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The Problem With the Solution: Why West Virginians Shouldn't "Settle" for the Uniform Debt Management Services Act

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**THE PROBLEM WITH THE SOLUTION:
WHY WEST VIRGINIANS SHOULDN'T "SETTLE"
FOR THE UNIFORM DEBT MANAGEMENT
SERVICES ACT**

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I. INTRODUCTION

In 2004, Roger, a nineteen year-old sophomore at West Virginia University, opened his dormitory mailbox to find a letter offering a too-good-to-be-true deal on a “platinum” credit card in Roger’s name. Many of Roger’s friends had come to college with shiny new cards, and, as all the commercials said, who couldn’t use a little extra spending power? It seemed like a good idea.

Upon opening the envelope, it seemed even better. Roger found that he had been pre-approved for a \$2,500 line of credit with “no-interest*” for 12 months and a 0.0% APR. To top it off, the card was “affiliated” with West Virginia University and could be customized with the logo of Roger’s favorite team—the Mountaineers.¹ Applying for the card was as easy as flipping past a few pages of fine print (just like those tedious software license agreements he ignored on a daily basis), filling in some personal information, and signing on

¹ Many colleges and college alumni associations have entered into contracts with banks and credit card companies that offer schools incentives for steering students toward their programs or payments in return for lists of students’ names. See Jonathan D. Glater, *The Debt Trap—Colleges Profit as Banks Market Credit Cards to Students*, N.Y. TIMES, Jan. 1, 2009, at B1; Editorial, *Responsible Use of Credit a Must for Students*, THE STATE NEWS, Oct. 13, 2008, http://www.statenews.com/index.php/article/2008/10/responsible_use_of_credit_a_must_for_students. The Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act), which went into effect on February 22, 2010, did not ban credit card companies from partnering with colleges and universities, but it did limit the formation of these partnerships. CARD Act, Pub. L. No. 111-24, 123 Stat. 1742 (2009).

the dotted line.² In days, Roger, now feeling rather grown-up, had his own shiny new card and was ready for action.

Over the next few years, Roger came to rely more and more on his plastic purchasing power. At first, he purchased only large-ticket items, like airline tickets, and paid the balance immediately. But gradually, Roger started to use the card for everyday purchases, such as nice dinners with his girlfriend and even a spring break trip to the beach. As Roger's spending increased, so did his credit limit, although the 0% APR was long gone having been replaced by a scheme of sliding rates from 14% to 28%. Nevertheless, Roger forged on, making minimum monthly payments as his balance increased. When his hard drive melted down the week before finals, he was happy to learn that his new "platinum" privileges allowed him to take out a \$2,000 cash advance. Roger relied on his card and used it so frequently that by graduation he had earned not only a bachelor's degree but also a credit card balance of more than \$5,000.

Due to the lagging economy, Roger had difficulty finding work, but was able to make ends meet by buying on credit and even taking out additional cash advances. As he struggled to pay his bills, his rent, and particularly his student loan payments, his credit card balance ballooned to more than \$13,000. Eventually, he could no longer make even the minimum payments, and that's when the calls began at his home, his office, and sometimes even his parents' home.³

Then one day, Roger heard a radio advertisement that changed his life:

Are you buried in credit card debt? Having trouble making minimum monthly payments to your creditors? Tired of receiving harassing collection calls? Then DebtBet America is the solution to all your problems. At DebtBet, our experienced and highly trained advocates will go to work for you, negotiating directly with your creditors for a drastic reduction of debt—you'll pay only pennies on the dollar! DebtBet is a low-risk program designed for consumers who want to avoid the perils of bankruptcy while regaining their financial freedom. Call now to speak with a certified counselor who can put you on the path to financial independence—or visit us on our website for a personal credit evaluation. At DebtBet, we get results for you!⁴

² Under the CARD Act, credit cards can no longer be issued to individuals under the age of twenty-one without a co-signor or proof of independent income. CARD Act § 301.

³ Such collection calls are regulated under the Fair Debt Collection Practices Act, 15 U.S.C. § 1692(a)–(p) (2006).

⁴ The text of this advertisement is based on actual advertisements appearing in national campaigns on satellite and syndicated radio networks. Although it appears that debt settlement companies prefer the low cost of radio advertising, television ads typically styled as "breaking news" segments have begun appearing on late night television. See, e.g., TVleads1, *TV Debt Settlement Leads 1-800-371-1112*, YOUTUBE (Nov. 5, 2009), http://www.youtube.com/watch?v=h_2l2rPmE9M&feature=related.

As the advertisement urged, Roger visited the company's website to learn more.⁵ There he found laudatory testimonials from satisfied customers, the "truth about debt settlement," and a toll-free number he could call to reach "certified debt settlement specialists."⁶ Feeling better already, Roger dialed the number.

A counselor at DebtBet America took Roger's call, asked a few questions, and, in mere minutes, performed a "personalized" debt analysis. Roger was thrilled to learn that, according to the counselor, debt settlement was a low-risk, guaranteed solution to his personal credit crisis. It was simple: Roger would stop paying his creditors and instead make just one monthly payment to a "settlement account" with DebtBet. Meanwhile, highly trained DebtBet specialists would negotiate with Roger's creditors on his behalf. In months, the company would settle his accounts for pennies on the dollar, and Roger would finally taste financial freedom.

In a few days, Roger received a 120-page contract from DebtBet. He read the document as carefully as he could, then signed and returned it feeling great.

But the collection calls began again—day and night—worse than before. One of his creditors threatened to sue. DebtBet was no help; "Sorry" they said, "we don't represent you on that. It's in the contract." He was shocked to learn that, although he had paid more than \$1900 in fees, less than \$200 had actually been applied to his settlement.

"Just be patient," the voice on the phone reassured him. But for Roger, "patient" meant continuing to pay monthly fees while his creditors became more aggressive and his debt crisis only grew worse. He made it two more months before withdrawing from the program. Although he later learned that DebtBet had not contacted a single creditor, the company refused to return his money, stating that the fees had been earned for "services rendered."

His credit ruined, and in worse financial shape than he started, Roger contacted a local attorney who, for \$1000, helped him seek discharge of his debts through bankruptcy.

"It seemed like a good idea," he thought to himself.

Sadly, Roger's nightmare is hardly unique. As the economy continues to underperform, many Americans, particularly young people, find themselves neck-deep in debt with little chance of recovery.

First, this Note examines the growth and evolution of the debt settlement industry. Promising to lead consumers down a low-risk, high-success path to financial freedom, debt settlement has become an attractive option for con-

⁵ Debt-settlement companies avoid initiating contact with consumers in order to keep from falling under the scope of federal telemarketing regulation, such as the FTC Telemarketing Sales Rule, 16 C.F.R. § 310 (2010). However, the West Virginia Attorney General asserts that inbound calls from consumers to telemarketers are covered under the West Virginia Telemarketing Act, W.VA. CODE §§ 46A-6F-101 to -703 (2006).

⁶ For a discussion of similar claims, see *infra* Part II.D.

sumers who want to get back on their feet while avoiding bankruptcy. The number of companies offering debt settlement services has exploded in the last decade, and in 2009, hundreds of thousands of consumers put their hopes and money in the hands of the debt settlement industry.⁷

Unfortunately, debt settlement is not the best option for most consumers. Many unscrupulous debt settlement providers prey on unsophisticated consumers, assessing exorbitant fees for little or no services rendered. Even when done "correctly," most consumer advocates feel that debt settlement is not an ideal strategy for consumers struggling in debt, because the fees involved reduce the funds available for paying creditors. A disturbingly low number of consumers who enroll in debt settlement plans actually complete the entire program.⁸ Thus, bankruptcy or debt management plans are often a better option.

Against this backdrop of abuse, confusion, and a general lack of regulation in the new and rapidly growing debt settlement industry, the National Conference of Commissioners on Uniform State Laws (NCCUSL) has developed the Uniform Debt Management Services Act (UDMSA or Uniform Act), a comprehensive model act regulating the debt relief industry, including debt settlement. Part A, Section III introduces the Uniform Act, which mandates certain disclosures, limits fees, and provides for public and private enforcement and remedies.

As part of the NCCUSL's efforts to promulgate the UDMSA in all states, the Uniform Act was introduced to a subcommittee of the West Virginia legislature in 2006. Though it was not formally introduced that year, it has continued to be the subject of legislative hearings and debate. As more and more states adopt the Uniform Act, the pressure for West Virginia to accept the model will only increase.

Unfortunately, the UDMSA is not an ideal solution for all states. In order to illuminate and refine the best practices and legal strategies to employ in defending West Virginia's consumers from predatory debt settlement providers, Part B, Section III investigates the West Virginia Attorney General's recent actions against debt settlement companies. Finally, Section IV explores some weaknesses of the Uniform Act as it compares to these legal strategies and concludes that, despite certain advantages inherent to uniform and comprehensive regulation, the Attorney General's strategy is the best approach for West Virginia.

⁷ In a 2009 survey, The Association of Settlement Companies estimated that its approximately 200 member organizations served more than 154,000 active consumer clients and managed more than \$4.9 billion in debt as of June 30, 2009. Letter from Andrew Houser, The Ass'n of Settlement Cos., to the Sec'y of the Fed. Trade Comm'n 4 (Oct. 26, 2009), *available at* <http://ftc.gov/os/comments/tsrdebtrelief/543670-00202.pdf>.

⁸ *See infra* Part II.D.5.

II. THE PROLIFERATION AND PROBLEM OF THE DEBT SETTLEMENT INDUSTRY

A. *Debt Settlement Distinguished From Debt Management*

At the outset, it is important to draw the appropriate distinctions between the various types of programs that fall under the debt relief umbrella. A debt management provider (DMP) helps consumers pay down debts through monthly payment plans established by agreements with creditors. The DMP may negotiate a reduction in interest rates, late-fees, and minimum payments.⁹ The DMP acts only as an advisor and manager; consumers make payments directly to creditors. Although, in the past, some for-profit DMPs were found to have engaged in a number of unfair and deceptive practices, regulatory action by state and federal agencies has drastically reduced the incidence of such abuses.¹⁰

Debt settlement works on an entirely different model. Rather than negotiating a decrease in fees or rates, debt settlement companies attempt to negotiate lump-sum settlements of entire accounts.¹¹ In most cases, consumers engaged in debt settlement plans do not make payments directly to their creditors.¹²

Various related programs and services are sometimes linked to the debt settlement and debt management industries. The National Association of Attorneys General reports on a “new breed” of debt relief services—the “debt negotiation” model—which claims the ability to negotiate dramatic and immediate interest rate reductions that can save thousands of dollars in a matter of months.¹³ Such companies market their insider knowledge of the consumer debt industry and promise to negotiate rapid and dramatic reductions in interest rates resulting in thousands of dollars of savings in a matter of months.¹⁴ Instead, after collecting its fees in advance, debt negotiation services merely “show” the consumer savings in the form of accelerated payment schedules based on assumed interest rates and increased monthly payments.¹⁵

Although the lines between the various models may sometimes be blurred, and some companies may offer debt management, debt settlement, and other services, this Note is exclusively concerned with solutions to the particular problems posed by the debt settlement industry.

⁹ Letter from the Nat’l Ass’n of Attorneys Gen. to the Sec’y of the Fed. Trade Comm’n 2 (Oct. 23, 2009) available at <http://www.ftc.gov/os/comments/tsrdebtreief/543670-00192.pdf> [hereinafter NAAG Letter].

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ *Id.* at 3.

¹⁴ *Id.*

¹⁵ NAAG Letter, *supra* note 9, at 3–4.

B. *The Debt Settlement Model*

It is difficult to develop a value-neutral description of the debt settlement model, which has been called both a lifesaver¹⁶ and “inherently harmful to consumers.”¹⁷ Additionally, not all companies follow the same model; they differ in eligibility requirements, fee structures, services rendered, and other policies. Nonetheless, it is possible to draw together a number of common elements and practices to create an industry model that suffices for the purposes of general identification.¹⁸

Debt settlement providers typically rely on consumers to make first contact with the company. Providers make no attempt to identify consumers in need of the services or to procure lists of individuals at particular debt levels. This is done in large part in order to avoid falling under the jurisdiction of state and federal telemarketing regulations that typically apply only when a marketer calls a consumer, not vice-versa.¹⁹ Thus, in recent years, debt settlement companies have ramped up advertising efforts, particularly through syndicated and satellite radio networks.²⁰ These ads, while touting the potential benefits of their debt settlement solution and promoting enthusiastic endorsements from satisfied customers, typically provide very little substantive information about the programs and instead encourage consumers to call a toll-free number or visit a website for more information.²¹ Over the phone, the agencies will determine whether consumers qualify for the program; if so, the two sides will enter into a contract setting forth the terms of the arrangement, usually conferring certain legal powers on the company.²²

Most debt settlement companies have a minimum debt requirement.²³ These debt requirements can be as low as \$5000 or as high as \$10,000 in unse-

¹⁶ *Testimonials*, DEBT SETTLEMENT USA, <http://www.debtsettlementusa.com/testimonials.aspx> (last visited Sept. 11, 2010) (“You saved my life!”).

¹⁷ NATIONAL CONSUMER LAW CENTER, AN INVESTIGATION OF DEBT SETTLEMENT COMPANIES: AN UNSETTLING BUSINESS FOR CONSUMERS I (2005) [hereinafter NCLC REPORT].

¹⁸ Numerous reports (NCLC, The Association of Settlement Companies) have purported to give a general description of the debt settlement model. In nearly all cases, these reports are underwritten by either industry or consumer-advocacy groups and may reflect the expected biases of such organizations. For the purposes of this section, I have attempted to distill the common elements of these reports.

¹⁹ W. VA. CODE §§ 46A-6F-101 to -703; 16 C.F.R. § 310 (2009). Under new FTC debt settlement rules, however, many inbound calls from consumers now come under the scope of the federal regulation. *See infra* Part II.F.

²⁰ David Stretfield, *The Debt Settlement Industry is Busy, but It's a Bit Nervous Too*, N.Y. TIMES, Jun. 9, 2009 (“The most successful ads . . . emphasize words like ‘stress’ and ‘anxiety’ and showcase notions like the inability to sleep or frequent fights with a spouse.”).

²¹ *See, e.g.*, q1data, *Debt Help Center USA TV Commercial*, YOUTUBE (Sept. 28, 2009), <http://www.youtube.com/watch?v=h4hHhuqGqrE>.

²² NCLC REPORT, *supra* note 17, at 2.

²³ *Id.*

cured debt.²⁴ When an individual owes money to multiple creditors, some companies also set creditor minimums, usually around \$1000, for each individual creditor.²⁵

The central element of the debt settlement model is the creation of a “reserve” account, from which any future settlement will be paid. Some companies will create a savings account for consumers.²⁶ Others merely require proof that such an account has been set up by the consumer.²⁷ In either case, the company often requires the consumer to grant the company access to the account so that fees can be withdrawn directly.²⁸

Once the account is established, the consumer begins making monthly deposits. There is some controversy over whether or not consumers are explicitly told to stop paying their creditors at this time, but because most consumers enter into debt-settlement plans for the very reason that they are already unable to pay their monthly bills, it is unlikely that very many individuals are capable of making simultaneous payments to a reserve account and to their creditors.²⁹ Regardless of whether or not the consumer stops making payments to his creditors, little action is likely to take place for several months or longer, possibly several years.³⁰

The primary tactic of the debt settlement negotiator is convincing the creditor that, after a long period of no payment and no contact, some income is better than none.³¹ The success of this strategy depends on manipulating the consumer’s delinquency and rate of savings such that they coincide with a creditor’s or debt collector’s incentive to settle.³² Generally, the chances for a favorable settlement increase as the creditors approach their self-imposed “charge-off” deadlines, at which point (usually after six to twelve months of delinquency) the debt is no longer listed as an account receivable, and its value is charged against the creditor’s reserve for losses.³³ If the debt settlement company gets the timing right, a creditor may be willing to take what it can get. Of course, this is not always the case, as many companies simply sell “charged-off” debt to

²⁴ *Id.* “Unsecured debt” is debt that is backed only by the creditworthiness of the debtor and not by any collateral security.

²⁵ To Qualify, DEBT SETTLEMENT USA, <http://www.debtsettlementusa.com/default.aspx> (last visited Sept. 9, 2010).

²⁶ NCLC REPORT, *supra* note 17, at 2.

²⁷ *Id.*

²⁸ *Id.*

²⁹ See *infra* Part II.D.4 for a discussion of the controversy surrounding debt settlement companies’ advice regarding payment of creditors.

³⁰ THE ASSOCIATION OF DEBT SETTLEMENT COMPANIES, PRELIMINARY STUDY 7 (2008) [hereinafter TASC STUDY].

³¹ NCLC REPORT, *supra* note 17, at 9.

³² Notice of Proposed Rulemaking, 74 Fed. Reg. 41987, 41993 (Aug. 19, 2009) [hereinafter TSR Notice].

³³ ROBERT J. HOBBS ET AL., FAIR DEBT COLLECTION 14–15 (6th ed. 2008).

third-party debt buyers, beginning the process (and for the consumer, the harassment) anew.³⁴

For the duration of this waiting game, the debt settlement company continues to automatically withdraw fees from the reserve account.³⁵ The majority of companies charge an up-front fee that may exceed \$1000 in addition to monthly fees that are typically assessed on a per-account basis.³⁶ To earn these fees, companies purport to offer a litany of services to the consumer, including performing the steps required to determine initial qualification; placing monthly calls to the consumer to give updated status reports, answering questions, and providing ongoing customer support; advising and helping stop collection calls and harassment; conducting “[o]ngoing written and/or telephonic negotiation between the client and the creditor for each account;” and other services.³⁷

If and when a settlement is reached, the company will withdraw a final fee, usually in proportion to the amount of money “saved” through negotiation. Because debts are typically settled one account at a time, and as mentioned, each account may take months to settle, it is not uncommon for an individual to take many years to complete an entire debt settlement “program” that involves debts owed to more than one creditor.³⁸

C. *History and Growth*

The modern debt settlement industry traces its roots to the commercial “debt adjusters,” “debt poolers,” and “debt pro-raters” of the first half of the twentieth century.³⁹ In the absence of regulation, such companies prospered, but abuses were rampant—fees were high, companies often paid themselves before paying creditors, little actual guidance was provided, and some adjusters simply

³⁴ In order to limit their losses, many credit card companies in possession of great amounts of unsecured debt choose to liquidate lost accounts. Non-performing accounts are packaged and sold in bulk, for pennies on the dollar, to third-party debt collection agencies that can turn a profit by collecting on only a small percentage of the accounts purchased. As a result of this process, it is not uncommon for a single account to be assigned to as many as eight collection agencies. See TASC STUDY, *supra* note 30, at 6–7 (providing a table that monitors accounts through the collection process noting several occasions on which “one account passes through several collection agencies which requires the debt settlement company to initiate dialogue on multiple occasions from the same account”).

³⁵ NCLC REPORT, *supra* note 17, at 7–8.

³⁶ NCLC REPORT, *supra* note 17, at 7–9; NAAG Letter, *supra* note 9, at 6.

³⁷ TASC STUDY, *supra* note 30, at 4–5. See also *infra* Part II.D.3 for a discussion of common complaints about the inadequacy of such alleged services.

³⁸ TASC STUDY, *supra* note 30, at 7; NCLC REPORT, *supra* note 17, at 4.

³⁹ Christopher H. Schmidt, Heather Timmons & John Cady, *A Debt Trap for the Unwary*, BUS. WK. Oct. 9, 2001, http://www.businessweek.com/magazine/content/01_44/b3755094.htm, cited in Carla Stone Witzel, *The New Uniform Debt Management Services Act*, 60 CONSUMER FIN. L. Q. REP. 650 (2006).

disappeared with consumers' funds.⁴⁰ In far too many instances, consumers who had trouble making ends meet before going to a debt adjuster found themselves in even worse financial shape afterward.⁴¹ By the 1970s, in response to growing concern over the proliferation of unscrupulous practices, most states had banned for-profit credit counseling, and many others adopted regulatory schemes that required licensing and bonding while imposing maximum fees and other requirements.⁴²

But the demand for some form of consumer debt relief did not disappear, particularly as the late 1970s and early 1980s marked the beginning of an upward surge in consumer debt.⁴³ As a result, the debt adjusting industry re-invented itself as the non-profit "credit counseling" industry, led by the National Foundation for Consumer Credit (NFCC), an association of local retailers and banks that issued credit cards.⁴⁴ States assumed that, without a profit motive, these non-profit counselors could more effectively educate and advise consumers and could be trusted not to repeat many of the harmful and deceptive practices of their commercial, for-profit predecessors.⁴⁵ Unfortunately, this was not an ideal solution. Many critics charged that while the debtors who relied on these organizations believed they were getting disinterested advice, in practice, most of the organizations exhibited a clear pro-creditor bias.⁴⁶ Although certain abuses disappeared, some non-profit credit counselors continued to harm consumers, and concern over such practices prompted statutory efforts to counter such abuses.⁴⁷

Beginning in the 1990s, nationalized credit card issuers, relaxed lending standards, and an increase in consumer income gave rise to a dramatic increase in credit card debt. This in turn led to an increase in the amount of debt in de-

⁴⁰ Carl Felsenfeld, *Consumer Credit Counseling*, 26 BUS. LAW. 925, 928 (1971) cited in Carla Stone Witzel, *The New Uniform Debt Management Services Act*, 60 CONSUMER FIN. L. Q. REP. 650 (2006).

⁴¹ Felsenfeld, *supra* note 40.

⁴² *Id.* at 928–29.

⁴³ *Consumer Credit Historical Data*, THE FED. RESERVE, <http://www.federalreserve.gov/releases/g19/hist/> (last visited Oct. 13, 2010); Saj Karsan, *Consumer Debt Levels: A Historical Perspective*, SEEKING ALPHA, <http://seekingalpha.com/article/156161-consumer-debt-levels-an-historical-perspective> (last visited Sept. 9, 2010).

⁴⁴ Leslie Linfield, *Uniform Debt Management Services Act: Regulating Two Related—Yet Distinct—Industries*, 28-APR AM. BANKR. INST. J. 50, 51 (2009).

⁴⁵ Witzel, *supra* note 39, at 651. The problem with this method is that the profit/non-profit distinction is based on an IRS determination that is in no way based on any assessment of the company's character, motive, or judgment.

⁴⁶ Abby S. Milstein & Bruce C. Ratner, *Consumer Credit Counseling Service: A Consumer Oriented View*, 56 N.Y.U. L. REV. 978, 988 (1981), cited in Witzel, *supra* note 39, at 652.

⁴⁷ NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, *THE UNIFORM DEBT MANAGEMENT SERVICES ACT—SUMMARY 2–3* (2008), available at <http://www.udmsa.org>.

fault and a renewed need for consumers to seek debt relief.⁴⁸ The “third generation” of credit counseling agencies was thus born, taking advantage of new technology and marketing techniques by utilizing toll-free 800 numbers and the Internet.⁴⁹ Unlike their NFCC predecessors, which had been organized and operated around regional interests, many of the new debt relief agencies became multi-state providers operated across a wide range of jurisdictions and regulatory schemes, creating a whole new set of headaches for state Attorneys General attempting to ensure that such agencies complied with all relevant state laws.⁵⁰ At best, multi-state providers were simply unable to stay abreast of changes in state laws and to adapt their practices in order to stay in compliance. At worst, national debt relief companies brazenly ignored unfavorable state laws and were frequently able to dodge enforcement by sheer volume while incorporating and sheltering their businesses in jurisdictions whose laws were more favorable.⁵¹

The full-fledged debt settlement industry began to take shape in the early 2000s. After decades in exile, shades of the original debt adjusters could be seen in this new wave of (mostly) for-profit companies that aim not to help consumers manage and pay their debts in full, but rather to convince creditors to settle large accounts for less than they are owed.⁵² Already booming, the debt settlement industry was indirectly boosted by the 2005 amendments to the bankruptcy code (BAPCPA), which required individuals filing for bankruptcy to seek the assistance of approved credit counseling agencies (including agencies that also offer debt settlement services).⁵³ As the American economy continues to struggle, and as struggling consumers look for solutions to their debt problems (especially when such solutions appear too good to be true), demand for the type of services offered by the latest generation of debt settlement companies will no doubt continue to rise.

D. *Common Abuses in the Debt Settlement Industry*

Despite decades of attempts to reform and regulate, the debt settlement industry continues to be a major problem area for both consumers and the various agencies tasked with protecting them. While industry trade groups maintain that the real problems lie with only a few rogue companies that do not represent the industry as a whole,⁵⁴ consumer advocacy groups have stopped just short of condemning the entire industry.⁵⁵

⁴⁸ Linfield, *supra* note 44, at 51.

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ *See id.*

⁵² *Id.*

⁵³ Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.).

⁵⁴ TASC STUDY, *supra* note 30. *But see* Peter S. Goodman, *Peddling Relief, Firms Put Debtors in Deeper Hole*, N.Y. TIMES, June 19, 2010, <http://www.nytimes.com/2010/06/19/business/>

In 2005, the United States Senate's Permanent Subcommittee on Investigations issued a scathing report entitled *Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling*⁵⁶ and in 2008, the Better Business Bureau included "Illegitimate Credit Repair & Debt Negotiation Services" among its annual list of the "Top Ten Scams That Stole People's Money."⁵⁷ In the past five years, twenty-one states have brought more than 128 enforcement actions against eighty-four debt settlement companies,⁵⁸ and since 2001, the Federal Trade Commission has brought seven major suits against debt settlement companies for a variety of consumer abuses.⁵⁹ As the economy lags and unscrupulous companies prey upon hopeless Americans buried in debt, complaints of such abuse are on the rise and have been reported with increasing frequency by a number of leading media sources.⁶⁰ The potential for such abuses begins with the marketing and advertising of debt settlement services, but problems frequently arise regarding fees, failure to provide promised services, damage to consumers' credit rating, and even whether or not debt settlement plans are fundamentally sound for the very consumers to which they are marketed.⁶¹

1. Debt Settlement Providers Frequently Use Misleading and Deceptive Marketing Techniques

As illustrated by Roger's story, the initial point of contact between consumers and debt settlement providers is typically through Internet, television, or radio advertising.⁶² It is becoming increasingly common for such advertising to be produced by "leads generators," who are not themselves debt settlement providers.⁶³ Typically, these ads encourage the consumer to call a "counselor" at a

economy/19debt.html (in which the CEO of U.S. Debt Resolve, a debt settlement firm based in Dallas, Texas, portrays his company as a "rare island of integrity in a sea of shady competitors" who operate "almost as a Ponzi scheme").

⁵⁵ NCLC REPORT, *supra* note 17, at 1 (characterizing the debt settlement model as "inherently harmful to consumers"); NAAG Letter, *supra* note 9, at 4.

⁵⁶ See generally U.S. SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS, *PROFITEERING IN A NON-PROFIT INDUSTRY: ABUSIVE PRACTICES IN CREDIT COUNSELING*, S. Hrg. 108-545, at 203.

⁵⁷ Better Business Bureau, *BBB Announces Top 10 Scams of 2008* (Jan. 21, 2009), <http://chicago.bbb.org/article/bbb-reports-on-top-10-scams-that-stole-peoples-money-in-2008-8492>.

⁵⁸ NAAG Letter, *supra* note 9, at 5.

⁵⁹ TSR Notice, *supra* note 32, at 41996.

⁶⁰ See, e.g., Goodman, *supra* note 54; Eleanor Laise, *Debt Relief Firms Attract Complaints*, WALL ST. J., Oct. 14, 2008, at D1; Francine Knowles, *Debt Settlement is No Cure*, CHICAGO SUN-TIMES, Jan. 28, 2010.

⁶¹ TSR Notice, *supra* note 32, at 41995.

⁶² *Id.*

⁶³ Transcript of Federal Trade Commission Workshop: Consumer Protection and Debt Settlement Industry, Sept. 25, 2008, Panel 3: Protecting the Consumer—A Discussion of Consumer

toll-free number for more information.⁶⁴ By encouraging consumers to contact providers directly, debt settlement companies and leads generators are able to avoid certain state and federal telemarketing regulations that apply only to outgoing sales calls.⁶⁵ Advertisements for debt settlement services are a common source of consumer complaints of fraud, deceit, and/or misrepresentation. Most debt settlement advertisements are intentionally vague and contain limited or no details about the actual substance of the services provided.⁶⁶ There is no mention that creditors may not be paid for many months, or even years, nor do most ads disclose that the consumer must open a savings account with, or turn over control of their own accounts to, the debt settlement company.⁶⁷ Practically without exception, these advertisements make grand claims about the results they can reach for consumers struggling with debt—a reduction of debt by 50%; elimination of debt in twelve to thirty-six months; immediate and permanent cessation of harassing phone calls from creditors and debt collectors; and “expert assistance from debt settlement providers who have special relationships with creditors and knowledge” of “insider secrets.”⁶⁸ For the most part, such claims are not supported, even by the industry’s own data.⁶⁹

Rarely, if ever, do advertisements make even the most cursory mention of the many potential problems associated with debt settlement.⁷⁰ Most imply, if not explicitly promise, a high likelihood of success. Some companies even go so far as to guarantee success, describing their programs as “no risk.”⁷¹ As discussed below, however, debt settlement plans are extremely risky for most con-

Protection Challenges at 150, *available at* <http://www.ftc.gov/bcp/workshops/debtsettlement/OfficialTranscript.pdf>.

⁶⁴ *FTC v. Debt-set, Inc.*, No 1:07-CV-00558-RPM (D. Colo. 2007).

⁶⁵ Telemarketing Sales Rule, 16 C.F.R. § 310 (2009). However, a series of 2010 amendments to the TSR bring many inbound calls from consumers under the scope of the federal regulation. *See infra* Part II.F.

⁶⁶ TSR Notice, *supra* note 32, at 41995.

⁶⁷ *Id.* at 41995–96.

⁶⁸ *Id.* at 41995.

⁶⁹ *See generally* TASC STUDY, *supra* note 30. The study, based on voluntary participation from TASC members, reported common completion percentages as low as 35%. Additionally, the report’s probative value is diminished by numerous methodological infirmities, including the failure to report on which and how many members of the association participated in the study, and the use of a floating definition for “completion.” While some participants considered a program completed only when all accounts had been settled, others defined completion as the settlement of a single account, regardless of how many additional outstanding accounts the consumer might have with the provider. For more criticism of the TASC Preliminary Study, see NAAG Letter, *supra* note 9, at 8, and TSR Notice, *supra* note 32, at 41995 n.104.

⁷⁰ TSR Notice, *supra* note 32, at 41995.

⁷¹ *See, e.g.*, *FTC v. Innovative Sys. Tech. Inc.*, No. CV04-0728 GAF JTLx (C.D. Cal. 2004) (showing that the defendant believed enrollment in debt settlement plan posed “no risk” because it guaranteed that its services would produce the promised results).

sumers, and in particular, for those consumers specifically targeted by debt settlement advertisements.

Finally, most advertisements for debt settlement services fail to provide any information regarding fees or other costs of the program.⁷² To the extent that any such statement is made, it usually takes the form of eye-catching inducements, such as “free online evaluation” or “free consultation.”⁷³ The real fees—substantial ones that a consumer must consider before deciding whether a debt settlement plan makes financial sense—are not discussed until the consumer initiates contact over the phone, or in some cases, not until the consumer receives a written contract.⁷⁴

2. Debt Settlement Companies Often Charge Exorbitant and Un-deserved Fees⁷⁵

It is not only the advertising—or lack thereof—of debt settlement fees that harm consumers, but also the fees themselves.⁷⁶ Exorbitant fees are one of the primary reasons why consumers rarely benefit from debt settlement plans. Consumers who seek out debt settlement services are typically those who have only a small amount of money left over each month after necessary expenses. In order to stay on their feet, these consumers must struggle to make the most out of their available funds. Perversely, the debt settlement companies to whom such consumers turn for help often gouge their clients with expensive up-front and maintenance fees so that the funds in consumers’ “reserve” accounts build slowly, if at all.⁷⁷

Industry surveys reveal three prevalent fee structures in the debt settlement industry.⁷⁸ In the “front end model,” companies generally require consumers to pay as much as 40% of the total fee within the first few months of enrollment, collecting the balance over the lifetime of the program.⁷⁹ In this

⁷² TSR Notice, *supra* note 32, at 41994–5.

⁷³ *Id.* at 41995.

⁷⁴ *Id.*

⁷⁵ Days before this Note was published, new Federal Trade Commission rules addressing the debt settlement industry went into effect. Among many provisions, a new rule prohibits debt-settlement companies that do business over the telephone from assessing up-front fees (discussed below). There is reason to believe, however, that the new FTC rules do not signal the end of up-front fees in the industry as many companies may simply adapt their models to make use of the Internet, face-to-face transactions, or other means not covered by the rules. For further discussion, see *infra* Part II.F.

⁷⁶ NCLC REPORT, *supra* note 17, at 7.

⁷⁷ *Id.*

⁷⁸ TSR Notice, *supra* note 32, at 41994.

⁷⁹ *Id.*; see also *FTC v. Connelly*, No. SA CV 06-701 (C.D. Cal. 2006) (in which defendants required customers to make a “down payment” of 30% to 40% of the total fee in the first two or three months with the remainder paid over the following year).

model, consumers may be expected to pay hundreds of dollars to their debt settlement provider before creditors are even contacted.⁸⁰ A second common practice is the “flat fee” model, in which consumers pay a lump sum early in the program.⁸¹ Finally, agencies using the “back end” model collect a small monthly fee for the duration of the program, as well as a percentage of the total amount saved if and when a settlement is finally reached.⁸² “Back end” fees are disturbing because, unlike an attorney’s share of damages, the money “saved” in debt settlement is an ephemeral sum that the consumer never truly had in the first place. The worst debt settlement providers combine the elements of the “front end” and “back end” models, assessing high up-front fees, monthly charges, and also taking a cut from the final settlement.⁸³

Most companies are not forthcoming with information about their fee structures, and as discussed above, it is difficult if not impossible to glean such information from most companies’ advertisements.⁸⁴ Nonetheless, in 2005, the National Consumer Law Center conducted a study that gathered data from debt settlement contracts, phone calls to companies, and information from company websites.⁸⁵ The data collected reflects fees that are “not only unreasonable and unaffordable for many consumers, but also take away valuable resources the consumer could use to actually repay the debts.”⁸⁶ In one instance, a company charged an up-front fee of \$300 per month for the first three months and “administrative fees” of \$112 per month for the remainder of the program in addition to collecting 15% of the total amount “saved” through settlement.⁸⁷ Another company charged a monthly administrative fee in addition to 25% of the settlement savings and refused to give refunds to consumers who withdrew from the program before any services were rendered.⁸⁸ Astonishingly, the provider charged the 25% fee even if consumers settled the debt on their own, so long as consumers were enrolled in the program.⁸⁹

Reports of outrageous fees have also emerged as debt settlement companies are forced to reveal their practices in court pleadings. In one such case, a company charged consumers an up-front fee of 3.5% of their outstanding credit

⁸⁰ TSR Notice, *supra* note 32, at 41994.

⁸¹ *Id.*

⁸² *Id.*

⁸³ State *ex rel.* McGraw v. Patriot Debt Solutions Corp., C.A. No. 07-Misc-309 (Kanawha Cnty. Cir. Ct. 2007).

⁸⁴ See *supra* Part II.D.1 for a discussion of abuses in the marketing of debt settlement services.

⁸⁵ NCLC REPORT, *supra* note 17, at 7.

⁸⁶ *Id.*

⁸⁷ *Id.* at 8.

⁸⁸ *Id.*

⁸⁹ *Id.*

card debt or \$500, whichever was higher.⁹⁰ The provider also collected a monthly fee of \$45 (plus \$3 for each additional account), and 25% of the money saved through settlement.⁹¹ The company even charged a \$10 “check handling” fee, and all payments and fees were automatically deducted from the consumer’s checking account.⁹²

3. Debt Settlement Companies Fail to Provide Valuable Services

Fees as high as the ones above create self-perpetuating problems for consumers, because depleting clients’ funds hinders the ability of individuals to solve their debt problems. But in some cases, high fees could be appropriate if actual, effective services were rendered. Unfortunately, it is all too often the case that debt settlement companies do very little to earn the fees they charge consumers.

Debt settlement companies typically promise to provide a wide range of services from employing “insider knowledge” to negotiate settlements to stopping harassing phone calls to improving consumers’ credit scores.⁹³ In emphatic apologetics responding directly to criticisms from consumer advocacy agencies, industry trade groups have claimed that high, up-front fees are necessary to cover the costs of typical activities involved in executing a debt settlement plan, including interacting and communicating with new clients, evaluating clients’ financial circumstances, mailing or otherwise transmitting documents and agreements to clients, entering client information into databases, providing periodic reports to clients, and interacting and negotiating with creditors on behalf of clients.⁹⁴ Many consumer advocates are skeptical that the costs associated with such minimal activities justify the rates of most debt settlement plans.⁹⁵

In some cases, debt settlement companies simply do not deliver on explicit promises.⁹⁶ Creditors are never contacted, and collection calls never stop.⁹⁷ Calls from consumers are not answered, and even when consumers are summoned into court, the debt settlement providers remain silent.⁹⁸ Often, con-

⁹⁰ ROBB EVANS, REPORT OF TEMPORARY RECEIVER’S ACTIVITIES, available at www.robbevans.com/pdf/nccinreport01.pdf [hereinafter RECEIVER’S REPORT].

⁹¹ *Id.*

⁹² *Id.*

⁹³ NAAG Letter, *supra* note 9, at 3.

⁹⁴ TASC STUDY, *supra* note 30, at 4–5.

⁹⁵ See generally NCLC REPORT, *supra* note 17.

⁹⁶ NAAG Letter, *supra* note 9, at 6 (reprinting a 2002 letter from an Illinois consumer, who reported that “[the debt settlement company] kept \$6,500 for the settlement of three accounts which they didn’t settle They did not get in touch with the credit card companies and we were called from 8 a.m. to 9 p.m. every day They didn’t even help us when we received the summons. We are retired and on a fixed income. Please do what you can for us.”).

⁹⁷ *Id.*

⁹⁸ *Id.*

sumers feel compelled to remain in a plan even when services are not provided as promised, because the fees they have paid are non-refundable.⁹⁹

Even when the promised services are performed, they can usually be performed by the consumer himself at little or no cost and with no particular expertise. Many creditors are willing to negotiate directly with debtors.¹⁰⁰ The primary tactic of the debt settlement professional is to simply "wait out" the creditor, which is an action easily accomplished by even the least sophisticated consumers.¹⁰¹ Likewise, most consumers are capable of composing and mailing to debt collectors their own "cease communication" letter, which is just as effective as any effort taken by a debt settlement company.¹⁰² Finally, free educational materials about personal finances and debt management are available online from a variety of credible consumer advocacy groups.¹⁰³

Insight into the actual value of the services allegedly performed by debt settlement companies can be gained by examining one of the rare published judicial decisions against a debt settlement company.¹⁰⁴ In *In re Sinnot*, the Supreme Court of Vermont found that the evidence supported a panel's conclusion that the fees charged by a debt settlement law firm "had nothing to do with work performed and that the work performed had no value to the client."¹⁰⁵ The firm never initiated negotiations with the client's creditor, a major credit card company, and in the three to four hours it actually spent on the client's case, the firm performed nothing more than "automated" or "routine" tasks.¹⁰⁶ In the end, the client himself negotiated his own settlement with the credit card company.¹⁰⁷

⁹⁹ *Id.* at 7.

¹⁰⁰ Transcript of Federal Trade Commission Workshop: Consumer Protection and Debt Settlement Industry, Sep. 25, 2008, comments of Anna Flores, Vice President of Consumer Affairs with American Express at 142, available at <http://www.ftc.gov/bcp/workshops/debtsettlement/index.shtm>.

¹⁰¹ See *supra* Part II.B for description of the debt settlement business model.

¹⁰² Such sample letters are available online and through the mail from a number of consumer advocacy and debt awareness groups. In fact, the NCLC reports that many debt settlement companies merely send consumers a sample letter to fill out on their own.

¹⁰³ See, e.g., *Facts for Consumers: Knee Deep in Debt*, FED. TRADE COMM'N, <http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre19.shtm> (last visited Sept. 8, 2010); WEST VIRGINIA ATTORNEY GENERAL CONSUMER PROTECTION AND ANTI-TRUST DIVISION HOME PAGE, <http://www.wvago.gov/consumers.cfm> (last visited on Sept. 8, 2010).

¹⁰⁴ See *In re Sinnot*, 845 A.2d 373 (Vt. 2004).

¹⁰⁵ *Id.* at 378.

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

4. Debt Settlement Requires Consumers to Stop Paying Their Creditors, Resulting in Irreparable Damage to the Consumers' Credit Ratings

State Attorneys General have discovered that, thanks to the advertising and marketing efforts of the debt settlement industry, many consumers believe that debt settlement is a safe, low-risk alternative to bankruptcy.¹⁰⁸ Unfortunately, although consumers turn to debt settlement as a solution to their debt problems, most find that they emerge from the programs with worse credit than before. This is because most debt settlement plans call for consumers to stop paying their creditors in order to strengthen the position of the negotiator.¹⁰⁹ Many companies explicitly warn clients not to make payments on their debts.¹¹⁰ Other companies merely imply that consumers should stop paying their creditors and provide information about the debt settlement process emphasizing the strategic benefits of non-payment.¹¹¹ Rarely do debt settlement companies provide adequate disclosures or true assistance in handling the consequences of their preferred strategy.¹¹²

Yet the consequences of such actions are dire. Failure to pay debts, even as part of a debt settlement program, exposes consumers to growing debt, deteriorating credit scores, collection actions, civil liability, and even wage garnishment.¹¹³ Though debt settlement providers often trumpet their ability to stop collection calls, many simply do not follow through.¹¹⁴ What consumers are not often told is that not all calls *can* be stopped—the federal fair debt collection laws apply only to third-party debt collectors; a creditor attempting to collect on its own accounts need not comply with a cease collection request.¹¹⁵ Even when calls can be stopped, creditors are still free to bring lawsuits against debtors.

¹⁰⁸ NAAG Letter, *supra* note 9, at 8.

¹⁰⁹ See *supra* Part II.B for a description of the debt settlement business model.

¹¹⁰ NCLC REPORT, *supra* note 17, at 5.

¹¹¹ *Id.* (“[O]ne company representative told us that they can’t tell consumers not to pay creditors, but this is what consumers need to do because the longer they’re not paying the creditors, the better deal they will eventually get from creditors.”).

¹¹² *Id.* at 6.

¹¹³ *Id.*

¹¹⁴ NCLC REPORT, *supra* note 17, at 6.

¹¹⁵ See Fair Debt Collection Act, 15 U.S.C. § 1692a(6) (2010). Under the FDCPA, a debt collector is one who attempts to collect “debts owed or due or asserted to be owed or due *another*” *Id.* (emphasis added).

5. Debt Settlement Programs Yield Startlingly Low Success Rates and Completion Percentages

Misrepresentations, excessive fees, lack of services, and intervening collection efforts all contribute to perhaps the greatest horror of the debt collection industry: its disturbingly low success rate.¹¹⁶ Although advertisements promise quick results, low-income consumers required to pay high up-front and monthly maintenance fees to debt settlement providers can take years to set aside enough money for a full settlement of all their accounts.¹¹⁷ In the meantime, consumers continue to face unsettling collection tactics, compounding fees and interest, and a worsening credit rating.¹¹⁸ The net result is that very few consumers have the financial wherewithal or emotional stamina to complete a debt settlement program.

One debt settlement provider admitted that the average “break-even point” was at least three months, and that creditors are generally not willing to even consider settlement until at least six months of delinquency.¹¹⁹ Employees of the same company admitted that the process was a “fire walk” for consumers that could last more than three years.¹²⁰ As a result, only 1.4% of consumers who entered the program actually completed it.¹²¹

Although industry-wide figures are difficult to nail down, these results are hardly unique.¹²² In a number of noteworthy cases, debt settlement companies have been unable to substantiate their claims about the likelihood of success. In a case from Texas, the Attorney General alleges that more than 80% of the debts serviced by a debt settlement company were not settled.¹²³ In a Mary-

¹¹⁶ NCLC REPORT, *supra* note 17, at 4; NAAG Letter, *supra* note 9, at 7; TASC STUDY, *supra* note 30, at 1.

¹¹⁷ NCLC REPORT, *supra* note 17, at 4–5.

¹¹⁸ *Id.* at 4.

¹¹⁹ RECEIVER’S REPORT, *supra* note 90. The “break-even point” is the point at which enough funds have been deposited to the reserve account to pay off the initial set-up fee and accumulated maintenance fees so that a consumer can begin saving money that will actually go toward settlement.

¹²⁰ *Id.* at 13.

¹²¹ *Id.*

¹²² The NAAG describes the difficulty of obtaining useful statistics on debt settlement completion rates:

Excuses offered by settlement agencies are either that such data does not exist or that the debt settlement industry is a relatively new industry and has not yet had time to accumulate sufficient and reliable data concerning success rates. This raises a separate concern, which is that if the settlement industry lacks reliable data to substantiate its advertised success rates, then why are these claims being made?

NAAG Letter, *supra* note 9, at 7–8 n.10.

¹²³ NAAG Letter, *supra* note 9, at 7 (citing *State of Texas v. CSA-Credit Solutions of Am., Inc.*, Cause No. D-1-GV-09-000417, 261st District Court, Travis County).

land action, a company was unable to substantiate its advertised claim that it could reduce consumers' debts by up to 70%.¹²⁴ Compounding the problem is that when debt settlement plans fail, companies are usually loath to provide consumers with adequate refunds,¹²⁵ a particularly slimy policy, given what is known about what services are actually rendered prior to negotiations with creditors.¹²⁶

Responding to these charges, The Association of Settlement Companies (TASC), a debt settlement industry trade group, released a "preliminary study" purporting to show average completion rates between 45% and 50%.¹²⁷ Such a rate would exceed reported success rates for Chapter 13 bankruptcy and certain types of credit counseling and debt management plans, making debt settlement a more viable option.¹²⁸ However, consumer advocates are skeptical about the validity of the TASC report. The NAAG pointed out, for example, that the report was labeled "[p]reliminary" with no final report forthcoming; that the report does not reveal TASC's methods for conducting the survey, nor what percentage of the industry was represented in the study; and that some of the participants in the study considered a program completed when in reality only 50% to 80% of the consumers' debts were actually settled.¹²⁹ Regardless of the industry average, it is clear that in a great many cases, for a variety of reasons, consumers' chances of successfully navigating a debt settlement program are slim.

6. Debt Settlement Companies Fail to Provide Consumers with Critical Information About Bankruptcy Options and the Tax Implications of Debt Settlement Programs

Debt settlement companies also frequently fail to provide consumers with adequate information related to two key considerations that should affect a consumer's decision about whether or not to enter into a debt settlement plan in the first place: the consumer's bankruptcy options and the potential tax implications of settling a debt for less than is owed.

Debt settlement companies advertise themselves as an alternative to bankruptcy. They appeal to a consumer's innate sense of pride and obligation, often featuring testimonials from customers who talk about how great it felt to

¹²⁴ See Press Release, Maryland Attorney General, Attorney General Settles with Companies Selling Debt Repayment Services (Oct. 19, 2007), available at <http://www.oag.state.md.us/Press/2007/101907.htm>.

¹²⁵ NAAG Letter, *supra* note 9, at 7 (reprinting a letter from a Missouri consumer who complained that "After paying in excess of \$3,000, creditors still were calling . . . My account is currently cancelled and I am seeking a full refund. They are offering 30%, saying they have performed work on the account, and the issues with the creditor calls was [sic] my fault.").

¹²⁶ See *supra* Part II.D.3 for a discussion of failure to provide valuable services.

¹²⁷ TASC STUDY, *supra* note 30, at 1.

¹²⁸ *Id.*

¹²⁹ NAAG Letter, *supra* note 9, at 8.

be able to make good on their financial promises.¹³⁰ For many consumers, however, bankruptcy might be a better option than debt settlement, particularly if the consumer is predictably unlikely to be able to complete a sustained debt settlement program. Bankruptcy proceedings typically cost a consumer no more than \$1500, and may result in a preferable arrangement for both debtor and creditor.¹³¹

Regardless, few, if any, debt settlement companies adequately advise potential customers about their bankruptcy options. To do so would certainly be bad for business. Arguably, it may not be appropriate for debt settlement companies to make such assessments as it may constitute the unlicensed practice of law in many jurisdictions.¹³² In any case, it is not possible for a consumer to make a fully-informed choice about whether or not to enter into a debt settlement program without at least considering the possibility of bankruptcy.

If some consumers are at least aware of the possibility of bankruptcy, it is far less likely that the average potential debt settlement consumer (or the average attorney, for that matter) is aware of the potential tax consequences of settling a debt for less than is owed. The debt settlement companies know, but rarely warn consumers ahead of time. Instead, if and when a settlement is actually reached, the consumer will simply receive a 1099-C Cancellation of Debt notice form from the IRS, explaining that money saved in settlement must be reported to the IRS as income.¹³³ In many cases, this additional tax burden, had it been known up-front, might have led a rational consumer toward a different debt relief solution.

E. *The GAO Sting*

In 2010, the Government Accountability Office (GAO) concluded an extensive investigation of the debt settlement industry.¹³⁴ Responding to complaints about debt settlement providers from numerous state and federal agencies, the GAO set forth to determine whether the allegations were accurate and, if so, whether the allegations were widespread. To answer these questions,

¹³⁰ Testimonials, *supra* note 16.

¹³¹ Various bankruptcy options are available to consumers under Title 11 of the United States Code.

¹³² See *infra* Part III.B.2.c for a discussion of the application of rules and statutes regulating the unlicensed practice of law to the debt settlement industry.

¹³³ Form 1099-C is a form created by the Internal Revenue Service used to prepare and file an "information return" to report various types of income other than wages, salaries, and tips (for which the usual form W-2 is used instead). While there are numerous varieties of 1099 obligations, form 1099-C applies specifically to income derived from the cancellation of outstanding debt. *Forms and Publications*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/formspubs/index.html> (last visited Sept. 25, 2010).

¹³⁴ UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, DEBT SETTLEMENT: FRAUDULENT, ABUSIVE, AND DECEPTIVE PRACTICES POSE RISK TO CONSUMERS (2010) [hereinafter GAO INVESTIGATION].

GAO agents conducted covert testing by calling debt settlement providers while posing as consumers with large amounts of debt; making overt and unannounced site visits to the companies called; conducting interviews with industry insiders; and reviewing information about federal and state legal actions against debt settlement providers.¹³⁵ The investigation ultimately uncovered clear and abundant evidence of fraudulent, deceptive, and abusive practices such as those described above.¹³⁶

GAO agents posing as embattled consumers found that debt settlement providers were eager to make promises that simply cannot be kept. One company promised that the “worst case scenario” for debt settlement would be “40 cents on the dollar,” and that 100% of the company’s clients get out of debt in three years or less.¹³⁷ It also assured that “every single creditor settles. There’s not one creditor we haven’t been able to reach a settlement with.”¹³⁸ Other companies promised to stop calls from creditors “immediately,” eliminate late fees, or even pay consumers \$100 if the company could not settle their debt within twenty-four hours.¹³⁹ Many companies also lied about their credentials and the very nature of their existence. They claimed to be “licensed and regulated by TASC” (a nonprofit trade association with no licensing or regulatory authority), displayed Better Business Bureau (BBB) insignia (the BBB recently designated the debt settlement industry as “inherently problematic”), and claimed links to fictitious “government authorized” programs like the “National Debt Relief Stimulus Plan.”¹⁴⁰ Several companies were not debt settlement providers at all, but rather marketing sites or leads generators.¹⁴¹ Most brazenly, one company specifically targeted Christians by employing a biblical marketing theme and promising consumers that funds from their debt settlement services went toward a related non-profit ministry.¹⁴² When asked to produce an IRS Form 990 for the non-profit side of the operation, the owner preached: “the Bible says you should never let the left hand know what the right hand is doing.”¹⁴³

The investigation also confirmed widespread complaints of excessive and undeserved fees. Of the eighteen companies from which fee information was obtained, seventeen collected advance fees before debts were settled.¹⁴⁴ In addition to up-front costs, several companies admitted that as many as four

¹³⁵ *Id.* at 2.

¹³⁶ *Id.* at 7.

¹³⁷ GAO INVESTIGATION, *supra* note 134, at 16.

¹³⁸ *Id.*

¹³⁹ *Id.* at 17–18.

¹⁴⁰ *Id.* at 14–18.

¹⁴¹ *Id.* at 16–17.

¹⁴² *Id.* at 19.

¹⁴³ GAO INVESTIGATION, *supra* note 134, at 19–20.

¹⁴⁴ *Id.* at 7.

monthly payments would go directly to fees before any money at all would be deposited to the settlement account.¹⁴⁵ At least one company had difficulty explaining what services were rendered in return for these fees.¹⁴⁶ Because GAO agents did not actually enter into business relationships with the target companies, they were unable to verify the extent and nature of ongoing services provided. Even their promises, however, were underwhelming: little more than forms for cease and desist letters, automated emails, and online links to basic educational materials.¹⁴⁷

Despite industry claims to the contrary, the GAO also concluded that an alarming number of debt settlement companies put consumers at risk by advising them to stop making payments to their creditors.¹⁴⁸ Representatives of seventeen out of twenty companies either required GAO agents to stop paying creditors as a precondition to entering their programs or informed them that cessation of payment was necessary for the program to work.¹⁴⁹ Though TASC and other industry advocates assert that companies do not explicitly advise consumers to stop paying their creditors, company representatives make the requirement abundantly clear. "I won't tell anyone not to pay their bills," claimed one representative. "I [say] one-hundred percent of the clients who have been successful have stopped paying their bills."¹⁵⁰

Finally, the GAO investigation confirmed allegations that the success rates claimed by debt settlement companies—as high as 85%, 93%, and 100% in their survey—do not comport with more realistic and methodologically sound studies that reveal shockingly low completion and success rates for the industry as a whole.¹⁵¹ All told, the GAO's investigation of the debt settlement industry provides clearly documented, first-hand examples of the inherent dangers of debt settlement.

F. *The New FTC Rules*

Just days before this Note was published, new Federal Trade Commission (FTC) rules regarding debt settlement went into effect. After issuing a Notice of Proposed Rulemaking and inviting comments and testimony from industry leaders and consumer advocates,¹⁵² the FTC finalized a series of amendments to its Telemarketing Sales Rule (TSR) aimed at limiting many of the

¹⁴⁵ *Id.*

¹⁴⁶ *Id.* at 8.

¹⁴⁷ *Id.* at 8–9.

¹⁴⁸ *Id.* at 9.

¹⁴⁹ GAO INVESTIGATION, *supra* note 134, at 9.

¹⁵⁰ *Id.*

¹⁵¹ *Id.* at 10.

¹⁵² TSR Notice, *supra* note 32.

abuses outlined above.¹⁵³ A detailed examination of the new rules and their likely effect is beyond the scope of this Note, although generally, they can be grouped into four parts. The first three parts, effective September 27, 2010, require certain disclosures,¹⁵⁴ prohibit certain common misrepresentations,¹⁵⁵ and extend the TSR to cover inbound calls from consumers to debt settlement agencies.¹⁵⁶ The fourth part, a ban on advance (or up-front) fees, becomes effective for new transactions on October 27, 2010.¹⁵⁷

The amendments to the TSR will no doubt make a significant impact. Many commentators, however, feel that the new rules do not signal the end of up-front fees in the debt settlement industry, as many companies may simply adapt their business model to make use of the Internet, face-to-face transactions, or other means not covered by the rules.¹⁵⁸ Consumer advocates point to the evolution of the payday lending industry, which has repeatedly re-invented itself over the years in the wake of state and federal attempts to eradicate it.¹⁵⁹ Moreover, if the industry itself is to be believed, it will have no choice but to attempt to skirt the regulations, as its representatives have repeatedly claimed that the revenue generated by up-front fees is critical to their bottom line.¹⁶⁰ For these reasons, this Note will continue to consider the problems posed by up-front fees and the best solutions for addressing them.

¹⁵³ 2010 Amendments to the Telemarketing Sales Rule, 75 Fed. Reg. 48458 (Aug. 10, 2010) (codified at 16 C.F.R. § 310).

¹⁵⁴ 16 C.F.R. § 310.3(a)(1) (2010).

¹⁵⁵ 16 C.F.R. § 310.3(a)(2)–(4) (2010).

¹⁵⁶ The provisions bringing inbound calls into the scope of the TSR are scattered throughout 16 C.F.R. § 310 (2010).

¹⁵⁷ 16 C.F.R. § 310.4(a)(5) (2010).

¹⁵⁸ See, e.g., Blake Ellis, *New Rules Crack-Down on Deceptive Debt Settlement Practices*, CNN MONEY (Sept. 27, 2010), http://money.cnn.com/2010/09/27/pf/debt_rules/.

But just as banks have found ways to circumvent new Federal rules on fees, debt settlement companies may be able to just as easily skirt some of the new provisions and take advantage of struggling consumers.

Because the debt settlement rules only apply to over-the-phone sales—which comprise the vast majority of transactions—debt relief companies can still hit consumers with fees over the Internet. Face-to-face transactions are also exempt from the rules.

Id.

¹⁵⁹ In a brief in a case against a payday lender, the West Virginia Attorney General briefly outlined the history of this evolution, describing “rent-a-bank” schemes and “the artifice of making loans over the Internet via interactive websites.” State’s Memorandum of Law in Support of Motion to Remand at 5-6, *McGraw v. Cashcall, Inc.*, No. 2:08-cv-0192 (S.D. W. Va. Dec. 15, 2008); See also NATIONAL CONSUMER LAW CENTER, *THE COST OF CREDIT* § 7.5.5.8 (4th ed. 2009).

¹⁶⁰ Letter from Andrew Houser, The Ass’n of Settlement Companies, to the Sec’y of the Fed. Trade Comm’n 16–25 (Oct. 26, 2009), available at <http://ftc.gov/os/comments/tsrdebtrelief/543670-00202.pdf>; TASC STUDY, *supra* note 30, at 4–5.

III. TWO APPROACHES TO REGULATION OF THE DEBT SETTLEMENT INDUSTRY

A. *The Uniform Debt Management Services Act*

By 2005, nearly every state had adopted some type of legislation that either directly or indirectly addressed the debt relief industry.¹⁶¹ However, these laws varied considerably in terms of scope, substance, and enforcement.¹⁶²

Against the backdrop of rapidly growing consumer debt, and the resulting proliferation of debt settlement providers, the NCCUSL began looking into a uniform solution to problems in the debt relief industry. After an in-depth review of the state of current debt management and debt settlement regulations, the NCCUSL's Study Committee on Debt Management proposed the creation of a Draft Committee on Debt Management.¹⁶³ In consultation with state commissioners, experts in the field, and industry trade groups, the Draft Committee promulgated the UDMSA.

Finalized in 2005, the UDMSA has been adopted into law in Nevada, Utah, Colorado, Tennessee, Delaware, Rhode Island, and the U.S. Virgin Islands.¹⁶⁴ As of 2010, some version of the Act has been formally introduced in the legislatures of eight other states.¹⁶⁵ Although the UDMSA has not been formally introduced in West Virginia, it was the subject of a special report to the Legislature by the West Virginia Commission on Uniform Laws in 2006.¹⁶⁶ In 2009, representatives of the NCCUSL once again appeared before a West Virginia Senate subcommittee to urge passage of the Uniform Act.¹⁶⁷ Although the

¹⁶¹ For a sampling of (non-UDMSA) state laws governing the debt relief industry, see, e.g., ARK. CODE § 5-63-301 to -304 (2010); HAW. REV. STAT. § 446-1 to -4 (2010); KY. REV. STAT. § 380.010 (2010); N.M. STAT. § 56-2-1 (2010); WYO. STAT. § 33-14-101 (2010).

¹⁶² See generally statutes cited *supra* note 161.

¹⁶³ NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS DRAFTING COMMITTEES (Dec. 6, 2002), http://www.nccusl.org/update/scope&program/Rpt_ConsDebt_1202.pdf.

¹⁶⁴ OFFICIAL WEBSITE OF THE UNIFORM DEBT MANAGEMENT SERVICES ACT, <http://www.udmsa.org> (last visited Sept. 12, 2010) [hereinafter UDMSA WEBSITE]. According to Michael Kerr, Legislative Director for the NCCUSL, some other states (Pennsylvania and Texas, for example) have enacted Debt Management Services Acts that may be patterned after, or draw heavily from, the UDMSA, but which are not sufficiently similar to be considered actual enactments of the Uniform Act. Telephone Interview with Michael Kerr, Legislative Dir., Nat'l Conference of Comm'n'rs on Unif. State Laws (July 7, 2010).

¹⁶⁵ Connecticut, Maine, Minnesota, Missouri, New Mexico, New York, and Washington. UDMSA WEBSITE, *supra* note 164.

¹⁶⁶ West Virginia Commission on Uniform State Laws Report to the West Virginia Legislature, W. VA. LEG. S. J. (Mar. 11, 2006), http://www.legis.state.wv.us/Bulletin_Board/2006/rs/senate/s_daily_journal/sdj-60th%20day.htm.

¹⁶⁷ Interview with Professor Vincent Cardi, ULC Comm'r for the State of W. Va. (Apr. 2010).

Legislature has not yet passed the Act into law, the NCCUSL continues to actively campaign for the promulgation of the UDMSA in West Virginia.¹⁶⁸

To date, the UDMSA has not been amended to reflect the latest FTC debt settlement rules, and no efforts to do so have been planned.¹⁶⁹ Accordingly, some parts of the Uniform Act covered by the FTC rules may be preempted; however, provisions of the UDMSA governing areas not within the scope of the new regulations, such as transactions occurring online or face-to-face, will remain in place for now both in the states that have already passed the Uniform Act and in those that would adopt it.

Extensive and detailed summaries of the many provisions of the Uniform Act have been published in various legal and trade journals.¹⁷⁰ The NCCUSL has also published an annotated version of the UDMSA, with detailed comments and suggestions about how sections of the Uniform Act might be adapted to fit the needs of particular states.¹⁷¹ For the purposes of this Note, the following sections outline the major provisions of the proposed law as they apply to the debt settlement industry, with some brief commentary about the purpose of each provision and the way in which the UDMSA is intended to function as a whole.

1. Scope and Applicability

The debt relief industry, as it is commonly recognized, includes service providers who define themselves as credit counseling, debt management, debt settlement, or debt negotiation providers. In the absence of uniform legislation, state consumer laws that address such services have often struggled to define the industries they seek to regulate in a way that is not overbroad, yet does not create loopholes that would exclude key segments of the industry.

The UDMSA addresses this problem by limiting its scope to those companies that act as an “intermediary” between debtors and creditors.¹⁷² As a result, the UDMSA brings together debt management and debt settlement companies, treating them, with only slight exceptions, as essentially the same.¹⁷³ This

¹⁶⁸ Letter from Michael Kerr, Legis. Dir., Nat’l Conf. of Comm’n’s on Unif. State Laws, to the Fed. Trade Comm’n, Office of the Sec’y, 2 (Oct. 14, 2009), available at <http://www.ftc.gov/os/comments/tsrdebtrelief/543670-00155.pdf> [hereinafter Kerr Letter].

¹⁶⁹ Email from Michael Kerr, Legislative Director for the NCCUSL (Aug. 30, 2010) (on file with author).

¹⁷⁰ See, e.g., Linfield, *supra* note 44; Fred H. Miller, *Update on Uniform Laws Affecting Consumer Credit*, 60 CONSUMER FIN. L.Q. REP. 238 (2006); Jeffrey S. Tenenbaum & Jonathon L. Pompan, *Proposed Uniform Debt Management Services Act to Effect Major Changes in the Law*, 123 BANKING L. J. 502 (2006); Witzel, *supra* note 40.

¹⁷¹ See Uniform Debt Management Services Act (2008).

¹⁷² *Id.* at § 2(9).

¹⁷³ As the definition suggests, the Uniform Act generally does not explicitly distinguish between debt management and debt settlement providers. Certain sections of the Act, however,

definition does not, however, include credit counseling services that offer solely educational programs.¹⁷⁴ The Act also creates a broad "good faith" exception for scenarios in which a debt settlement company (1) enters into an agreement with an individual which it has no reason to know resides in the state at the time of the agreement, (2) provides or offers to provide services to an individual it has no reason to know resides in the state, or (3) receives no compensation for providing debt settlement services.¹⁷⁵

2. Registration

The first critical reform brought by the Uniform Act is the registration requirement. Under the proposed regulations, no provider of debt settlement services may enter into any agreement with a debtor without first registering as a consumer debt management service in the state in which the consumer resides.¹⁷⁶ Registration under the UDMSA requires a company wishing to provide debt settlement services to submit detailed information about the company, including audited financial statements;¹⁷⁷ names and addresses of all officers, directors, and owners holding more than a 10% interest;¹⁷⁸ locations at which services will be offered;¹⁷⁹ business history in other jurisdictions;¹⁸⁰ and its forms for agreements with consumers.¹⁸¹

As part of its registration, a company must provide proof of an effective insurance policy against fraud, dishonesty, theft, and similar acts in the amount of \$250,000 or more.¹⁸² It must also post a surety bond of at least \$50,000 or, at the discretion of the administrator, a smaller amount, and it must maintain a trust account accessible by the state.¹⁸³

The state may deny registration of a debt settlement company if the application is incomplete; an officer, director, or owner of the company has been convicted of a crime or has been on the losing end of a civil judgment for dishonesty or the violation of securities laws; an officer, director or owner has defaulted on a debt; or the state finds that the character, financial responsibility, experience, or general fitness of a company does not indicate that it will be op-

logically apply to only one model or the other, and in the official comments, legislators are sometimes advised as to how some options may be manipulated with respect to the different models.

¹⁷⁴ Tenenbaum & Pompan, *supra* note 170, at 504.

¹⁷⁵ Uniform Debt Management Services Act § 3.

¹⁷⁶ *Id.* at § 4(a).

¹⁷⁷ *Id.* at § 6(7).

¹⁷⁸ *Id.* at § 6(4).

¹⁷⁹ *Id.* at § 6(3).

¹⁸⁰ *Id.* at § 6(6).

¹⁸¹ Uniform Debt Management Services Act § 6(12).

¹⁸² *Id.* at § 5(b)(4).

¹⁸³ *Id.* at § 13(b)(1).

erated in compliance with the UDMSA.¹⁸⁴ Denial is mandatory if the fee is not provided or the company's board of directors is not disinterested and independent of the company's employees and agents.¹⁸⁵

If the application is accepted and registration is valid, the state shall issue a certificate to do business.¹⁸⁶ Yearly renewal is required.¹⁸⁷

3. Prerequisites and Disclosures

In order to enter into a valid agreement for the provision of debt settlement services, the UDMSA imposes a number of prerequisite and disclosure requirements. Even before an agreement is reached, debt settlement companies are required to provide potential clients with an itemized list of the goods and services to be rendered and the charges for each, including up-front fees, monthly service fees, settlement fees, or any other charges.¹⁸⁸ The company must prepare an individualized financial analysis that includes information about the number and schedule of payments to be made under the plan and a determination of whether the company expects the consumer to be able to meet the payment obligations.¹⁸⁹ Within these initial disclosures, the company must alert the consumer to the possibility that debt settlement may have an adverse effect on the consumer's credit rating¹⁹⁰ and of the potential tax implications of settling a debt for less than its full value.¹⁹¹ Though the provider is not required to give information about bankruptcy alternatives, it must make the consumer aware that he may ask the provider about "other ways, including bankruptcy, to deal with indebtedness."¹⁹² In addition to debt negotiation and management services, the Uniform Act requires companies to provide "reasonable education" about the management of personal finances through certified counselors.¹⁹³

¹⁸⁴ *Id.* at § 9.

¹⁸⁵ *Id.* at § 9(d).

¹⁸⁶ *Id.* at § 9.

¹⁸⁷ *Id.* at § 11(a).

¹⁸⁸ Uniform Debt Management Services Act § 17; Tenenbaum & Pompan, *supra* note 170, at 511.

¹⁸⁹ Uniform Debt Management Services Act § 17(b)(3).

¹⁹⁰ *Id.* at § 17(d)(3).

¹⁹¹ *Id.* at § 17(d)(6).

¹⁹² *Id.* at § 17(d)(2).

¹⁹³ *Id.* at § 17(b)(1). The comments accompanying this section of the Uniform Act suggest that "reasonable education" may take the form of an individual session with a certified counselor, a group class, or an "electronic educational program." Regardless of the setting, the comments advise that such education should consist of "substantially more than an explanation of the benefits of the program." These comments of course are mere suggestions and not part of the Act itself; in the absence of more specific legislative guidance, it is unlikely that "reasonable education" under the UDMSA will be substantially different from that which is currently offered.

The form and content of the agreement itself are also determined by statute.¹⁹⁴ In order to comply with the terms of the UDMSA, an agreement must be memorialized in a signed document that includes contact information for all parties and makes most of the same basic disclosures that are required in the pre-agreement communications.¹⁹⁵ In the agreement, the company must make the consumer aware of the existence of the company's surety bond and insurance policy.¹⁹⁶ If the provider intends to hold consumers' funds for eventual disbursement to creditors, the provider must also make available all account information and information about the financial institution in which the funds will be kept.¹⁹⁷

The statute also regulates the cancellation of an agreement between a provider and a consumer. Consumers must be afforded a penalty-free three-day right of rescission.¹⁹⁸ If the agreement violates certain sections of the UDMSA,¹⁹⁹ the penalty-free right to cancel is extended for thirty days.²⁰⁰ The statute provides rigid guidelines for the form and substance of the notice of this right to cancel.²⁰¹ If the consumer fails to make required payments for a period of at least sixty days, the provider may, at its option, terminate the agreement.²⁰² If the provider does choose to terminate a delinquent agreement, it must return to the consumer all money held in trust for the benefit of the individual and 65% of any portion of the up-front fee that has not been credited to the account settlement.²⁰³

Certain provisions of the UDMSA pertaining to the agreement between providers and consumers apply specifically to debt settlement providers.²⁰⁴ Under the Uniform Act, a consumer can pre-authorize a provider to settle any or all of the accounts covered by the agreement for up to 50% of the total amount of the debt.²⁰⁵ If the provider feels that it is unable to settle a debt for less than 50% of its total value, but nonetheless seeks to settle the account, the provider

¹⁹⁴ Uniform Debt Management Services Act § 19.

¹⁹⁵ *Id.* at § 19.

¹⁹⁶ Tenenbaum & Pompan, *supra* note 170, at 512.

¹⁹⁷ *Id.*

¹⁹⁸ Uniform Debt Management Services Act § 20(a).

¹⁹⁹ The thirty day extension is triggered by violation of § 20(b) (disclosure of three-day right to cancel), § 19 (form and contents of agreement), or § 28 (prohibited acts or practices).

²⁰⁰ *Id.* at § 20(a).

²⁰¹ *Id.* at § 20(b).

²⁰² *Id.* at § 26(a).

²⁰³ *Id.* at § 26(b). Because, in the debt settlement model, no money is actually credited against the consumer's debts until a final settlement is reached, no such deduction should be made.

²⁰⁴ See Tenenbaum & Pompan, *supra* note 170, at 512.

²⁰⁵ *Id.*

must obtain the permission of the consumer after the creditor has agreed to the settlement.²⁰⁶

4. Fee Structure

The UDMSA also imposes limits on the type and size of fees that may be charged for the provision of debt settlement services. In return for the provision of debt settlement services, a company may charge an individual a “set-up fee” in an amount not exceeding the lesser of \$400 or 4% of the amount of debt in the plan at its inception.²⁰⁷ The provider may also collect a “monthly service fee,” not to exceed \$10 per creditor left in the plan at the time the fee is assessed, and in no case more than \$50 per month.²⁰⁸ Even if the consumer does not enter into an agreement for the provision of debt settlement services, a provider may collect a fee of \$100 (or more upon the approval of the state administrator) in return for educational and counseling services rendered.²⁰⁹ Finally, in the event that a settlement is reached, the Uniform Act authorizes debt settlement companies to collect a settlement fee of 30% of the excess of the principle amount of the debt over the amount paid to the creditor, offset by certain fees already charged to the individual.²¹⁰

The UDMSA also allows providers to assess flat-rate penalties to clients who fail to make required payments. In such cases, providers are authorized to charge consumers a “reasonable charge,” not to exceed the lesser of \$25 and the amount permitted by any other state law.²¹¹

The Uniform Act specifically provides that the dollar amounts stated throughout the regulation are to be adjusted to reflect inflation as measured by the United States Bureau of Labor Statistics Consumer Price Index for All Urban Consumers or by another index available to the administrator.²¹²

5. Enforcement and Remedies

Enforcement of the UDMSA occurs at two levels: administrative and individual.²¹³

²⁰⁶ *Id.*

²⁰⁷ Uniform Debt Management Services Act § 23(d)(2)(A). Under the new FTC rules, “set-up” and other advance fees would be prohibited even in a UDMSA state. However, the fee structure created by the Uniform Act would likely apply to Internet transactions, face-to-face transactions, and other means not covered by the TSR. *See supra* Part II.F.

²⁰⁸ Uniform Debt Management Services Act § 23(d)(1)(B).

²⁰⁹ *Id.* at § 23(d)(4).

²¹⁰ *Id.* at § 23(f)(1).

²¹¹ *Id.*

²¹² *Id.* at § 32(f).

²¹³ Tenenbaum & Pompan, *supra* note 170, at 516–17.

Under the Uniform Act, the administrator (Attorney General, Secretary of State, or other agency) may act on its own initiative or in response to complaints to enforce the UDMSA and seek the remedies it provides.²¹⁴ The administrator is granted authority to investigate the activities, books, accounts, and records of any person or company that provides or offers to provide debt management services in order to ensure compliance.²¹⁵ The administrator may also issue cease and desist orders,²¹⁶ orders to grant restitution, and civil penalties of up to \$10,000 (\$20,000 for knowingly violating an administrator-issued cease and desist order or order to grant restitution).²¹⁷ It is also authorized to bring civil actions in state court.²¹⁸

An individual may bring a civil action for compensatory damages, including treble damages if a provider obtains fees or payments not authorized by the UDMSA, and may also seek punitive damages and attorneys' fees.²¹⁹

B. *The West Virginia Attorney General's Strategy*²²⁰

In West Virginia, the Attorney General's Consumer Protection Division is tasked with the responsibility of mediating consumer claims and enforcing the state's generally strong consumer protection statutes.²²¹ Though the division has handled complaints related to consumer credit counseling for many years, only recently has it begun to deal directly with the debt settlement industry.²²² In

²¹⁴ Uniform Debt Management Services Act § 32(a).

²¹⁵ *Id.* at § 32(b).

²¹⁶ *Id.* at § 33(a)(1).

²¹⁷ *Id.* at § 33(a)(3), (b).

²¹⁸ *Id.* at § 33(a)(4).

²¹⁹ *Id.* at § 35(c).

²²⁰ "The West Virginia Attorney General's Strategy" has never been a formal designation used by the Office of the Attorney General. Rather, I use this phrase to reflect the overall approach taken by the Attorney General's Consumer Protection Division in combating unscrupulous debt settlement companies. Though each case is unique, I have, through interviews with attorneys and review of numerous briefs, filings, and other documents in debt settlement litigation, attempted to illuminate and refine the common elements of the Attorney General's legal strategies.

²²¹ Most frequently, the Attorney General enforces the West Virginia Consumer Credit and Protection Act, found at W. VA. CODE § 46A-1-101 to -8-102 (2010).

²²² The West Virginia Attorney General defines "debt settlement" as:

[A] plan or strategy offered for a fee to provide debt relief for consumers in which consumers are advised or expected to stop making payments to their unsecured creditors. The consumers are directed to make periodic payments to the debt settlement company or into a separate fund for an unspecified time until the debt settlement company determines that sufficient funds have been accumulated to attempt to negotiate a lumpsum settlement of one or more of the consumers accounts for less than the actual balance owed.

Assurance of Discontinuance, In the Matter of the Investigation of Consumer Credit Counseling of America, Inc., Before the Attorney Gen. of W. Va. 2 (2007) [hereinafter CCCA Assurance] (on file with author).

2006, the Attorney General reached settlement agreements in three such cases,²²³ and since that time has executed “Assurances of Discontinuance”²²⁴ with ten more debt settlement companies.²²⁵

Over time, the Consumer Protection Division has developed an informal but comprehensive strategy for protecting West Virginians from debt settlement abuses. While keeping alive the possibility that debt settlement may be lawfully practiced by duly licensed and qualified attorneys, the Attorney General maintains that the non-attorney, for-profit debt settlement industry, as it is currently practiced, is inherently unlawful in West Virginia.²²⁶ This position is based on several existing statutory protections—the West Virginia Debt Pooling statute, the West Virginia Credit Services Organization Act (CSO Act), and the various rules and regulations governing the unauthorized practice of law—that, while not directly confronting the debt settlement industry, have been held to apply to the most common and harmful deceptive practices of debt settlement companies.²²⁷ Taken together, the Attorney General asserts that the violation of these laws, or any other law created to protect the public or foster fair and honest competition, are deemed to be unfair or deceptive acts or practices as defined by

²²³ Press Release, W. Va. Attorney Gen., State ex. rel. McGraw v. Cambridge Credit Counseling Corp. (May 25, 2006), available at <http://www.wvago.gov/press.cfm>; Press Release, W. Va. Attorney Gen., State ex. rel. McGraw v. Debt Mgmt. Credit Counseling Corp. (Jan. 1, 2006) available at <http://www.wvago.gov/press.cfm>; Press Release, W. Va. Attorney Gen., State ex. rel. McGraw v. Help Ministries d/b/a Debt Free (Sept. 13, 2006), available at <http://www.wvago.gov/press.cfm>.

²²⁴ Assurances of Discontinuance are binding agreements entered into by the Attorney General and a party under investigation, authorized by W. VA CODE § 46A-7-107 (2010). For a more detailed explanation, see *infra* Part III.B.1.

²²⁵ Press Release, W. Va. Attorney Gen., State ex. rel. McGraw v. Debt Relief L.P. (May 16, 2007), available at <http://www.wvago.gov/press.cfm>; Press Release, W. Va. Attorney Gen., State ex. rel. McGraw v. Fidelity Debt Consultants, Inc. (May 16, 2007), available at <http://www.wvago.gov/press.cfm>; Press Release, W. Va. Attorney Gen., State ex. rel. McGraw v. David Huffman d/b/a Freedom Group (May 16, 2007), available at <http://www.wvago.gov/press.cfm>; Press Release, W. Va. Attorney Gen., State ex. rel. McGraw v. New Horizons Debt Relief (May 16, 2007), available at <http://www.wvago.gov/press.cfm>; Press Release, W. Va. Attorney Gen., State ex. rel. McGraw v. PDM Int’l, Inc. (2009), available at <http://www.wvago.gov/press.cfm>; Press Release, W. Va. Attorney Gen., State ex. rel. McGraw v. Consumer Credit Counseling of Am., Inc. (Sept. 3, 2008), available at <http://www.wvago.gov/press.cfm>; Press Release, W. Va. Attorney Gen., State ex. rel. McGraw v. Debt Relief USA, Inc. (Sept. 3, 2008), available at <http://www.wvago.gov/press.cfm>; Press Release, W. Va. Attorney Gen., State ex. rel. McGraw v. Acushield Fin. Serv.’s (Sept. 3, 2008), available at <http://www.wvago.gov/press.cfm>; Press Release, W. Va. Attorney Gen., State ex. rel. McGraw v. Am. Debt Solutions, Inc. (May 8, 2009), available at <http://www.wvago.gov/press.cfm>.

²²⁶ Telephone Interview with Norman Googel, Deputy Attorney Gen., West Virginia Attorney Gen. Consumer Prot. Div. (Jan. 4, 2010). See also Goodman, *supra* note 54 (quoting Mr. Googel: “The industry’s not legitimate”).

²²⁷ See *infra* Part III.B.2.

the West Virginia Consumer Credit and Protection Act (WVCCPA).²²⁸ Any individual or company that engages in willful and repeated violations of the WVCCPA may be subject to civil penalties for each violation, in addition to compensatory damages.²²⁹

1. Procedural Overview of the Attorney General's Strategy

When a claim is filed with the Attorney General's office, trained mediators interview consumers, contact the companies in question, and verify, to the best of their ability, the facts in question. The mediators also serve a screening function, making sure that legitimate businesses are not unduly harmed by frivolous claims.

When the mediators determine that a claim has potential merit, it is assigned to an Assistant Attorney General for further investigation. The attorney conducts further interviews with the consumer, contacts the company if appropriate, and attempts to collect any signed agreements, bank or credit card statements, authorizations, or other paperwork that might be relevant to the investigation. If a company is not forthcoming, the Attorney General has the power to subpoena witnesses, compel their attendance, adduce evidence, and/or require the production of any documents relevant to the investigation.²³⁰

If a debt settlement company is found to have violated the law, the Attorney General may initiate a suit in state court.²³¹ Though the Consumer Protection Division has won a number of favorable rulings in preliminary hearings, to date, no case involving debt settlement has advanced to the trial stage. Instead, the Attorney General has generally exercised its statutory power to settle complaints through the execution of an "Assurance of Discontinuance."²³² When it is claimed that a company or individual has engaged in conduct that violates the law and may be subject to an order by the Attorney General or by a court, the Attorney General may accept an assurance in writing that the company or individual will not engage in the same conduct in the future.²³³ Though such an assurance is not an admission of guilt, should the party making the assurance fail to abide by its terms, it becomes prima facie evidence that prior to the execution of the agreement, the company or individual did in fact engage in

²²⁸ See CCCA Assurance, *supra* note 222; Assurance of Discontinuance, In the Matter of the Investigation of Debt Relief USA, Inc., Before the Attorney Gen. of W. Va. (Apr. 2, 2008) [hereinafter Debt Relief Assurance]; Assurance of Discontinuance, In the Matter of the Investigation of PDM International, Inc., Before the Attorney Gen. of W. Va. (Jun. 5, 2008) [hereinafter PDM Assurance].

²²⁹ W. VA. CODE § 46A-7-111 (2010).

²³⁰ § 46A-7-104(1) (2010).

²³¹ § 46A-7-102(1)(a).

²³² § 46A-7-107.

²³³ *Id.*

the conduct described therein.²³⁴ Usually, such assurances include not only the promise to cease the prohibited conduct, but also the terms under which the company or individual will redress the grievances of the consumers (present and future) who have been harmed.²³⁵ In the debt settlement context, a typical Assurance of Discontinuance may require the company (and any and all subsidiaries, agents, and affiliates) to do the following, among other, conditions:²³⁶

1. Comply with all terms of the West Virginia Consumer Credit and Protection Act, Debt Pooling Act, Credit Services Organization Act, West Virginia regulations governing the practice of law, and any other relevant federal or state laws.²³⁷
2. Permanently refrain from offering any debt settlement or related services to West Virginia consumers.
3. Provide the Attorney General with a report containing the names, contact information, and amount charged to any West Virginia consumer.
4. Refund all fees and charges made to West Virginia consumers in connection with debt settlement activity, less any amount actually paid to creditors.
5. Facilitate the process of releasing any funds deposited in savings accounts in banks affiliated with the company.

The use of Assurances of Discontinuance has proved to be an effective strategy, and will likely continue in its role as the primary enforcement mechanism in future actions against debt settlement providers.

2. Legal Elements of the Attorney General's Strategy

Of course, in order to convince a debt settlement company to enter into such an agreement, the Attorney General must present compelling legal argu-

²³⁴ *Id.*

²³⁵ CCCA Assurance, *supra* note 222; Debt Relief Assurance, *supra* note 228; PDM Assurance, *supra* note 228.

²³⁶ Though the elements of a particular Assurance of Discontinuance may vary and are subject to negotiation by the parties, the examples listed are drawn from actual Assurances of Discontinuance entered into by the Attorney General and various debt settlement providers. *See generally* CCCA Assurance, *supra* note 222; Debt Relief Assurance, *supra* note 228; and PDM Assurance, *supra* note 228.

²³⁷ *See infra* Part III.B.2 for a discussion of the Attorney General's application of these statutes to the debt settlement industry.

ments that are likely to succeed in front of a West Virginia circuit judge.²³⁸ Although each case presents its own unique factual and legal elements, generally speaking, the Attorney General bases his Assurances of Discontinuance on three main legal arguments: the Debt Pooling Statute, the Credit Services Organizations Act, and the laws governing the unauthorized practice of law.

a. Debt Pooling Statute

Today's debt settlement companies are heir to the legacy of the "debt poolers" of the early 20th century.²³⁹ Frequent abuses at the hands of unscrupulous debt poolers and credit counselors led many states, including West Virginia, to enact legislation aimed at protecting consumers from the most common and harmful schemes, officially known as "crimes against public policy."²⁴⁰ Although the debt settlement model differs in certain aspects from the debt pooling schemes contemplated when the statute was enacted, the plain language of the statute clearly covers many of the practices currently employed by debt settlement companies doing business in the state, and the Attorney General continues to enforce it as it applies.

The "Debt Pooling Statute" limits the fees that may be charged by a firm offering debt reduction services. Specifically, the statute defines "debt pooling" as:

[T]he rendering in any manner of advice or services of any and every kind in the establishment or operation of a plan pursuant to which a debtor would deposit or does deposit funds for the purpose of distributing such funds among his creditors.²⁴¹

The statute authorizes a non-profit firm offering such services to charge a monthly service fee of up to 7% of the total amount of money paid pursuant to the plan as reimbursement for its costs, including the costs of general counseling services regarding personal money management.²⁴² For-profit firms (such as most modern debt settlement companies) may charge a monthly service fee of no more than 2% of the total amount of money deposited pursuant to the plan.²⁴³

²³⁸ There is virtually no published case law in this area of the law. The Attorney General is charged by statute with interpreting, applying, and enforcing the various provisions of the West Virginia Consumer Credit and Protection Act, and so until such time as any circuit courts, or the West Virginia Supreme Court of Appeals interprets the various statutes applied to the debt settlement industry, the Attorney General's interpretation remains the most persuasive statement of the law.

²³⁹ See *supra* Part II.C.

²⁴⁰ W. VA. CODE § 61-10-23 (2010).

²⁴¹ *Id.*

²⁴² *Id.*

²⁴³ *Id.*

In no event (for-profit or non-profit) does the statute authorize a company offering such services to collect an “up-front fee” or any other fees or charges.²⁴⁴

Since it first began handling debt settlement complaints in the early 2000s, the Attorney General has maintained that the practice of offering debt settlement services as a means of helping consumers obtain debt relief constitutes debt pooling as defined by the Debt Pooling Statute, and is subject to the terms and restrictions set forth therein.²⁴⁵ And in the course of its investigations, the Attorney General has frequently concluded that the various fees and charges assessed by debt settlement providers doing business in West Virginia violate the Debt Pooling Statute. In one typical case, a debt settlement company charged consumers a “monthly maintenance fee” ranging from \$29.95 per month to \$39.95 per month, depending on the total amount of debt the consumer sought to eliminate (rather than the statutorily imposed percentage of the amount deposited); an up-front fee, characterized as an “administrative fee,” of 10% of the total amount of debt that the consumer sought to eliminate; and a “negotiation fee” of 13% of the total amount of debt allegedly saved for the consumer in each account settlement.²⁴⁶ Such fees clearly exceeded the amounts allowed by law, and the Attorney General was able to force the offending company to enter into an Assurance of Discontinuance.²⁴⁷

Enforcement of the Debt Pooling Statute protects West Virginian consumers by limiting the ability of debt settlement companies to charge exorbitant fees that reduce the amount of money used to pay down debt and cause many consumers to be unable to complete a debt settlement program.

b. Credit Services Organization Act

The Attorney General also seeks to protect consumers against unscrupulous debt settlement providers through enforcement of the Credit Services Organization Act (CSO Act), which imposes a wide range of obligations on any company that purports to provide “credit services.”²⁴⁸ Under the CSO Act, a company offers “credit services” when it claims that it will:

- (1) improve the consumer’s credit record, history, or rating;
- (2) obtain an extension of credit for a consumer; or

²⁴⁴ *Id.*

²⁴⁵ Debt Relief Assurance, *supra* note 228, at 3.

²⁴⁶ *Id.* at 4–5.

²⁴⁷ *Id.* at 1.

²⁴⁸ W. VA. CODE § 46A-6C-1 to -12 (2008).

(3) provide advice or assistance to a consumer with regard to subsections (1) or (2).²⁴⁹

Companies falling under the scope of the CSO Act cannot do business in West Virginia without first filing a registration statement with the Secretary of State.²⁵⁰ If such a company wishes to charge consumers fees before completing performance of the credit services (i.e., monthly service charges), it must also obtain a surety bond or establish a surety account with the Secretary of State.²⁵¹ Prior to rendering any credit services, a company must provide consumers with an extensive disclosure statement, as outlined in the CSO Act.²⁵²

²⁴⁹ § 46A-6C-2(a).

²⁵⁰ § 46A-6C-5.

²⁵¹ § 46A-6C-4(a).

²⁵² The CSO Act requires that

[b]efore executing a contract or agreement with a buyer or receiving money or other valuable consideration, a credit services organization shall provide the buyer with a statement in writing, containing:

(1) A complete and detailed description of the services to be performed by the credit services organization for the buyer and the total cost of the services;

(2) A statement explaining the buyer's right of proceed against the bond or surety account required by section three of this article;

(3) The name and address of the surety company that issued the bond, or the name and address of the depository and the trustee, and the account number of the surety account;

(4) A complete and accurate statement of the buyer's right to review any file on the buyer maintained by a consumer reporting agency, as provided by the Fair Credit Reporting Act. (15 U.S.C. Sec. 1681 *et seq.*);

(5) A statement that the buyer's file is available for review at no charge on request made to the consumer reporting agency within thirty days after the date of receipt of notice that credit has been denied, and that the buyer's file is available for a minimal charge at any other time;

(6) A complete and accurate statement of the buyer's right to dispute directly with the consumer reporting agency the completeness or accuracy of any item contained in a file on the buyer maintained by that consumer reporting agency;

(7) A statement that accurate information cannot be permanently removed from the files of a consumer reporting agency;

Any agreement between a credit services provider and a consumer must be memorialized in a contract containing the specific terms prescribed by the statute, including an unconditional right to cancel.²⁵³

The Attorney General has interpreted the statute to apply to companies offering debt settlement services as a means of affording debt relief to West Virginian consumers.²⁵⁴ Promises to assist consumers in reducing credit card interest, lowering monthly payments, reducing or eliminating debt, and improving credit are ubiquitous in the marketing of debt settlement services.²⁵⁵ Debt settlement companies doing business in West Virginia have touted their services as an alternative to bankruptcy, promised consumers a drastic improvement in debt-to-income ratio, and even pledged to eliminate debt entirely.²⁵⁶ Taken as a whole, the Attorney General contends that such promises amount to an offer to improve a consumer's overall credit worthiness.²⁵⁷

In nearly every instance, debt settlement companies with high numbers of consumer complaints have also failed to meet the requirements of the CSO Act: they have not registered or posted a bond with the Secretary of State, made appropriate disclosures, or complied with the CSO Act's contract requirements.²⁵⁸ In such cases, the Attorney General is able to threaten enforcement under the CSO Act to force non-compliant debt settlement companies to discontinue their harmful practices.

c. Unauthorized Practice of Law

Often, debt settlement companies purport to offer services that may be lawfully provided only by a licensed attorney. Even in cases in which debt settlement providers actually employ one or more licensed attorneys, such associa-

(8) A complete and accurate statement of when consumer information becomes obsolete, and of when consumer reporting agencies are prevented from issuing reports containing obsolete information; and

(9) A complete and accurate statement of the availability of nonprofit credit counseling services.

§ 46A-6C-6.

²⁵³ W. VA. CODE § 46A-6C-7 (2010).

²⁵⁴ Debt Relief Assurance, *supra*, note 228, at 3.

²⁵⁵ CCCA Assurance, *supra* note 222, at 8.

²⁵⁶ Debt Relief Assurance, *supra* note 228, at 5; CCCA Assurance, *supra* note 222, at 8.

²⁵⁷ Debt Relief Assurance, *supra* note 228, at 5; CCCA Assurance, *supra* note 222, at 8.

²⁵⁸ See, e.g., Debt Relief Assurance, *supra* note 228, at 5–6; CCCA Assurance, *supra* note 222, at 8; PDM Assurance, *supra* note 228, at 5.

tions typically amount to little more than the limited rental of a law license in a superficial attempt to show legitimacy and compliance.²⁵⁹

In West Virginia, the Supreme Court of Appeals is vested with the constitutional authority to define, regulate, and control the practice of law.²⁶⁰ In accordance with such authority, and to “protect the public from being advised and represented in legal matters by unqualified and undisciplined persons over whom the courts could exercise little, if any control,”²⁶¹ the Court has defined the practice of law as follows:

In general, one is deemed to be practicing law whenever he or it furnishes to another advice or service *under circumstances which imply the possession of [or] use of and use of legal knowledge and skill.*

More specifically. . . one is deemed to be practicing law whenever (1) one undertakes, with or without compensation. . . to advise another in any matter involving the application of legal principles to facts, purposes or desires; (2) one undertakes, with or without compensation. . . to prepare for another legal instruments of any character; or (3) one undertakes. . . to represent the interests of another before any judicial tribunal or officer. . .²⁶²

In order to render such services, an individual must be admitted to the West Virginia State Bar by the Board of Law Examiners in accordance with the Rules for Admission to the Practice of Law promulgated by the Court.²⁶³

Many of the services typically provided by debt settlement companies fall under this broad definition of the practice of law. Evaluating a consumer's financial circumstances to determine whether debt settlement is an advisable plan, negotiating with creditors on behalf of a consumer to achieve account settlements, and charging a contingency fee based on a percentage of the amount allegedly saved in settlement are all services that, in West Virginia, must be performed by a licensed member of the Bar.²⁶⁴ The ability to go after debt settlement providers who recklessly endanger consumers by offering unsound legal advice is an important tool in the Attorney General's fight to eliminate predatory debt settlement practices.

²⁵⁹ Testimony before the Texas State Legislature, Michael Kerr, Legislative Director, Nat'l Conference of Comm'rs on Unif. State Laws (June 29, 2010); Telephone Interview with Norman Googel, Deputy Attorney Gen., W. Va. Attorney Gen. Con. Prot. Div. (Jan., 4 2010).

²⁶⁰ W. VA. CONST. art. 8 §1; W. VA. CODE § 51-1-4(a) (2010).

²⁶¹ *Frieson v. Isner*, 168 W. Va. 758, 769 (1981).

²⁶² *Brammer v. Taylor*, 338 S.E.2d 207, 212 n.7 (W. Va. 1985) (emphasis in original).

²⁶³ W. VA. CODE § 51-1-4(a) (2010).

²⁶⁴ *CCCA Assurance*, *supra* note 222, at 5.

IV. THE ATTORNEY GENERAL'S STRATEGY IS THE BEST SOLUTION FOR WEST VIRGINIA

The Attorney General's strategy and the UDMSA, although similar in many respects, are born of vastly different philosophies about the function and value of debt settlement providers to consumers.

The UDMSA is as much about facilitating the expansion of the debt settlement industry as it is about helping consumers avoid abuses. The NCCUSL exists, in large part, to help nationwide commercial enterprises avoid the confusion of multiple jurisdictions and conflicting legal requirements.²⁶⁵ The stated purpose of its product, the UDMSA, is to "rein in excesses" while permitting debt settlement companies to continue providing services without drastically altering their business model.²⁶⁶ Although the Uniform Act aims to, and succeeds in, providing genuine protections against the worst debt settlement practices, it is no secret that numerous industry trade groups took part in the drafting of the UDMSA and actively campaign for its promulgation in all states.²⁶⁷ At best, it is an effort to balance the competing interests of commerce and consumer protection that takes the commerce side of the equation quite seriously.

The West Virginia Attorney General's strategy weighs those factors differently. The Attorney General's primary duty is to the citizens of West Virginia, and while that duty includes the responsibility not to harm West Virginia's economy by hampering legitimate business interests, many debt settlement companies are neither legitimate nor substantial contributors to the local economy.²⁶⁸ Unlike the UDMSA, the Attorney General sides with consumer advocacy groups, like the National Consumer Law Center, who find the debt settlement model "inherently harmful" to consumers.²⁶⁹ Although tough financial times and the revised bankruptcy laws create a demand for debt counseling and management services, the Attorney General sees no reason to encourage or facilitate the expansion of the debt settlement industry.

Thus, for West Virginia and West Virginians, the Attorney General's comprehensive strategy for policing the debt settlement industry is the superior solution. By taking advantage of West Virginia's long tradition of aggressive

²⁶⁵ *About the NCCUSL*, NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, <http://www.nccusl.org>, (last visited Sept. 7, 2010).

²⁶⁶ Linfield, *supra* note 44, at 61; UNIFORM DEBT MANAGEMENT SERVICES ACT, Prefatory Note.

²⁶⁷ According to the official website of the UDMSA, the International Association of Professional Debt Arbitrators, the United States Organization's for Bankruptcy Alternatives, and the Association of Settlement Companies each are "participating in the adoption of the [UDMSA] for all 50 states." Official Website of the Uniform Debt Management Services Act, Links of Interest, <http://www.udmsa.org/links.htm> (last visited Sept. 7, 2010).

²⁶⁸ As of 2010, no debt settlement companies maintain physical offices in West Virginia, employ any West Virginians, or pay business taxes of any kind in the state.

²⁶⁹ NCLC REPORT, *supra* note 17, at 1; Telephone Interview with Norman Googel, Deputy Attorney Gen., W. Va. Attorney Gen. Consumer Prot. Div. (Jan. 4, 2010).

consumer advocacy and strong consumer protection laws and remedies, it maximizes the natural attributes that make West Virginia an unattractive environment for predatory schemes, while minimizing a company's ability to take advantage of consumers.

A. *The Debt Settlement Industry Cannot be Effectively Regulated by Laws that Focus Primarily on Debt Management Services or on the Debt Relief Industry as a Whole*

Historically, one of the great challenges in regulating the consumer debt relief industry has been in keeping up with changing business models.²⁷⁰ As the industry shifts from one paradigm to the next, laws tailored for older business models may become inapplicable or ineffective. One solution to this problem is to attempt comprehensive reform of the entire debt relief industry by employing broad and general protections and regulatory schemes that aim to bring a great number of existing and potential programs under its scope. Unfortunately, laws designed primarily to regulate DMPs or credit counseling programs are unlikely to provide ideal protection against abuses specific to the debt settlement industry.

This difficulty has led many consumer protection experts to the conclusion that the debt settlement industry must be regulated separately from the debt-relief industry as a whole.²⁷¹ On this point consumer advocates and at least one main industry trade group are in concurrence. Analysis of various regulatory models, including the UDMSA, has led the NCLC to unequivocally assert that "debt settlement practices should be separately regulated from debt management practices."²⁷² Somewhat more surprisingly, in a report created primarily to refute many of the claims made by the NCLC, the Association of Settlement Companies reached the same conclusion by bluntly acknowledging that the debt settlement model requires a unique solution.²⁷³

The UDMSA represents a prime example of such regulatory overbreadth. While the Uniform Act does, to a limited degree, draw distinctions between debt settlement and debt management providers, most of its provisions tend to treat the debt settlement model as something of an afterthought.²⁷⁴ In certain parts, "general" provisions become nonsensical when applied to the debt settlement context.²⁷⁵ Such internal inconsistency is indicative of the problems inherent in drafting a single act intended to regulate distinct business models.

²⁷⁰ See *supra* Part II.C for a discussion of the evolution of debt settlement services.

²⁷¹ NCLC REPORT, *supra* note 17, at 21.

²⁷² *Id.*

²⁷³ TASC STUDY, *supra* note 30, at 8.

²⁷⁴ NCLC REPORT, *supra* note 17, at 15.

²⁷⁵ For example, § 26(b) of the UDMSA requires a provider who elects to terminate an agreement to refund to a consumer any money held in trust for the consumers benefit, less any amount already credited toward settlement. In the debt settlement context, such a provision is absurd—by

Though the Attorney General's approach relies on laws not originally created for regulation of the modern debt settlement industry, its application, as evidenced in the various Assurances of Discontinuance, has been specifically tailored to deal with common abuses in the debt settlement industry, such as excessive fees, failure to provide refunds, and the unauthorized practice of law. It satisfies the need to anticipate future changes in the debt relief industry through flexibility and adaptability. Such strengths are a boon for consumers and legitimate industry alike—because the Attorney General's strategy is aimed uniquely at debt settlement, it places no additional cost or undue burden on responsible debt management or credit counseling agencies that do business in accordance with state and federal law.

B. The UDMSA Legitimizes the Debt Settlement Industry and Undermines the Attorney General's Current, Successful Approach

Passage of the UDMSA in West Virginia would force the State to officially acknowledge the legitimacy of any debt settlement company that facially complies with the terms of the Uniform Act, and would likely result in an increase in the number of debt settlement companies operating within its borders.

Although industry representatives are quick to blame rogue companies for debt settlement's bad reputation,²⁷⁶ many consumer advocates believe that even those providers that operate without deception are a bad deal—in financial terms—for most consumers.²⁷⁷ Though it has stopped short of declaring the debt settlement model unlawful, per se, the Attorney General's enforcement actions against companies providing debt settlement services in West Virginia are a powerful indictment of the legitimacy of the debt settlement industry as a whole. This position has been the Attorney General's trump card—fearful that the State might push even further, most debt settlement companies are willing to make aggrieved consumers whole.

Under the UDMSA, the Attorney General would no longer be able to leverage this position. Although the protections afforded by the UDMSA might be preferable to the status quo in some states, in West Virginia, it would completely undermine the successful approach currently in place. The Debt Pooling Statute, CSO Act, and unauthorized practice of law regulations would be preempted or rendered toothless by the UDMSA.

Further, the UDMSA would strip the Attorney General's strategy of its adaptability. Currently, when consumers report new types of abuses, the WVCCPA provides sufficient leverage to force debt settlement providers to voluntarily cease such activities. Under the UDMSA, instead of using the

its nature, no money can be so applied until settlement of an account is final. For a more detailed description of section 26(b), see *supra* Part III.A.3.

²⁷⁶ See TASC STUDY, *supra* note 30, at 2.

²⁷⁷ See *supra* Part II.D.3 for a discussion of the questionable value of the services provided by many debt settlement companies.

WVCCPA to force debt settlement companies to the bargaining table, the Attorney General would be limited to enforcing only those actions made explicitly unlawful by the UDMSA. This leaves consumers vulnerable because, as illustrated below, a UDMSA compliant debt settlement provider is not, in all circumstances, a harmless one.

C. The Terms of the UDMSA do not Provide Sufficient Protection for Consumers

There is reason to be concerned that the specific protections embodied in the UDMSA do not go far enough to protect consumers from abuses and ill-informed decisions to enter into debt settlement programs. Alternatively, the Attorney General's strategy offers many of the same protections as the UDMSA, while absolutely prohibiting certain harmful practices that the Uniform Act allows.

While the UDMSA makes an admirable attempt to limit the fees that debt settlement providers can extract from consumers, a company may be in total compliance with the Uniform Act while charging its customers excessive fees in return for relatively few services rendered. The UDMSA authorizes virtually every fee that unregulated debt settlement companies rely on, including simultaneous assessment of set-up, monthly maintenance, and settlement fees. Although the Act places caps on such fees, they are hardly insubstantial; they place a potentially unreasonable strain on a consumer's finances and increase the likelihood that the consumer will be unable to complete the program. And while the Act provides for an unconditional three-day right to cancel an agreement, it does not require a debt settlement company to provide refunds to consumers whose accounts are never settled.

Consider a hypothetical consumer who enrolls online in a debt settlement plan with \$20,000 worth of unsecured debt from five different creditors. The fees charged by his debt settlement provider are in total compliance with the UDMSA. Before any services whatsoever are rendered, he is assessed a \$400 set-up charge and a \$50 monthly fee.²⁷⁸ Over the next 18 months, while the debt settlement company simply "waits out" his creditors, he will owe upwards of \$900 in monthly maintenance fees while being expected to make regular contributions to the "reserve" account intended for settlement. When a monthly payment is late, he is assessed what amounts to a 50% penalty. If the consumer can fend off collection efforts and avoid lawsuits, and the accounts are finally settled for 50% of the principle balance, the company will collect an additional \$1600 settlement fee. If not, the debt settlement company is entitled to keep the fees for "services rendered." Even under the limits set by the UDMSA, it is unreasonable to believe that the sort of financially at-risk con-

²⁷⁸ Although the new FTC rules prohibit companies enrolling consumers over the telephone from charging advance fees, an Internet-based or face-to-face debt settlement provider is not subject to the ban. See *supra* Part II.F.

sumers targeted by the debt settlement industry will be able to complete a debt settlement program that imposes such fees.

On the other hand, through enforcement of the Debt Pooling Statute, the Attorney General's strategy bans up-front fees in all debt settlement agreements, which are most harmful because they limit the ability of consumers to save money towards paying their creditors before any actual savings have been realized. Unlike the fees allowed by the UDMSA, the monthly charges authorized under the Debt Pooling Statute are directly tied to the amount of money deposited by the consumer into the reserve fund. This insures that the consumer is actually building toward a realistic settlement, rather than squandering his limited resources on excessive fees. The company is not authorized to assess a settlement fee, a fraction of a sum that the client never possesses in the first place. Under this scheme, consumers are much more likely to complete a debt settlement program—a win-win scenario for debtors and creditors alike.

Aside from limiting fees, the main mechanism by which the UDMSA purports to protect consumers is through the imposition of an extensive disclosure regime. Under the Uniform Act, a debt settlement provider must make certain disclosures to the state through the registration process—financial statements, corporate officers, proof of accreditation and insurance, etc.²⁷⁹—and certain disclosures to consumers—termination rights, fee schedules, trust account information, and other relevant rights—before entering into an agreement.²⁸⁰ This seems to reflect the philosophy that an open deal is a fair deal.

The Attorney General's strategy rejects this notion and adheres to the philosophy that a raw deal, disclosed, is a raw deal. Consumer advocates have long suspected that mere disclosures provide inadequate protection for consumers, and recent empirical studies support their suspicion.²⁸¹ It is unrealistic to expect that consumers, particularly the cohort of consumers that tend to find themselves in debt crises in the first place, are able to fully comprehend the impact that a debt settlement plan will have on their personal financial fortunes, regardless of how clearly that plan is set forth.

²⁷⁹ See *supra* Part III.A.2 for a description of the UDMSA's registration requirements.

²⁸⁰ See *supra* Part III.A.3 for a description of the UDMSA's required disclosures.

²⁸¹ Paul O'Shea, *Consumer Credit Code Disclosure: Does it Work?*, 16 U. OF QUEENSLAND J. OF BANKING AND FIN. L. AND PRACTICE 5, available at <http://ssrn.com/abstract=1312963>. ("Since 1996 all consumer credit transactions in Australia have been regulated by the Consumer Credit Code. The principal means by which the Code purports to protect consumers and prevent market failure is a detailed and prescriptive disclosure regime. [Prior to this study] [t]here has been little empirical work done on whether or not such disclosure actually improves consumers' understanding of their credit contracts. By exposing participants to typical consumer credit documents, this research discovered quite poor comprehension of important features of the relevant transactions. Most significantly, there appeared to be little difference in comprehension when the consumers read contracts which complied with the disclosure requirements of the Code, and when they read contracts which did not. These results cast doubt on the effectiveness of the Code disclosure regime.").

Disclosure that “debt management plans are not right for all individuals”²⁸² means little to a debt-burdened consumer who has been bombarded by targeted advertisements, or spoken with a customer service representative who asserted otherwise. Disclosure that a debt settlement program may result in damage to a consumer’s credit rating is of little benefit when consumers have been promised that debt settlement will stop harassing collection calls. And what consumer, capable of fully comprehending such a disclosure, would agree to a provision that allows a debt settlement company to keep 100% of all set-up and monthly maintenance fees, regardless of whether a settlement is ever reached? The disclosure of a term that is harmful to consumers does not alter the fundamental wrongness of the practice, and to that extent, reliance on disclosure as a primary mechanism of consumer protection is a critical weakness of the UDMSA.

Other issues, either overlooked or unanticipated in the drafting of the Uniform Act, are also cause for concern. Although the UDMSA does cover “agents” and “affiliates” of debt settlement providers²⁸³ the failure to explicitly include “leads generators” opens the door to abuses from companies who are not themselves debt settlement companies, but merely advertise, perform intake functions, and pass on consumers to a third-party debt settlement provider. The same is true for so-called “escrow” companies, who provide substantially the same services as debt settlement providers but may be able to escape regulation under the UDMSA definitions. The UDMSA also fails to adequately address the problems caused by the use of licensed attorneys to avoid state regulation or to lead consumers to believe that threatened litigation, garnishments, or other issues are being handled by an attorney, when no such services are in fact provided. Finally, the UDMSA does little to curb the use of deceptive advertising, particularly claims about success rates and misleading allusions to fictitious government programs.

In general, to the extent that the UDMSA does offer valuable consumer protections, any such protection is substantially replicated, or strengthened, by the Attorney General’s strategy.

D. Enforcement of the UDMSA is Inferior to Enforcement Under the West Virginia Strategy

It is not yet clear how enforcement of the UDMSA will fare in practice, as it has only recently gone into effect in the states that have already adopted it.²⁸⁴ On paper, however, enforcement under the Uniform Act appears to be a rather cumbersome and potentially ineffective process.

²⁸² Uniform Debt Management Services Act §17(e)(1).

²⁸³ *Id.* at § 2(2).

²⁸⁴ As of October 2010, no opinions directly involving the UDMSA (as implemented by any state) have been published.

In most states, implementation of the UDMSA will require the creation of a new agency tasked with registering providers, investigating claims, and enforcing remedies. In a “legislative note” to Section 1 of the Act, the drafters suggest that choices for the “administrator” of the Act might logically include the Attorney General or other agency tasked with consumer protection responsibilities.²⁸⁵ In West Virginia, finding a staff capable of taking on the bureaucratic responsibilities of the Act would likely require the creation of an entirely new branch of the Consumer Protection Division. Creation of such a department would come at no small expense.

On its surface, the UDMSA seems to grant the administrator (in whatever form it may take) fairly broad enforcement powers.²⁸⁶ The administrator is responsible for investigating claims of non-compliance “by subpoena or otherwise.”²⁸⁷ If the investigation supports such action, the administrator may issue cease-and-desist orders, order restitution to an aggrieved party, or impose a civil penalty of up to \$10,000 per violation.²⁸⁸ The administrator may also initiate a lawsuit in state court.²⁸⁹

Upon closer examination, however, these powers appear relatively weak. The subpoena power mentioned under the Act is vague, and might be rendered ineffectual by state court rulings generally limiting the scope of investigative subpoenas by state agencies.²⁹⁰ And like any administrative agency, the administrator of the UDMSA would be powerless to enforce its own decrees.²⁹¹ Undoubtedly, some debt settlement companies, right or wrong, will refuse to voluntarily comply with an order, and the administrator will be forced to find a judge willing to enforce it. The Act specifically provides for affirmative “good faith” defenses to alleged violations, an exception that cries out for judicial interpretation.²⁹² Debt settlement companies, well-versed in litigation, will challenge these weaknesses, which will increase the costs to the state and delay justice for consumers.

In sharp contrast, the West Virginia Attorney General has developed a relatively quick, low-cost, litigation-free method for enforcing its legal positions. As described above, investigations of debt settlement claims are handled as part of the same basic mechanism by which any claim of consumer fraud is initiated.²⁹³ Under West Virginia law, the Attorney General’s subpoena power

²⁸⁵ Uniform Debt Management Services Act §2 (legislative note accompanying draft).

²⁸⁶ See *supra* Part III.A.5 for a summary of the UDMSA’s enforcement mechanisms.

²⁸⁷ Uniform Debt Management Services Act § 32(b).

²⁸⁸ *Id.* at § 33(a)(1)–(3).

²⁸⁹ *Id.* at §33(a)(4).

²⁹⁰ See *Hoover v. Berger*, 483 S.E.2d 12 (W. Va. 1996).

²⁹¹ See *id.*

²⁹² Uniform Debt Management Services Act §§ 33(e), 35(f) (2008).

²⁹³ See *supra* Part III.B.1 for a discussion of the procedure by which the Attorney General investigates consumer claims.

is broad, and courts have generally been willing to enforce it.²⁹⁴ In addition, when enforcing the WVCCPA, the Attorney General enjoys a special standard of review for procuring temporary injunctions.²⁹⁵ When an investigation unearths credible evidence of crimes against West Virginia consumers, the Attorney General uses these powers to bind the offending company to a favorable Assurance of Discontinuance.

The Attorney General prefers the use of Assurances of Discontinuance because they provide great leverage in setting the terms of the settlement, and lay the groundwork for future legal action should the agreement be violated.²⁹⁶ Companies prefer Assurances of Discontinuance because they typically do not include punitive damages and generate less publicity than extended court battles. Both sides are happy to avoid costly litigation, and because the assurances are mutually agreed upon, they typically do not require court enforcement. The civil penalties available under West Virginia law, particularly the WVCCPA, provide ample leverage with which to convince debt settlement companies to meet the Attorney General's demands.

Assurances of Discontinuance also take advantage of West Virginia's position in the national marketplace. Though West Virginians struggle with debt as much as the citizens of any other state, in absolute terms they comprise a relatively small market. Through industry trade groups, debt settlement companies keep well apprised of one another's legal battles. Where companies see a small market with an aggressive enforcement agency, they are less willing to take on the costs of expensive litigation. Thus, at least until the market shifts, the industry has shown little inclination to challenge the Attorney General's position as expressed through the Assurances.

E. The Attorney General's Strategy Works Best with the Federal Trade Commission's Recent Debt Settlement Regulations

As discussed above,²⁹⁷ new FTC rules governing the debt settlement industry went into effect in the fall of 2010. This series of amendments to the 1995 Telemarketing Sales Rule extends a number of important new protections

²⁹⁴ See *W. Va. Human Rights Comm'n v. Moore*, 411 S.E.2d 702, 707 (W. Va. 1991); *Palumbo v. Graley's Body Shop*, 425 S.E.2d 177, 186 (W. Va. 1992).

²⁹⁵ *McGraw v. Imperial Mktg*, 472 S.E.2d 792, 794 (W. Va. 1996). ("The method of analysis which governs the propriety and scope of an injunction under W. Va. Code 46A-7-110 (1974) deviates from the customary standard for the issuance of temporary relief and may best be described as whether the Attorney General has shown by the existence of some credible evidence, even if disputed, that reasonable cause exists to believe that the respondent is engaging in or is likely to engage in conduct sought to be restrained.")

²⁹⁶ See *supra* Part III.B.1 which explains that while a party bound to an Assurance of Discontinuance typically does not admit guilt, subsequent violation of the terms of the agreement may constitute prima facie evidence of the party's guilt in an action initiated by the Attorney General.

²⁹⁷ See *supra* Part II.F.

to consumers, but in contrast to the UDMSA, the new FTC rules work with, rather than against, the Attorney General's strategy.

First, the FTC's recognition of the seriousness of the debt settlement problem strengthens the Attorney General's stance against the industry. As discussed above, consumer advocates have long been hindered by the lack of publicly available information about debt settlement companies. During the investigation and comment period leading up to the finalization of the TSR amendments, however, the FTC collected and reported on a wealth of data, much of which derived directly from the industry itself.²⁹⁸ This data is now available to the Attorney General and will fuel its litigation in the future. Additionally, federal acknowledgement of the particular problems posed by up-front fees is likely to be persuasive to judges considering the broader ban imposed under West Virginia law.

Second, the protections offered by the FTC rules reduce the incentive for West Virginia to legitimize the debt settlement industry by adopting the UDMSA. The Uniform Act proposes a trade off: in return for licensing and accepting the industry, it offers some protection. Thanks to the FTC rules, West Virginians can enjoy structured protections²⁹⁹ against the industry's worst abuses without recognizing the legality of the industry as a whole.³⁰⁰ And although their effect remains to be seen, the FTC rules will likely provide stronger protection for consumers as evidenced by the industry's strong preference for the UDMSA.³⁰¹

Finally, the Attorney General's strategy and the new FTC rules can work together as a comprehensive ban on the worst debt settlement abuses. As discussed above, the FTC rules are a powerful tool, but they apply only to transactions conducted over the phone. In UDMSA states, consumers will still be susceptible to companies that adapt to provide services via the Internet or through face-to-face transactions. In West Virginia, the CSO Act, Debt Pooling statute, and laws governing the unauthorized practice of law can fill the gaps left by the FTC rules, while providing a flexible shield against whatever tactics the industry may develop in the future.

²⁹⁸ An index of every comment or filing in response to the proposed TSR amendments is available at <http://www.ftc.gov/os/comments/tsrdebtrelief/index.shtm>.

²⁹⁹ Including disclosure requirements, prohibition of common misrepresentations, the advance fee ban, and other protections. *See supra* Part II.F.

³⁰⁰ Goodman, *supra* note 54.

³⁰¹ United States Organizations for Bankruptcy Alternatives, *In the Matter of Telemarketing Sales Rules – Debt Relief Amendments*, COMMENTS OF THE UNITED STATES ORGANIZATIONS FOR BANKRUPTCY ALTERNATIVES, Oct. 26, 2009, at 16.

V. CONCLUSION

As long as Americans, young and old, have access to ever-increasing levels of personal credit, many consumers will continue to struggle under the burden of unmanageable debt. And wherever there is consumer debt, companies such as today's debt settlement providers will spring-up, tempting beleaguered consumers with too-good-to-be-true promises of financial freedom. There will always be a Roger, and debt settlement will always seem like a good idea.

History has shown us that when consumers are most desperate, abuses abound. The concept underlying the modern debt settlement industry is nothing new, and unfortunately, neither are its attendant problems. Today, many debt settlement providers are guilty of numerous deceptive or unfair practices that can be extremely harmful to consumers. In marketing their services, debt settlement companies make unfounded claims about the services they offer, and fail to disclose details about their programs that are critical in order for consumers to make informed, beneficial decisions. These companies often charge exorbitant fees while failing to provide services of any real value to consumers. Debt settlement companies advise consumers to stop paying their creditors, resulting in ruined credit and even greater hardship for the majority of consumers who are unable to complete a debt settlement program. They encourage consumers to avoid bankruptcy even when bankruptcy is a better option, and they fail to inform consumers about the potential tax consequences of the debt settlement program.

Clearly, some form of regulation is needed. The National Conference of Commissioners on Uniform State Laws recognized this when it created the Uniform Debt Management Services Act, a comprehensive regulatory plan for the debt management and debt settlement industries. The UDMSA creates extensive registration requirements, mandates certain disclosures, limits fees, and provides remedies for aggrieved consumers. The Uniform Act, however, is not strictly a consumer protection measure. In keeping with the purposes of the NCCUSL, the UDMSA exists in large part to facilitate the expansion of the debt settlement industry. As a result, in many instances, the UDMSA often does not go far enough to protect consumers from common abuses.

In West Virginia, the Attorney General has also recognized the problems posed by predatory debt settlement providers, and has addressed it by developing its own comprehensive strategy for regulating the industry under existing state and federal laws. Through enforcement of the Debt Pooling Statute, Credit Services Organizations Act, the rules and regulations governing the unlicensed practice of law, and various provisions of the West Virginia Consumer Credit and Protection Act, the Attorney General has successfully forced unscrupulous debt settlement providers into Assurances of Discontinuance under which the companies make restitution to consumers and agree to cease their harmful practices.

For many reasons, the Attorney General's strategy is a far better fit for West Virginia than the UDMSA. Unlike the Uniform Act, it is specifically tailored to the unique problems posed by debt settlement providers rather than the debt management industry as a whole. It offers practically every substantive protection available under the UDMSA, while prohibiting certain harmful practices that the Uniform Act allows. Under the UDMSA, the administrator has relatively weak powers of enforcement. The West Virginia Attorney General, on the other hand, has developed a relatively quick, low-cost, litigation-free, and effective method for enforcing its strategy. Finally, the Attorney General's approach is flexible, adaptive, and more compatible with federal efforts to regulate the debt settlement industry.

The UDMSA is a potent, much-needed, and well-reasoned solution to many of the problems created by the debt settlement industry, and may be the best available option in many jurisdictions. However, in West Virginia, adoption of the UDMSA would force the Attorney General to affix its imprimatur to an industry that it finds to be inherently harmful to consumers. It would likely result in an increase in the number of debt settlement companies doing business in the state. It would undermine existing strategies that have served the citizens of the state well, and most importantly, it would reduce the protections available to desperate and vulnerable consumers. West Virginia has long been a leader in consumer protection. If the Legislature seeks to continue in this tradition, with respect to the debt settlement industry, it would be well-served not to "settle" for the UDMSA.

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