

Comments
To the Federal Trade Commission
Regarding the
Fair Debt Collection Practices Act

**Protecting Consumers in Debt Collection Litigation and Arbitration:
A Roundtable Discussion**

By the
National Consumer Law Center
On behalf of its
Low Income Clients

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Introduction

The National Consumer Law Center applauds the Federal Trade Commission for following up on its February 2009 Report, *Collecting Consumer Debts: The Challenges of Change – A Workshop Report*, in holding this roundtable on consumer debt collection litigation and arbitration topics. We are a nonprofit organization that specializes in consumer issues affecting low-income and elderly people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations, from all states who represent low-income and elderly individuals on consumer issues.

As a result of our daily contact with these advocates, we are keenly aware of the abusive practices and hurdles that individuals face when they are sued in court or forced to enter arbitration. We supply these comments for this Roundtable to underscore the urgent need to reform the litigation and arbitration process, to reiterate our previous findings and recommendations, and to inform the public about recent developments affecting debt collection.

The Increase of Unaffordable Debt

At the time the Fair Debt Collection Practices Act (FDCPA) was passed in 1977, the FTC noted that the primary reason that debts were not paid was due to a loss of income, caused by either change in employment or illness.¹ Now, even though loss of income remains a significant factor in delinquent debts, abuses in the credit industry bear a major responsibility for pushing consumers over the brink. In fact, credit card debt has become one of the largest sources of debt that leads to collection activity and the problems associated with it are emblematic of many other types of debts as well.

- Since the passage of the Fair Debt Collection Practices Act in 1977, credit card deregulation has encouraged creditors to solicit consumers aggressively.

¹ Federal Trade Commission, Statement of Basis and Purpose for the Credit Practices Rule, 49 Fed. Reg. 7740, 7747 (Mar. 1, 1984).

- At the beginning of 1977, revolving debt was about \$32 billion; by 2007, it had increased more than 27 times to \$880 billion.² There are now almost 1.5 billion cards in circulation—over a dozen credit cards for every household in the country.³
- Creditors make huge profits from the fees and penalties assessed on consumers. The income from just three fees—penalty fees, cash advance fees and annual fees—reached \$24.4 billion in 2004, and total fee income topped \$30 billion.⁴

With the dramatic increase of consumer debt, the debt buyer industry has ballooned as well. SEC filings show that revenues and profits of the largest debt buyers have multiplied as much as four to six times from 2001 to 2005.⁵

- The face value of all delinquent debt in 1993 was \$1.3 billion; it was estimated to be \$110 billion in 2005.⁶
- The big debt buyers buy multimillion dollar portfolios ranging from pennies per dollar on the debt to a fraction of a cent on the dollar for an entire portfolio.
- Debt buyers will not, and many cannot, tell consumers much information about the debt. Critical information such as consumer complaints about billing errors or identity theft is typically not given to the debt buyer, often because the information has been destroyed by the original creditor.
- Some debt is resold numerous times. The Baltimore Sun reported that one identity theft victim, Nancy Rose, was contacted repeatedly by a series of debt collectors for a \$5,045 bill that was not hers. Even after she sued and won a \$40,000 settlement, the debt was simply sold again and she had to fight with yet another collector.⁷

The collection of these debts exacts a heavy toll on low-income and senior citizens in particular, who are saddled with debt often because of their precarious financial situation. Since they live on fixed-incomes or paycheck to paycheck, there is little margin for error;

² See Federal Reserve Board, Statistical Release - Consumer Credit Historical Data (Revolving), available at www.federalreserve.gov/releases/g19/hist/cc_hist_mt.txt

³ U.S. Census Bureau, Statistical Abstract of the United States: 2003 at 751 (Table 1190): Credit Cards – Holders, Numbers, Spending, and Debt, 1990 and 2000, and Projections, 2005, available at www.census.gov/prod/2004pubs/03statab/banking.pdf; U.S. Bureau of the Census, *Projections of the Number of Households and Families in the United States: 1995 to 2010* at 9 (1996), available at www.census.gov/prod/1/pop/p25-1129.pdf (projecting 108.8 million households by 2005).

⁴ *Id.*

⁵ Eileen Ambrose, “Debt That Won’t Die,” *Baltimore Sun*, May 6, 2007, (citing Paul Legrady, director of research for Kaulkin Ginsberg, a company that advises the debt collection industry), available at <http://www.baltimoresun.com/business/investing/bal-bz.ambrose06may06,0,5473187.column>.

⁶ Comments of the Debt Buyers Association to the FTC regarding Telemarketing Rule 3 (April 4, 2002), available at <http://www.ftc.gov/os/comments/dncpapercomments/04/debtbuyersassociation.pdf#search=%22credit%20america%20debt%20buyers%22>.

⁷ See “Debt that Won’t Die,” *supra* note 5.

flawed services of process or nonexistent evidentiary standards during court and arbitration hearings can easily lead to extreme financial deprivation. A lack of financial knowledge and unfamiliarity with the legal process often make the situation that these individuals face even worse.

- Among seniors with income under \$50,000 (70 percent of seniors), about one in five families with credit card debt is in debt hardship, spending over 40 percent of their income on debt payments, including mortgage debt.⁸
- Debt levels for households headed by someone 75 and older averaged \$20,234 in 2004, a 160 percent jump from 1992, the Employee Benefits Research Institute reported.⁹
- In 2004, 27% of families in the bottom income quintile faced a debt-to-income ratio of 40% or greater.¹⁰
- The mean amount of credit card debt was \$6,504 for households with incomes less than \$35,000 per year.¹¹

Past Findings on Abuses of the Courts, Mandatory Arbitration, and Other Debt Collection Practices and Techniques.

Consumers all too often face abusive debt collection practices and techniques regardless of the type of process through which they face debt collectors, whether it be in the courts, throughout an arbitration process, or with them directly. Debt collectors and buyers frequently file lawsuits that they are not prepared to litigate—and may not even be factually valid—with the expectation that a large number of consumers will default or will not be prepared to defend themselves. Arbitration organizations claim there are impartial, but in reality, are reliably pro-business. Abusive, threatening, and illegal phone calls and threats remain typical. Debt collectors still fail to validate debts, which leads them to pursue debts against the wrong person or after a debt that has been settled with a prior holder.

- Debt collectors like to file in small claims courts because of their relaxed procedural formalities, low evidentiary standards, inexpensive filing fees, and negligible pleading requirements.

⁸ Heather C. McGhee and Tamara Draut, Demos, “Retiring in the Red: The Growth of Debt Among Older Americans,” January 19, 2004, *available at* <http://www.demos.org/pub101.cfm>.

⁹ Leslie Haggin Geary, “Debt gaining on many U.S. Seniors,” June 4, 2007, *available at* http://www.bankrate.com/brm/news/pf/20070604_seniors_in_debt_a1.asp#1.

¹⁰ See Urban Justice Center, “Debt Weight: The Consumer Credit Crisis in New York City and its Impact on the Working Poor,” October 2007, *available at* http://www.urbanjustice.org/pdf/publications/CDP_Debt_Weight.pdf at 5.

¹¹ *Id.*

- For every rare consumer who shows up prepared to defend herself, the collector obtains many more default judgments based on minimal or nonexistent proof against consumers who fail to appear, may not even have received notice, or are simply unable to afford to take time to defend themselves.
- In 2005, almost 122,000 small claims were filed in Massachusetts Small Claims Courts, and approximately 60 percent of those claims were brought by debt collectors.¹² Abuses of the small claims courts are also common in other states.
- By one estimate, about 80 percent of consumers sued by debt buyers do not show up to court.¹³ All of those cases result in default judgments which are obtained without any evidence of the debt ever presented to the court.¹⁴
- Once a collector has a judgment—even if it is a faulty one against a person who was not properly served, for a debt outside the statute of limitations, or against the wrong person or in the wrong amount—the judgment effectively launders a bad debt.
- A common complaint heard from consumers occurs when they have provided their bank account and routing numbers to a debt collector to allow a specific, single withdrawal, only to find that the debt collector has withdrawn all funds or has made multiple unauthorized withdrawals.¹⁵
- Debt collectors frequently will offer and then finalize settlement agreements, only to continue to seek the full balance through dunning, in court, or by selling the claim to another debt buyer without noting the settlement agreement.¹⁶
- Collectors sometimes will coerce a consumer into making a small payment without telling them that such a payment may revive the legal viability of a debt that was beyond the statute of limitations.¹⁷

Past Recommended Reforms

The dramatic increase in consumer debt, the growth of the debt collection industry, and the increasing use of abusive practices demonstrates that not only does the FDCPA need to be seriously strengthened, but the general regulatory and legal framework, as well as its procedures, also needs to be reformed as well.

¹² See Beth Healy, Michael Rezendes, Francie Latour, Heather Allen, and Walter Robinson, ed., “Dignity Faces a Steamroller: Small-Claims Proceedings Ignore Rights, Tilt to Collectors,” *The Boston Globe*, July 31, 2006, at A1.

¹³ Telephone Interview with Paul LaRoche, Esq. an attorney from Gardner, Massachusetts with significant experience in bankruptcy and defending debt collection cases (June 1, 2006).

¹⁴ *Id.*

¹⁵ The National Consumer Law Center and the National Association of Consumer Advocates, Comments to the Federal Trade Commission Regarding the Fair Debt Collection Practices Act (June 6, 2007), at 19-20, available at <http://www.ftc.gov/os/comments/debtcollectionworkshop/529233-00018.htm>.

¹⁶ *Id.* at 21.

¹⁷ *Id.*

Better Information, Communication, and Disclosures

- Before initiating collection efforts, debt collectors should be required to possess certain basic information about the debt that at minimum should include: (1) proof of indebtedness; (2) the date that the debt was incurred and the date of the last payment; (3) the identity of the original creditor as known to the consumer; (4) the amount of the debt principal and an itemization of all interest, fees or charges added to it by the original creditor and all subsequent holders; and (5) the chain of title if the debt has been sold.
- Before a collector files a complaint, the collector should possess the basic information listed above in a form admissible in the court, certify that fact in the complaint, and certify to the court or arbitrator that the collector possesses any license required by state law.
- The creditor and each subsequent holder of the debt must retain and pass on to the next holder all communications from the consumer concerning the debt and information about all known disputes and parties.
- Debt collectors should not be permitted to launder the debt of claims and defenses simply by selling it to another collector.
- The initial written communication to the consumer should include the name of the original creditor, as well as an itemization of fees and interest included in the debt.
- When a consumer requests verification of the debt, collectors should be required to verify with a reasonable investigation that is responsive to the consumer's specific dispute.
- Collectors should be required to disclose to a consumer that she cannot be sued when the collector seeks payment for a time barred debt.
- Consumers should be informed of their right to cease communications and should be allowed to exercise this right orally.

Specific Abusive Practices And Lenders That Should Be Targeted

- Illegal freezing of exempt funds. The FTC should recommend statutory or regulatory changes to prohibit banks from freezing accounts containing exempt funds under federal and state law.
- Payday loans. The FTC should ban the holding of a post-dated check or electronic authorization as security for a payment, since the practice is the modern day equivalent of a wage assignment. The FTC should also open a rulemaking process

- Mortgage servicers. A stronger and more specific federal law should be adopted to deal with the terrible problems mortgage servicers cause in the collection of debts, such as the misapplication of payments, including the failure to timely credit payments, improper force-placed insurance, and false claims of defaults or amounts due. FDCPA should be expanded to cover all servicers' collection of all mortgage debts.
- Cross collection by refund anticipation lenders. The consumer should be told at the beginning of the tax preparation session that if they have a prior outstanding RAL debt, there will be an attempt to collect that debt and any information obtained will be used for that purpose.
- Abuse of credit cards as a debt collection device. Debt collectors should be required to disclose to consumers that old debt will be transferred to the balance of a new credit card and that accepting the card will extend the time to collect old debt and may reduce the consumer's credit score.
- Unfettered electronic access to consumer accounts. The FTC should declare the following practices to be unfair: (1) failing to honor a consumer's oral or written instruction to stop or modify electronic or ACH access to the consumer's account; (2) debiting a consumer's account, whether by ACH or electronic debit, in an amount other than which the consumer has specifically authorized; (3) requiring consumers to inform or obtain consent from the payee before stopping an electronic payment; (4) charging the consumer a fee to revoke authorization for a preauthorized electronic or ACH debit; and (5) permitting or causing multiple representation of an electronic debit. In addition, debt collectors should also be required (1) to obtain written confirmation of any orally authorized withdrawal from the consumer's account, which must be signed by the consumer prior to the withdrawal, and (2) to provide consumers with a clear disclosure that any authorization of withdrawal is revocable.

Simple, but Critical Updates to FDCPA

- Consumers should be able to record abusive telephone calls of collectors. The Act should be amended to provide that a consumer or a debt collector is authorized to record a telephone conversation without the knowledge or consent of the other party, and that such a recording shall be admissible in court or other proceedings pursuant to this Act or state law respecting debt collection practices.
- "Mistakes" of law are not bona fide errors. Although most courts follow the majority view that excludes errors of law, the Act should be amended to clarify that mistakes of law are not bona fide errors.

- Remedies provided by the Act should be updated and improved. The Act should be amended to explicitly provide that consumers may seek injunctive relief to restrain illegal tactics from continuing.
- The Act should be amended to give FTC the rulemaking authority to adjust the figures for class relief and statutory damages in accordance with inflation each year and to permit damages for each violation. Additionally, the Internal Revenue Code should be amended to state that fees paid to a consumer's attorney under the Act are not taxable income to the consumer, regardless of the manner in which the fees are calculated.

When the FTC asked for comments in 2007, they also requested some feedback on some of their proposed modifications to the FDCPA. Our responses are below.

- We would be happy to have the Act explicitly require that collectors notify credit bureaus about oral disputes of a debt, although we believe that the law is already clear on this point. However, we support an amendment stating that an oral dispute prevents the collector from assuming a debt is valid since circuit courts have split on this issue.
- We would not object to the FTC making the "least sophisticated consumer" standard explicit in a formal advisory letter, although we do not believe the Act needs to be clarified in this regard.
- Model collection letters that are true to FDCPA's protections would be helpful to both consumers and industry. However, imperfect model letters would be worse than the current situation.
- We would welcome an amendment confirming the FTC's correct interpretation that the single response after receiving a consumer's "cease communication" notice may not include a demand for payment, whether phrased as a settlement offer or any other way.
- Collectors should be absolutely required to provide the name and address of the original creditor of the debt in their first communication with consumers.

Recent Developments

Since we last sent a comment to the FTC about the FDCPA and the debt collection industry in June 2007, new data and studies continue to show that debt collectors and buyers continue to abuse the court system and mandatory arbitration.

Abuse of the Courts

- According to the Urban Justice Center, debt collectors and buyers filed roughly 320,000 cases against New York City consumers in 2006, a number comparable to the total number of civil and criminal cases filed in the federal trial courts

¹⁸ In all, debt collectors filed nearly \$1 billion worth of lawsuits and obtained judgments for almost \$800 million, an amount equivalent of building one new stadium for the Mets every year.¹⁹

- An overwhelming majority, 89.3 percent of all cases, was filed by debt buyers, yet only 12 of the 39 debt buyers in its study were licensed by New York City.²⁰ Of the 80 percent of all cases that result in default judgments, 99 percent of them were granted based on inadmissible hearsay and therefore did not meet the standard set forth in New York law for entry of a default judgment.²¹
- According to a MFY Legal Services study of New York City, process servers rarely make personal service. Two of the three companies examined by MFY never served by personal delivery, while one of them served 93 percent of its cases by “nail and mail.”²²
- A 2008 Florida Law Review study of filings in Virginia state court found that hundreds of thousands of Virginians are sued for defaulting on consumer debts. Less than 14 percent of the defendants in Richmond general district court owned their own homes, well below the state average of 75.1 percent and the Richmond average of 76.2 percent.²³
- A 2009 William Mitchell Law Review article found that in Minnesota’s Hennepin County, which includes Minneapolis, 41 percent of total default judgments filed between January and August 2008 were filed by debt buyers, while another 28 percent were filed by credit card companies. In 2007, debt collectors filed around 2,400 default judgments every month in the entire state.²⁴
- In April 2009, the New York Attorney General filed civil and criminal fraud charges against American Legal Process, a legal process server. Many of ALP’s process servers filed records showing they were in as many as four places at once, sometimes at opposite ends of the state.²⁵

¹⁸ See Urban Justice Center, “Debt Weight: The Consumer Credit Crisis in New York City and its Impact on the Working Poor,” October 2007, *available at* http://www.urbanjustice.org/pdf/publications/CDP_Debt_Weight.pdf at 3.

¹⁹ See *Id.* at 9 and 21.

²⁰ See *Id.* at 13.

²¹ See *Id.* at 1, 9-10.

²² See MFY Legal Services, Inc., “Justice Disserved: A Preliminary Analysis of the Exceptionally Low Appearance Rate by Defendants in Lawsuits Filed in the Civil Court of the City of New York,” *available at* www.mfy.org/Justice_Disserved.pdf.

²³ Richard M. Hynes, *Broke But Not Bankrupt: Consumer Debt Collection in State Courts*, 60 Fla. L. Rev. 1 (2008).

²⁴ Sam Glover, *Has the Flood of Debt Collection Lawsuits Swept Away Minnesotans’ Due Process Rights?*, 35 Wm. Mitchell L. Rev. 1115 (2009).

²⁵ Elizabeth Stull, “Lynbrook Process Servers Charged With Fraud,” *The Daily Record (Rochester, NY)*, April 15, 2009, *available at* http://findarticles.com/p/articles/mi_qn4180/is_20090415/ai_n31536385/.

- In July 2009, the New York Attorney General filed a lawsuit against two collection agencies and 35 lawyers and law firms and has asked the court to void over 100,000 default judgments that were fraudulently obtained due to improper service by ALP. The default judgments allowed these debt collectors and buyers to seize over \$500 million, or an average of \$5,474 from each consumer, and the lawsuit seeks that the money be returned to consumers as well.²⁶

Abuse of Mandatory Arbitration by Debt Collectors

- On July 14, 2009, the Minnesota Attorney General filed a lawsuit against NAF alleging violations of state statutes that prohibit consumer fraud, deceptive trade practices, and false statements in advertising.²⁷
- NAF is partly owned by a New York hedge fund that also owns the major collection law firm Mann Bracken LLP, which steers business to NAF. NAF has gone out of its way to hide these conflicting financial ties from the public.²⁸
- In 2006, NAF processed 214,000 consumer debt collection arbitration claims, of which nearly 60 percent were filed by law firms now merged as Mann Bracken LLP.²⁹
- The complaint also details how NAF encourages corporations to file arbitration claims with it. NAF has assisted corporations in drafting arbitration clauses, draft claim forms, advises them on arbitration legal trends, and even refers companies to debt collection firms.³⁰
- Less than a week from the lawsuit, NAF said it would exit the consumer arbitration business nationwide as part of a settlement with the Minnesota Attorney General's Office.³¹ NAF now can no longer administer arbitrations involving consumer debt, including credit cards, consumer loans, telecommunications utilities, health care and consumer leases.³²
- On July 21, 2009, the American Arbitration Association said it will stop taking debt-collection arbitrations "until some standards or safeguards are established."³³

²⁶ Jonathan D. Glater, "N.Y. Claims Collectors of Debt Used Fraud," *New York Times*, July 22, 2009, available at <http://www.nytimes.com/2009/07/23/business/23cuomo.html>.

²⁷ Robert Berner, "Minnesota Sues a Credit Arbitrator, Citing Bias," *BusinessWeek*, July 14, 2009, available at http://www.businessweek.com/bwdaily/dnflash/content/jul2009/db20090714_952766.htm.

²⁸ *Id.*

²⁹ State of Minnesota v. National Arbitration Forum, Inc., National Arbitration Forum, LLC, and Dispute Management Services, LLC d/b/a Forthright, Complaint, July 14, 2009.

³⁰ *Id.*

³¹ Nick Ferraro, "State Settles Suit Against Arbitration Company It Alleges Mised Consumers," *St. Paul Pioneer Press*, July 20, 2009, available at http://www.twincities.com/allheadlines/ci_12872198.

³² Tom Abate, "Arbitration Firm Calling It Quits," *San Francisco Chronicle*, July 22, 2009, available at <http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2009/07/22/BU6I18SJKN.DTL>.

³³ Robin Sidel and Amol Sharma, "Credit-Card Disputes Tossed Into Disarray," *Wall Street Journal*, July 21, 2009, available at <http://online.wsj.com/article/SB124822374503070587.html>.

Conclusion

We again applaud the FTC for choosing to highlight at this Roundtable the need to examine and address problems that exist in litigation and arbitration proceedings. Greater transparency, accountability, and meaningful access to justice should be the principles that guide the FTC's policy recommendations on debt collection. Despite recent progress in fighting abusive practices against arbitration organizations, process servers, and debt collectors, comprehensive changes to the debt collection process are still needed. The explosion of consumer debt and the current economic crisis that we face make reforms to debt collection all the more urgent.