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# Do We Have a Debt Collection Crisis? Some Cautionary Tales of Debt Collection in Indiana

Judith Fox

*Notre Dame Law School*, [judith.l.fox.30@nd.edu](mailto:judith.l.fox.30@nd.edu)

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# DO WE HAVE A DEBT COLLECTION CRISIS? SOME CAUTIONARY TALES OF DEBT COLLECTION IN INDIANA

*Judith Fox* \*

## INTRODUCTION

Carol Jones<sup>1</sup> called the Notre Dame Legal Aid Clinic for assistance. She had received a summons and complaint regarding a credit card she was unable to pay. Approximately a year earlier, Carol had become ill and was now unable to work. As a result, her income consisted solely of social security disability benefits and she simply had no money to pay the bill.

My student intern and I met with Carol and reviewed her paperwork. Carol agreed that the complaint referenced her credit card and the balance was correct. During the conversation she mentioned “that other complaint” that she had not brought along because it “was not her debt.” In the case of both complaints, for the debt she owed and could not pay and for the debt she did not recognize, Carol saw no reason to appear in court. She simply wanted to know what to expect when she did not appear. Carol was judgment proof and too poor for bankruptcy court.<sup>2</sup>

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\* Associate Clinical Professor of Law, Notre Dame Law School.

<sup>1</sup> Not her real name. All the particular examples of debt-collection cases used in this paper are either current and former clients of the Notre Dame Legal Aid program who have granted permission for their stories to be told or stories taken from the public records we examined. In both cases, I have chosen to use fictitious names.

<sup>2</sup> Some debtors have no income that can be garnished and no assets to be attached. They are considered “judgment proof.” It does not mean that a judgment cannot be entered. It means that it cannot be collected. Federal law protects funds derived from social security income from garnishment or attachment. 42 U.S.C. § 407 (1998). Bankruptcy is expensive and, if you have nothing that can be taken to pay the debt, it makes little sense to expend your limited resources to file a bankruptcy action. Professors Dawsey and Ausbel have named this an “informal bankruptcy.” For a discussion of the informal bankruptcy system, see Amanda E.

Both complaints were collection actions attempting to collect debt far below the \$6,000 jurisdictional limit for small claims actions in Indiana,<sup>3</sup> and yet one collector filed in small claims court, a division of the Superior Court, and the other filed in the Circuit Court.<sup>4</sup> Nothing about the nature of the claims accounted for the decisions to file in different courts; the only difference between the claims was the nature of the plaintiff. The plaintiff filing in small claims court was collecting its own debt, the other was a national collection agency. Why would the collection agency spend more money to file an action in a Circuit Court, a court of general jurisdiction, when it could file so much more cheaply in small claims court?<sup>5</sup>

At the time Carol walked into my office, I had just begun a study of third-party debt collection cases filed in Indiana from January 1, 2009 through March 31, 2009.<sup>6</sup> The study group does not

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Dawsey et. al., *The Regulation of Non-Judicial Debt Collection and the Consumer's Choice Among Repayment, Bankruptcy and Informal Bankruptcy*, VA. LAW & ECON. RESEARCH PAPER, Oct. 12, 2009, available at <http://ssrn.com/abstract=1487649>; Richard M. Hynes, *Broke But Not Bankrupt: Consumer Debt Collection in State Court*, 60 FLA. L. REV. 1 (2008).

<sup>3</sup> IND. CODE § 33-29-2-4(b)(1) (2004).

<sup>4</sup> Both the Superior and Circuit Court are courts of general jurisdiction in Indiana. In St. Joseph County, where these actions were filed, claims are filed and then randomly assigned to either court. St. Joseph Cnty., Ind. Local Ct. R. 111, App. A. However, actions filed in the small claims court, which is a division of the Superior Court, remain in that court and are not randomly assigned to other courts. Additionally, a local rule allows debt collectors to file large numbers of cases at one time and keep them all in Circuit Court. St. Joseph Cnty., Ind. Local Ct. R., App. A § IV.

<sup>5</sup> The filing fee in Superior and Circuit Court at the time was \$137 plus \$10 per defendant and a one-time \$13 fee for the sheriff to serve the summons. The filing fee in small claims court was \$77 plus the same \$10 per defendant fee and \$13 one-time fee if the sheriff serves the defendant. Most defendants are served by sheriff in Indiana.

<sup>6</sup> In 2011, the American Association of Law Schools, Section on Clinical Education, Committee on Lawyering in the Public Interest named me a Bellow Scholar for my project, *Debt Collection: A Survey of Indiana Courts*. Although the study is not yet completed, this paper is the result of some early findings of that research. This project would not be possible without the help and support of a lot of people who are assisting in the data collection. As a start, I need to acknowledge the support of the Notre Dame Law School, the Notre Dame Center for Social Concerns, the Notre Dame Hesburgh Scholar's program, and the Riley Center. In addition, a special thanks to my diligent data collectors: Marquita Trotter, Thomas Kenney, Paul Mickan, Stephen Fox, Michael Jackson, Marc Martinez, Duy Nguyen and Jean Bak.

include cases filed in small claims court. Looking back over the statistics, I noticed many other cases filed in Superior and Circuit Courts that were below the jurisdictional limits of small claims court. 64% of the cases in the study group were for claims below \$6000. This is significant because much of the conversation around collection activity and abuses has focused on the problems in small claims courts.<sup>7</sup> National collection firms are forum shopping in Indiana. They are increasingly avoiding small claims courts. This paper explores why collection agencies are not filing claims in small claims court and how that decision may impact the debate over reform of the collection industry.

## I. THE DEBT COLLECTION INDUSTRY: A BOOM DURING THE BUST

### A. *The Evolution of the Debt Buying Industry*

As a first step, it is necessary to understand how both the consumer credit and debt collection industries have changed in recent years.<sup>8</sup>

The debt industry is one of the few booming industries left in America.<sup>9</sup> At a recent workshop sponsored by the Federal Trade

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<sup>7</sup> For a comprehensive review of the small claims literature prior to 1975 see Barbara Yngvesson & Patricia Hennessey, *Small Claims, Complex Disputes: A Review of the Small Claims Literature*, 9 LAW & SOC'Y REV. 219 (1975); Suzanne E. Elwell & Christopher D. Carlson, *Contemporary Studies Project: The Iowa Small Claims Court: An Empirical Analysis*, 75 IOWA L. REV. 433 (1990); Tal Finney & Joel Yanovich, *Expanding Social Justice Through the "People's Court"*, 39 LOY. L.A. L. REV. 769 (2006); Peter A. Holland, *The One Hundred Billion Dollar Problem in Small Claims Court: Robo-Signing and Lack of Proof in Debt Buyer Cases*, 6 J. BUS. & TECH. L. 259 (2011); Rick Jurgens & Robert J. Hobbes, THE NAT'L CONSUMER LAW CTR., *The Debt Machine: How the Collection Industry Hounds Consumers and Overwhelms Courts* (July 2010), [www.nclc.org/images/pdf/pr-reports/debt-machine.pdf](http://www.nclc.org/images/pdf/pr-reports/debt-machine.pdf); Bruce Zucker & Monica Herr, *The People's Court Examined: A Legal and Empirical Analysis of Small Claims Court System*, 37 U.S.F. L. REV. 315 (2003).

<sup>8</sup> I am focusing on the credit card industry because the vast majority of collection actions are credit card accounts. FED. TRADE COMM'N, COLLECTING CONSUMER DEBTS: THE CHALLENGES OF CHANGE, A WORKSHOP REPORT 11-12 (2009) [hereinafter COLLECTING CONSUMER DEBTS], available at <http://www.ftc.gov/bcp/workshops/debtcollection/dcwr.pdf>.

<sup>9</sup> *Id.* at 12-14; see also Robert M. Hunt, *Collecting Consumer Debts in America*, FED. RES. BANK OF PHILADELPHIA BUS. REV. (Jan. 2007), [www.philadelphiafed.org/econ/br/index.html](http://www.philadelphiafed.org/econ/br/index.html) (providing an overview of the

Commission ("FTC"), experts estimated that debt collection firms' revenue will "increase from \$10 billion in 2006 to 11.6 billion in 2011."<sup>10</sup> According to the Bureau of Labor Statistics, jobs in debt collection are expected to increase by 19% for the period from 2008 through 2018, faster than any other occupation.<sup>11</sup>

How did this become such a large and profitable industry? There are several contributing factors, beginning with the adoption of the Fair Debt Collection Practices Act ("FDCPA") in 1977.<sup>12</sup> The FDCPA banned numerous unfair and deceptive practices previously used to collect debts and the industry began to change in response.<sup>13</sup> Unfortunately, the Fair Debt Collection Practices Act has not kept up with the changing industry.<sup>14</sup>

The process of collecting a delinquent account begins in-house. Creditors have employees whose job it is to keep customer accounts current or encourage delinquent customers to bring their accounts current.<sup>15</sup> These attempts are not always successful and at some point, typically when an account is 180 days late, the delinquent debt is charged-off.<sup>16</sup>

However, collection efforts rarely end at charge-off. It is at this point that the secondary market takes over. There is evidence to suggest that the creditors have been outsourcing debt collection for centuries,<sup>17</sup> but only recently has the secondary debt market emerged as a billion dollar industry.<sup>18</sup> In the late 1980s, the Federal Deposit

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development of the debt collection industry in America).

<sup>10</sup> COLLECTING CONSUMER DEBTS, *supra* note 8 at 13.

<sup>11</sup> BUREAU OF LABOR STATISTICS, U.S. DEPARTMENT OF LABOR, OCCUPATIONAL HANDBOOK: BILL AND ACCOUNT COLLECTORS (2011), [www.bls.gov/oco/ocos143.htm](http://www.bls.gov/oco/ocos143.htm).

<sup>12</sup> Fair Debt Collection Practices Act, Pub. L. No. 95-109, 91 Stat. 874 (1977) (codified as amended at 15 U.S.C. §§ 1692-1692o (2000)). See generally Lauren Goldberg, Note: *Dealing in Debt: The High-Stakes World of Debt Collection After the FDCPA*, 79 S. CAL. L. REV. 711 (2006).

<sup>13</sup> 15 U.S.C. §§ 1692e (12)-(14) (1998).

<sup>14</sup> See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-748, CREDIT CARDS: FAIR DEBT COLLECTION PRACTICES ACT COULD BETTER REFLECT THE EVOLVING DEBT COLLECTION MARKETPLACE AND USE OF TECHNOLOGY 43 (2009), [hereinafter GAO REPORT 09-748], available at <http://www.gao.gov/new.items/d09748.pdf>.

<sup>15</sup> Hunt, *supra* note 9, at 12.

<sup>16</sup> *Id.* A charge-off is an accounting term used when a company determines that a debt is unlikely to be paid. The company writes off the account receivable as uncollectable and, in today's market, sells the debt to a debt buyer.

<sup>17</sup> *Id.* at 13.

<sup>18</sup> See Goldberg, *supra* note 12 at 725; COLLECTING CONSUMER DEBTS, *supra*

Insurance Company and Bank of America sold large debt portfolios, signaling the beginning of the debt-buying boom.<sup>19</sup>

Creditors take advantage of the secondary market by outsourcing delinquent accounts to entities that collect for a contingency fee. If contingency collection proves unsuccessful, debt-buying entities can then sell their debt in its entirety to another debt-buying entity.<sup>20</sup> In 2005, the median contingent fee was 28% of the amount collected,<sup>21</sup> and nothing suggests that the fee has increased significantly since that time. Economist Robert Hunt, in a report written for the Philadelphia Federal Reserve, illustrated how the contingent arrangement creates a profit from data provided by ACA International, a trade organization for the debt collection industry. In 2005, the median ACA member firm generated \$402,000 in collection revenues from small accounts.<sup>22</sup> Two-thirds of the collections were returned to the original creditors.<sup>23</sup> The company retained its commission and, after deducting for expenses, the firm generated a profit of about \$2 per account.<sup>24</sup>

When contingency collection proves unsuccessful, the debt can be sold its entirety to another debt-buying entity. Once a debt becomes delinquent, it sells at a bargain price. In 2007, DBA International, another trade organization for the debt collection industry, reported to the FTC that between December 31, 1996 and December 31, 2006, three of the four publically traded debt buying companies purchased “over \$77 billion dollars, face value, of charged-off debt . . . for which they paid a total purchase price in excess of \$1.8 billion dollars.”<sup>25</sup> This stark difference between the face value of the debts and the purchase price is common in the industry.

According to the Wall Street Journal, while the debt typically sells at a bargain price, the price is largely a factor of geography.<sup>26</sup>

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note 8 at 13; DBA INTERNATIONAL, PAPER ON THE COLLECTION OF PAST STATUTE DEBTS (2001) [hereinafter DBA INTERNATIONAL], available at [www.ftc.gov/os/comments/debtcollectionwprkshop/index.shtm](http://www.ftc.gov/os/comments/debtcollectionwprkshop/index.shtm) (outlining the FTC’s debt collection workshop).

<sup>19</sup> Goldberg, *supra* note 12 at 725.

<sup>20</sup> GAO REPORT 09-748, *supra* note 14 at 18-19.

<sup>21</sup> COLLECTING CONSUMER DEBTS, *supra* note 8 at 3; Hunt, *supra* note 9 at 14.

<sup>22</sup> Hunt, *supra* note 9 at 13-14.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> DBA INTERNATIONAL, *supra* note 18 at 2.

<sup>26</sup> Jessica Silver-Greenberg, *In Debt Collecting, Location Matters*, WALL ST. J., July 18, 2011, at A10.

This is true for several reasons. To begin, the FDCPA requires third party debt collectors to bring judicial collection actions in the county where the debtor resides.<sup>27</sup> In addition, states have varying laws as to what procedures can be used to collect a debt and what assets can be attached to satisfy that debt.<sup>28</sup> Therefore, the price of a debt varies according to the laws in the state where the judicial collection will occur. A debt will sell for “seven cents on the dollar in Indiana,” a state quite favorable to debt collectors, “compared with two cents in Texas,” a state where more assets are protected from debt collection.<sup>29</sup>

It is not uncommon for a debt to pass through the hands of several collection firms unsuccessfully before a judicial action to compel payment is brought in state court. One example of this is a 2011 case brought by RLW Accounts in St. Joseph County Superior Court, Indiana. According to documents filed by the plaintiff, the original creditor was Citibank. The debt was then sold to Unifund Portfolio, who sold it to Cliffs Portfolio Acquisitions, who sold it to Unifund Partners, who finally sold it to the plaintiff, RLW Accounts.<sup>30</sup> Even after a judgment is issued by a state court, the process does not end.<sup>31</sup> The judgment may continue to be sold down the debt buying chain.<sup>32</sup> While it is common for debts to be sold numerous times, it is uncommon for any record of those assignments to be found in the court file, especially a credible one.<sup>33</sup> At each level

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<sup>27</sup> 15 U.S.C. § 1692i (2006) requires a debt collector to file a judicial action in the country where the debtor lives or the county where the debtor signed the contract.

<sup>28</sup> Silver-Greenberg, *supra* note 26 at A10.

<sup>29</sup> *Id.*; see also Henry L. Woodward, *Beware the Return of the Undead Debt*, ROANOKE TIMES, Nov. 7, 2010, at 1 (explaining the proliferation of debt buyers, specifically LVNV Funding, Unifund Partners, LLC and Portfolio Recovery Associates, LLC, that buy large portfolios of debt for “2.47 cents on the dollar”).

<sup>30</sup> RLW Accounts, LLC v. Larry J. Hodges, 71-D05-1103-CC-00152 (St. Joseph Cnty. Super. Ct. Mar. 10, 2011). In another RLW account filed in the previous month, the account was originated by Direct Merchants Credit Card, who merged with HSBC and then sold the account to Worldwide Asset Purchasing, LLC, West Asset Purchasing, LLC and then to RLW Accounts. RLW Accounts, LLC v. Robert Gilliam, 201171-D05-1102-CC-00097 (St. Joseph Cnty. Super. Ct. Feb. 15, 2011).

<sup>31</sup> See Holland, *supra* note 7, at 260.

<sup>32</sup> *Id.* This raises other concerns. A judgment has the effect of legalizing a debt, whether or not it was valid at the time of collection. It is a kind of money laundering, but of debts.

<sup>33</sup> *Id.* (discussing the lack of evidence, including proof of the assignment of the debt in debt collection actions).

of the process, the amount of documentation the debt buyer possesses or is able to obtain from the original debtor decreases.<sup>34</sup>

### B. The Economy's Impact

Clearly, some of the boom in the debt collection industry is a direct result of the bust in the economy; but research from the recession of the 1980s suggests more.<sup>35</sup> A 1999 study done by the Federal Reserve Bank of New York explained that the increased charge-offs of that period were likely the result of “[g]reater indebtedness *and* the shift in cardholding toward people in more cyclical occupations.”<sup>36</sup> Issuers of consumer credit, like their cousins in the subprime mortgage market, have been offering loans to more risky borrowers.<sup>37</sup> Mortgage lenders and credit card issuers attempted to limit their risk and increase their profits by securitizing the debt.<sup>38</sup> Some of the largest debt-buying firms got into this game, offering securitized debt pools.<sup>39</sup> Prior to the collapse of Lehman Brothers in September of 2008, the securitization of credit cards was an active business.<sup>40</sup> In 2009, it was reported that 31.8% of all outstanding credit card debt had been securitized.<sup>41</sup> This market, like all securities markets, has been negatively affected by the collapse of the mortgage securities market.<sup>42</sup>

The increase in risky borrowers and the economic downturn have created the perfect storm. Banks are now charging off bad debts

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<sup>34</sup> RACHEL TERP & LAUREN BOWNE, PAST DUE: WHY DEBT COLLECTION PRACTICES AND THE DEBT BUYING INDUSTRY NEEDS REFORM NOW, (Consumers Union of United States 2011), available at [http://www.ebcl.org/documents/Past\\_Due\\_Report\\_2011.pdf](http://www.ebcl.org/documents/Past_Due_Report_2011.pdf); see also, Woodward, *supra* note 29.

<sup>35</sup> Sandra E. Black & Donald P. Morgan, *Meet the New Borrowers*, FED. RES. BANK OF N.Y. CURRENT ISSUES IN ECON. AND FIN. (Feb. 1999), [www.ny.frb.org/research/current\\_issues/ci5-3.pdf](http://www.ny.frb.org/research/current_issues/ci5-3.pdf) (report for the Federal Reserve Bank suggesting that charge-offs are increasing because credit cards are being offered to riskier borrowers).

<sup>36</sup> *Id.* at 2.

<sup>37</sup> *Id.* at 1.

<sup>38</sup> J. ECON. COMM., 111TH CONG., VICIOUS CYCLE: HOW UNFAIR CREDIT CARD PRACTICES ARE SQUEEZING CONSUMERS AND UNDERMINING THE RECOVERY (2009), [hereinafter VICIOUS CYCLE] available at [http://jec.senate.gov/public/?a=Files.Serve&File\\_id=42840b23-fed8-447b-a029-e977c0a25544](http://jec.senate.gov/public/?a=Files.Serve&File_id=42840b23-fed8-447b-a029-e977c0a25544).

<sup>39</sup> Hunt, *supra* note 9 at 15.

<sup>40</sup> See VICIOUS CYCLE, *supra* note 38 at 4.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*



at historic levels. The Federal Reserve reported that charge-off rates for credit cards increased from 4.24% in the fourth quarter of 2008 to a high of 10.96% in the second quarter of 2010.<sup>43</sup> Similarly, the S&P Credit Card Quality index reported that charge-off rates for credit cards increased from 4.85% at the start of the recession to 8.80% in 2009.<sup>44</sup>

While consumers suffer, collection law firms, on the other hand, are doing particularly well.<sup>45</sup> It is estimated that their revenues will grow 16% from 2006 until 2011, resulting in revenues of \$2.3 billion dollars.<sup>46</sup>

Furthermore, consumers are not faring as well. A Joint Economic Committee of Congress Report stated that the U.S. revolving consumer debt, which was almost entirely comprised of credit card debt, reached approximately \$950 billion in March 2009.<sup>47</sup> Moreover, it stated that 13.9% of disposable consumer income went towards servicing this debt in the final quarter of 2008.<sup>48</sup> Adding to consumer difficulties, the credit card industry has shifted the cost of default to borrowers by raising the interest rate on current credit card holders.<sup>49</sup> A sudden increase in the interest rate is often enough to push a debtor into default; this is bad for the debtor and the economy, but good for the debt collection industry.<sup>50</sup>

The collection industry has always turned to the courts for assistance in collecting debts. By 1788, Indiana had created the justice of the peace courts to handle claims of less than five dollars, most of them debts.<sup>51</sup> Recently, litigation has moved from a method of last resort to a preferred method of collecting debts.<sup>52</sup> According to

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<sup>43</sup> *Charge-off and Delinquency Rates on Loans and Leases at Commercial Banks*, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, available at [www.federalreserve.gov/releases/chargeoff/chgallsa.htm](http://www.federalreserve.gov/releases/chargeoff/chgallsa.htm). There is some evidence that charge-off rates are beginning to fall back to more normal levels. FITCH, JUNE BANKCARD CHARGE-OFFS MARK SECOND-LARGEST DECLINE SINCE 2005, (2011), available at <http://www.collectionscreditrisk.com/news/june-bankcard-chargeoffs-mark-decline-3007631-1.html>.

<sup>44</sup> VICIOUS CYCLE, *supra* note 38 at 2.

<sup>45</sup> See COLLECTING CONSUMER DEBTS, *supra* note 8, at 14.

<sup>46</sup> *Id.*

<sup>47</sup> See VICIOUS CYCLE, *supra* note 38 at 1.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.* at 5.

<sup>50</sup> *Id.* at 2. After the report, Congress enacted the Credit Card Accountability, Responsibility and Disclosure Act of 2009 to address some of the abuses reported.

<sup>51</sup> John G. Baker, *The History of the Indiana Trial Court System and Attempts at Renovation*, 30 IND. L. REV. 233, 239 (1997).

<sup>52</sup> Bernice Yeung, *Some Lawyers Want to Keep Debt Collection Out of the*

industry reports, close to 80% of debtors fail to respond to collection lawsuits and most result in default judgments.<sup>53</sup>

The collection industry has recently come under a storm of controversy.<sup>54</sup> Numerous governmental officials decry the alleged abusive behavior of major collection firms.<sup>55</sup> In a recently concluded study of debt collection practices, the Federal Trade Commission reports that our “system for resolving disputes about consumer debts is broken.”<sup>56</sup> The report identifies a series of concerns in debt collection litigation, including “(1) filing suits based on insufficient judgments; (2) failing to properly notify consumers of suits; (3) the high prevalence of default judgments; (4) improperly garnishing exempt funds from bank accounts; and (5) suing or threatening to sue on time-barred debts.”<sup>57</sup> The report encourages states to enact

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*Courts*, N.Y. TIMES, April 22, 2010, at A21A, available at <http://www.nytimes.com/2010/04/23/us/23sfdebt.html>.

<sup>53</sup> *Id.*

<sup>54</sup> See Jurgens & Hobbes, *supra* note 7; TERP & BOWNE, *supra* note 34; CLAUDIA WILNER, DEBT DECEPTION: HOW DEBT BUYERS ABUSE THE LEGAL SYSTEM TO PREY ON LOWER-INCOME NEW YORKERS (2010), available at [http://www.nedap.org/pressroom/documents/DEBT\\_DECEPTION\\_FINAL\\_WEB.pdf](http://www.nedap.org/pressroom/documents/DEBT_DECEPTION_FINAL_WEB.pdf); see Holland, *supra* note 7.

<sup>55</sup> Minnesota’s Attorney general recently filed a lawsuit against Midland Funding alleging, among other things, that the company used robo-signed documents. Robo-signing is the practice of having employees sign thousands of affidavits of debt without knowledge of the facts within the affidavit, which was made famous by the mortgage foreclosure crisis. Press Release, The Office of Attorney General Lori Swanson, Attorney General Lori Swanson Charges One of Nation’s Largest “Debt Buyers” with Defrauding Minnesota Courts and Citizens by Filing “Robo-Signed” Affidavits (Mar. 28, 2011), available at <http://www.ag.state.mn.us/consumer/pressrelease/110328debtbuyers.asp>. The Illinois Attorney General announced it was taking legal action against PN Financial, Inc. for abusive collection activity. Press Release, Illinois Attorney General Lisa Madigan, Madigan: 2011 Consumer Complaints Show Debt Collectors Using Illegal, Abusive Tactics (Jan. 11, 2012), available at [http://www.ag.state.il.us/pressroom/2012\\_01/20120111.html](http://www.ag.state.il.us/pressroom/2012_01/20120111.html). The Texas Attorney General filed a lawsuit against First Integral Recovery in December, 2011. Plaintiff’s Original Petition, The State of Texas v. First Integral Recovery, LLC, No. D-1-GU-11-001919 (126th Jud. Dist. Dec. 9, 2011). The Federal Trade Commission reached a settlement that banned Landmark Clearing, Inc. from debiting accounts to make debt payments. Press Release, Federal Trade Commission, FTC Action Bans Payment Processor from Using a Novel Payment to Debit Accounts (Jan. 5, 2012), available at [http://www.ag.state.il.us/pressroom/2012\\_01/20120111.html](http://www.ag.state.il.us/pressroom/2012_01/20120111.html).

<sup>56</sup> FED. TRADE COMM’N, REPAIRING A BROKEN SYSTEM: PROTECTING CONSUMERS IN DEBT COLLECTION LITIGATION AND ARBITRATION I (2010).

<sup>57</sup> *Id.* at ii.

legislative and procedural solutions to the abuses reported.<sup>58</sup> My research is an effort to identify where, if any, procedures in Indiana need to be reformed in response to the FTC report.

## II. A SURVEY OF DEBT COLLECTION IN INDIANA COURTS

While several studies have been done on small claims courts nationally,<sup>59</sup> no systematic study of Indiana's judicial collection practices has ever been reported.<sup>60</sup> In my study, I examined the third party debt collection cases filed in the Indiana courts of general jurisdiction during the first quarter of 2009.<sup>61</sup> The majority of allegations of collection abuse involve third party debt buyers.<sup>62</sup> The FDCPA, the federal act which aims to eliminate abusive debt collection practices by debt collectors, defines a debt collector as an entity collecting "debts owed or due or asserted to be owed or due another."<sup>63</sup> Unfortunately, the FDCPA was written at a time when most collection activity was non-judicial. It has not kept up with the changes in the practice of debt collection and is largely silent when it comes to litigation abuse.<sup>64</sup> The Federal Trade Commission receives more complaints about debt collection than any other industry.<sup>65</sup>

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<sup>58</sup> *Id.* at iii-iv.

<sup>59</sup> See *supra* note 7 and accompanying text.

<sup>60</sup> Few studies of any kind have been done in any state outside of the small claims system. One notable exception, and the model I used for my research, is a recent investigation of collection cases in Dallas County, Texas. See Mary Spector, *Debts, Defaults and Details: Exploring the Impact of Debt Collection Litigation on Consumer and Courts*, 6 VA. L. & BUS. REV. 257 (2011).

<sup>61</sup> I chose the first quarter of 2009 for a variety of reasons. At the time the study was initiated, 2009 was the most recent year that the court data compiled by the State Court Administrator was available. This allowed me to compare my findings with the court data and also gave me access to important additional information I would not otherwise easily obtain. In addition, most of the first quarter 2009 files are closed, making the files easy to access without disturbing the court personnel; but they have not been closed so long ago that they have been removed to remote storage, making them very difficult to access in some locations.

<sup>62</sup> See REPAIRING A BROKEN SYSTEM, *supra* note 56.

<sup>63</sup> 15 U.S.C. § 1692a(6) (2010).

<sup>64</sup> See *supra* note 14 and accompanying text.

<sup>65</sup> FED. TRADE COMM'N., FEDERAL TRADE COMMISSION ANNUAL REPORT 2011: FAIR DEBT COLLECTION PRACTICES ACT 5 (2011) [hereinafter FTC REPORT], available at <http://www.ftc.gov/os/2011/03/110321fairdebtcollectreport.pdf>. According to Abby Kuzma of the consumer division of the Indiana Attorney General's office, the Indiana Attorney General receives a large number of complaints. However, they are not logged or acted upon because, until very recently, the Indiana Attorney General had no jurisdiction in this area. Deceptive

Further, complaints against third party collectors continue to rise as the debt collection industry continues to consolidate, increasing the role of third party debt collectors.<sup>66</sup>

### A. Methodology

The process for collecting the data in this study was as follows. First, we obtained the docket sheets for all the civil collection cases filed from January 1, 2009 through March 31, 2009 from the relevant counties.<sup>67</sup> Then, we recorded initial information about the case such as the plaintiff's name, the cause number, the amount of the debt, the amount of the judgment, if any, and how service was perfected. This information is an important step in determining whether a third party debt collector is involved.<sup>68</sup> Once a file had been identified as a third party collection case, the researchers had to go to the file room of the courthouse to examine the entire file for that case.<sup>69</sup> In addition to basic demographic information,<sup>70</sup> we collected data related to these primary questions: 1)

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Consumer Sales Act, Ind. Code § 24-5-0.5-3(20) (2011). The Attorney General will have the ability to enforce the Fair Debt Collections practices Act in Indiana.

<sup>66</sup> See FTC REPORT, *supra* note 65, at 5; see also COLLECTING CONSUMER DEBTS, *supra* note 8, at 11-20.

<sup>67</sup> The docket sheets record all the activity on the case, as well as some basic information such as the plaintiff, the law firm and how the debtor was served. You can also find interesting notes by the judges that do not necessarily appear in the file. Unfortunately, the information is not consistent or uniform across counties. The study group focused on the counties whose docket sheets were available from doxpop, an online court records website, as well as St. Joseph County, where the dockets were manually scanned. Initially, I looked at Starke, Marshall, LaPorte, Elkhart and St. Joseph Counties.

<sup>68</sup> It is not always obvious who is a third party collector and who is not. Some third party debt collectors, such as Midland Funding and Portfolio Recovery, are known entities. Others require more inquiry. For example, commonly known banks such as Citibank and Bank of America, which do not qualify as third party debt collectors when collecting on their own debt, may qualify as third party collectors if they purchase debt from other banks. Therefore, in some cases, the docket sheet was not enough to determine if the plaintiff was a third party debt collector and it was necessary to review the entire file.

<sup>69</sup> In every county we encountered a small number of files that were simply missing. Although we have made every attempt to look at every available file in a given county, some will not be found.

<sup>70</sup> We recorded sex and address of the debtor. We did not record consumer's names. This is a requirement of our human subject research committee. Once all the data is collected, we will examine the demographic information to see if there are any patterns in geographic location, gender or race.

What is the nature of the debt being collected; 2) How was the defendant notified of the lawsuit; 3) What evidence was presented to the tribunal to substantiate the claim; 4) What was the ultimate disposition of the case; and 5) What post judgment activity followed. This paper focuses on the first of these questions.<sup>71</sup>

### B. Debt Collection Process in Indiana

In order to fully understand the data, one must first understand the structure of Indiana Courts and the procedure of judicial debt collection in Indiana. The history of Indiana courts goes back almost to the beginning of the country itself.<sup>72</sup> Throughout its history, Indiana courts have been created, abolished and recreated. Many of these changes were motivated by the tension between litigant fairness and judicial economy in the handling of cases of little economic value.

Indiana was originally part of the Northwest Territory and its first courts were created by an act of Congress in 1788.<sup>73</sup> The courts included county courts of common pleas and quarter session courts.<sup>74</sup> The highest court was a territorial court with members from what are now Indiana, Illinois, Michigan and Ohio.<sup>75</sup> This court had "original as well as appellate jurisdiction in all civil and criminal cases."<sup>76</sup> The court of common pleas and the quarter session courts were both courts of general jurisdiction.<sup>77</sup> The court of common pleas handled civil matters "between citizens of the same county."<sup>78</sup> These courts met twice a year in the county where the quarter session court sat.<sup>79</sup>

In 1788, the justice of the peace courts were established to handle small claims, defined at the time as claims of five dollars or less.<sup>80</sup> The importance of judicial debt collection became apparent with the expansion of the justices of the peace in 1795. These courts were given exclusive, non-appealable jurisdiction over all debt collection matters and their jurisdiction was expanded to include the

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<sup>71</sup> As the study continues, I will address the other issues.

<sup>72</sup> Baker, *supra* note 51, at 238.

<sup>73</sup> *Id.* at 237-38.

<sup>74</sup> *Id.* at 239.

<sup>75</sup> *Id.* at 238-9.

<sup>76</sup> *Id.* at 238-39.

<sup>77</sup> *Id.*

<sup>78</sup> *Id.* at 239.

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

entire county.<sup>81</sup> If the debt was between five and twelve dollars, the justice of the peace had concurrent jurisdiction with the common pleas courts; but a decision by the justice of the peace in this matter could be appealed to the court of common pleas.<sup>82</sup>

In 1799 small claims courts were officially established, but “their jurisdiction was reduced and made co-extensive with the township in which their court sat.”<sup>83</sup> The Northwestern Territory was divided in 1800 into the Indiana territory and the Northwest Territory, which is now Ohio, the northern tip of Indiana, and Michigan.<sup>84</sup> Soon afterwards, the Territory began to consolidate its courts by combining the quarter session, common pleas, probate and orphans courts into one court of common pleas.<sup>85</sup> A chancery court was established in Indiana in 1805 that met twice a year in Vincennes, Indiana.<sup>86</sup> In 1806, small claims jurisdiction was increased to eighteen dollars and venue requirements were imposed. The stated rationale for these changes was “to prevent abuses of the system which were possible due to distances which had to be traveled on horseback or by wagon.”<sup>87</sup>

The Territory went through several more changes, establishing and then abolishing the circuit courts. When it came time to seek statehood, Indiana “had settled on a three-tier system which consisted of the: 1) justice of the peace courts which handled minor civil and criminal matters, 2) circuit courts which were courts of general jurisdiction, and 3) a general court which acted as an appellate tribunal.”<sup>88</sup> The Indiana Constitution of 1816 established a judicial that included one Supreme Court, Circuit Courts, and left room for the legislature to create other courts, such as small claims courts or justices of the peace.<sup>89</sup> Originally there were three circuits and each with three circuit judges who visited the counties in that circuit.<sup>90</sup> The justices of the peace were also reestablished as elected, township

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<sup>81</sup> *Id.* at 240.

<sup>82</sup> Baker, *supra* note 51, at 240.

<sup>83</sup> *Id.* at 241.

<sup>84</sup> *Indiana Statehood*, THE INDIANA HISTORIAN, Sept. 1999, at 3, available at [www.in.gov/history/files/instatehood.pdf](http://www.in.gov/history/files/instatehood.pdf).

<sup>85</sup> Baker, *supra* note 51, at 241.

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

<sup>88</sup> *Id.* at 242.

<sup>89</sup> Ind. Const. of 1816, art. V, § 1, available at <http://www.in.gov/history/2878.htm>.

<sup>90</sup> Baker, *supra* note 51, at 243.

judges.<sup>91</sup> As before, the courts had overlapping jurisdiction and a debt collection matter could be filed in either court.

In 1851 a new constitution was drafted; which, for the most part, is the current constitution of the State. The new constitution reorganized the courts once again, but followed old patterns. “[A]rticle VII established a three-tiered court system with the supreme court, circuit courts of general jurisdiction, and justice of the peace courts.”<sup>92</sup> Power was reserved for the legislature to create inferior courts.<sup>93</sup> Shortly thereafter, the courts acted on this delegation and reestablished courts of common pleas that had exclusive probate jurisdiction and concurrent jurisdiction with the circuit court on a number of matters, including civil matters of less than \$1000.<sup>94</sup> Over the next hundred years, the courts changed; new courts of specific jurisdiction were added until Indiana had “[t]he supreme court, court of appeal, circuit, superior, criminal, juvenile, probate, municipal, justice of the peace, city, town and magistrate courts.”<sup>95</sup>

Despite these efforts to create a fair judicial system, problems persisted. More than one hundred years later, Reginald Heber Smith, in his book *Justice and the Poor* complained of the “disparity between the ability of the richer and poorer classes to utilize the machinery of law” while arguing for the creation of small claims courts with less rigid rules.<sup>96</sup> The debates that followed the creation and abolition of these various courts would still sound familiar today. Small claims and city courts are created to allow for swift justice on matters considered small and easy to handle and then abolished when due process and fairness concerns arise. Currently, only Marion County, the location of Indianapolis, the state capital, has a stand-alone small claims court.<sup>97</sup> The Indiana courts now consist of the Supreme Court, the highest court in the State; the Court of Appeals, an intermediate appellate court; the Tax Court, a court with both original and intermediate appellate jurisdiction; Superior and Circuit courts, both courts of general jurisdiction; Probate Courts, courts of

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<sup>91</sup> *Id.*

<sup>92</sup> *Id.* at 245.

<sup>93</sup> Ind. Const. of 1851, art. VII, § 1, available at <http://www.in.gov/history/2864.htm>.

<sup>94</sup> Baker, *supra* note 51, at 246.

<sup>95</sup> *Id.* at 250-51. Frankly, it was all a bit much and in 1965 the legislature created its first unified court, the St. Joseph Superior Court and called for a similar system throughout the state. The idea never caught on.

<sup>96</sup> Yngvesson & Hennessey, *supra* note 7, at 221.

<sup>97</sup> *Id.* at 253.

limited jurisdiction; Marion Small Claims Court,<sup>98</sup> and town and city courts of limited jurisdiction.<sup>99</sup> Most counties have small claims divisions of their superior or circuit courts that can hear matters of less than \$6000.<sup>100</sup> There are 92 counties in Indiana and 30 of them have city courts.<sup>101</sup> Nineteen counties have town courts and many of these are in the same county as the city courts. City and town court jurisdiction are largely related to city ordinances and infractions, though they can have jurisdiction over civil matters of less than \$500, which can include debt collection.<sup>102</sup> Every county has a circuit court.<sup>103</sup> Seventy-nine of the ninety-two counties have Superior Courts.<sup>104</sup> Both circuit and superior courts have original jurisdiction over civil debt collection matters.<sup>105</sup>

All these changes have left us with a system that allows civil collection actions to be filed in a number of different courts in most Indiana counties. This creates problems for anyone wishing to make a systematic study of the overall practice of debt collection. In 86% of the counties a case could appear in the superior court, the small claims division of the superior court, the circuit court, or the small claims division of the circuit court. If the debt is less than \$500, and a court exists in that location, it may even appear in a city or town court.<sup>106</sup> To further complicate the matter, cases other than debt collection matters are filed in all the aforementioned forums. How does one tell them apart?

When debt collection cases are filed, they are designated as either “cc” for civil collection or “sc” for small claims. The decision on how to designate a case is made by the litigant, pursuant to Indiana Administrative Rule 8, and not by the court.<sup>107</sup> Designating a

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<sup>98</sup> Marion Small Claims court is not a court of record. All cases are entitled to a *de novo* review in Marion Superior Court. Because it is such an anomaly, it is not the subject of this paper. However, for an interesting look at some of the problems in Marion Small Claims Court, see Silver-Greenberg, *supra* note 26.

<sup>99</sup> INDIANA JUDICIAL SERVICE REPORT, JUDICIAL YEAR IN REVIEW, at 44 (vol. 1 2009) [hereinafter INDIANA JUDICIAL REPORT], available at <http://issuu.com/incourts/docs/2009-vol1>.

<sup>100</sup> IND. CODE ANN. § 33-34-3-2 (West 2011).

<sup>101</sup> IND. CODE ANN. §§ 33-33-1-1 to -92-6. (West 2011).

<sup>102</sup> INDIANA JUDICIAL REPORT, *supra* note 99, at 47.

<sup>103</sup> IND. CODE ANN. § 33-23-1-2 (West 2011); IND. CODE ANN. §§ 33-33-1-1 to -92-6. (West 2011).

<sup>104</sup> IND. CODE ANN. §§ 33-33-1-1 to -92-6. (West 2011).

<sup>105</sup> IND. CODE ANN. § 33-23-1-2 (West 2011); IND. CODE ANN. § 33-29-1-1.5 (West 2011); IND. CODE ANN. § 33-29-1.5-1 (West 2011).

<sup>106</sup> IND. CODE § 32-29-2-4 (West 2011).

<sup>107</sup> IND. ADMIN. CODE 8(B)(3). In some courts, court personnel may make



case as a “cc” as opposed to a “sc” has real consequences.

How a case is designated determines the procedures that will be used in adjudicating that claims. A civil collection case (“cc”) is governed by the Indiana Rules of Trial Procedure and the Indiana Rules of Evidence regardless of the amount of the claim.<sup>108</sup> Cases designated as small claims (“sc”) are governed by the small claims rules regardless of the forum in which they are filed.<sup>109</sup> Small claims proceedings “shall not be bound by the statutory provisions or rules of practice, procedure, pleadings or evidence except provisions relating to privileged communications and offers of compromise.”<sup>110</sup> Claims designated as “sc” are assigned to the small claims division of the court or, in Marion County, to the small claims court itself. This study focuses largely on those cases designated as “cc” in either Superior or Circuit Courts filed in the state.

### III. INITIAL FINDINGS

The number of cases designated as civil collection matters (“cc”) in Indiana have increased 51.8% from 2005 through 2009, while the number of cases designated as small claims (“sc”) has decreased by 7.9% during the same period.<sup>111</sup> In part, this is due to a large number of debt collection cases being designated civil collection cases, regardless of the size of the claim or whether it meets the definition of “small claims”.<sup>112</sup> Thus far, data has been collected on 640 complete files and several thousand docket sheets. While it is too early to answer most of the big questions, some initial patterns have already emerged.

Of the complete files examined, 414, or 64% fall within the jurisdictional limit for small claims court and could have been filed in small claims court.<sup>113</sup> Of the docket sheets examined, 57% fall within

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these decisions. I have not yet found a court, however, where that is the case.

<sup>108</sup> IND. R. TRIAL P. 1; IND. R. EVID. 101 (“Except as otherwise provided, these rules govern the procedure and practice in all courts of the state of Indiana in all suits of a civil nature whether cognizable as cases at law, in equity, or of statutory origin. They shall be construed to secure the just, speedy and inexpensive determination of every action.”).

<sup>109</sup> IND. S.C. 1.

<sup>110</sup> IND. S.C. 8.

<sup>111</sup> INDIANA JUDICIAL REPORT, *supra* note 99, at 114. If you take out the cases filed in Marion small claims court, the decrease in small claims filings is slightly higher at 8%.

<sup>112</sup> *Id.* at 84-86.

<sup>113</sup> The jurisdictional limit for a small claim in Indiana is \$6,000. IND. CODE ANN. § 33-31-2-3 (West 2011). This has remained constant throughout the time

the small claim jurisdictional limit.<sup>114</sup> It is counter-intuitive to most attorneys that a litigant would choose a forum that is more expensive and has more strenuous procedural rules. It is surprising that they are permitted to choose at all. It is also contrary to the vast amount of commentary that practically defines the problems in judicial debt collection as problems in the small claims court system.<sup>115</sup>

Many erroneous assumptions cloud this area of law, largely as a result of conclusions drawn from the circumstances in one court that fail to account for the local rules and practices in another. For example, many people assume that collection actions occur more often in small claims courts, despite the fact that several states have banned collection agencies from their small claims courts.<sup>116</sup> Other states have procedures that encourage collectors not to file in small claims courts. For example, in Minnesota a cause of action filed in the court of general jurisdiction is commenced when the defendant is served, not when the complaint is filed in court. This leads to what is known locally as “a pocket lawsuit.” The collector keeps the complaint in his pocket while he tries to negotiate payment and only files in court if the negotiation is unsuccessful.<sup>117</sup> It is true that it is less expensive to file a claim in a small claims court, but the fact that many collection agencies are opting out of small claims venues suggests that it may be more expensive to litigate in those same courts. Clearly, sophisticated business professionals have made the decision not to file in small claims court, but instead to litigate in a more complicated and expensive forum, for a reason. The fact that the lack of procedural rules in small claims courts can be used to the disadvantage of defendants is well documented.<sup>118</sup> This study

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period of this study.

<sup>114</sup> Docket sheets do not show claim amounts. Therefore, we must rely on final judgment amounts. Because the judgments are either by default or uncontested summary judgment, it is clear they reflect the claim amount.

<sup>115</sup> See Jurgens & Hobbes, *supra* note 7; Holland, *supra* note 7, at 259.

<sup>116</sup> See Spector, *supra* note 47 at 271. Michigan, California, Kansas, Texas and Colorado are just examples of the states whose rules prohibit or restrict assignees and/or collection agencies from filing in small claims court. MCL 600.8407[1]; Cal. R. Civ. P. 116.420; KSA 61-2703(2012); Tex. Gov't Code 28.003 (2012); COLO. REV. STAT. 13-6-407 (2007).

<sup>117</sup> Minn. R. Civ. P. 3.01(a); Interview with Jeremy Carvell, Legal Aid Society of Minneapolis (Oct. 19, 2011).

<sup>118</sup> See, e.g., Holland, *supra* note 7 at 104 (describing small claims courts as being “characterized by a sophisticated business represented by a skilled lawyer suing an unsophisticated, unrepresented consumer in which no formal rules of evidence applied, and rank hearsay is rampant.”); Jurgens & Hobbes, *supra* note 7 at 13 (claiming debt collectors have “learned to use small claims and other low-

documents the opposite: debt collectors are choosing a different forum and using the procedural rules in those courts to do the same.

*A. The Players: A Spotlight on Midland Funding*

In the study group of 640 completed files, thirteen plaintiffs were responsible for filing almost 79% of the collection actions. The remaining fifty-four plaintiffs filed the final 21% of the claims. Twenty-eight plaintiffs filed two to five cases, for a total of eighty-two filings. Another nineteen only filed one case. Seven collectors filed six to nine cases, for a total of forty-eight claims. The chart below shows the collection agencies that filed ten or more complaints in the study group.

Collection Agency	Number of cases
Midland Funding	140
Arrow Financial Services	60
Asset Acceptance	56
LVNV Funding LLC	55
American Acceptance	46
Atlantic Credit & Finance	38
Credit Max	31
CACH, LLC	19
RAB Performance Recovery	13
NCO Financial	13
Unifund	12
Patriot	11
Portfolio Recovery	10

Of the thirteen plaintiffs who filed ten or more collection actions, seven were not licensed when they filed the cause of action that is the subject of this study.<sup>119</sup> Unfortunately, the odds of being subject to an enforcement action are very small and the sanctions not very harsh.<sup>120</sup> A typical sanction only requires the collection agency

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level courts as a low-cost machine for turning claims into judgments against consumers.”).

<sup>119</sup> Under Indiana law, debt collectors are required to obtain a license and pay a bond. IND. CODE §§ 25-11-1-1 to -16. Atlantic Credit & Finance, although unlicensed for the period of the study, obtained a license in June of 2009.

<sup>120</sup> A complete list of all enforcement actions can be found at the Secretary of State webpage. *Administrative Actions Yearly Listing*, INDIANA SECRETARY OF STATE, <https://myweb.in.gov/SOS/AAOnline/List.aspx?Year=2011> (last visited

to pay the licensing fee it had previously been required, but failed, to pay.<sup>121</sup> Therefore, there is little incentive to comply with the licensing statute.

In 2011, the Indiana Supreme Court amended its court rules to require plaintiffs in collection actions to file an affidavit of debt.<sup>122</sup> The affidavit of debt must include the name of the original lender, the date of the default, and the date of last payment,<sup>123</sup> among other things.<sup>124</sup> As a result of this change in the law, the study has been expanded to include a review of 2011 filings to ascertain whether plaintiffs are complying with the new requirement. Midland Funding filed the most cases in the small sample group and is currently the subject of a robo-signing investigation. The newly required affidavit must be signed by an individual familiar with the relevant business record, so allegations of robo-signing have become more significant in Indiana collection cases. Therefore, Midland Funding is the logical focus for this more specific inquiry.

From January 1, 2011 through March 31, 2011, Midland Funding filed 1,342 collection cases in the seventy-one counties whose docket sheets are available through the doxpop online docket system. Of these, only 107 were filed during the month of January.<sup>125</sup> This suggests that the law change either suppressed or delayed the claims filing. Of those claims filed in January, nearly one-third were dismissed. The reason for the dismissals is not clear from the docket sheets, so we must wait for a review of the full case files later in the study. Apart from the dismissals, action in several other cases was delayed while the plaintiff was required to produce the affidavit of debt.<sup>126</sup> While these numbers are too small to allow for broad conclusions, there is at least a suggestion that Midland was having difficulty complying with the law early in 2011.

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Mar. 8, 2012). In 2009, 278 enforcement actions were initiated, 11 against collection agencies. In 2010, 5 of the 370 actions involved collection agencies. In 2010, 7 of the 354 enforcement actions, including one against Portfolio Recoveries, involved collection agencies.

<sup>121</sup> This information can be found by reviewing the sanctions on the Secretary of State webpage, *available at* <http://www.in.gov/sos/securities/index.htm>.

<sup>122</sup> IND. TRIAL R. 9.2.

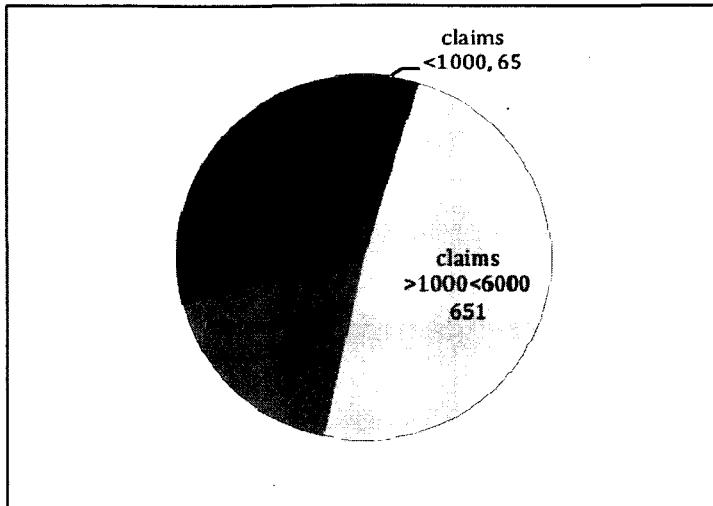
<sup>123</sup> The date of the last payment is required in order to establish the statute of limitations.

<sup>124</sup> IND. TRIAL R. 9.2. A corollary rule applies in small claims court, so this rule should not provide an incentive to return to small claims courts.

<sup>125</sup> Docket sheets on hand with author.

<sup>126</sup> One example is *Midland Funding, LLC v. Doris Blunk*, 22-D03-1101-CC-0006 (Floyd Cnty. Super. Ct. Jan. 3, 2011). The case was filed in January, but the default was not granted until September, after the affidavit of debt was produced.

What the 2011 filings do document is that a substantial number of claims were filed in the courts of general jurisdiction in these seventy-one counties that could have been filed in small claims court. The graph below documents the size of the claims filed by Midland Funding during the first quarter of 2011 in the counties studied. At a minimum, 715, or about 53% of the cases were filed for amounts of less than \$6000, making them by definition small claims matters ("sc" cases) and not civil collection cases ("cc" matters). Of these, 65 were claims of less than \$1000.



Despite this information, the number of claims that fell below the \$6000 jurisdictional limit is likely much larger. For 392 of the cases filed, the docket sheet contained no financial information. If even one-third of these files fell below the small claims jurisdictional level, the number of claims that could have been filed in small claims court would increase to 58%.

The answer to the question is not one of simple economics. Midland Funding also filed 533 claims in the small claims courts in the same seventy-one counties in the same period. Nothing obvious in the docket sheets accounts for these forum choices, though more may be revealed when we are able to view the entire case files. Some files defy economics. For example, a case from Clinton County Circuit Court, 12C01-1102-CC-051<sup>127</sup> was filed in February for \$486.72. It was not filed in small claims court even though there is a small claims court available. The filing fee was \$136, or roughly 28% of the value of the claim. Default judgment was entered on April 7

<sup>127</sup> Midland Funding, LLC v. Marty Frye, 12C01-1102-CC-051 (Clinton Cnty. Cir. Ct. Feb. 10, 2011).

for \$622.72.<sup>128</sup> Although one attempt was made at post-judgment collection, it was dismissed. Nothing has happened on the file for many months. Likely, the judgment with a statute of limitation of twenty years has been resold down the food chain.<sup>129</sup>

In all counties where cases were filed on the plenary docket, there were some cases that fell below the \$6000 threshold and others that exceeded it. In a few counties, there were no corresponding small claims files. In some counties, such as Adams, the lack of small claims filings may simply be a matter of volume. Only four civil collection cases were filed by Midland in that county. Two of those exceeded \$6000, so the other two may have been filed in the same court for convenience. In others, there were equal numbers of small claims and plenary claims.

A more interesting situation can be found in Bartholomew County. No small claims actions were filed by Midland Funding in Bartholomew County during the first quarter of 2011. Of the seven civil collection actions that were filed, five of these fell below \$6000, for one there was no financial information and one was for more than \$6000, making it ineligible for small claims court.<sup>130</sup> Bartholomew County is interesting because the local rule requires all civil collection actions be filed in one court, the same court with jurisdiction over small claims.<sup>131</sup> For example, a plaintiff who files a claim for less than \$6000 in Bartholomew County as a “cc” civil

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<sup>128</sup> Claimants can recover the cost of filing, so if they recover the fee it may account for why they are not deterred from filing in a more expensive forum.

<sup>129</sup> Judgments expire in Indiana after twenty years. IND. CODE § 34-11-2-12 (West 1998). Debts of accounts have a statute of limitations of 6 years, commencing at the time of last bill or payment. IND. CODE § 34-11-2-7 (1998); *see also* *Smither v. Asset Acceptance, LLC*, 919 N.E.2d 1153 (Ind. Ct. App. 2010).

<sup>130</sup> Six cases fell below the \$6000 jurisdictional limit: *Midland Funding, LLC v. Steven B. Wallace*, 03D02-1103-CC-001400 (Bartholomew Cnty. Super. Ct. Mar. 10, 2011); *Midland Funding, LLC v. John Campbell*, 03D02-1103-CC-1401 (Bartholomew Cnty. Super. Ct. Mar. 3, 2011); *Midland Funding, LLC v. Lisa A. Bay*, 03D02-1103-CC-001592 (Bartholomew Cnty. Super. Ct. Mar. 21, 2011); *Midland Funding, LLC v. Tommy Ray Lamphier*, 03D02-1103-CC-0001794 (Bartholomew Cnty. Super. Ct. Mar. 30, 2011); *Midland Funding, LLC v. Pamela Holderness*, 03D02-1103-CC-0001795 (Bartholomew Cnty. Super. Ct. Mar. 30, 2011). In one file, *Midland Funding, LLC as Assignee for Chase Bank v. Shane Ross*, 03D02-1103-CC-001593 (Bartholomew Cnty. Super. Ct. Mar. 21, 2011), the judge recused himself due to a conflict and there is no further information in the file. The final case, *Midland Funding, LLC v. Larrikay Mahoney*, 03D02-1103-CC-001594 (Bartholomew Cnty. Super. Ct. Mar. 21, 2011), resulted in a default judgment of \$9249.

<sup>131</sup> Bartholomew County LR03-AR1-1-Rule 1(G); Bartholomew County LR03-AR1-1-Rule 1(H).

collection will pay the higher filing fee, just as he will in any county. In Bartholomew County, however, the same plaintiff will only be permitted to recoup a filing fee equivalent to the small claims filing fee, roughly half as much as was spent.<sup>132</sup> This would seem an incentive to file in small claims court. Yet, Midland filed no cases in small claims court during the relevant period. Something else is surely motivating this decision.

Allen County is another puzzling example. As previously mentioned, few cases were filed in January. The vast majority of those filed were filed in Allen County. The cases filed in January were similar to those filed in other counties in that the dollar amounts requested ranged from a high of \$4400 to a low of \$1100. In the subsequent months, all the cases filed by Midland as "cc" cases were above the jurisdictional limit of the small claims court, and Midland additionally filed hundreds of cases in small claims court. The same judge has jurisdiction over the cases in either court, so Midland's decision was not a matter of judge shopping. It appears, though not documented, that local practice motivated the change in filing patterns.<sup>133</sup> This illustrates the real difficulty in identifying exactly what is motivating the practice of filing debt collection cases in both small claims and civil collections. Before discussing the procedural ramifications of the choice of forum, it is first necessary to review some of the other relevant information that has been collected.

### *B. Appearance and Answer*

The significance of being in a court of general jurisdiction, as opposed to small claims court, begins with the commencement of the action. In the court of general jurisdiction, which is the forum for a civil collection file, the cause is commenced with the complaint and summons.<sup>134</sup> To avoid a default judgment, the defendant must appear

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<sup>132</sup> The following notation appears in all of the docket sheets where the claim filed did not exceed the jurisdictional limit for small claims: "Recovery of court costs is limited to \$89, the small claims filing fee." In those same files, the actual costs of filing were \$149. Docket sheets on hand with author.

<sup>133</sup> Off the record discussions between the author and attorneys from collection firms suggest the reason is the initial appearance required for cases filed in small claims court.

<sup>134</sup> IND. TRIAL R. 3. This, of course, assumes that service is actually accomplished. "Sewer service" refers to the "practice of failing to serve court papers (and instead throwing them in the "sewer") and filing false affidavits of service." This practice was well documented in New York, causing the Attorney General to file lawsuits to vacate over 100,000 default judgments. See Wilner,

and file an answer.<sup>135</sup> In small claims court, the case is commenced with a proof of claim.<sup>136</sup> No answer is required, though a personal appearance will be necessary to avoid default.<sup>137</sup> In the vast majority of examined case files, the defendants failed to appear. When they do, unrepresented defendants rarely appear in a manner prescribed by the Indiana Trial Rules. In the study group,<sup>138</sup> only 26 litigants, totaling 4% of total litigants, were represented by attorneys. The chart below illustrates the manner in which study group litigants responded to the summons and complaint. For the sake of discussion, it is assumed that service was perfected unless the file reflects otherwise.

Method of Defendant's first response to Complaint	Number of Defendants	Percentage
No response	535	83%
No service, as documented in file	16	2.5%
Letter to the court	40	6.2%
Formal answer	23	3.6%
Chronological case summary <sup>139</sup>	4	0.62%
Notice of bankruptcy filing	10	1.6%
Agreement other than to a judgment	4	0.62%
Appeared at a subsequent default hearing	6	0.93%

### C. Judgment

As previously mentioned, one can reliably assume that the amount allegedly owed in debt collection matters is roughly equivalent to the judgment obtained because the judgment is almost

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*supra* note 54 at 6. For the purposes of this analysis, I am assuming proper service. Service is an issue, however, that will be documented and discussed in upcoming papers.

<sup>135</sup> IND. TRIAL R. 55.

<sup>136</sup> IND. S.C. 2.

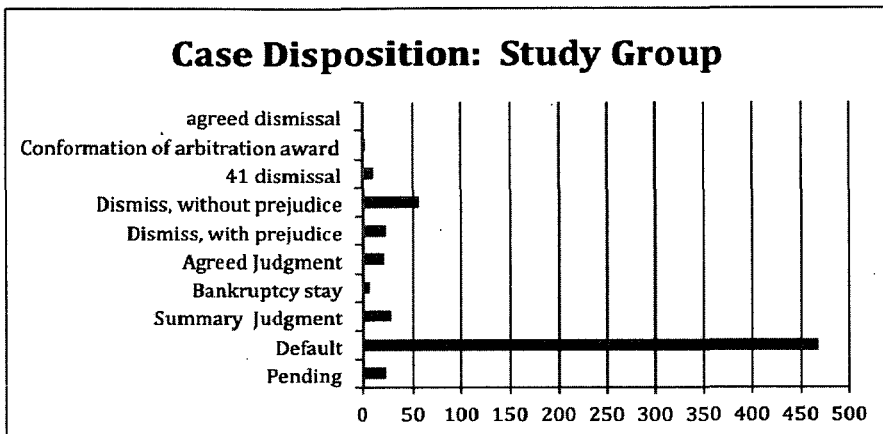
<sup>137</sup> IND. S.C. 10.

<sup>138</sup> The study group consists of 638 complete collection files reviewed from St. Joseph, LaPorte, Marshall, Stark and Elkhart Counties in Indiana.

<sup>139</sup> In Indiana, every filing must be accompanied by a chronological case summary. It acts as the cover sheet to a filing, documenting what was filed and by whom. It is also often used to document continuances and settlements in lieu of formal filings. When unrepresented litigants present themselves to court personnel in response to a complaint, they will sometimes be told to write down their answer on one of these forms and file it with the Court.



always a default. Of the 97,027 cases resolved by the Indiana courts in 2009, 58,979, or roughly 61% were resolved by default judgments for the plaintiffs.<sup>140</sup> A comparison of the statewide statistics and those in the study group can be found below. It is important to remember that the state only measures cases that were resolved in a given year. By contrast, the study group data reflects the disposition of cases filed in a given period of time. Necessarily, the court data contains files filed for a variety of years, while the study group only contains claims filed in 2009. As a result, the study group has a “pending” category, while the state statistics do not.



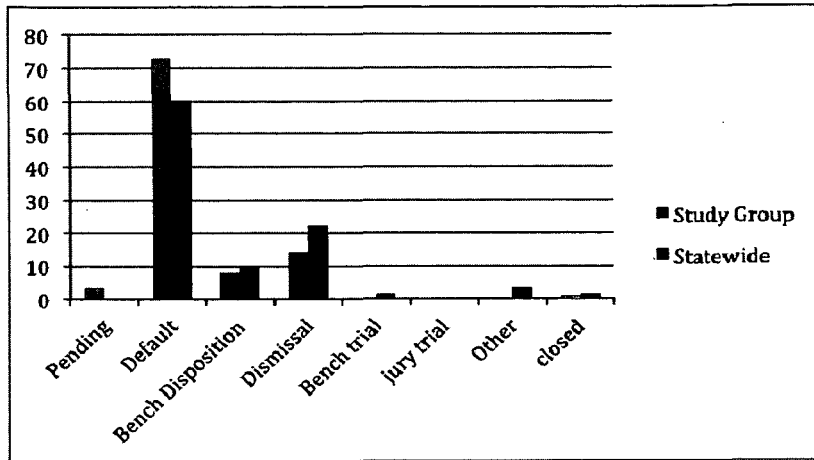
In order to compare the study group statistics with those of the State, some assumptions must be made. For the study group, the dismissals were broken down into four categories: with prejudice (4%), without prejudice (8.6%), Rule 41 dismissals (1.7%)<sup>141</sup> and agreed dismissals (0.1%). To compare these to the state statistics, these categories must be combined. The state labels all matters that require the judge to act “bench disposition.”<sup>142</sup> In the study group, this would include summary judgments (4.3%), agreed judgments (3.3%), and confirmations of arbitration awards (0.5%). Cases that have been stayed for bankruptcy (1%) are considered “closed” by the state and appear as such in those statistics. The state defines “other” as a catchall category to cover things like the death of a litigant or a

<sup>140</sup> INDIANA JUDICIAL REPORT, *supra* note 99 at 96, 104.

<sup>141</sup> A rule 41 dismissal is a dismissal brought on motion of the court for failure to prosecute. IND. TRIAL R. 41. When and whether such dismissals occur differs widely by county.

<sup>142</sup> INDIANA JUDICIAL REPORT, *supra* note 99 at 80.

file created in error.<sup>143</sup> We had no files in the study group to fit that category, nor did we have any trials.



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The results thus far compare favorably to the state results. We found fewer defaults and more dismissals, but there are pending cases that have not been decided that could easily fall into one of those two categories.

#### IV. FORUM CREATING SUBSTANCE

##### *A. Appear and Answer*

The raw statistics are interesting, but they do not tell us why debt collectors may be deciding not to file in small claims courts and the implications of that decision on consumers. A review of small claims practice in Indiana may help explain how it could be cost-effective for some debt collectors to opt out of the small claims courts. As discussed above, a cause of action in small claims court commences with a Notice of Claim and no responsive pleading is required.<sup>145</sup> Prior to 2005, the procedure in most small claims courts was for the Notice of Claim to set a date and time for a pre-trial appearance. Plaintiff's counsel was required to attend that conference

<sup>143</sup> *Id.*

<sup>144</sup> Derived from data provided by the State Court Administrator for the State of Indiana. INDIANA JUDICIAL REPORT, *supra* note 99 at 96-104. There were actually 15 jury trials held, but because that is such a small percentage of the 97,027 total, it appears as a "0 %" on the chart.

<sup>145</sup> IND. S.C. 2.

in person.<sup>146</sup> If the defendant appeared and contested the claim, the matter was set over to another day for trial.<sup>147</sup> If the debtor did not appear, a default judgment was entered.

In January of 2005, Rachel Penrod received a notice of claim, advising her to appear for a pre-trial conference on March 15 at the Kosciusko County Superior Court, small claims division.<sup>148</sup> She failed to appear and a default judgment was entered. She appealed.<sup>149</sup> The Court of Appeals reversed the judgment, basing its decision on the language of small claims rules.<sup>150</sup> Rule 10(b) allowed for default judgments if the defendant failed to appear at the trial.<sup>151</sup> Small Claims Rule 2 required the Notice of Claim to set out the time and place “to appear for trial.”<sup>152</sup> The notice to Penrod only specified the time and place for a pre-trial and, as a result, the Court determined that Penrod had not failed to appear for trial; therefore, Penrod could not be defaulted.<sup>153</sup>

The practical consequence of the *Penrod* decision was to require plaintiffs filing in small claims court action to make two physical appearances in court, one at the pre-trial and one at trial, before a default judgment could be entered. Previously, if the defendant failed to appear at the pre-trial, a trial was not set and the plaintiff prevailed by default. Since *Penrod*, the rules have been amended and many courts have returned to the original procedure of allowing a default if the defendant fails to appear at the pre-trial. But under both the old and new version of the rule, the plaintiff must still physically appear at that courthouse at least once before a default can be entered.<sup>154</sup> State statistics suggest that it was in 2005 that the cases began to decrease in small claims and increase in the plenary dockets.<sup>155</sup> It seems likely that the *Penrod* case marked the beginning of the move, but something else has kept it going.

As the debt collection industry has consolidated, so have the

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<sup>146</sup> IND. S.C. 2. The rule now allows for default “if the defendant fails to appear at the time and place specified in the notice of claim.” IND. S.C. 2.

<sup>147</sup> This process has its own concerns. It is not always possible for defendants to differentiate court personnel from collectors. Subsequent investigation of this process is warranted, but not part of this study.

<sup>148</sup> *Penrod v. The Car Company*, 832 N.E.2d 1020, 1021 (Ind. Ct. App. 2005).

<sup>149</sup> *Id.* at 1021.

<sup>150</sup> *Id.*

<sup>151</sup> IND. S.C. 10(b).

<sup>152</sup> IND. S.C. 2 (2005).

<sup>153</sup> *Penrod*, 832 N.E.2d at 1022.

<sup>154</sup> IND. S.C. 2; IND. S.C. 10(b).

<sup>155</sup> INDIANA JUDICIAL REPORT, *supra* note 99 at 114.

number of firms representing them. As discussed earlier, 79% of the claims in the study period were filed by thirteen plaintiffs.<sup>156</sup> Those 504 cases were filed by approximately eleven law firms. Most of the plaintiffs were represented by one collection firm located in Merrillville, Indiana. The remaining firms who managed a high volume in this study came from Chicago, Illinois; Louisville, Kentucky; Cincinnati, Ohio; Indianapolis, Indiana; and Fort Wayne, Indiana. You do not need to know much about Indiana geography to realize that it would be expensive and time consuming for these firms to travel throughout the state appearing at every small claims pre-trial. 68% of the firms in the study group would have to travel more than one hour, and closer to three hours, to reach the courthouses in question.<sup>157</sup> All of the cases in the current study group are located in Northwestern, Indiana, much closer to Chicago and Merrillville than Indianapolis or Louisville, but a review of the docket sheets suggests that the distance to travel to court would be similar wherever the case was filed in Indiana. As a result, a debt collection practice in Indiana is largely a write-in practice.

Instead of traveling to the courts to appear at the pre-trial, which would be required should the case be filed as a small claims matter, the case is filed as a civil collection, by mail. The plaintiff's attorney need never appear physically at the courthouse. Statistically 73% of the cases in the study group, and 60% of the collection cases resolved in 2009 statewide, were resolved by default.<sup>158</sup> Therefore, a collection attorney has very good odds that he or she will not have to appear for a hearing if the case is filed as a civil collection.<sup>159</sup>

Let us return to the \$486.72 case filed in Clinton County in February 2011. The distance between the collection firm and the courthouse in this case was over one hundred miles, requiring nearly 4 hours of round trip travel. With that in mind, paying the forty-seven extra dollars to file the claim in a court of general jurisdiction makes economic sense because it is cheaper than the gas alone required for the four-hour drive to and from the courthouse. The travel distance, however, does not explain why this same firm, representing the same plaintiff, filed a large number of claims in small claims court as well. Perhaps they too are assessing the differing forums. It seems clear

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<sup>156</sup> See *supra* Part III.A.

<sup>157</sup> Although only 25% of the firms travel long distances, they file 75% of the cases.

<sup>158</sup> See discussion of disposition results, *supra* Part III.C.

<sup>159</sup> Some courts are requiring hearings on default matters. It did not seem to be a practice in the courts in the study group, but has been reported anecdotally by practicing attorneys. This, too, will need further inquiry.

that this question will need more research before it can be fully answered. However, the implications of the decision to file outside of small claims court are easier to see.

### B. The Answer

Despite its problems, small claims courts still have the advantage of not requiring formal pleadings. Most claimants are unrepresented.<sup>160</sup> Because most defendants in a collection matter are pro se, they do not know how to properly answer the complaint.<sup>161</sup> When they do attempt an answer, sometimes in the form of a letter, numerous problems can occur. Some answers are not skillfully written and can act as an admission.<sup>162</sup> Moreover, some courts will not accept a letter as an answer, but only as an appearance.<sup>163</sup> In these cases, Indiana Trial Rule 55, provides that the defendant should be given three days notice before a default is entered.<sup>164</sup> We did not

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<sup>160</sup> For a discussion of the problems created by the lack of civil legal representation for the poor see Jessica Steinberg, *In Pursuit of Justice? Case Outcomes and the Delivery of Unbundles Legal Service*, available at <http://ssrn.com/abstract=1960765>. A report by the Legal Services Corporation concludes that there is now one private attorney for every 429 people and one legal services attorney for every 6,415 needing assistance. *Documenting the Justice Gap: the Current Unmet Civil Legal Needs of Low Income Americans* (2009), available at [http://www.lsc.gov/sites/default/files/LSC/pdfs/documenting\\_the\\_justice\\_gap\\_in\\_america\\_2009.pdf](http://www.lsc.gov/sites/default/files/LSC/pdfs/documenting_the_justice_gap_in_america_2009.pdf). In 2009, 98,214 individuals seeking assistance on a consumer matter had to be turned away. *Id.* at 11.

<sup>161</sup> Only 89 litigants in our study group filed any kind of appearance or answer (1.4% of the study group). Of those, only 26 litigants were represented by attorneys. Some of those who were represented were represented as part of a bankruptcy filing and not directly on this collection matter. *See supra* Part III.B for details on the methods of appearance. The State Court Administrator reports those litigants who appear pro se. In 2009, there were 10,945 litigants who appeared pro se. Remember, however, that no one appeared in more than half of all claims. *See* INDIANA JUDICIAL REPORT, *supra* note 99 at 127.

<sup>162</sup> *See, e.g.*, *RJM v. Deborah Haddan*, 14C01-0902-CC 00088 (Daviness Cnty. Cir. Ct. Feb. 23, 2009). Ms. Haddan filed a letter to the court where she admitted to the debt, but denied the amount alleged. The court treated the letter as an admission. Indiana Trial Rule 55 requires a party be given three days notice before a default can be entered if they have appeared. IND. TRIAL R. 55(B). Ms. Haddan was not given that notice. In addition, Indiana Trial Rule 55 gives the court the power "to take an account or to determine the amount of damages" even when a defendant has not answered. This did not occur either.

<sup>163</sup> *See id.*

<sup>164</sup> IND. TRIAL R. 55(B). This problem has been complicated by recent revisions to Indiana Trial Rule 3.1(B), which now requires a formal appearance be filed on the form prescribed by the state. IND. TRIAL R. 31(B).

locate a single file where this notice was given.<sup>165</sup>

The small claims rules would seem to give a little more protection to defendants than the rules in the plenary courts. Under Small Claims Rule 10, a defendant cannot be defaulted until the judge has determined, among other things, that there is a “reasonable probability that the defendant received . . . notice” and the “plaintiff has a prima facie case.”<sup>166</sup>

In theory, small claims court offers defendants some additional protection against default judgments for frivolous claims. In contrast to the formal requirement of proving a prima facie case in the small claims court, the judge in a court of general jurisdiction has no formal requirement to determine whether the plaintiff has a prima facie case unless someone raises the issue. In sum, the relative ease of obtaining a default judgment could be driving litigants away from the small claims court. In practice, though, defaults appear to occur with equal frequency in all courts for collection matters.<sup>167</sup>

### C. The Summary Judgment

Even when a pro se defendant succeeds in answering a complaint, he or she is not likely to win. In fact, we did not find a single file with a judgment in favor of a pro se defendant. The difficulty pro se litigants have was illustrated for me on the morning of August 29 when my student intern and I appeared in South Bend Circuit Court for a hearing. After resolving our case, my intern and I stayed to watch the next case on the docket because it was also a collection matter, but this one involved an unrepresented defendant. The defendant alleged that he did not owe the debt and had never had an account with the plaintiff. In addition, his name was George R. Miller and the information supplied by the plaintiff was for a Chase Visa card for a George E. Miller.<sup>168</sup> The attorney for the plaintiff, frustrated by the turn of events, withdrew his motion for judgment on the pleadings and said to the court, “I’ll just send him admissions and then do a summary judgment.” The judge was visibly disturbed by the implication, but had no grounds to prevent the plaintiff from proceeding. A pro se defendant is unlikely to properly respond to the admissions, even if he manages to respond to the summary judgment.

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<sup>165</sup> IND. TRIAL R. 55.

<sup>166</sup> IND. S.C. 10

<sup>167</sup> In 2009, 109,642 small claims matters were resolved by default. See INDIANA JUDICIAL REPORT, *supra* note 99 at 104. Not all of these would be collections.

<sup>168</sup> We have changed the defendant’s name to respect his privacy.

It was clear he would lose this case. It was not clear that such a loss would be just.

Few pro se defendants understand the summary judgment process. Many do not understand that the court cannot rely on the answer filed in response to the complaint when evaluating the summary judgment.<sup>169</sup> The judiciary in St. Joseph County became concerned about the use of summary judgment in collection cases against unrepresented parties. In May of 2009, they adopted a local rule to address their concerns. A notice must be sent to all unrepresented parties as part of any summary judgment motion. The notice informs pro se litigants that their “previous answer, denial or even counter-claim in response to the original complaint is not sufficient to defend a motion for summary judgment.”<sup>170</sup> It goes on to explain that “failure to respond to the pending motion for summary judgment would be equivalent to failing to present any evidence in your favor at a trial.”<sup>171</sup> It is a good model and one that should be adopted statewide. Having said that, the rule was not in effect when the majority of cases that make up the data set were filed. Therefore, there is no evidence to verify the effectiveness of the rule.

Indiana law is clear, however. “Summary judgment shall not be granted as of course because the opposing party fails to offer opposing affidavits or evidence, but the court shall make its determination from the evidentiary matter designated to the court.”<sup>172</sup> In the vast majority of the cases in this study, little, if any, evidence of the debt was submitted to substantiate the debt.<sup>173</sup> I do not mean to suggest that all summary judgments are illegitimate. Clearly, that is not the case. However, an invalid summary judgment can be harder to correct than an invalid default if for no other reason than the defendant did appear and was given the chance to respond, whether or not he understood that chance. A summary judgment granted in error on, for example, a debt that is beyond the statute of limitation, has the effect of laundering the defect from that debt. The debt is now a judgment that can be collected for the next twenty years. The ability to use the summary judgment procedures is a substantial benefit. It alone is good reason not to file in small claims court.

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<sup>169</sup> IND. TRIAL R. 56.

<sup>170</sup> St. Joseph County LR71-TR12 Rule 206.4.2.

<sup>171</sup> St. Joseph County LR71-TR12 Rule 206.4.2, Appendix B.

<sup>172</sup> IND. TRIAL R. 56(C).

<sup>173</sup> An in depth discussion of the evidence issue is beyond the scope of this article, but will appear in subsequent reports on this research. To understand the problem with the evidence presented in debt collection cases, see *Holland, supra* note 7; *REPAIRING A BROKEN SYSTEM, supra* note 56; *Wilner, supra* note 54.

*D. The Dismissal Without Prejudice*

While researchers saw no judgments in favor of the plaintiff, this does not mean that there were no dismissals. A dismissal can be a good result for the defendant, if he or she wins. Unfortunately, not all dismissals are created equal. A case dismissed without prejudice may be reinstated. A dismissal with prejudice can only be reinstated for excusable neglect, mistake of fact or fraud.<sup>174</sup> A dismissal without prejudice can create as many problems for a defendant as it solves. The debt will likely be sold back into the debt market and eventually come back to haunt the defendant.<sup>175</sup> It was common to see dismissals without prejudice in cases where the defendant filed an answer.<sup>176</sup> For example, in a case out of Vigo County, the defendant filed a letter to the court in response to the complaint.<sup>177</sup> The docket sheet does not provide the contents of the letter, but the complaint was immediately dismissed by the plaintiff, without prejudice. This action certainly suggests that something in that letter motivated the plaintiff to dismiss. Perhaps the plaintiff no longer believed the defendant owed this debt. If that is the case, why not dismiss with prejudice? The answer is simple. A dismissal without prejudice leaves the collection agency with a valuable asset it can sell. A dismissal with prejudice does not.

Another fairly common scenario was the dismissal, without prejudice, once the debt was discharged in bankruptcy.<sup>178</sup> Again, there is no reason to preserve the case if the debt is no longer legally owed. Selling debts extinguished in bankruptcy is, unfortunately, a booming business. The Wall Street Journal reported that Portfolio Recovery Associates bought “\$1.52 billion of bankruptcy debt in the first nine months of 2011.”<sup>179</sup> Courts should not allow themselves to be used in this shameless business. In most cases, plaintiffs submit the request for dismissal along with a form of order. Judges rarely evaluate the case to determine whether a dismissal with prejudice is

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<sup>174</sup> IND. TRIAL R. 41.

<sup>175</sup> Jessica Silver-Greenberg, *Debts Go Bad, Then it Gets Worse*, WALL ST. J., Dec. 23, 2011, at C1, available at <http://online.wsj.com/article/SB10001424052970203686204577114530815313376.html>.

<sup>176</sup> See, e.g., *Midland Funding, LLC v. McCloud*, 84D02-1103-CC-2347 (Vigo Cnty. Super. Ct. Mar. 21, 2011).

<sup>177</sup> *Id.*

<sup>178</sup> See, e.g., *Midland Funding, LLC v. Patricia Montgomery*, 88C0-1102-CC-00107 (Washington Cnty. Cir. Ct. Feb. 14, 2011).

<sup>179</sup> Silver-Greenberg, *supra* note 175. In 2011, Capital One filed notices in bankruptcy courts informing the courts it had erroneously sold debt discharged in bankruptcy. Notice, on file with author.



more equitable. If not specified otherwise, a dismissal in Indiana is without prejudice.<sup>180</sup> Judges should insist that a dismissal be with prejudice once the debt is no longer legally owed.<sup>181</sup>

Yet, we found cases where the claim was dismissed without prejudice, despite evidence that the debt was not valid. One example is the case of *Arrow Financial v. Maxine Adams*.<sup>182</sup> The sheriff attempted to serve Ms. Adams and returned the summons with a notation that the defendant had died in 2001. The statute of limitations on a credit card debt is six years from the date of the last payment or from the first time the bill is left unpaid.<sup>183</sup> This case was filed in 2009, eight years after the death of the defendant. Clearly, the debt was beyond the statute of limitations. The case was dismissed, without prejudice. Another disturbing development in debt collection is the harassment of families of deceased debtors; these family members are hounded by collectors, despite the fact they are not legally responsible for the debts.<sup>184</sup> Dismissing claims without prejudice when the defendant is deceased adds to this problem.

The most disturbing dismissal came in a Vanderburgh County case.<sup>185</sup> The plaintiff had not diligently prosecuted the case. It was filed in January of 2009 and in October of that year the court issued a notice under Trial Rule 41.<sup>186</sup> Rule 41 allows a court to dismiss a cause of action for failure to prosecute.<sup>187</sup> The court dismissed the action on March 5, 2010, nearly a year after it was originally filed, with the following notation in the docket sheet: "The Court now dismisses this action, without prejudice, and with leave to reinstate retroactively to the date of the filing of this action and without

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<sup>180</sup> IND. TRIAL R. 41(A).

<sup>181</sup> This may not stop the most unscrupulous, but it would at least end the inadvertent support of the court in the collection of debt that cannot legally be collected.

<sup>182</sup> *Arrow Financial Services, LLC v. Maxine Adams*, 75C01-0903-CC-00143 (Starke Cnty. Cir. Ct. Mar. 25, 2009).

<sup>183</sup> See *supra* note 129.

<sup>184</sup> Jessica Silver-Greenberg, *Judge Says Widow Harassed: Collection Firm Was Hired by Bank of America to Pursue Dead Man's Debts*, WALL ST. J., Dec. 26, 2011, at C3, available at <http://online.wsj.com/article/SB10001424052970204296804577124661890130838.html>; Jessica Silver-Greenberg, *For the Families of Some Debtors, Death Offers No Respite*, WALL ST. J., Dec. 3, 2011, available at <http://online.wsj.com/article/SB100014240529702042246045770300043890121710.html>.

<sup>185</sup> See *LVNV Funding v. Mohamed Sidahmed*, 82D03-0901-CC-0010 (Vanderburgh Cnty. Super. Ct. Three Jan. 10, 2009).

<sup>186</sup> *Id.*

<sup>187</sup> IND. TRIAL R. 41.

payment of any additional fees.”<sup>188</sup> Consider the implication of that notation. This debt was owned by LVNV, a debt buyer. If we assume it was a legitimate debt, it would have been charged off by industry standards approximately 180 days after becoming delinquent.<sup>189</sup> Suppose for the sake of argument, it was immediately sold to LVNV and the case was immediately filed in court, with no additional efforts at collection.<sup>190</sup> That suggests, at the very least, the debt was seven or more months delinquent when the case was filed. It was nearly a year older when the case was dismissed. This is a cause of action with, at most, a six-year statute of limitations. The judge’s actions, however, have frozen the statute of limitations in time, allowing the collector to sell the debt, knowing that the buyer can revive the claim frozen in time in January of 2009.

All of these examples illustrate why a dismissal without prejudice is not a win. Judges need to look at dismissals with the same critical eye used to evaluate other motions before the court. If the file indicates that the debt is not owed, is beyond the statute of limitations, or has been discharged in bankruptcy, the case should be dismissed with prejudice, not without. At the very least, defendants should be given notice and an opportunity to object to a dismissal without prejudice. While this practice can occur in small claims court as well, small claims judges are less willing to use procedural maneuvers to keep a claim alive.

### *E. Conclusions and Recommendations*

After the FTC issued its workshop report and call to action in 2009, researchers around the country began to re-examine the collection processes in their respective jurisdictions.<sup>191</sup> As more studies develop, researchers may be looking for data in all the wrong places. In jurisdictions where collectors can choose a forum, they may well be choosing the unexpected one. Diligent inquiry into the reasons collectors are filing in any given forum is needed. Only then can we truly know what is motivating the choice of forum.

This study is in its infancy, but already some areas of concerns have been identified. Judicial neutrality is an important goal and one that should be preserved. However, neutrality does not absolve the judiciary of its equally important role of preserving

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<sup>188</sup> Docket sheet on hand with author.

<sup>189</sup> For a discussion of the typical route of a delinquent debt see *supra* Part II.

<sup>190</sup> This would not be typical, but the assumptions are necessary to simplify the example.

<sup>191</sup> *Id.*

justice. The results of this study suggest that courts could do more. Some very simple steps could improve the current system. For example, before granting a default motion, judges could make sure that notice was actually perfected and that the plaintiff has presented a prima facie case.<sup>192</sup> Simple notices could be provided to pro se litigants facing discovery or summary judgment motions. Judges could, and should, refuse to grant summary judgment when the plaintiff has failed to prove the case, regardless of whether the defendant has answered. And, finally, judges should be very careful about granting motions to dismiss, without prejudice. In collection cases where the evidence has shown that that debt is no longer owed, dismissals should all be "with prejudice." These are simple steps and, though they will not solve the crisis in the judicial collection process, they are a first step.

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<sup>192</sup> The question of what is a prima facie case is a large and important one. Sadly, it is beyond the scope of this article. The data collected and that which will be collected in the coming weeks, will add much to that discussion. This is one of the most important issues to be addressed in subsequent reports on this research.