined in Iowa Code § 537.1301(38).

<sup>10</sup> A hospital would be a seller. Iowa Code § 537.1301(39). (An organization is a "person," Iowa Code § 537.1301(32)(b).)

<sup>11</sup> Under Truth in Lending, a consumer credit transaction must either be payable by written agreement in more than four installments (not including a down payment), or may be subject to a finance charge. 15 U.S.C. § 1602(f); Reg. Z § 226.2(a)(17)(i)(A).

<sup>12</sup> "Payable in installments" means that payment is "required or permitted by agreement to be made in more than four installments, excluding a down payment." Iowa Code § 537.1301(31). An "agreement" can be oral or written, and may be found by implication from a course of dealing, usage of trade or course of performance. Iowa Code § 537.1301(3).

the hospital permits patients to pay their bills in five installments, even if only by a course of silent acquiescence, the fourth prong would be met under this alternative test.<sup>13</sup>

Finance charge -- The alternative "finance charge" trigger has been litigated under both the ICCC and Truth in Lending. Your letter does not indicate whether the hospital's practice is to impose any finance or delinquency charges (other than the flat 25% collection fee) on the hospital's accounts. As some health care providers bill on terms such as, "accounts remaining unpaid after 30 days will be subject to a 1 1/2% charge," a discussion is warranted of whether such a billing practice might constitute a "finance charge." If any charge which constitutes a finance charge is imposed, then this alternative trigger is met, and transactions below the \$25,000 threshold would be "consumer credit transactions," subject to the ICCC.

A finance charge is defined as all charges payable directly or indirectly by the consumer, imposed directly or indirectly by the creditor as an *incident to* or a condition of the extension of credit.<sup>14</sup> The term does not include charges for "actual, unanticipated late payment."<sup>15</sup>

The ICCC, however, goes on to specifically provide that charges imposed on a common accounts-receivable billing model is not a late charge which may be excluded from the definition of a finance charge.

A charge is not made for actual unanticipated late payment, delinquency, default or other like occurrence if imposed on an account which is or may be debited from

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<sup>13</sup> Cf. *Bright v. Ball Memorial Hospital Association, Inc.* 616 F.2d 328, 336 (7th Cir. 1980) (TIL case: hospital, while desiring and encouraging payment at discharge, also established option to arrange to pay in installments; "[g]iven the size of the Hospital's bills, there is no doubt that some patients are offered installment plans payable in more than four installments.") (NB: Truth in Lending, under prior version applicable in *Bright*, did not require that agreement to pay in installments be written; old Reg. Z § 226.2(s)).

<sup>14</sup> Iowa Code § 537.1301(19) (a) (ICCC). See also 15 U.S.C. § 1605(a), Reg. Z § 226.4(a) (TIL).

<sup>15</sup> Iowa Code § 537.1301(19) (b) (1). See also Reg. Z § 226.4(c) (2) (TIL).

time to time for purchases... and, under its terms, payment in full or at a specified amount is required when billed, and in the ordinary course of business the consumer is permitted to continue to have purchases ... debited to the account after the imposition of the charge.

Iowa Code § 537.1301(19) (b) (1).

The Iowa Supreme Court, reviewing the pattern of conduct of a fuel vendor over time, found the charges imposed to be a finance charge, waived if payment was made within 30 days, rather than a late charge for actual, unanticipated late payment. The account was therefore a "consumer credit transaction." *Landon v. Mapco, Inc.* 405 N.W.2d 825 (Iowa 1987).

In the context of a hospital, it would appear that if medical services, in the ordinary course of business, are provided to consumers though accounts remain open after a delinquency or default charge has been imposed, the charge would constitute a "finance charge" sufficient to trigger application of the ICC. <sup>16</sup>

If either the installment payment or finance charge trigger is met, a transaction of \$25,000 or under would then constitute a "consumer credit transaction," making it impermissible to impose the collection charge. Iowa Code § 537.3402.

#### "Almost" Consumer Credit Transactions

If the hospital's sale of medical services meets all of the above prongs except the fourth one, then one or more of three provisions of the ICC nonetheless may be implicated.

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<sup>16</sup> Under Truth in Lending, which does not include the above-quoted language relating to accounts receivable, whether a charge is for actual, unanticipated late payment on a 30-day account, for example, is fact-specific, weighing factors such as the terms of the account and the actual practices of the creditor, including how aggressively collection efforts are made. Official Staff Commentary § 226.4(c)(2)-1. Compare *Bright v. Ball Memorial Hospital and Vega v. First Fed. Sav. & Loan Ass'n*, 622 F.2d 918 (6th Cir. 1980) (charges were for actual unanticipated late payments) with *Wadesboro Rainbow Farm Supply, Inc. v. Lookabill*, 357 S.E.2d 373 (N.C. Ct. App. 1987). See also *Iberlin v. TCI Cablevision of Wyoming*, 855 P.2d 716 (Wyo. 1993) (charges were for actual unanticipated late payment under Wyoming UCCC).

- A delinquency charge may not exceed the amount permitted as a finance charge for open-end credit sales.<sup>17</sup> As of July 1, 1997, the parties may fix the amount of finance charge by agreement.<sup>18</sup>

- A debt collector<sup>19</sup> cannot impose a collection fee unless it is both reasonably related to the actions taken by the debt collector, and the debt collector is legally entitled to collect the fee.<sup>20</sup>

- A debt collector cannot collect any other type of charge or fee unless it is expressly authorized by the agreement creating the obligation and is legally chargeable.<sup>21</sup>

Assuming that the hospital's Condition of Admission will constitute the requisite written agreement, the remaining question is whether a 25% fee is "reasonably related to the actions taken by the debt collection."

Your letter indicates that the surcharge would not exceed the collection agency's fee. Presumably the hospital's justification for a "reasonable relationship," therefore, is in the nature of indemnification. However, as Iowa Code §537.7103(5)(c) focusses on the collection fee the debtor is being asked to pay, a "reasonable relationship to the actions" taken by the agency with respect to that account nonetheless would ultimately have to be shown.<sup>22</sup>

#### Reasonableness and Other Standards

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<sup>17</sup> Iowa Code § 537.2601(2).

<sup>18</sup> Iowa Code § 537.2202, as amended by H.F. 611 Section 2, 3. (Iowa Acts \_\_\_\_\_ 1997).

<sup>19</sup> "Debt" includes transactions which would be consumer credit transactions if the fourth prong of the definition were met. Iowa Code § 537.7102(3).

In the scenario you describe, both the hospital and the collection agency would be "debt collectors," subject to Article 7 of the Consumer Credit Code. Iowa Code § 537.7102(4).

<sup>20</sup> Iowa Code § 537.7103(5)(c).

<sup>21</sup> Iowa Code § 537.7103(5)(d).

<sup>22</sup> cf. Bondanza v. Peninsula Hospital & Medical Center, 590 P.2d 22 (Cal. 1979), discussed below.

Whether a flat percentage-based fee can meet a reasonableness test has apparently not been addressed by the Iowa courts in this century, nor in the context of adhesion contracts.<sup>23</sup> Neither is it a question fully resolved by the courts in other jurisdictions.

Enclosed is an excerpt from National Consumer Law Center, *Fair Debt Collection* (3d ed. 1996) which discusses case law on collection fees, including percentage-based fees. Though the discussion mingles the fees for collection attorneys and collection agencies, both would appear to be relevant in the context of your question.<sup>24</sup>

One case cited therein which may be particularly useful to you is *Bondanza v. Peninsula Hospital and Medical Center*, 590 P.2d 22 (Cal. 1979). The California Supreme Court held that a 1/3 collection fee on hospital accounts, without regard to actual costs incurred, violated California's unfair and deceptive practices act. While the hospital's contracts provided that the patient would be responsible for "reasonable attorneys' fees and collection costs," rather than specifying the percentage fee, it appears that the court's analysis may have been no different if the contract had in fact specified a 1/3 collection fee.<sup>25</sup> It cites several factors, including the fact that these are adhesion contracts, that a patient may be penalized for delays caused by his insurer, and that there may be no relationship between the actual expense and the fee. The court explicitly rejected the notion that, because the hospital paid the fee to the collection agency, it represents the "actual expense of collection." It held that the creditor could not increase the burden by assigning the debt, (applying California law). 590 P.2d at 27.

Your letter asked whether there were any interpretations of collection fees under unconscionability standards. The *Fair Debt*

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<sup>23</sup> See *McIntire v. Cagley*, 37 Iowa 676 (1873) (10% attorneys fee was an enforceable liquidated damage clause; not an unenforceable penalty in absence of such disproportion as to make it clear the principle of compensation was disregarded, or evidence that it was a cloak for usury).

<sup>24</sup> See NCLC, *Fair Debt Collection* § 13.7.5.1.

<sup>25</sup> Under California law, late and default charges are permissible where they constitute "liquidated damages," but are not permissible where they constitute a penalty. See, e.g. *Beasley v. Wells Fargo Bank*, 1 Cal. Rptr. 2d 446 (Ct. App. 1991). That may also be the Iowa standard, in absence of explicit statutory guidance. See *McIntire v. Cagley*, *supra*.

Collection excerpt divides case law into three categories: those which allow contractual fees under a freedom of contract perspective (§ 13.7.5.2), those which examine the fees in light of expenses actually incurred (§ 13.7.5.3), and those which prohibit them in the absence of explicit statutory authorization. Unconscionability is among the theories used by courts taking the third approach. (§ 13.7.5.4).

If you wish to discuss this matter further, or provide additional information concerning the hospital's actual billing practices, please feel free to call.

Sincerely,



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Iowa Consumer Credit Code

Encl.