U.S. House of Representatives
Domestic Policy Subcommittee
Committee on Oversight and Government Reform
Jim Jordan (OH-4), Ranking Member, Domestic Policy Subcommittee
Darrell Issa (CA-49), Ranking Member, Full Committee

Justice or Avarice:
The Misuse of Litigation to Harm Consumers

Staff Report
U.S. House of Representatives
111th Congress
July 22, 2009

Table of Contents

#

I. Executive Summary

Arbitration is a form of alternative dispute resolution (ADR) that has been used as an effective method to resolve disputes outside of the courts. The Supreme Court, in *Southland Corp. v. Keating*,[1] interpreted the Federal Arbitration Act,[2] as enacted in 1925, as a "national policy favoring arbitration."

Our investigation has found that debt collection is a pervasive, multi-faceted problem affecting arbitration and litigation. The same issues affect the National Arbitration Forum (NAF), the American Arbitration Association (AAA), and the courts. In its Majority report, the Domestic Policy Subcommittee claims that NAF denied consumers service of process, due process, and failed to properly apply the law.[3] However, the Majority omitted relevant facts indicating that consumers face identical issues in trial courts.

It is a logical fallacy to abstract from 239 case files from an organization that focused sixty percent of its business on debt collections and claim from this limited data that all mandatory consumer arbitration is harmful to consumers. Notwithstanding, the Majority report released by the staff of the Domestic Policy Subcommittee is a bridge to their political ends. AAA's debt collection cases composed less than ten percent of its business and it faced the same difficulties with due process as the Majority reported concerning NAF.

The problem is not arbitration. The problems consumers face in debt collection arbitration have nothing to do with arbitration. Arbitration provides a service; if businesses use that service and consumers are injured as a result, the remedy is to target those businesses, not dispute resolution providers.

A Congressional investigation on mandatory arbitration for consumers is not yet ripe. **First**, the Executive branch is taking a hard look at consumer debt collection. **Second**, the Searle Center at Northwestern University is conducting a full-blown comparison between consumer-focused arbitration and litigation and plans to release its findings by the end of the year. **Third**, any legislative action that seeks to abolish mandatory arbitration has failed to exhaust less restrictive and more effective alternatives, including model due process protocol legislation and amendments to the Fair Debt Collection Practices Act (FDCPA). **Fourth**, there is not sufficient evidence to show that litigation is better for consumers, and the best evidence available indicates the outcomes in court are abysmal for consumers.

This report should signal the need for hearings on legislative options that do not terminate mandatory arbitration. The relevant question is not mandatory arbitration – such an inquiry should not be about how to protect the income of trial lawyers – instead,

---

[1] 465 U.S. 1 (1984).
[2] 9 U.S.C. §1, *et seq*.
[3] *See generally*, Staff Report of the Domestic Policy Subcommittee Majority Staff, Oversight and Government Reform Committee, Chairman Dennis J. Kucinich, *Arbitration Abuse: an examination of Claims Files of the National Arbitration Forum*, July 21, 2009.

investigations should focus on the salience of mandatory due process consumer arbitrations.

II. Litigation, More Than Arbitration, Harms Consumers

The number of consumer debt cases filed in New York City is comparable to the total number of civil and criminal cases filed in the federal trial courts.[4] According to the Urban Justice Center, New York City Civil Court is the "credit card court," where the majority of the cases filed throughout the five boroughs are consumer debt cases.[5] The Urban Justice Center stated:

> **Once a judgment is obtained by a creditor against a debtor, the situation goes from bad to tragic. A creditor with a judgment can garnish wages and freeze bank accounts.** Often, due to additional penalties, interest, fees and costs, **the ultimate judgment obtained far exceeds any original debt** that might have accrued. **Sometimes, the defendant never owed the alleged debt, which may have been the result of identify theft, mistaken identity, clerical errors, or illegal fees and charges**.[6]

A report by the Urban Justice Center (Urban Justice Report) claimed debt collectors game the court system by failing to serve consumers with either a summons or a complaint, giving consumers no notice of the lawsuits against them.[7] In New York, all creditors are represented by counsel while consumers are "virtually never represented by counsel."[8] In the court system, "80.0% of cases result in default judgments, which are routinely granted without the requisite proof to establish the damages sought."[9] The materials submitted in support of default judgments "almost always constitute inadmissible hearsay" yet "were approved 100% of the time."[10] The Urban Justice Center reported, "[t]he court system is being used to endorse hundreds of thousands of default judgments, which then wreak havoc on the lives of hundreds of thousands of New Yorkers."[11] Moreover, "debt collection litigation in New York City Civil Court has a massive monetary impact [of] almost $800 million [on New Yorkers]."[12]

The Urban Justice Report stated debt collectors obtained default judgments because consumers failed to answer the complaint or appear at a court-ordered hearing or conference.[13] This evidence parallels a 2006 investigation of consumer debt cases in small claims court in Massachusetts, where 80% of the people sued on consumer debts in

---

[4] Urban Justice Center, *Debt Weight: The Consumer Credit Crisis in New York City and its Impact on the Working Poor*, (Oct. 2007), *available at* www.urbanjustice.org/cdp (last visited June 22, 2009) at 1.
[5] *Id*.
[6] *Id*.
[7] *Id*.
[8] *Id*.
[9] *Id*.
[10] *Id*. at 1-2.
[11] *Id*. at 2.
[12] *Id*. at 9.
[13] *Id*. at 17.

Massachusetts courts failed to appear.[14] According to the *Boston Globe*, 60% of the more than 120,000 small claims cases filed in Massachusetts in 2005 were filed by debt collectors.[15] In Chicago, more than 119,000 civil lawsuits against alleged debtors were pending as of June 2008.[16] Twelve-thousand of these Chicago suits were assigned to a single judge—twice the number of debt collection lawsuits on that judge's docket one year previously.[17]

According to the Federal Trade Commission (FTC), debt collection law firms have experienced significant growth and debt collection attorneys collect on all types of consumer debt, including "credit card accounts, healthcare debts, mortgages, and auto loans."[18] The FTC reported, "collection law firms in the United States had revenues of $1.17 billion in 2006, and . . . this figure will grow at a rate of 16% a year to $2.3 billion by 2011."[19]

A. Consumers Lack Notice In Litigation

The Urban Justice Center described the lack of notice in consumer debt litigation, where "the problem is 'sewer service,' the failure of the plaintiff or its process server to serve the defendant. As a result, many defendants are simply not aware that they have been sued."[20]

As the Urban Justice Report explains, the overwhelming majority of judgments in consumer credit litigation are obtained on default, and consumers have no knowledge that a judgment has been entered against them.[21] Moreover, the courts become forums for abuse, as "[l]earning that a bank account has been frozen is particularly shocking and debilitating when a person has no knowledge that a judgment has been entered against him or her. When the funds are exempt from collection, freezing an account subjects a person to needless litigation and expense."[22] Courts harm consumers, who "incur significant expenses in the form of attorney fees and lost wages for time spent appearing in court."[23]

---

[14] *Id*.
[15] Beth Healy, *A Debtor's Hell: Part 2, A Court System Compromised*, BOSTON GLOBE, July 31, 2006, *available at* http://www.boston.com/news/special/spotlight_debt/part2/page1.html (last visited July 18, 2009); *See also* FTC Report, *infra*, "Often these addresses [of debtors] are out of date, yet the courts assume the defendant was notified unless the letter is returned. This is a flawed system, the *Globe* found in a test: Of 100 letters sent to the same person at incorrect addresses across the state, just 52 came back . . . the other 48 simply went missing." *Id*.
[16] Ameet Sachdev, *Debt Collectors Pushing To Get Their Day In Court*, CHICAGO TRIBUNE, June 8, 2008, *available at* http://www.chicagotribune.com/news/nationworld/chi-sun-debtchasers-jun08,0,2426495,print.story (last visited July 18, 2009).
[17] *Id*.
[18] FTC Report, *Collecting Consumer Debts: The Challenges of Change – A Workshop Report*, (2009), available at: http://www.ftc.gov/bcp/workshops/debtcollection/dcwr.pdf, at 14 (hereinafter "FTC Report").
[19] *Id*.
[20] *Supra* note 1 at 22-23.
[21] *Id*.
[22] *Id*. at 23.
[23] *Id*. at 24.

The Federal Trade Commission (FTC) undertook a "comprehensive assessment of the debt collection industry and its practices" on the Fair Debt Collection Practices Act (FDCPA) (hereinafter "FTC Report").[24] The FTC Report stated, "consumers frequently do not appear to contest debt collection lawsuits because they have not been properly served, and, if they do not appear, the court enters a default judgment."[25] In short, "[c]ollectors are almost never asked to prove the debts they claim; defendants are rarely informed of their rights. And debtors, usually too strapped to afford a lawyer, have to contend with this legal mismatch alone."[26]

B. Litigation Clogs the Court, Further Harming Consumers

The FTC stated, "[t]he vast number of debt collection suits filed in recent years has posed considerable challenges to the smooth and efficient operation of courts."[27] The FTC reported, "[t]he majority of cases on many state court dockets on a given day often are debt collection matters."[28] Consumer advocates report "courts across the country are flooded by debt collection lawsuits."[29] As noted by the FTC, "[j]udges have expressed concern that the burden of handling the number of debt collection lawsuits on their dockets is making it difficult for them to handle other cases in an expeditious manner."[30]

The FTC stated, "debt collectors frequently use the court system in ways that harm consumers."[31] One consumer group described the litigation tragedy for consumers as follows:

> We estimate that in the past year, upwards of 80% of lawsuits against our clients based on credit cards were filed by a debt buyer. . . . When our lawyers challenge the bare and conclusory assertions made in lawsuits, the plaintiffs are unable to come forward with basic proof of the debt. . . . The frustration for our clients is endless, and they sometimes suffer monetary loss. The time and expense for our staff in unraveling these situations is significant.[32]

The problem is not arbitration but the unenforceability of the Fair Debt Collection Practices Act (FDCPA) because "[debt] collection law firms routinely take actions that appear to violate the FDCPA as well as raise troubling ethical questions."[33]

---

[24] FTC Report, at 2.
[25] *Id*. at 57.
[26] *Id*. at 56-57.
[27] *Id*. at 55-56.
[28] *Id*.
[29] *Id*.
[30] *Id*.
[31] FTC Report, at 56.
[32] *See generally id*. (citing NCLC-NACA Comment at 16-19; DC 37 Comment at 3).
[33] *Id*. (citing NEDAP Comment at 4).

III. Mandatory Arbitration Is Better for Consumers

In 2007, Public Citizen published a report to demonstrate how "binding mandatory arbitration is a rigged game in which justice is dealt from a deck stacked against consumers."[34] Public Citizen's report centered on the use of mandatory arbitration clauses by the credit card industry.[35] While Public Citizen's report relied solely on data from two sources, National Arbitration Forum (NAF) arbitrations involving First USA Bank and NAF arbitrations in California involving MBNA Bank, the report broadly asserted arbitration, as a whole, was unfair and unjust.[36]

Empirical evidence suggests that mandatory arbitration clauses are not harmful to consumers. Arbitration, unlike litigation, can be efficiently improved. The Federal Trade Commission recently forced a debt collection company "that used false threats and other unlawful tactics to collect consumers' debt to settle FTC charges that they violated federal law."[37]

A. There Is No Arbitration Bias: If Anything, Consumers Do Better in Arbitration Than in Court

Current empirical legal research reflects the degree to which Public Citizen's attempt to discredit mandatory arbitration clauses is statistically flawed.[38] The FTC stated:

> Debt collection *court* cases in major United States cities were likely to be decided in favor of creditors or debt collectors 96 to 99 percent of the time. According to arbitration proponents, because the 'outcomes in arbitration mirror outcomes in court,' this suggests that there is no greater 'creditor bias' in arbitration awards than in adjudicated cases.[39]

The FTC claims arbitration is better for consumers because it allows consumers to "engage in 'document hearings' or 'telephone hearings' (thus avoiding the need and expense of traveling or taking time away from work) . . . pay an inexpensive fee . . . have their cases resolved more quickly; and . . . use simpler rules and procedures."[40] While

---

[34] Public Citizen Report, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers*, (2007), at 1, *available at*: http://www.citizen.org/documents/ArbitrationTrap.pdf.
[35] *Id*.
[36] *Id*. at 1-2.
[37] Press Release, FTTC, *Debt Collectors Settle with FTC; Abusive Practices Affected Consumers Nationwide*, FTC v. Oxford (2009), *available at*: http://www.ftc.gov/opa/2009/07/oxford.shtm (last visited July 8, 2009).
[38] *See* Amy J. Schmitz, *Legislating in the Light: Considering Empirical Data in Crafting Arbitration Reforms*, _ HARV. NEG. L. REV. __ (forthcoming); *see also* Peter B. Rutledge, *Arbitration – A Good Deal for Consumers: A Response to Public Citizen* 10-11 (2008) (report prepared for and released by the U.S. Chamber Institute for Legal Reform), *available at* http://www.instituteforlegalreform.com/issues/docload.cfm?docId=1091.
[39] FTC Report at 58-59.
[40] *Id*. at 59-60.

debt collection cases in courts are typically resolved by a judge entering a default judgment, "arbitrators are required to review the merits of each matter before reaching a decision even if the consumer does not appear."[41]

The Searle Civil Justice Institute (SCJI), part of the Searle Center on Law and Regulation at Northwestern University Law School, reviewed 301 American Arbitration Association (AAA) case files involving consumer arbitrations.[42] Research by the Searle Center ("Searle Study") reported, "[i]n cases with claims seeking less than $10,000, consumer claimants paid an average of $96 ($1 administrative fees + $95 arbitrator fees)."[43] The Searle Study found consumers won relief in 53.3% of the cases they filed and recovered an average of $19,255.[44] Arbitrators awarded attorneys' fees to prevailing consumer claimants in 63.1% of the cases where consumers sought such an award.[45] Moreover, the Searle Study concluded there are reputation-based incentives for arbitrators to be impartial.[46]

In several debt collection cases where businesses prevailed in arbitration, the arbitrator protected the consumer from overreaching claims by awarding less than the full amount requested by the creditor.[47] The American Enterprise Institute confirmed that arbitration provides more protection than the consumers would typically receive in a default judgment proceeding in court.[48]

Protecting consumers in arbitration is not merely a question of protecting the consumer defendant when sued by a debt collector, but also protecting the consumer plaintiff who seeks arbitration to remedy his or her disagreements. While the Minority staff does not agree that the Arbitration Fairness Act (AFA) is the best remedy for protecting consumers, we do believe arbitration can provide more fairness to consumers. In the American Arbitration Association's (AAA) analysis of consumer cases awarded between January and August 2007, consumers prevailed in 48% of cases in which they were the claimant and businesses prevailed in 74% of the cases in which they were the claimant.[49] Moreover, arbitrators are less overburdened than judges when dealing with consumer claims. In 2006, AAA appointed 535 different arbitrators to 930 consumer

---

[41] *Id*. at 59-60.
[42] Searle Civil Justice Institute, *Consumer Arbitration Before the American Arbitration Association*, (hereinafter "Searle Study") at xii, *available at*: http://www.searlearbitration.org/report/.
[43] *Id*. at xiii.
[44] *Id*.
[45] *Id*. at xiv.
[46] Searle Study at 13, citing GORDON TULLOCK, TRIALS ON TRIAL: THE PURE THEORY OF LEGAL PROCEDURE 127-128 (1980).
[47] Sarah Rudolph Cole and Ted Frank, *The Current State of Consumer Arbitration*, Fall 2008, *available at* http://www.aei.org/docLib/20081117_DRFall2008.pdf, reviewing the following studies: *Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure*; Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases (Ernst & Young, 2004); The Same Result as in Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes (Mark Fellows, 2006); Arbitration – A "Good Deal" for Consumers (Professor Peter Rutledge, 2008).
[48] *Id*.
[49] AAA Document Productions, *Analysis of the American Arbitration Association's Consumer Arbitration Caseload* (AAA 0017633).

cases, with the median number of appointments as one.[50] Sixty-four percent of the arbitrators were appointed to only one case and 81% of the arbitrators were appointed on two or fewer cases.[51]

The Majority staff report alleged problems with debt collection arbitration by focusing on NAF. However, in a series of consumer debt collection cases handled by the AAA, neutral and former law school dean Francis Spalding withdrew from his assigned debt collection cases. Spalding found inconsistencies with AAA's protocol, false statements by debt collectors, improper notice and acceptance by consumers, and a lack of proof for the allegations.[52]

Spalding argued:

> [I]t would be entirely improper for an arbitrator to enter an award in favor of [a debt collector] in the instance of any of the cases to which I was assigned on September 2, 2008. Nor, in my opinion, is it proper to classify as a fair system one in which, typically, only [the debt collector] appears . . . in which it is far easier for the arbitrator to enter an award in favor of [the debt collector] than for [the consumer]—and in which, one supposes, the expectation both of [the debt collector] and AAA staff is likely that a high proportion of default awards will fully favor [the debt collector]; and in which [the debt collector]'s standard presentation format appears in every file in a batch of nineteen presumably random selected cases is utterly deficient in multiple dimensions, as discussed above.[53]

The Majority's narrow analysis and its failure to incorporate other facts that arose from the investigation cloaks the fact that debt collection, not arbitration, is the catalyst harming consumers most.

Ernst & Young noted consumers prevailed more often than businesses in cases that went to arbitration, consumers obtained favorable results in close to 80% of the cases reviewed, and a substantial majority of consumers surveyed were satisfied with the arbitration process as shown by the 69% who indicated that they were satisfied or very satisfied with the arbitration process.[54]

---

[50] Email from Ryan Boyle to Jennifer Coffman, Dec. 18, 2007 4:49 PM E.S.T. (AAA 0025526); *See also* Email from Ryan Boyle to Richard Naimark, July 25, 2007 5:35 P.M. E.S.T. (AAA 017407); Email from Ryan Boyle to Pierre Paret, Richard Naimark, Dec. 7, 2007 4:18 P.M. E.S.T. (AAA 0025697).
[51] *Id.*
[52] AAA Produced Documents, at AAA 0017392 – 0017394.
[53] *Id.* at AAA 0017394.
[54] Mary Batcher, et al., The Ernst & Young Study, Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases, 16 WORLD ARBITRATION AND MEDIATION REPORT, 3 (2005); *Cf.* Ernst & Young, *Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases* 16-17, App. A (2004), *available at* http://www.adrforum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005ErnstAndYoung.pdf.

Seventy-eight percent of trial attorneys find arbitration faster than lawsuits.[55] Ninety-three percent of consumers using arbitration find it to be fair.[56] Consumers prevail 20% more often in arbitration than in court.[57]

Professor Peter B. Rutledge, in discussing litigation, stated, "studies of debt collection actions in major cities reveals that the lender typically wins between 96% and 99% of the time, right in line with lender win-rate date cited in the Public Citizen Report."[58] Rutledge argued the higher win-rate for business claimants is due to the fact that businesses tend to bring debt collection actions in which the likelihood of success for the business is high.[59]

In recent state action to protect consumers, California recognized the ability for arbitration to "safeguard . . . impartiality by retaining unbiased arbitrators, by complying with the California Arbitration Act in letter and in spirit, and by treating opposing parties to a dispute with fairness and equality."[60]

B. Consumers Prefer Arbitration

A 2005 study by the U.S. Chamber of Commerce Institute for Legal Reform surveyed 609 adult arbitration participants and a sub-sample national cross-section of 31,045 adult arbitration participants in binding arbitrations that reached a decision, finding 66% said they would use arbitration again, 75% found arbitration to be a fair process, 72% percent found arbitration to result in a fair outcome, and 84% were satisfied with the length of their arbitration.[61] Eight-hundred registered voters who indicated they were likely to vote in the 2008 Presidential election were surveyed by the U.S. Chamber of Commerce between December 17-20, 2007 regarding consumer disputes.[62] Eighty-two percent of those surveyed strongly preferred arbitration over litigation to "resolve any serious dispute between a business and a consumer," 71% believed arbitration agreements "should not be removed" from contracts consumers sign with companies providing goods and services, 40% believed it would be "very difficult" to resolve "a

---

[55] AAA Document Productions, (AAA 0017829).
[56] *Id*.
[57] *Id*.
[58] Peter B. Rutledge, *Arbitration – A Good Deal for Consumers: A Response to Public Citizen* 10-11 (2008) (report prepared for and released by the U.S. Chamber Institute for Legal Reform), *available at* http://www.instituteforlegalreform.com/issues/docload.cfm?docId=1091.
[59] *Id*.
[60] COMPLAINT FOR INJUNCTIVE RELIEF AND CIVIL PENALTIES FOR VIOLATIONS OF BUSINESS AND PROFESSIONS CODE SECTION 17200, *California v. National Arbitration Forum.; FIA Card Services, N.A.; Columbia Credit Services, Inc.*; (Filed Mar. 21, 2008) Case No. C80-98-473569.
[61] John Allen Chalk, Sr., Chair-Elect of the State Bar of Texas ADR Section, *Arbitration Empirical Studies*, ALTERNATIVE RESOLUTIONS, Winter 2009, v. 18, No. 1, at 2, citing *Arbitration: Simpler, Cheaper, and Faster Than Litigation*, Harris Interactive Survey (April 2005).
[62] *Id*. at 3, citing Survey by Public Opinion Strategies and Benenson Strategy Group, *Key Findings From a National Survey of Likely Voters* (U.S. Chamber Institute for Legal Reform) (2008).

serious consumer dispute with a company," and more than 50% believed that a court dispute, if resolved, would not be "resolved fairly to the consumer."[63]

A Navigant Consulting study observed consumers were successful in 32.1% of approximately 34,000 California consumer arbitration cases between 2003 and 2007.[64] The Navigant study reported that in an additional 16.4% of these arbitrations, the initial claims against consumers were reduced in the arbitration awards; in the cases that went to final hearing, the claims against consumers were reduced in 37.4% of the final hearing cases; in 33,935 of these cases where an arbitration fee was paid, the consumer paid no arbitration fee in 99.3% of the cases; and in the other 0.7% of the cases, the consumer paid a median fee of $75.00; and in cases where the consumer did not appear, the actual damages awarded to the debt collector-claimant were 22.6% less than damages sought by the claimant.[65]

The Searle Study presented empirical evidence showing consumer arbitration to be a speedy process, with the AAA reporting that, on average, its consumer cases took four months to resolve on the basis of documents and six months to resolve on the basis of in-person hearings.[66] The California Dispute Resolution Institute (CDRI), examining data disclosed by six arbitration providers from January 2003 to February 2004, found a mean disposition time of 116 days and a median disposition time of 104 days.[67] Mark Fellows reported that the National Arbitration Forum's (NAF) average disposition time in 2003-2004 was 4.35 months for consumer claimants and 5.60 months for business claimants.[68] These consumer claimants paid arbitration fees averaging $46.63 while business claimants paid arbitration fees averaging $149.50.[69]

IV. There are less restrictive and more effective alternative means, other than banning mandatory arbitration, to help consumers.

To claim that mandatory arbitration for consumer debt disputes is abusive or predatory is not only anecdotally false but empirically unproven. The FTC has stated, "[d]espite useful discussion . . . the workshop record does not contain adequate information to enable the agency at this time to make recommendations relating to debt

---

[63] *Id*., citing Jeff Nielsen, Garrett Rush, Jonathan Hartley, MEMORANDUM, *National Arbitration Forum: California Consumer Arbitration Data*, July 11, 2008, *available at* http://www.instituteforlegalreform.com/index.php?option=com_ilr_docs&issue_code=ADR&doc_type=STU.
[64] *Id*.
[65] *Id*.
[66] Searle Study at 8.
[67] California Dispute Resolution Institute, *Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure*, 21 (Aug. 2004), *available at* http://www.mediate.com/cdri/cdri_print_aug_6.pdf. The six providers were the AAA, ADR Services, Arbitration Works, ARC Consumer Arbitrations, JAMS, and Judicate West. Searle Study at 14.
[68] Mark Fellows, *The Same Result as in Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes*, METRO. CORP. COUNSEL, at 32 (2006).
[69] *Id*.

collection litigation and arbitration."[70] In August 2009, the FTC will convene a roundtable at Northwestern law school to "discuss problems in debt collection litigation and arbitration and possible solutions," and will involve "state court judges, debt collectors, collection attorneys, consumer advocates, arbitration firms, and other interested stakeholders."[71]

Moreover, in a letter from Professor Peter Rutledge to the House Judiciary Committee, he stated:

> Congress may well conclude that additional study is needed to fill in gaps in the available data. In light of Public Citizen's concession that "data on arbitration are scarce," it is particularly hard to understand why Congress should rush headlong into abolishing a system of dispute resolution that has prevailed for nearly twenty years before the empirical picture is even complete.[72]

The arbitration debate is too often split between those who are staunch advocates of banning the enforcement of pre-dispute agreements versus those who are unwaveringly committed to the individual freedom to contract. A middle approach would be one advocated by Professor Schmitz: regulating consumer arbitrations through due process protocols.

Professor Amy J. Schmitz of the University of Colorado law school views the Arbitration Fairness Act (AFA) as overbroad, claiming it limits the options for consumers by leaving them in either small-claims court or slow and costly litigation.[73] Schmitz argued, "FTC notice is a starting place for disclosures, but is not sufficient and does not address other issues."[74] Schmitz finds that "FTC notice is cheap and easy for companies to incorporate."[75] Schmitz identified cost, notice, venue, small claims court carve-outs, and provisions for class proceedings in arbitration as the five key consumer issues affecting the arbitration versus litigation debate.[76] The AAA Consumer Due Process Protocol allows consumers to opt for small claims court and the Minority staff supports legislation that allows for venue to be in the consumer's home-state. A policy that combines consumer due process protocols together with notice provisions from the Fair Debt Collection Practices Act is an effective, well-tailored approach to protecting consumers in arbitration. Schmitz defends this position as a starting place and advocates

[70] Federal Trade Commission, *Collecting Consumer Debts: The Challenges of Change*, Feb. 2009 at 55.
[71] *Id*. at viii.
[72] Letter from Peter B. Rutledge, Professor of Law, University of Georgia, to Honorable John Conyers and Honorable Lamar Smith, House Judiciary Committee (July 30, 2008) (on file with author).
[73] Interview with Amy J. Schmitz, Professor of Law, University of Colorado, in Washington, D.C. (July 20, 2009).
[74] *Id*.
[75] *Id*.
[76] *Id*.

that fair notice and venue to consumers does not negatively impact the benefits of arbitration to businesses.[77]

A. Enhancing the Fair Debt Collection Practices Act (FDCPA)

Abolishing mandatory arbitration fails to address two inherent problems with arbitration: first, debt collectors lack information about consumers,[78] and second, debt collectors "do not provide adequate information to consumers, thereby making it more difficult for consumers to assess whether they actually owe the debt in question and exercise their rights under the FDCPA. Improving the flow of information within the debt collection system is critical to reforming the industry."[79]

To remedy these informational problems, the FTC recommends that Section 809(a) of the FDCPA be amended to require debt collectors to obtain and provide in the "validation notices" sent to consumers, the name of the original creditor and an itemization of the principal, total of all interest, and total of all fees and other charges constituting the debt.[80]

The FTC has found that consumers would benefit from knowing about their rights under the FDCPA, and "including information about them in the validation notices collectors already are required to provide would seem to impose small marginal costs on debt collectors."[81]

Additionally, the FDCPA already provides a private action for consumers who suffer abusive debt collection practices:

> In enacting the FDCPA, Congress made clear that the FDCPA was intended to be a "primarily self-enforcing" statute, with private individual and class actions providing collectors with a powerful incentive to comply with the statute. To deter illegal collection practices, Congress authorized courts to award individual consumers who sued successfully under the FDCPA any actual damages they suffered, plus additional, "statutory," damages up to $1,000. Congress capped statutory damages for a class action of consumers at the lesser of $500,000 or 1 percent of the debt collector's net worth.[82]

[77] *Id*.
[78] FTC Report, at iv-v.
[79] *Id*. at 20-21.
[80] *Id*. at v.
[81] *Id*. at 27.
[82] *Id*. at 66.

FTC enforcement works, for "[d]efendants in FTC actions challenging debt collection practices as unlawful have paid tens of millions of dollars in disgorgement of ill-gotten gains, consumer redress, and civil penalties."[83]

B. Model Protocol Legislation

Based upon concerns that arbitration allows "business to systematically prevent consumers from enforcing their full procedural and substantive rights," the American Arbitration Association (AAA) established the National Consumer Disputes Advisory Committee made up of representatives from the courts, the alternative dispute resolution (ADR) profession, consumer groups, government, academia, and industry in 1997.[84] The mission of the Committee was "to reach a consensus among diverse interest groups about the development and implementation of fair consumer conflict resolution standards."[85] In April 1998, the Committee created the Consumer Protocol, a statement of 15 principles designed "to impact not only the AAA, but also to influence courts, state and federal legislatures, and other providers of ADR services to consumers."[86]

The Searle Study reported, "[e]ach of the major arbitration providers has its own due process protocol or protocols."[87] The AAA's Consumer Due Process Protocol, together with the notice recommendations made in the previous section concerning the FDCPA, ensures that consumers have fair arbitrations while having knowledge of their rights.[88]

As noted in the Searle Study, the AAA reviews the arbitration clauses submitted with a demand for arbitration to determine compliance with the Due Process Protocol before it administers any consumer cases.[89] The Searle Study stated, "AAA's review of arbitration clauses for protocol compliance was effective at identifying and responding to clauses with protocol violations."[90] If, after undertaking a review, the AAA determines that "a dispute resolution clause on its face, substantially and materially deviates from the

---

[83] *Id*. at 9.
[84] Lucille M. Ponte, *Boosting Consumer Confidence In E-Business: Recommendations For Establishing Fair And Effective Dispute Resolution Programs For B2c Online Transactions*, 12 ALB. L.J. SCI. & TECH. 441, 450-451 (2002).
[85] *Id*.
[86] *Id*. at 451-452.
[87] Searle Study at 16; National Consumer Disputes Advisory Committee, Consumer Due Process Protocol (Apr. 17, 1998), *available at* http://www.adr.org/sp.asp?id=22019; JAMS, JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses: Minimum Standards of Procedural Fairness (revised Jan. 1, 2007), *available at* http://www.jamsadr.com/rules/consumer_min_std.asp; National Arbitration Forum, Arbitration Bill of Rights (2007), *available at* www.adrforum.com/users/naf/resources/ArbitrationBillOfRights3.pdf.
[88] *See* AAA Document Productions at (AAA 0003779) and (AAA 0004517).
[89] Searle Study, at 30.
[90] Searle Study, at xiv.

minimum due process standards of this Protocol, the Association may decline to administer cases arising under this clause."[91]

The Due Process Protocol sets out an overarching principle of "fundamental fairness."[92] The Searle study found, "the bulk of protocol provisions address procedural aspects of arbitration . . . [t]he protocols typically require: (1) independent and impartial arbitrators; (2) reasonable arbitration costs; (3) a reasonably convenient hearing location; (4) reasonable time limits for the proceeding; (5) the right to representation; (6) adequate discovery; and (7) a fair hearing."[93]

As an additional protection, the AAA Consumer Rules allows a party to seek relief in small claims court even when the party had agreed to arbitrate.[94] In addition, the Due Process Protocol requires the arbitrator to follow the law in making a decision and to issue a written award (with reasons upon request).[95] The American Bar Association (ABA), observed that 86.2% of attorneys in the General Practice Solo and Small Firm Division believed their clients' interest were best served by alternative dispute resolution (ADR) solutions and 68.6% would use arbitration more if arbitrators were required to follow the law, with 55.4% claiming they would use arbitration more often if the arbitrators were lawyers or judges.[96] The AAA Due Process Protocol clearly meets these demands.

The AAA's Consumer Due Process Protocol is effective and in a "sample of AAA consumer arbitrations, the majority of consumer arbitration clauses (2229 of 299, or 76.6%) fully complied with the Consumer Due Process Protocol as applied by the AAA."[97] According to the Searle Study, the AAA's review of arbitration clauses for protocol compliance is effective at "identifying and responding to those clauses with protocol violations."[98] The Searle Study claimed:

> [T]he AAA effectively reviews arbitration clauses for protocol compliance and appropriately responds to clauses that do not comply. A number of businesses have responded to AAA compliance efforts by changing their arbitration clauses to comply with the Protocol. Any consideration of the need for legislative

---

[91] *Id*. at 27, citing American Arbitration Association, Rules Updates, *Consumer Arbitrations: Notice to Consumers and Businesses*, *available at* http://www.adr.org/sp.asp?id=24714&printable=true (last visited July 18, 2009).
[92] National Consumer Disputes Advisory Committee, Consumer Due Process Protocol (Apr. 17, 1998), *available at* http://www.adr.org/sp.asp?id=22019, princ. 1.
[93] Searle Study, at 21, Consumer Due Process Protocol, princs. 3, 6-9, 12 & 13.
[94] AAA Consumer Rules, American Arbitration Association, *Supplementary Procedures for the Resolution of Consumer-Related Disputes* (effective Sep. 15, 2005), *available at* http://www.adr.org/sp.asp?id=22014.
[95] Searle Study, at 21, Consumer Due Process Protocol, princ 15.
[96] John Allen Chalk, Sr., Chair-Elect of the State Bar of Texas ADR Section, *Arbitration Empirical Studies*, 18 ALTERNATIVE RESOLUTIONS, Winter 2009, No. 1, at 2, citing an independent survey administered by Surveys and Ballots, Inc., and published by the National Arbitration Forum.
[97] Searle Study at 110.
[98] *Id*.

> action should take into account such private regulation of consumer arbitration.[99]

In 98.2% of cases subject to AAA's protocol compliance review, the arbitration clause either complied with the Due Process Protocol or the non-compliance was identified and responded to by the AAA.[100] According to Kansas law professor Chris Drahozal, in 2007 "[t]he AAA refused to administer at least 85 consumer cases, and likely at least 129 consumer cases because the business failed to comply with the Consumer Due Process Protocol. More than 150 businesses have either waived problematic provisions or revised arbitration clauses in response to the Consumer Due Process Protocol."[101]

Congress should protect consumers by requiring that all arbitration providers abide by a model Due Process Protocol, shaped after the AAA's Consumer Due Process Protocol and that all arbitration agreements inform the consumer of his or her rights under the Fair Debt Collection Practices Act (FDCPA). Banning mandatory arbitration is not the solution. Professor Amy Schmitz stated, "legislative solutions should focus on regulating procedures in arbitration and curbing arbitration clause terms, rather than barring enforcement of all pre-dispute arbitration agreements in consumer contracts."[102]

V. Conclusion

The Majority cherry-picked case files from an investigation to buttress their political objectives. This report takes a more balanced view, by considering facts left out from the Majority report. Debt collection was a problem for the two major arbitration providers and will continue to be a problem for the courts. This report has shown how debt collection harms consumers more in litigation than in arbitration and the FDCPA and a model Due Process Protocol can be fruitfully combined to preserve arbitration while protecting consumers. Moreover, Congress must be cautious in its legislative actions because empirical data on debt collection and arbitration is still needed. The FTC will hold a roundtable on "Protecting Consumers in Debt Collection Litigation and Arbitration" on August 5-6, 2009 at the Searle Center on Law, Regulation, and Economic Growth at Northwestern University School of Law. Kansas law professor Chris Drahozal is currently working on an empirical study concerning debt collection arbitration and the consumer. The results of these efforts will more clearly frame an investigation on arbitration and debt collection and guide Congress's next steps. It is important that Congress not attempt solutions without the necessary data to support them.

---

[99] *Id*. at 111-112.
[100] Statement of Christopher R. Drahozal, *Hearing on Arbitration or 'Arbitrary': The Misuse of Arbitration to Collect Consumer Debts*, July 22, 2009, Subcomm. on Domestic Policy, H. Comm. on Oversight and Government Reform, at 11.
[101] *Id*.
[102] Amy J. Schmitz, *Curing Consumer Warranty Woes Through Regulated Arbitration*, 23 OHIO ST. J. ON DISP. RESOL. 627, 640-641.

About the Committee

The Committee on Oversight and Government Reform is the main investigative committee in the U.S. House of Representatives. It has authority to investigate the subjects within the Committee's legislative jurisdiction as well as "any matter" within the jurisdiction of the other standing House Committees. The Committee's mandate is to investigate and expose waste, fraud and abuse.

Contacting the Committee

For information regarding this report:

Daniel Z. Epstein, Counsel
(202) 225-5074

Mitchell S. Kominsky, Counsel
(202) 225-5074

For press inquiries:

Frederick R. Hill, Director of Communications
(202) 225-0037

For general inquires or to report waste, fraud or abuse:

Phone: (202) 225-5074
Fax: (202) 225-3974
http://republicans.oversight.house.gov

Committee on Oversight and Government Reform
Ranking Member, Darrell Issa (CA-49)

B350A Rayburn House Office Building
Washington, DC 20515
Phone: (202) 225-5074 • Fax: (202) 225-3974