Remarks of Commissioner Julie Brill
United States Federal Trade Commission

Before the ACA International Annual Convention and Exposition

July 12, 2010

Good afternoon and thank you for that kind introduction. I am pleased to be here today and to share with you some of my thoughts on issues relating to debt collection. As you may know, I am a relative newcomer to the Federal Trade Commission: I was sworn in as a Commissioner barely three months ago. But I am not a newcomer to working on behalf of consumers. For more than 20 years, I have worked with state attorneys general throughout the United States to protect consumers from unfair and deceptive business practices, first from my position in the Vermont Attorney General's office, and more recently in the North Carolina Attorney General's office.

As you know, state attorneys general and the FTC share jurisdiction over debt collectors and debt collection practices, and over the past two decades I have had the opportunity to work with creditors, debt collectors, and debt buyers to try to achieve compliance with state and federal debt collection laws. I have also sued some of those folks when other forms of suasion did not turn out to be effective. And I have engaged in extensive legislative debates to help reform debt collection laws. So I am very familiar with the issues faced by collectors and consumers alike in this area.

In my time with you today, I would like to talk about three things: First, I would like to give you my perspective on some serious problems that I see in the way some debt collectors try to extract money from consumers. And note, this is *my* perspective. My comments are my own, and do not necessarily reflect the view of the Commission or any other Commissioners.

Second, I have something for you hot off the presses: This afternoon, the Commission is releasing a report that is the product of a several year dialogue with industry, consumer groups, private attorneys, government officials, judges, and others. The report, entitled "Repairing a Broken System: Protecting Consumers in Debt Collection Litigation and Arbitration," paints a troubling picture with respect to several aspects of debt collection litigation and arbitration, and then makes many recommendations to address the issues.[1]

Finally, I would like to go into more detail regarding some of the practices I consider particularly problematic. The FTC's report does a great job of looking at these areas, and the Commission makes several recommendations that I wholeheartedly agree with. But I would also

[1] The text of the report may be found at http://www.ftc.gov/os/2010/07/debtcollectionreport.pdf. My statement concurring in the issuance of the report may be found at http://www.ftc.gov/speeches/brill/100712debtcollect.pdf.

like to share with you my own perspective, and explain why I think the Commission's recommendations should only be considered a starting point.

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The debt collection business is booming.[2] And while that is not good news for consumers, the future certainly looks bright for your industry. With the ongoing financial crisis, consumers are falling further and further behind on their debt obligations each day, which means more work for you. Federal Reserve numbers show that consumer delinquencies are at an all time high — reaching over $300 billion dollars in the first quarter of 2010, an increase of over 500% since 2004.[3] And many observers think things will get worse for consumers before they get better. According to the Bureau of Labor Statistics, employment of bill and account collectors is projected to grow over the next eight years at a substantially higher rate than other occupations.[4]

But it goes without saying that a rosy picture for the debt collection industry means something entirely different for consumers hit hard by the economic downturn. Consider some of the things that these financially distressed consumers face: unemployment or under-employment, lack of health insurance and proper health care, difficulties in paying for basic needs like food, shelter, and child care. Now add to these stressors the efforts by legitimate debt collectors to lawfully collect delinquent debts that the consumers owe — the telephone calls, the late notices, repossessions, foreclosures, garnishment orders — and you have consumers in a desperate, vulnerable state of mind.

Now, take these most vulnerable consumers, and add to the mix the bad actors, the debt collectors who engage in unscrupulous if not illegal practices. The ones who call at all hours of the night, the ones who lie and make threats they cannot follow through on, the ones who sue without having any basis for doing so, the ones who use subterfuge to obtain money judgments and garnishment orders. These are below the belt punches aimed at consumers who have already been pummeled. And these types of questionable activities appear to be on the rise. In calendar year 2009, the FTC received just shy of 10,000 complaints a month about third party and creditor

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[2] *See*, *e.g.*, Christian Davenport, *Debt Collectors Want You to Know They're Here to Help (No, Really)*, Washington Post (Feb. 14, 2010), *available at* www.washingtonpost.com/wp-dyn/content/article/2010/02/12/AR2010021205934.html; Isaac Wolf, *Complaints Rising Over Shady Practices by Debt Collectors*, Scripps Howard News Service (Nov. 30, 2009), *available at* www.scrippsnews.com/content/complaints- rising-over-shady-practices-debt-collectors; Tony Pugh, *One Industry That's Booming: Debt Collection,* McClatchy Newspapers (Oct. 15, 2009), *available at* www.mcclatchydc.com/2009/10/15/77253/one-industry-thats-booming-debt.html; Robin Sidel, *Collect Calls: Demand Rises For Those Voices That Dun by Phone*, Wall St. J. (Mar. 3, 2009), *available at* online.wsj.com/article/SB123603469212314183.html.

[3] Federal Reserve Bank of Philadelphia, Consumer Statistics — Updated Statistics Related to Consumer Credit and Consumer Payments (Credit Performance) (updated July 7, 2010), *available at* www.philadelphiafed.org/payment-cards-center/tools-for-researchers/ consumer-statistics/.

[4] Employment of bill and account collectors is projected to grow by about 19 percent over the 2008-18 decade, which is faster than average for all occupations. Bureau of Labor Statistics, U.S. Department of Labor, Occupational Outlook Handbook, 2010-11 Edition, Bill and Account Collectors, *available at* www.bls.gov/oco/ocos143.htm (visited July 07, 2010).

debt collection, an increase of over 14% from 2008.[5] In terms of volume, debt collection complaints outrank every other category except complaints about identity theft.

Unscrupulous and illegal debt collection practices, particularly relating to debt collection and arbitration, have long been a concern of the Federal Trade Commission. These concerns were part of the discussion at workshops in 2007 and in a report issued in February 2009.

During the latter part of 2009, the FTC undertook a more in-depth study of these issues. As many of you know, we convened public roundtables in Chicago, San Francisco, and Washington, DC. These events brought together representatives of the debt collection industry, consumer advocates, private attorneys, academics, government officials, arbitration providers, judges, and others. To supplement the information gleaned from the discussions at these roundtables, the Commission also solicited and received public comments. I think it is fair to say that we took a long, hard look at the debt collection system.

What did the Commission learn? We learned that the debt collection system in this country is broken.

We learned that the vast majority of suits for alleged unpaid debts resulted in default judgments. In many cases the default judgment is the result of improper service — either service on the wrong person or, in the most egregious cases, "sewer service," that is to say, the process server simply throws the court papers "down the sewer" and then perjures himself in an affidavit attesting to service. In other cases the consumers never show up in court because they cannot afford a lawyer, or they cannot afford to leave work to attend a court proceeding. Perhaps there are other reasons why so many consumers do not appear in court. Whatever the cause, sky high default rates — upwards of 90% in some jurisdictions — strike me as simply unacceptable.

We learned that for those consumers who attempt to participate in a court proceeding, the process is often unnecessarily expensive. Collectors frequently seek continuances or dismissals without prejudice because they are unprepared or because they cannot produce documentation when requested. When courts grant such requests and set a new hearing or trial date, the consumer is required once again to bear the costs of taking off work and coming to court.

We learned about the continuing problems with debt documentation. Many consumers who are sued have no idea what the underlying debt was, and as a result, have no way to contest it. Moreover, in recent years, as the secondary market of debt buyers has burgeoned, many collection suits brought by debt buyers have little if any documentation to support them. According to a May 2010 report by the Neighborhood Economic Development Advocacy Project and the Urban Justice Center, debt buyers typically do not purchase documentation of debts, such as credit applications bearing signatures, the contracts that applied to each account, account statements, or customer service records that would confirm or clarify fraud claims or customer

[5] *See* Federal Trade Commission, *Consumer Sentinel Network Data Book for January - December 2009* (Feb. 2010), *available at* www.ftc.gov/sentinel/reports/sentinel-annual-reports/sentinel-cy2009.pdf; Federal Trade Commission , *Consumer Sentinel Network Data Book for January - December 2008* (Feb. 2009), *available at* www.ftc.gov/sentinel/reports/sentinel-annual-reports/sentinel-cy2008.pdf.

disputes.[6] While a few debt buyers are able to dig up that information when pressed, most cannot, and in the vast majority of cases filed, debt buyers cannot provide any documentation of the underlying debt. Despite the overwhelming lack of documentation in suits brought by debt buyers, according to this study, debt buyers prevail in over 90% of their suits.[7] And as some of you may know, the Commission is doing its own debt buyer study that will, among other things, assess the information that debt buyers obtain along with the debts they purchase.

The Commission also learned about concerns surrounding debt collectors' continuing efforts to collect on time-barred debt. By "time-barred debt," I mean debt that is older than the applicable statute of limitations, so that any suit to try to collect it should be dismissed at the outset. Despite the fact that a debt collector should never actually prevail in a lawsuit to collect a time-barred debt, and despite the fact that filing such a lawsuit would violate the Fair Debt Collection Practices Act, many debt collectors cajole and coerce consumers into making payments towards these time-barred debts that the consumer has no legal obligation to pay. What's worse, in some jurisdictions, a partial payment towards a time-barred debt revives the statute of limitations, resetting the clock so that the consumer now owes the entire balance. Of course, this fact is almost never mentioned by the debt collector when he asks the consumer to pay. This is unacceptable.

We learned about continuing serious problems relating to freezing and garnishment of exempt funds in bank accounts. Federal and state law declare that certain funds in consumer bank accounts are exempt from garnishment. In particular, federal law exempts from garnishment Social Security, SSI, veterans' benefits, and other funds that some of our most vulnerable citizens rely on to meet their most basic of needs. Congress and many states have determined — rightly, in my view — that these funds should not be touched by judgment creditors. Nevertheless, banks frequently freeze accounts that contain these exempt funds pending resolution of a debt collector's application for a garnishment order. As a result of the freeze and any subsequent garnishment, consumers end up bouncing checks, incurring fees, and most importantly, losing access to funds that they critically need and to which they are unambiguously entitled. I realize that it is often impossible for a debt collector to learn whether a bank account contains exempt funds before seeking to garnish it. And much of the responsibility will be on the banks to come up with ways to ensure that when they receive restraining or garnishment orders, that exempt funds are not frozen. Yet something must be done, to the extent feasible, to ensure that exempt funds remain under the control of the consumer at all times.

Finally, the Commission learned about some serious issues concerning debt collection arbitration. Everyone in this room undoubtedly is familiar with the lawsuit brought by my friends in the Minnesota Attorney General's Office against the country's largest provider of consumer debt arbitration services, the National Arbitration Forum, alleging that NAF had

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[6] Claudia Wilner and Nasoan Sheftel-Gomes, *Debt Deception: How Debt Buyers Abuse the Legal System to Prey on Lower-Income New Yorkers* 6 (May 2010), *available at* nedap.org/pressroom/documents/DEBT_DECEPTION_FINAL_WEB.pdf.

[7] *Id.* at 8.

engaged in consumer fraud, deceptive trade practices, and false advertising. The lawsuit alleged that the NAF had held itself out as an impartial provider of dispute resolution, while in fact it had significant ties to the debt collection industry through a series of complex and purposefully hidden affiliations. As you know, NAF quickly settled the case and, among other things, agreed to cease providing debt collection arbitration services.

And as you all also know, in the wake of the NAF settlement, the American Arbitration Association — the nation's second largest provider of consumer debt arbitration services — imposed a moratorium on conducting debt collection arbitrations.[8] A number of large banks joined in the chorus, announcing that they would discontinue the use of mandatory pre-dispute provisions in their credit card contacts.[9]

These are positive steps. Yet there are still serious, unaddressed issues relating to arbitration. For example, as in the litigation context, consumers often fail to receive actual notice of arbitration proceedings. And as in the litigation context, consumers frequently cannot afford to participate in the proceedings. Unlike the litigation context, though, consumers actually may be required to pay part or all of the costs of the proceeding, including the fees of the arbitrator, making arbitration a more expensive option than litigation for these consumers.

There are also issues with bias, or at least the appearance of bias, in the arbitration industry. Putting aside the express financial ties that NAF had to the industry, arbitration forums have an incentive to favor the people who pick the arbitrators, that is to say, they have an incentive to favor the creditors. During the roundtables, several commenters expressed concern that creditors and arbitration forums appear to black-ball arbitrators who are perceived as being too "pro-consumer." Indeed, a study by the Center for Responsible Lending found that arbitrators who decided in favor of debt collectors, as opposed to consumers, subsequently received more matters from the arbitration firm.[10] Of course consumers have no way of knowing any of this. They know nothing about the arbitrators' track records or their affiliations — financial or otherwise — with the debt collection industry.

And there are some more fundamental problems with regard to mandatory pre-dispute arbitration at the time of contract. Many consumers simply do not understand what arbitration is or that their contract contains an arbitration provision. Even assuming the consumer understands what arbitration is, and knows that her contract contains an arbitration provision, what meaningful opportunity does the consumer have to make a choice or weigh options at the point

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[8] *See* Letter from William K. Slate II, American Arbitration Association, to Lori Swanson, Minnesota Attorney General (July 20, 2009), at 2, *available at* www.nclc.org/images/pdf/arbitration/testimonysept09-exhibit4.pdf (announcing moratorium until "there is some consensus on how concerns about the administration of debt collection arbitrations might be successfully addressed").

[9] *See*, *e.g.*, National Consumer Law Center, *Forced Arbitration — Consumers Need Permanent Relief* 13 (Apr. 2010), *available at* www.nclc.org/images/pdf/arbitration/report-forced-arbitration.pdf (stating that JPMorgan Chase, Bank of America, Capital One, and HSBC reached tentative settlements to stop enforcing existing mandatory arbitration clauses and to refrain from including such clauses in their contracts until at least 2013).

[10] *See* Joshua M. Frank, Center for Responsible Lending, *Stacked Deck: A Statistical Analysis of Forced Arbitration* 8 (May 2009), *available at* www.responsiblelending.org/credit-cards/research-analysis/stacked_deck.pdf

of contract? Consumer credit agreements usually are offered on a take-it-or-leave-it basis, giving the consumer no opportunity to negotiate the pre-dispute arbitration clause. And even if consumers had the ability to "shop around" for a provider who does not require arbitration, they would have found that, until very recently, the vast bulk of consumer contracts for credit contained mandatory arbitration provisions, leaving consumers with no realistic alternatives.

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Now, after having given these and other issues careful consideration, the Federal Trade Commission is today issuing a report entitled "Repairing a Broken System: Protecting Consumers in Debt Collection Litigation and Arbitration." This report, in my opinion, does an outstanding job of identifying some of the most critical debt collection issues confronting consumers, and the report also makes several recommendations with which I wholeheartedly agree.

With regard to issues surrounding litigation by creditors and debt collectors, and the lack of notice to consumers about the litigation and the resulting high default rates, the report makes several significant and concrete recommendations. I do not have time to discuss all of them, so I will highlight a few of the more salient ones.

- The Commission recommends that states amend service of process rules to require greater verification that the correct consumers are served. Supplemental notice provisions — such as rules requiring service by U.S. Mail, in addition to regular service — can also help ensure that consumers are made aware of the proceedings against them.
- The Commission urges criminal and civil law enforcement authorities to take action against bad actors, such as "sewer servers," to discourage those who would lie and cheat their way into a default judgment against a consumer.
- To lower the cost of consumer participation in debt collection cases filed in court, the Commission urges courts to consider allowing consumers to appear by phone or Internet.
- To discourage collectors from seeking continuances or dismissals without prejudice when consumers do show up in court and even demand documentation of the underlying debt, the Commission urges courts to consider awarding consumers the costs of preparing for and attending a canceled hearing or postponed trial, including their lost wages and transportation costs.
- And if certain collectors or their attorneys repeatedly engage in such practices, or if they fail altogether to attend a scheduled hearing, the Commission urges courts to consider entering dismissals with prejudice.

Turning now to debt documentation, the Commission recommends that collectors be required to take a number of steps in order to provide sufficient documentation of the purported debt to enable consumers to understand why they are being sued and to prevent judgments that are premised on empty assertions. The Commission believes that collectors should be required to include, with their complaints filed in court, some basic information about the debt, such as

(1) the name of the original creditor and the last four digits of the original account number;
(2) the date of default or charge-off and the amount due at the time;
(3) the name of current owner of the debt;
(4) the total amount currently due on the debt; and
(5) a breakdown of the total amount currently due by principal, interest, and fees.

Several states have already enacted laws requiring greater documentation in debt collection litigation,[11] and the Commission recommends that all jurisdictions consider adopting similar rules. In my view, if a collector or a debt buyer cannot produce this most basic of information, then the case should be dismissed.

With respect to garnishment of exempt funds, such as Social Security and Veterans benefits, the Commission notes that, once again, several states have enacted laws to address this problem. Some states have set a pre-determined amount that banks may not freeze in an account with any exempt funds. For example, New York preserves $2,500 in bank accounts into which exempt funds have been deposited in the previous forty-five days.[12] And just a few months ago, a number of federal agencies, including the Department of the Treasury and the Social Security Administration, issued a joint notice of proposed rulemaking that proposes a rule prohibiting banks from freezing exempt funds.[13] The Commission recommends that jurisdictions enact protections like these to ensure exempt funds are protected from garnishment.

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I would now like to focus on two areas of particular interest to me: the collection of time-barred debts, and mandatory pre-dispute arbitration of consumer debt collection matters.

First: time-barred debts. The key question is whether it is time to put an end to the practice of enticing a consumer to make a payment on debt when the debt collector or debt buyer knows or reasonably should know that the debt is time-barred. The Commission, in its report, takes no formal position as to whether the FDCPA should be amended to preclude collectors from using such tactics to collect on a debt that they know or should know is time-barred. In this case, I part ways with my esteemed colleagues. I believe that it is time for Congress to amend federal law to prohibit such collection efforts.

Even though the report does not recommend amending federal law to bar attempts to collect on debt that the collector knows or should know is stale, the Commission makes clear that

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[11] *See*, *e.g.*, N.C. Gen. Stat. §§ 58-70-115, 58-70-145, 58-70-150, 58-70-155; Mass. Ann. Laws Unif. Small Claims Rules 2(a), 2(b); Michigan Court Rules 3.101.

[12] N.Y. C.P.L.R. 5222(h) (2009).

[13] Garnishment of Accounts Containing Federal Benefit Payments, 75 Fed. Reg. 20299 (Apr. 19, 2010).

debt collectors need to tread carefully in this area. Among the Commission's recommendations are the following:

- Since most consumers do not know or understand their legal rights with respect to the collection of time-barred debt, the Commission states that, in many circumstances, such attempts to collect may create a misleading impression that the collector can sue the consumer in court to collect the debt. The Commission states that such a misrepresentation would be a deceptive act or practice in violation of federal law. To avoid creating this misleading impression, the Commission states that collectors should disclose clearly and prominently to consumers, before seeking payment on time-barred debt, that because of the passage of time, the collector can no longer sue in court to collect the debt or otherwise compel the consumer's payment.
- And if the consumer lives in a jurisdiction where a partial payment will revive stale debt, the Commission believes that collectors must notify consumers of this fact, when soliciting a partial payment, lest they create a misleading impression, in violation federal law.
- Regarding the burden of proof as to whether the debt is time barred, the Commission recommends that states change their laws to require collectors to prove that the debt that is the subject of the suit is not beyond the statute of limitations, rather than imposing on consumers the burden of raising the running of the statute of limitations as an affirmative defense.

The FTC is watching this area closely. Because increased enforcement activity against collectors who file time-barred lawsuits would deter filings and attempts to collect debt that the collector knows or should know is time-barred, the Commission intends to focus more of its enforcement efforts on collectors who engage such practices. So a word of caution: please proceed carefully.

Finally, arbitration. As I mentioned earlier, I have serious concerns regarding mandatory pre-dispute arbitration of consumer collection matters. In the report we are issuing today, the Commission makes several excellent recommendations to try to address the issues of bias — real and perceived — as well as fairness, transparency, cost, and meaningful choice. I will highlight a few of these recommendations.

First, the Commission believes that it is imperative that arbitrators and arbitration forums take significant and concrete steps to prevent bias and the appearance of bias. Arbitrators who have a financial interest in a creditor should not be allowed to decide matters involving that creditor, and creditors with a financial interest in an arbitration forum should not be allowed to bring matters to that forum to be arbitrated. That is just common sense.

More generally, the Commission concludes that rigorous standards of ethical conduct for arbitration forums, arbitration administrators, and arbitrators are sorely needed. The Commission believes that the private sector should try to develop debt collection arbitration standards, promote compliance with these standards, and vigorously enforce them. If the private sector cannot or will not take the action needed, then the Commission believes either the government should step in and develop and enforce such standards, or Congress should prohibit debt collection arbitration altogether and have these matters resolved in the public court system.

In order to increase the transparency of the arbitration process, the Commission recommends several things. First, the procedures that arbitration forums use to select arbitrators should be made as transparent as possible to restore public confidence in the integrity of debt collection arbitration proceedings. Arbitrators should issue reasoned opinions to accompany any awards. The opinions should state the law applied, explain the application of the law to the facts, and set forth a calculation of the amount awarded, including breaking the amount into principal, interest, and fees. And the opinions should be made public. A handful of states have already passed laws requiring arbitration decisions to be made public.[14] The Commission thinks that Congress should consider the creation of a nationwide reporting and disclosure system for debt collection arbitration awards to make such arbitrations more transparent.

Turning to the issue of consumer choice, the Commission concludes that consumers should, but generally do not, have a meaningful choice regarding mandatory pre-dispute arbitration provisions. The Commission believes that, in order for consumers to have a meaningful choice, they must have: (1) a basic understanding of arbitration and its consequences; (2) the option whether to agree to arbitration, and under what conditions; and (3) a reasonable method of exercising that option. The FTC thinks that substantial changes in mandatory pre-dispute arbitration provisions are needed to meet these criteria. Creditors should draft their consumer credit contracts in a way that ensures consumers are aware of their choice whether to arbitrate, and provide consumers with a reasonable method of exercising that choice. We need more research into alternative models of choice — like the work that has been done in the privacy sphere. If arbitration is going to remain an option, then both the public and private sectors need to educate consumers so that they can make better-informed choices related to arbitration.

The Commission will closely monitor and evaluate debt collection arbitration models, to ensure that they provide consumers with meaningful choice and a fair process. But, to be honest, I do not think that is enough. The process is broken, and simply studying it in the future will not protect consumers now. I very much appreciate industry's self-imposed moratorium on arbitration of consumer debt collection matters, and industry's sensitivity to the serious problems we have identified. However, as you know, the debt collection industry is free to lift its voluntary moratorium at any time. So, in addition to the recommendations all of the Commissioners have made, I separately call

[14] *See* Cal. Civ. Code §1281.96; An Act to Provide Protections for Consumers Subject to Mandatory Arbitration Clauses, 2010 Maine Pub. Law Chap. 572, LD 1256.

on Congress to formalize the voluntary moratorium currently in place, by enacting a ban on mandatory pre-dispute arbitration in consumer debt collection matters. I think that such a ban should remain in place until the arbitration process can be shown to be fair, transparent, and as affordable as traditional litigation, and until consumers have a meaningful opportunity to opt out of pre-dispute arbitration without losing access to the credit services they seek. If Congress enacts such a ban, then once these conditions have been met, Congress could lift the ban itself, or it could delegate the authority to determine whether appropriate changes have been instituted to the Federal Trade Commission or, assuming that the financial reform bill is enacted into law, to our new fellow consumer protection agency, the Consumer Financial Protection Bureau.

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So, to conclude: The current system for collecting consumer debts is broken. Consumers are not adequately protected in either debt collection litigation or arbitration. Today I have gone over some of the reasons why the Commission believes the system is broken, and the steps the Commission believes must be taken to remedy the situation. The agency is interested in continuing to work with all interested parties to implement these reforms as soon as possible. We very much appreciated the participation of industry in the roundtables, and the Commission hopes that our continuing discussions and the report issued today will be catalysts for change, resulting in a debt collection system which provides better protection for consumers without unduly burdening legitimate debt collection.

Thank you for listening to me today. I would be glad to take some time to answer some questions.