

CONSUMER FINANCE LITIGATION AND CREDITORS' RIGHTS IN THE UNITED STATES: LEGAL AND ECONOMIC IMPLICATIONS OF DEBT COLLECTION REGULATION

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Abstract. Debate on the regulation of consumer debt collection in the United States is usually conducted as a single argument: protection of the consumer against preservation of credit supply. This article shows that the argument is mis-specified, because the empirical literature does not in fact disagree about whether regulation has a price. It disagrees about which regulatory margin carries that price. Fedaseyeu finds that a one-point increase in a state index of structural restrictions reduces third-party collector density by 62.8 employees per million people, about 15 per cent of the sample mean, lowers credit-union recovery rates on charged-off credit-card loans by 1.038 percentage points, and reduces new revolving accounts by 1.849 per 1,000 consumers per quarter. Romeo and Sandler, examining conduct restrictions adopted in four states, report that such rules reduce credit-card access and raise interest rates but that the effect is very small. Fonseca finds that restricting collections reduces mainstream credit and increases payday borrowing, so that part of the cost falls on the households the rules were written to protect. Against those economic findings the article sets the procedural record: the Pew Charitable Trusts report that debt collection cases rose from about one in nine civil cases in 1993 to about one in four in 2013, that more than seventy per cent of such suits end in default judgment, and that fewer than ten per cent of defendants are represented while almost every plaintiff is. The article concludes that the most defensible reform is procedural rather than structural, because the measured credit cost of conduct and documentation rules is small while the measured procedural defect is large, and it proposes four measures on that basis.

Keywords: consumer finance litigation, creditors' rights, debt collection regulation, default judgment, Fair Debt Collection Practices Act, Regulation F, credit supply, recovery rates, payday borrowing, state civil courts

INTRODUCTION AND RELEVANCE

Consumer debt collection occupies an unusual position in American law. It is governed by a federal conduct statute, by a federal implementing rule, by state licensing and documentation statutes, and, at the decisive moment, by the ordinary civil procedure of state trial courts. Each of these layers was designed separately, and none of them was designed with the others in view.

The scale of the activity is documented. The Pew Charitable Trusts report that debt collection cases grew from roughly one in nine civil cases in 1993, some 11.6 per cent of the docket, to roughly one in four by 2013, some 23.6 per cent, and that the number of such suits more than doubled over the same period, from fewer than 1.7 million to about 4 million [1]. Debt collection is therefore no longer one category of civil litigation among many. In many state courts it is the largest single category.

Two further findings from the same report define the problem this article addresses. First, more than seventy per cent of debt collection suits end in default judgment; the reported jurisdictional figures include about eighty per cent in New York City for 2006 to 2008, seventy-one per cent across five Colorado counties for 2013 to 2015, and over eighty per cent in Washington State for 2012 to 2016 [1]. Second, fewer than ten per cent of defendants in these cases had legal representation, while almost every plaintiff did [1].

A default judgment is not a finding that the claim is good. It is a finding that the defendant did not appear. Where seven cases in ten end that way, the substantive law governing the creditor's right is tested in only a minority of proceedings, and the rules about what a creditor must prove operate mainly as rules about what a creditor must prepare rather than as rules about what a court will examine.

Against this procedural picture stands an economic literature which treats collection as an input into the price and availability of unsecured credit. That literature is often summarised as showing that consumer protection in collection reduces access to credit. The summary is too coarse. As set out below, the studies measure different regulatory instruments and reach different magnitudes, and the difference between them is not noise. It is the finding.

The scientific novelty of this study lies in joining the two bodies of evidence that are normally read apart. The legal literature describes what happens inside the courtroom; the economic literature estimates what happens in the credit market. Read together, they support a conclusion that neither supports alone: the regulatory margin with the largest measured economic cost is not the margin with the largest measured legal defect.

The aim of the study is to determine which instruments of debt collection regulation carry a measurable cost to credit supply, which do not, and what follows for the design of consumer finance litigation. The objectives are: to set out the procedural record in state courts; to classify the regulatory instruments by the margin on which they operate; to compare the estimated economic effects of each margin; and to formulate reform proposals that follow from the comparison.

MATERIALS AND METHODS

The object of study is the regulation of consumer debt collection in the United States. The subject is the relationship between the regulatory margin on which an instrument operates and the measured economic effect attributed to it.

Legal materials comprise the Fair Debt Collection Practices Act [5]; Regulation F, the implementing rule of the Consumer Financial Protection Bureau effective 30 November 2021 [6]; the Dodd-Frank Act, under which the Bureau exercises its authority [7]; Article 9 of the Uniform Commercial Code so far as it governs the account debtor's defences and discharge [11]; the California Fair Debt Buying Practices Act as a leading example of state documentation legislation [12]; and Rule 55 of the Federal Rules of Civil Procedure on default and default judgment, together with its state analogues [16].

Empirical materials fall into two groups. Court-side evidence comprises the Pew report on debt collection in state courts [1], the survey of civil caseloads published by the National Center for State Courts [18], and the report of the Conference of Chief Justices and the Conference of State Court Administrators on civil justice [17]. Market-side evidence comprises the Federal Trade Commission study of the debt buying industry [8] and its earlier report on collection litigation and arbitration [9], together with the periodic reporting of the Consumer Financial Protection Bureau [10].

Econometric materials comprise three studies which estimate the effect of state collection regulation on credit outcomes: Fedaseyeu on structural restrictions [2], Romeo and Sandler on conduct restrictions [3], and Fonseca on the substitution between mainstream and payday credit [4]. Secondary legal literature on collection practice in state courts was consulted for context [13; 14; 15].

The method proceeds in three steps. First, each regulatory instrument was classified by the margin on which it operates: entry into and structure of the collection industry, conduct of collectors, documentation required in litigation, or court procedure. Second, the estimated economic effect reported in the econometric literature was attached to the margin that the study actually measured, rather than to regulation in general. Third, the resulting map was compared with the

procedural record, so that the size of the measured legal defect could be set beside the size of the measured economic cost.

One methodological caution governs the comparison. The three econometric studies use different outcome variables, different state samples and different indices, so their coefficients are not interchangeable and are not combined here. Each is reported in the form and the units given in the source.

Note on the limits of the study. *This is a doctrinal and analytical study. No survey, docket sample, or original econometric estimation was carried out by the author. Every quantitative statement is drawn from a published source identified in the references and is reported in the units used there. Court decisions are cited only where reported. The article describes general legal and regulatory frameworks and does not constitute legal advice on any particular account or proceeding.*

RESULTS

1. The procedural record: adjudication without adjudication

The first result concerns the forum rather than the rule. Debt collection litigation is conducted overwhelmingly in state trial courts of limited jurisdiction, and the Pew data establish that it has become the dominant civil activity of those courts, rising from about 11.6 per cent of civil cases in 1993 to about 23.6 per cent in 2013 while the absolute number of suits grew from fewer than 1.7 million to about 4 million [1]. The survey of state civil caseloads published by the National Center for State Courts reaches a consistent picture of a docket dominated by contract and debt claims of modest value [18].

The second element of the record is the disposition pattern. With more than seventy per cent of suits resolved by default [1], the ordinary adversarial mechanism does not operate in most cases. The asymmetry of representation compounds this: fewer than ten per cent of defendants appear with counsel against plaintiffs who are almost always represented [1]. The Conference of Chief Justices and the Conference of State Court Administrators have described the resulting condition as a structural problem of the civil justice system rather than as a feature of particular cases [17].

The legal consequence is specific and is often stated too loosely. Default does not mean that the creditor's claim was weak; many claims are perfectly good. It means that whatever rule the law imposes on the creditor regarding ownership of the claim, the amount owed, or the documentation of the account, that rule is applied by the clerk and the creditor rather than tested by an opponent. The Federal Trade Commission reached essentially this conclusion in its review of

collection litigation and arbitration more than a decade ago [9], and the practitioner literature on defending collection actions is built around the same premise [15].

2. The economic literature: three studies, three margins

The economic literature is frequently summarised as establishing that collection regulation reduces credit. The summary conceals the result that matters. The three principal studies measure different instruments.

Fedaseyeu constructs a state index of restrictions on third-party collection built from six components: regulatory boards, licensing requirements, bonding requirements, declared prohibited practices, private rights of action, and criminal penalties. Using a difference-in-differences design that exploits the timing of state adoptions, he estimates that a one-point increase in the index reduces third-party collector density by 62.8 employees per million people, which is about 15 per cent of the sample mean and 29 per cent of its standard deviation; reduces credit-union recovery rates on charged-off credit-card loans by 1.038 percentage points, about 7 per cent of the sample mean; and reduces new revolving credit lines by 1.849 accounts per 1,000 consumers per quarter, about 2 per cent of the sample mean [2].

Four of the six components of that index regulate entry and standing to operate rather than behaviour towards the debtor. The measured effect therefore belongs, in the main, to the structural margin: it is a measure of what happens when the capacity of the collection industry is reduced.

Romeo and Sandler examine a different instrument. Studying conduct restrictions adopted in four states, they find that such restrictions reduce access to credit-card accounts and raise interest rates, but report that the effect is very small [3]. The contrast with the previous study is not a contradiction in the data. It is a difference in what was regulated.

Fonseca supplies the third element. Using individual credit records and a difference-in-differences comparison of neighbouring states with different collection policies, she finds that restricting collections reduces access to mainstream credit and increases payday borrowing [4]. This result matters for the normative argument more than for the descriptive one: where restriction pushes borrowing from mainstream to higher-cost channels, part of the cost of the protection is borne by the households the protection was designed for.

3. The creditor side stated fairly

A study of this kind must state the creditor's position in its strongest form rather than as a foil. Unsecured consumer credit is extended without collateral, so the lender's only recourse against non-payment is the legal process. The expected value of that recourse enters the price of credit before any individual borrower

defaults. If enforcement becomes slower, less certain, or more expensive, the effect appears not as a loss to the particular creditor but as an adjustment in the terms offered to future borrowers, and the recovery-rate and revolving-account coefficients reported by Fedaseyeu are a direct measurement of that adjustment [2].

The Federal Trade Commission findings on the debt buying market qualify this argument without defeating it. In the purchase and sale agreements the Commission obtained, sellers generally disclaimed representations and warranties as to the accuracy of the information supplied about individual debts, and creditors limited buyers' post-sale access to documents [8]. A market in which the purchaser is contractually prevented from verifying what it has bought will produce claims that cannot be proved even when they are valid. On that view, documentation requirements in litigation do not obstruct enforcement; they correct a failure that originates upstream in the sale.

4. Mapping instruments to measured effects

The classification of instruments by margin, with the economic effect attached to the margin actually measured, is set out in Table 1.

Table 1. Regulatory margin, instruments, and the measured economic effect

Regulatory margin	Representative instruments	Measured economic effect	Source
Entry into and structure of the collection industry	Licensing, bonding, regulatory boards, private rights of action, criminal penalties	One index point: collector density lower by 62.8 employees per million (15 % of mean); recovery on charged-off cards lower by 1.038 pp (7 % of mean); new revolving accounts lower by 1.849 per 1,000 consumers per quarter (about 2 % of mean)	Fedaseyeu (2020) [2]
Conduct of collectors towards the consumer	Contact limits, required disclosures, prohibited practices	Access to credit-card accounts reduced and interest rates raised, but the effect is reported as very small	Romeo and Sandler (2021) [3]
Aggregate restriction of collection activity	Composite state restrictions	Mainstream credit reduced; payday borrowing increased	Fonseca (2023) [4]
Federal conduct and disclosure rules	FDCPA; Regulation F validation notice and itemisation from a stated date	Not separately estimated in the econometric literature reviewed	[5; 6; 7]

Regulatory margin	Representative instruments	Measured economic effect	Source
Documentation required of the plaintiff in litigation	State debt-buyer statutes conditioning suit on specified records	Not separately estimated; addresses a defect originating in the sale contract	[12]; FTC (2013) [8]
Court procedure and disposition	Default judgment under Rule 55 and state analogues; service of process rules	More than 70 % of suits resolved by default; fewer than 10 % of defendants represented	Pew (2020) [1]; NCSC [18]
Defences preserved against the assignee	UCC Article 9 provisions on defences and discharge	Not separately estimated; operative only where the defendant appears	[11]; Pew (2020) [1]

Source: compiled by the author from sources [1] to [12] and [16] to [18]. The coefficients are reproduced in the units reported in each study and are not combined, because the studies use different indices, samples and outcome variables.

The table yields the central result of the article. The margin on which the measured credit cost is concentrated is the structural one, which governs who may collect. The margin on which the measured legal defect is concentrated is the procedural one, which governs how a claim is adjudicated. These are different margins, and a reform directed at the second does not incur the cost measured at the first.

5. What the evidence does not establish

Several matters relevant to this comparison cannot presently be resolved. No published series reports how often default judgments in debt collection cases rest on claims that would have failed had they been contested, so the volume of erroneous judgments is unknown. The econometric studies estimate effects on credit outcomes and not on the accuracy of adjudication, so they cannot be read as evidence that regulation improves or worsens judicial outcomes. Regulation F has applied only since 30 November 2021 [6], and no body of evidence yet permits an assessment of its effect on either margin.

These gaps are themselves findings. They mean that the argument advanced here rests on the asymmetry between a large measured procedural defect and a small measured conduct-side cost, and not on a demonstration that procedural reform would produce a quantified improvement.

DISCUSSION

The central finding is that the apparent disagreement in the economic literature dissolves once the regulated margin is identified, and that the resulting map does not align with the way the policy debate is usually framed.

The counter-argument, stated at its strongest

The most serious objection to the argument advanced here is that the distinction between structural and conduct regulation may be less clean than the table suggests. Conduct rules carry compliance costs; sufficiently demanding conduct rules may deter entry and therefore act on the structural margin indirectly. On that view, the small effect reported by Romeo and Sandler [3] may reflect the particular four-state sample and the particular restrictions studied rather than a general property of conduct regulation, and a more demanding conduct regime might produce effects closer to those Fedaseyeu measures [2].

This objection has force and cannot be dismissed on the available evidence. Two observations limit it. First, the components of the Fedaseyeu index that most plausibly drive the measured reduction in collector density are licensing, bonding and the creation of regulatory boards, which are entry conditions in form as well as in effect [2]. Second, documentation requirements of the kind imposed by state debt-buyer statutes [12] operate on claims the creditor has already decided to file, so they alter the cost of litigating rather than the cost of entering the market. The distinction is therefore defensible, but it should be treated as a hypothesis supported by the structure of the instruments rather than as an estimated result.

Where the cost of protection falls

The Fonseca result requires separate treatment because it changes the character of the trade-off rather than its size [4]. If restricting collection reduced credit uniformly across the population, the policy question would be a straightforward balance between protection and access. Because the restriction instead shifts borrowing towards payday credit, the burden falls disproportionately on households with the fewest alternatives, which are the households the restriction was intended to protect. A protective rule whose incidence runs against its intended beneficiaries is not simply costly; it is partly self-defeating, and this is an argument for selecting instruments by incidence rather than by stringency.

Why the procedural margin is the one to reform

Three considerations support concentrating reform on procedure. First, the measured defect is large and is measured directly: seven suits in ten resolved without an opponent, and nine defendants in ten unrepresented [1]. Second, the measured credit cost attached to conduct and documentation rules is small [3], and the documentation instruments address a defect that originates in the terms on

which portfolios are sold rather than in the court's process [8]. Third, procedural rules bind at the point where the error is cheapest to prevent. A claim that cannot be proved is better identified before judgment than unwound afterwards, and the practitioner literature on defending collection actions is largely an account of how expensive the later correction is [15].

The academic literature on collection in state courts reached compatible conclusions well before the present data were available. Hynes described the state-court collection process as the principal mechanism by which consumer obligations are actually enforced, operating largely outside the bankruptcy system that scholarship had concentrated on [13]. Holland examined the evidentiary basis of debt-buyer claims in small-claims courts and identified the absence of proof, rather than the absence of merit, as the characteristic defect [14]. The contribution of the present study is to place beside those legal findings the estimate of what the corresponding reform would cost, which the earlier literature did not have.

Limits of the analysis

Three limits should be recorded. The econometric estimates are derived from variation among American states and cannot be transferred to other legal systems without re-estimation. The procedural figures are drawn from jurisdictional studies conducted between 2006 and 2019 and may not describe current practice in any particular court. Finally, the argument is comparative rather than absolute: it establishes that one margin carries a smaller measured cost than another, not that reform on that margin is costless.

Further research should link the two literatures directly by estimating the effect of state documentation statutes on default-judgment rates and on dismissal rates, which would test the central claim of this article on its own terms.

CONCLUSION

1. Debt collection has become the dominant category of civil litigation in American state courts, rising from about one in nine civil cases in 1993 to about one in four in 2013, with the number of suits growing from fewer than 1.7 million to about 4 million [1].

2. The adversarial mechanism does not operate in most of these proceedings. More than seventy per cent end in default judgment and fewer than ten per cent of defendants are represented, while almost every plaintiff is [1]. Rules about what a creditor must prove therefore function in most cases as rules about preparation rather than as rules of adjudication.

3. The economic literature does not show that collection regulation uniformly reduces credit. It shows that structural restrictions carry a measurable cost, with a

one-point index increase associated with 62.8 fewer collector employees per million people, a 1.038 percentage-point fall in recovery on charged-off credit-card loans and 1.849 fewer new revolving accounts per 1,000 consumers per quarter [2], whereas conduct restrictions produce effects reported as very small [3].

4. Part of the cost of restriction is borne by the intended beneficiaries, since restricting collection reduces mainstream credit and increases payday borrowing [4]. Instruments should therefore be selected by the incidence of their cost and not by their stringency.

5. It follows that the regulatory margin with the largest measured economic cost is not the margin with the largest measured legal defect. Reform directed at procedure and documentation addresses the larger defect at the smaller measured cost.

Proposals. *Four measures follow from the analysis.*

First, a plaintiff in a consumer collection action should be required to file, with the complaint, the documents establishing the amount claimed and the chain by which the plaintiff came to hold the account, and the court should be required to examine them before entering judgment by default. This places the documentation requirement at the only point in the proceeding where a court reliably looks at the file, and several states have already adopted the substantive requirement without attaching it to that point [12].

Second, the sufficiency of service of process should be verified independently of the plaintiff's affidavit in cases proceeding to default. A default rate above seventy per cent [1] is consistent either with widespread non-appearance by notified defendants or with defective notice, and the two cannot be distinguished on the present record.

Third, the blanket disclaimer of warranties as to the accuracy of account information should not be enforceable as between the parties to a sale of consumer receivables. The Commission's findings show that such disclaimers, combined with contractual limits on post-sale access to documents, create the evidentiary gap that later appears in court [8]; correcting it at the point of sale is cheaper than litigating it afterwards.

Fourth, states reviewing their collection statutes should distinguish instruments by margin. Conduct and documentation requirements carry a small measured credit cost [3] and should be the preferred instruments; restrictions that operate as entry conditions carry a larger measured cost [2] and should be adopted only where the conduct-side instruments have been shown to be insufficient.

The underlying point is narrow. American law already specifies what a creditor must establish to recover on a consumer debt. What it does not reliably specify is the occasion on which anyone will check, and in a system where most judgments are entered without an opponent, that second question determines whether the first one has any practical content.

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