Supplemental Comment to the Federal Trade Commission
Regarding Debt Collection Workshop (P074805)

Collecting Consumer Debts: The Challenges of Change

Submitted by:

Roger Haydock, Managing Director,
National Arbitration Forum, LLC

November 9, 2007

Federal Trade Commission
Office of the Secretary
Room H-135 (Annex N)
6000 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

RE: Empirical data reveals that arbitration outcomes match court outcomes

The National Arbitration Forum, a leading administrator of alternative dispute resolution proceedings (e.g., arbitration and mediation), is submitting this supplemental comment in order to apprise the Federal Trade Commission of various studies demonstrating that arbitration and litigation produce similar results, both when a business entity files a collection claim against a consumer, and in contested contract cases whether filed by a consumer or a business entity.

The National Arbitration Forum stands by our original comment[1] and wishes to supplement the record of the Debt Collection Workshop with information from empirical studies of the outcomes of debt collection cases resolved in court. As noted during the recent Debt Collection Workshop, when a collection claim is filed against a consumer in the arbitral forum, the business entity prevails 93.8 percent of the time.[2] Of course, in the absence of an apples-to-apples comparison, this "win rate" sheds no light on the fairness or efficacy of consumer arbitration.

An apples-to-apples comparison is best achieved by comparing the 93.8 win rate with the win rate of business entities who file collection claims in court. We are aware of two studies on this question.

---

[1] Available at http://www.ftc.gov/os/comments/debtcollectionworkshop/529233-00030.pdf.

[2] This figure is based on a Public Citizen study that examined 19,294 arbitration filings in California. *See* Public Citizen, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers* 15 (Sept. 27, 2007), available at http://www.citizen.org/documents/Final_wcover.pdf. The study was not specifically limited to collection matters, but as the author of the study noted, all but 15 of the cases were identified as "collection" matters. *Id.* In other words, 99.9 percent of the filings were collection matters. We have not independently verified the accuracy of the underlying data or analysis, and we are assuming the study is accurate solely for the purpose of comparing the reported win rate with outcomes in court.

The Caplovitz Study

The first is a classic study from the 1960's that was funded primarily by a grant from the now-defunct Office of Economic Opportunity.[3] This study examined several issues pertaining to consumer debt, including the role of the courts in the collection process.

The authors of the study compiled their data by analyzing 1,131 court records in three major cities: (1) New York City; (2) Chicago; and (3) Detroit.[4] More specifically, the authors obtained their data from court files in which a business entity had sued an individual for unpaid debt on an installment loan or purchase.

According to the study, the business entity prevailed in 96-99 percent of the cases, and in 91-92 percent of the cases, the business entity prevailed by obtaining a default judgment.[5] The exact percentage varied by city, as illustrated by the table below.

	Percentage of Cases in which Lender Obtained…	
	…a Favorable Outcome	*… a Default Judgment*
New York City	99	92
Chicago	96	91
Detroit	96	91

The Sterling-Schrag Study

A more recent study examined collection cases filed against consumers in the District of Columbia's small claims court.[6] In this study, the authors compiled their data by randomly selecting 287 collection cases filed in 1998.[7] They augmented their data by interviewing a subset of consumers.[8]

The study found that the business entity prevailed in 96 percent of the cases.[9] The likelihood of a default judgment (74 percent) was less than in the earlier study, presumably because the small claims procedure only required the borrowers to appear in

[3] *See* David Caplovitz, *Consumers in Trouble: A Study of Debtors in Default* (1974).
[4] *Id.* at 8. Philadelphia was part of the general study but excluded from the court outcome analysis because of a wrinkle in Pennsylvania law. *Id.* at 323.
[5] *Id.* at 221.
[6] *See* Sterling & Schrag, *Default Judgments Against Consumers: Has the System Failed?*, 67 Denv. U. L. Rev. 357 (1990).
[7] *Id.* at 361.
[8] *Id.* at 362.
[9] *Id.* at 360.

court while the usual court procedure requires defendants to submit a written answer in response to the complaint. These results are summarized in the table below.

	Percentage of Cases in which Lender Obtained…	
	…a Favorable Outcome	*… a Default Judgment*
Washington D.C.	99	74

Comparing the Win Rates

In light of those two studies, the reported 93.8 percent win rate in arbitration is slightly less than the win rate for comparable cases filed in court. The reality is that lenders prevail in a high percentage of collection cases, whether brought in court or in arbitration, because liability for debt is ordinarily a clear-cut proposition.

No one seriously disputes that fact. Even consumer advocate Bud Hibbs recently acknowledged that the lender obtains a default judgment in over 80 percent of the debt collection cases brought in small claims court.[10] Similarly, according to a *Boston Globe* feature on debt collection in small claims court, approximately 80 percent of consumer defendants fail to appear in court.[11]

In addition, research has shown that arbitration and court produce similar outcomes in contested cases. For instance, one study compared outcomes in contested cases initiated by a consumer and found that the consumer prevailed 66 percent of the time in arbitration and 62 percent of the time in court.[12] Appendix A presents this study in tabular format, along with the studies previously discussed.

The Benefits of Arbitration

In reality, arbitration offers distinct advantages to consumers embroiled in a collection dispute. Most notably, for consumers who have a colorable defense, arbitration is more likely to facilitate their presentation of that defense. There are two major reasons for this.

---

[10] Teresa McUsic, *Unpaid Credit-Card Bills Giving Rise to Lawsuits*, Fort Worth Star-Telegram, Aug. 31, 2007.

[11] *Dignity Faces a Steamroller: Small-Claims Proceedings Ignore Rights, Tilt to Collectors*, Boston Globe, July 31, 2006, available at http://www.boston.com/news/specials/debt/part2_main [hereinafter *Dignity Faces a Steamroller*].

[12] *See* Mark Fellows, *The Same Result as in Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes*, 14 Metropolitan Corp. Counsel 32 (2006).

Hearing Options

First and foremost, arbitration allows for non-participatory hearings[13] (also known as document hearings or desk hearings) and telephone hearings,[14] which enables borrowers to present a defense without missing work, incurring travel expenses, or entering uncharted waters that are the attorneys' domain.

Appearing in court presents an economic difficulty for many consumers, especially those who cannot afford to miss work (i.e., low-income consumers) or those who must travel a long way to reach the courthouse (i.e., rural consumers).[15] In fact, according to the Sterling-Schrag study, nearly half of the consumers who failed to appear in court cited their inability to miss work as a reason for their default.[16]

Anecdotal evidence also highlights the economic difficulty of appearing in court. For example, in a case of mistaken identity that was discussed in the *Boston Globe* feature on debt collection, the supposed borrower "had to take time off work, costing him $200 a day, to convince the court it had the wrong guy."[17]

Appearing in court also poses a psychological difficulty for consumers with no attorney because the formality of the setting coupled with the presence of authoritative figures can be very intimidating for the uninitiated.[18] The consumer's adversary, on the other hand, almost always has an attorney because the law in most jurisdictions requires a business entity appearing in court to be represented by an attorney.[19] Given these circumstances, the business entity often enjoys a "home field advantage" in court proceedings involving a consumer.

With the availability of non-participatory hearings, arbitration removes these obstacles and thereby facilitates a consumer's participation in the legal process. This aspect of arbitration, along with the relative simplicity of the procedures, enables consumers to get a fair shake without losing a day's wages to appear in court or, potentially, spending a month's salary to hire an attorney.

---

[13] *See, e.g.*, Rule 28 of the National Arbitration Forum *Code of Procedure*, available at http://www.adrforum.com.
[14] *See, e.g.*, Rule 26(A)(2) of the National Arbitration Forum *Code of Procedure*.
[15] In those cases where an in-person hearing is held, the National Arbitration Forum *Code of Procedure* minimizes any inconvenience to the consumer by requiring the hearing to occur in "a reasonably convenient location" within the federal judicial district where the consumer resides. *See* National Arbitration Forum *Code of Procedure* Rule 32(A).
[16] *See* Sterling & Schrag, *supra* note 5, at 372 (noting "[t]his reason was especially weighty for those consumers who had lower incomes").
[17] *Dignity Faces a Steamroller*, *supra* note 11.
[18] *See id.* (noting that "[d]ebtors often feel intimidated in this arena, and with reason"); McUsic, *supra* note 9 (noting that some "people don't show up for their court date because they are . . . intimidated by the thought of going before a judge").
[19] *See*, *e.g.*, *Nicollet Restoration, Inc. v. Turnham*, 486 N.W.2d 753, 754 (Minn. 1992) ("Minnesota follows the common law rule that a corporation may appear only by attorney.").

Simple Rules and Procedures

The relative simplicity of arbitration is a great benefit for consumers because it spares them the labyrinth of rules and procedures that must be followed in a court proceeding, even by parties who have no attorney.[20] The complexity and rigidity of court rules can be a minefield for unwary consumers.

For example, when a debt collection case is brought in court, the consumer may have only 20 days to serve a written answer on the lender, and if the consumer fails to do so, the lender can obtain a default judgment for the full amount without giving any additional notice to the consumer.[21] By contrast, under the FORUM *Code of Procedure*, all disputes are decided on the merits even if one of the parties fails to respond, and if a party fails to respond, a second notice of arbitration is provided.[22]

Court can impose hurdles for consumers

To learn more about court proceedings, we recently inspected the court files for some debt collection cases brought in a Minnesota district court.[23] Not surprisingly, we found that most of these cases ended in a default judgment, but we were surprised to discover that even when a consumer answers the complaint, the case may still end in a default judgment if the consumer fails to answer the lender's discovery requests.

For instance, in a case arising from a debt with $3,000 in principal, the consumer initially avoided a default judgment by sending a letter that effectively satisfied the requirement of a written answer.[24] Nevertheless, the case ended in a default judgment because the consumer failed to answer the borrower's discovery requests, which included 23 interrogatories and 30 requests for admission. Even more troubling, the amount of the default judgment actually exceeded the amount originally sought by the lender (by $2,840.80) because the court sanctioned the consumer for failing to respond to the lender's discovery requests and because interest accrued during the pendency of the lawsuit.

---

[20] *See, e.g.*, *Fitzgerald v. Fitzgerald*, 629 N.W.2d 115, 119 (Minn. Ct. App. 2001) ("[T]his court has repeatedly emphasized that *pro se* litigants are generally held to the same standards as attorneys and must comply with court rules.").

[21] *See*, *e.g.*, Minn. R. Civ. Proc. 55.01(b) (requiring three days notice only for parties who have made an appearance).

[22] *See* Rule 7(C) of the National Arbitration Forum *Code of Procedure*.

[23] Minnesota is generally considered a consumer-friendly state. Prentiss Cox, *Goliath Has the Slingshot: Public Benefit and Private Enforcement of Minnesota Consumer Protection Laws*, 33 Wm. Mitchell L. Rev. 163, 216 n.300 (2006) ("At least one commentator also has suggested that Minnesota has broad, pro-consumer statutory fraud laws."). As such, we have no reason to believe that Minnesota court rules are particularly unfavorable to consumers or otherwise anomalous. Besides, there is ample evidence suggesting that court proceedings in other states are likewise challenging for consumers. *See*, *e.g.*, *Dignity Faces a Steamroller*, *supra* note 11.

[24] *See First Resolution Investment Corp. v. Ali*, Court File No. 27-CV-06-5418, Fourth Judicial District, State of Minnesota.

The outcome in that case illustrates the difficulty that consumers must face when attempting to navigate an unforgiving labyrinth of formal rules and procedures. Arbitration, on the other hand, facilitates consumer participation through the use of simplified rules and procedures that are meant to yield to the merits of the dispute.

Conclusion

As the cited studies demonstrate, a collection dispute is likely to have same the outcome regardless of whether the dispute is resolved in court or at arbitration. "Win rates" in consumer collections cases tend to favor lenders who bring claims against consumers. The win rate is determined by the nature of this type of dispute and is not an artifact of the forum – whether court or arbitration – where the claim is decided.

Moreover, for consumers who do have a colorable defense, arbitration facilitates their presentation of that defense through the use of simplified procedures and the availability of non-participatory hearings. For consumers who want to respond to a collections claim, arbitration provides a realistic avenue for the response, even where the consumer is unable to obtain legal representation.

In closing, we thank the Federal Trade Commission for its important work in this area and for the opportunity to submit this supplemental comment. Please feel free to contact me or the National Arbitration Forum if we can be of any assistance going forward.

Sincerely,

Roger D. Haydock
Managing Director

Appendix A

Comparing Arbitration and Court Litigation "Win Rates"

Apples-to-apples comparisons of business and consumer win rates in debt collection disputes as well as general contract disputes demonstrate that consumers fare just as well (and sometimes marginally better) in arbitration as they do in court:

Debt Collection Matters

Arbitration	*Court Litigation*		
Lender Win Rate (%)		**Lender Win Rate (%)**	**Default Judgment for Lender (%)**
93.8[1]	*New York City*[2]	99	92
	Chicago	96	91
	Detroit	96	91
	D.C. [3]	96	74

Contract Claims Brought by Consumers Against Businesses

Arbitration	*Court Litigation*
Consumer Win Rate (%)	**Consumer Win Rate (%)**
65.5[4]	61.5[5]

Contract Claims Brought by Businesses Against Consumers

Arbitration	*Court Litigation*
Business Win Rate (%)	**Business Win Rate (%)**
77.7[6]	76.8[7]

[1] *See* Public Citizen, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers* 15 (Sept. 27, 2007), available at http://www.citizen.org/documents/Final_wcover.pdf.
[2] *See* David Caplovitz, *Consumers in Trouble: A Study of Debtors in Default* (1974).
[3] *See* Sterling & Schrag, *Default Judgments Against Consumers: Has the System Failed?*, 67 Denv. U. L. Rev. 357 (1990).
[4] *See* Mark Fellows, *The Same Result as in Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes*, 14 Metropolitan Corp. Counsel 32 (2006).
[5] *See* Thomas H. Cohen, Bureau of Justice Statistics, U.S. Department of Justice, *Contract Trials and Verdicts in Large Counties, 2001*, 4 (2005); Lea S. Gifford, et al., *Bureau of Justice Statistics, U.S. Department of Justice, Contract Trials and Verdicts in Large Counties, 1996*, 5 (2000).
[6] *See* Fellows *supra* note 4.
[7] *See* Cohen, *supra* note 5; *see* Gifford, *supra* note 5.