

Magazine

# Banks vs. Consumers (Guess Who Wins)

By [Robert Berner and Brian Grow](#) on June 04, 2008

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Data: Companies, NAF documents, <i>BusinessWeek</i> research			



The business of resolving credit-card disputes is booming. But critics say the dominant firm favors creditors that are trying to collect from unsophisticated debtors

What if a judge solicited cases from big corporations by offering them a business-friendly venue in which to pursue consumers who are behind on their bills? What if the judge tried to make this pitch more appealing by teaming up with the corporations' outside lawyers? And what if the same corporations helped pay the judge's salary?

It would, of course, amount to a conflict of interest and cast doubt on the fairness of proceedings before the judge.

Yet that's essentially how one of the country's largest private arbitration firms operates. The National Arbitration Forum (NAF), a for-profit company based in Minneapolis, specializes in resolving claims by banks, credit-card companies, and major retailers that contend consumers owe them money. Often without knowing it, individuals agree in the fine print of their credit-card applications to arbitrate any disputes over bills rather than have the cases go to court. What consumers also don't know is that NAF, which dominates credit-card arbitration, operates a system in which it is exceedingly difficult for individuals to prevail.

Some current and former NAF arbitrators say they make decisions in haste—sometimes in just a few minutes—based on scant information and rarely with debtor participation. Consumers who have been through the process complain that NAF spews baffling paperwork and fails to provide the hearings that it promises. Corporations seldom lose. In California, the one state where arbitration results are made public, creditors win 99.8% of the time in NAF cases that are decided by arbitrators on the merits, according to a lawsuit filed by the San Francisco city attorney against NAF.

"NAF is nothing more than an arm of the collection industry hiding behind a veneer of impartiality," says Richard Neely, a former justice of the West Virginia supreme court who as part of his private practice arbitrated several cases for NAF in 2004 and 2005.

**A DIFFERENT REALITY**

NAF presents its service in print and online advertising as quicker and less expensive than litigation but every bit as unbiased. Its

Web site promotes "a fair, efficient, and effective system for the resolution of commercial and civil disputes in America and worldwide."

But internal NAF documents and interviews with people familiar with the firm reveal a different reality. Behind closed doors, NAF sells itself to lenders as an effective tool for collecting debts. The point of these pitches is to persuade the companies to use the firm to resolve clashes over delinquent accounts. JPMorgan Chase (JPM) and Bank of America (BAC) are among the large institutions that do so. A September, 2007, NAF PowerPoint presentation aimed at creditors and labeled "confidential" promises "marked increase in recovery rates over existing collection methods." At times, NAF does this kind of marketing with the aid of law firms representing the very creditors it's trying to sign up as clients.

NAF, which is privately held, employs about 1,700 freelance arbitrators—mostly moonlighting lawyers and retired judges—who handle some 200,000 cases a year, most of them concerning consumer debt. Millions of credit-card accounts mandate the use of arbitration by NAF or one of its rivals. NAF also resolves disputes involving Internet domain names, auto insurance, and other matters. In 2006 it had net income of \$10 million, a robust margin of 26% on revenue of \$39 million, according to company documents.

NAF's success is part of a broader boom in arbitration dating back to the 1980s, when companies began introducing language into employment contracts requiring that disputes with workers be resolved out of court. Mandatory arbitration spread to other kinds of agreements, including those involving credit cards.

#### NUMEROUS LOYAL PATRONS

Now, with the economy stumbling, NAF's focus on consumer credit could prove even more lucrative. U.S. credit-card debt hit a record high of \$957 billion in the first quarter of 2008, up 8% from the previous year, according to Federal Reserve data. People who had relied on home-equity loans are seeing that money evaporate in the mortgage crisis and are running up card balances. Card providers, meanwhile, are increasingly turning to arbitration to collect on delinquent accounts.

Even consumer advocates concede that most people accused of falling behind do owe money. But the amounts are often in dispute because of shifting interest rates, fees, and penalties. Sometimes billing mistakes or identity fraud lead to confusion. Plenty of acrimony surrounds the traditional collections process in which lenders' representatives or companies that buy debt at a discount pressure consumers to pay up. Arbitration is supposed to be different. Endorsed by federal law, it purports to offer something akin to the evenhanded justice of the court system. That's why state and federal judges overwhelmingly uphold arbitration awards challenged in their courtrooms. This confidence may be misplaced, however, at least in many cases that come before NAF. (Its main competitors—the nonprofit American Arbitration Assn. in New York and JAMS, a for-profit firm in Irvine, Calif.—tend to attract employment disputes and contractual fights between companies.)

NAF has numerous loyal patrons among the country's financial titans. Chase says in a statement that it "uses NAF almost exclusively in its collection-arbitration proceedings due to NAF's lower cost structure." Companies pay from \$50 to several hundred dollars a case, depending on its complexity. "Many legal commentators have found arbitration to be fair, efficient, more consumer friendly, and faster than the court system," Chase adds. Roger Haydock, NAF's managing director, says: "This is like the Field of Dreams: Build a ballpark, and they will come."

Others argue that NAF umpires make calls that put debtors at a disadvantage. In March, Dennis J. Herrera, San Francisco's city attorney, sued the firm in California state court, accusing it of churning out awards for creditors without sufficient justification. The lawsuit cites state records showing that NAF handled 33,933 collection arbitrations in California from January, 2003, through March, 2007. Of the 18,075 that weren't dropped by creditors, otherwise dismissed, or settled, consumers won just 30, or 0.2%, the suit alleges. "NAF has done an end run around the law to strip consumers of their right to a fair collection process," Herrera says in an interview.

The firm counters in court papers that federal law intended to encourage arbitration precludes the suit. NAF's "neutral decision-makers constitute a system that satisfies or exceeds objective standards of fairness," the firm says in a press release. NAF adds in an e-mail that the suit obscures thousands of cases in which consumers prevail because creditors abandon their claims or the disputes are "otherwise terminated."

So far, the San Francisco litigation relies mostly on publicly available information about NAF. Internal documents and interviews provide a more detailed picture of the firm.

The September, 2007, marketing presentation, which NAF left with a prospective customer, boasts that creditors may request procedural maneuvers that can tilt arbitration in their favor. "Stays and dismissals of action requests available without fee when requested by Claimant—allows Claimant to control process and timeline," the talking points state.

A current NAF arbitrator speaking on condition of anonymity explains that the presentation reflects the firm's effort to attract companies, or "claimants," by pointing out that they can use delays and dismissals to manipulate arbitration cases. "It allows the [creditor] to file an action even if they are not prepared," the arbitrator says. "There doesn't have to be much due diligence put into the complaint. If there is no response [from the debtor], you're golden. If you get a problematic [debtor], then you can request a stay or dismissal." When some creditors fear an arbitrator isn't sympathetic, they drop the case and refile it, hoping to get one they like better, the arbitrator says.

The firm goes out of its way to tell creditors they probably won't have to tussle with debtors in arbitration. The September, 2007, NAF presentation informs companies that in cases in which an award or order is granted, 93.7% are decided without consumers ever responding. Only 0.3% of consumers ask for a hearing; 6% participate by mail.

NAF says in a statement that it legitimately markets its services. As for the evenhandedness of the process, it adds: "Arbitration procedures are quite flexible and make stays and adjournments available to both claimants and respondents."

Many arbitrators praise NAF. In response to BusinessWeek's (MHP) inquiries, the firm sent an e-mail to a group of arbitrators asking for statements "demonstrating that you provide an invaluable service to the public by acting as a fair, independent, and unbiased Neutral." NAF passed along 10 testimonials. In one, Michael Doland, an arbitrator and attorney in Los Angeles, says: "The cynical view that arbitrators favor businesses over consumers is not correct with regards to the NAF. No communication, direct or indirect, from the NAF to myself as an arbitrator ever suggested such an approach." In an interview, Doland says: "If I ever thought this process was corrupt, that would be the day, the hour, that I would resign."

But other arbitrators have quit NAF for just that reason. Elizabeth Bartholet, a Harvard Law School professor and advocate for the poor, worked as an NAF arbitrator in 2003 and 2004 but resigned after handling 24 cases. NAF ran "an unfair, biased process," she said in a deposition in September, 2006, in an Illinois state court lawsuit. NAF isn't named as a defendant in the pending case, which challenges a computer maker's use of an NAF arbitration clause. Bartholet said that after she awarded a consumer \$48,000 in damages in a collections case, the firm removed her from 11 other cases. "NAF ran a process that systematically serviced the interests of credit-card companies," she says in an interview.

In response, the firm says that both sides in each case have the right to object to one arbitrator suggested by NAF, based on the arbitrator's professional biography, which is provided to the parties. Creditors had simply exercised that option with the Harvard professor, NAF says.

## SWIFT DECISIONS

Even arbitrators who speak highly of NAF say that the decision-making process often takes very little time. Anita Shapiro, a former Los Angeles superior court judge, says she has handled thousands of cases for the company over the past seven years. Creditors' lawyers have always assured her that consumers are informed by mail when they are targeted in arbitration, as NAF rules require, she says. But in the majority of cases consumers don't respond. She assumes this is the consumers' choice. Shapiro says she usually takes only "four to five minutes per arbitration" and completes "10 to 12 an hour." She is paid \$300 an hour by NAF. If she worked more slowly, she suspects the company would assign her fewer cases.

Asked about Shapiro's account, NAF says: "Arbiters alone determine the amount of time required to make their decisions." It adds that collections cases tried in court are often decided swiftly when consumers don't respond. NAF says its "arbitrators provide much greater access to justice for nonappearing consumer parties by ensuring that the [corporate] claimant submits sufficient evidence."

But some consumers, including those on whose behalf the city of San Francisco is suing, complain that they don't have a real opportunity to contest NAF arbitration cases. By design, arbitration rules are less formal than those of lawsuits. The target of an arbitration can be informed by mail rather than being served papers in person. Evidence can be introduced without authentication.

In March the law firm Wolpoff & Abramson settled a class action in federal court in Richmond, Va., alleging unfairness by the firm in NAF arbitrations. The suit, filed on behalf of 1,400 Virginia residents pursued by the credit-card giant MBNA, claimed that Wolpoff & Abramson, which represented the company, promised them in writing that they could appear at hearings before an NAF arbitrator but then failed to arrange for the hearings. NAF wasn't named as a defendant in the suit. Denying wrongdoing, Wolpoff & Abramson agreed to pay a total of \$60,000 in damages. The firm, based in Rockville, Md., declines to comment. NAF denies that consumers were falsely promised hearings.

## TROUBLING FORMS

Diane McIntyre, a 52-year-old legal assistant and one of two lead plaintiffs in the Virginia class action, says she was gradually

paying down \$9,000 she owed MBNA. She had reduced her debt to about \$6,000 when she got word in May, 2005, from Wolpoff & Abramson of an arbitration award against her for \$6,519, plus \$977 in legal fees. She intended to contest the amount of the award and the fees at a hearing but never had a chance. "I wanted to pay the debt" but not all at once, she explains. As part of the class action settlement, Wolpoff & Abramson agreed to accept \$4,000 from McIntyre.

A number of other NAF arbitrators BusinessWeek contacted independently say that even apart from the absence of debtors contesting most cases, NAF's procedures tend to favor creditors. What most troubled Neely, the former West Virginia supreme court justice, was that NAF provided him with an award form with the amount sought by the creditor already filled in. This encourages the arbitrator to "give creditors everything they wanted without having to think about it," says Neely.

In the three NAF cases he decided, Neely says he granted the credit-card companies the balances and interest they claimed but denied them administrative fees, which totaled about \$300 per case. Neely says such fees wouldn't be available to creditors who filed suit in court. "It's a system set up to squeeze small sums of money out of desperately poor people," he asserts. Neely stopped receiving NAF assignments in 2006 after he published an article in a legal publication accusing the firm of favoring creditors.

NAF says that Neely's accusations lack "any shred of truth." The independence of its arbitrators ensures they will decide cases diligently, NAF adds. "Arbitrators are in no way discouraged from deviating from the [creditor's] requested relief."

Lewis Maltby, a lawyer in Princeton, N.J., decided six credit-card cases for NAF in 2005 and 2006 but says he stopped because, like Neely, he became "uncomfortable" with the process. Maltby runs a nonprofit group promoting employee rights and has served as a director of the American Arbitration Assn. (AAA). Working for NAF, he was surprised at how little information he received to make his decisions. Files contained printouts purporting to summarize a consumer's debt and an unsigned, generic arbitration agreement, he says. "If you wanted free money, you could do [each case] in five minutes."

Maltby says the most difficult cases to decide were three claims by MBNA to which consumers did not respond. The files lacked any evidence that the consumer had been notified, he says. He ruled in MBNA's favor, having assumed that the debts were "probably" genuine. But he adds: "I would have liked to have been more confident that was the case." He did slice the fees requested by creditors' lawyers, because he thought they had expended little effort. He decided one other case for MBNA after the debtor conceded in writing that he owed money but couldn't afford to pay. MBNA withdrew another claim after the consumer said he had been the victim of identity theft, Maltby says.

In a statement, NAF says that BusinessWeek misrepresented Maltby's views. But Maltby later said he stands by all his comments. In a statement, Bank of America, which acquired MBNA in January, 2006, declines to comment because of the suit filed by San Francisco against NAF.

William A. Gould Jr., a Sacramento lawyer with a general private practice, says he stopped handling arbitrations for the company after doing several in 2003 and 2004 because the process "just seemed to be pretty one-sided." He says he didn't observe specific instances of bias but became concerned about the imbalance between creditors and their law firms—which were highly sophisticated about NAF procedures—and most consumers, who were naive and lacked legal representation. "The whole organizational mechanism was set up to effect collections," Gould says. Asked to respond, NAF says creditors and their attorneys are "no more sophisticated" about arbitration than they are about court procedures, and consumers are "no more naive."

Founded in 1986, NAF at first depended heavily on one customer, ITT Consumer Financial, the now-defunct lending arm of conglomerate ITT. (ITT) Milton Schober, then the general counsel of ITT Consumer Financial, says he opposed the relationship, fearing it could deny individuals the broader rights they enjoyed in court, such as greater latitude to appeal. Top officials of ITT Consumer Financial, which like NAF was based in Minneapolis, felt otherwise. "Management thought [NAF's] rules for arbitration favored creditors more," says Schober, who is now retired. "Shopping for justice: That's what it was." Neither NAF nor ITT, now a defense electronics manufacturer, would comment on Schober's assertions.

### BUSINESS STRATEGY

Haydock, NAF's managing director, says that from the outset, it tried to familiarize corporations and their attorneys with the benefits of arbit

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