

Staying on the Right Side of the Law: A Legal Road Map for Debt Settlement Companies

USOBA Summer Conference
July 21, 2006, 1:15 – 2:45 pm
Adam's Mark Hotel, Denver, CO

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Introduction

- The Laws that Apply to Debt Settlement Companies
- Historical Perspective
- Debt Adjusting Statutes
- Uniform Debt-Management Services Act (UDMSA)
- Recently Enacted/Amended State Debt Adjusting Statutes
- Credit Repair Organization Act and State Credit Services Organization Acts
- Federal Trade Commission Act
- Nine of the Most Important Things a Debt Settlement Company Needs to Know Stay on the Right Side of the Law
- Questions and Discussion

The Laws that Apply to Debt Settlement Companies

- State Debt Adjusting Statutes
- Federal Credit Repair Organizations Act and State Credit Services Organization Acts
- Check Seller/Bill Payer Laws
- Home Sales Solicitation Statutes
- FTC Act and State Unfair and Deceptive Acts/Practices Laws
- Unauthorized Practice of Law
- Others

Historical Perspective

- **1950s** – About half of the states prohibited “debt adjusting” (e.g., prorating, debt pooling, debt management, etc.); approximately one third of the states regulated debt adjusting (imposing a variety of requirements); many state laws exempted tax-exempt 501(c)(3)s.
- **Today** – Nearly *all* of the states regulate debt adjusting; few exempt tax-exempt 501(c)(3)s; only two states prohibit “debt adjusting” for compensation; only 2 states and DC do not regulate debt adjusting. Additionally, there are *a number of other state laws* debt settlement companies must navigate (e.g., qualification to do business as foreign corporation, mini-FTC Acts, mini-Credit Repair Organization Acts, unauthorized practice of law restrictions, check seller/bill payer laws, etc.).

Comprehensive Federal and State Efforts to Regulate Debt Adjusting

- FTC and State Enforcement to Address Abuses of the late '90s and early '00s
- Federal Credit Repair Organizations Act (CROA)
- Ongoing IRS “Credit Counseling Compliance Project”
- Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (enforced primarily by EOUST)
- NCCUSL - Uniform Debt-Management Services Act
- Continuous and Rapid State Law Changes

Result of Importance and Growth of Credit Counseling Industry and Consumer Debt



48 States



Debt
Adjusting
Laws



Virtually all of
these laws apply
based on the
state of
residence of the
client.

Debt Adjusting Statutes

48 States

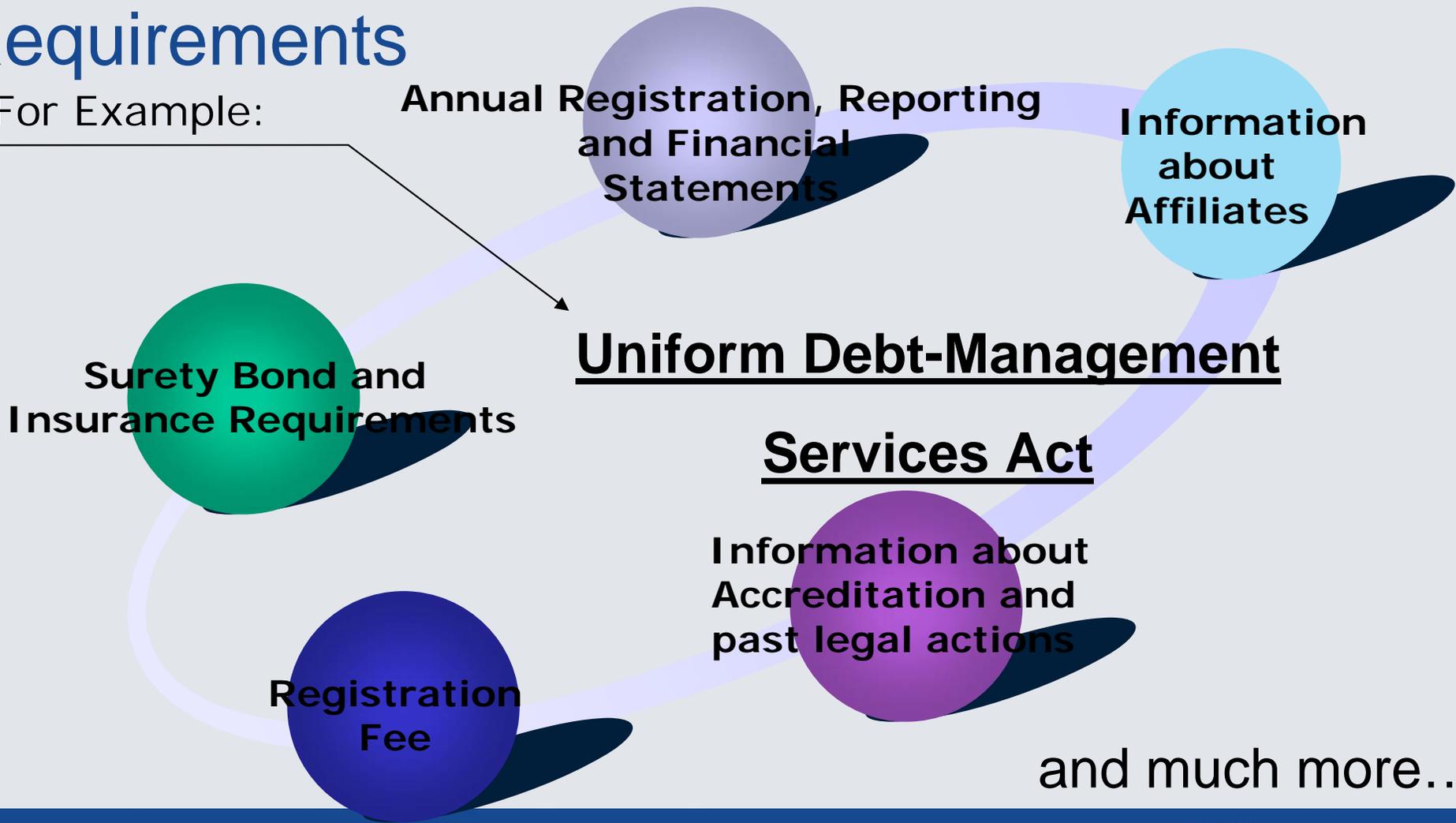
**Exemptions
and Exclusions**

A debt settlement company that services clients nationally in the U.S. must typically register and/or obtain licensure in approx. 30 different states before it starts to provide negotiation services to clients in these states.

Vary from state to state (in some cases, depends on whether debt settlement company touches or controls client funds destined for creditors.

Typical State Debt Adjusting Registration Requirements

For Example:



Violations of State Debt Adjusting Statutes

- Common failures to adhere to specific statutory requirements include:
 1. Licensure/Registration, if applicable
 2. Fee Caps
- Using unfair or deceptive acts or practices or engaging in fraudulent conduct that creates a likelihood of confusion or misunderstanding.

State Debt Adjusting Statutes Fines and Penalties

Example - UDMSA



The law authorizes the imposition of restitution and penalties of up to \$10,000 per violation (or more). In addition, the law authorizes private remedies against debt settlement companies not registered under the Act (e.g., actual and punitive damages and attorneys fees). (Some violations of debt adjusting statutes carry criminal penalties.)

Uniform Debt-Management Services Act

- Effective July 1, 2007 in Utah (amends provisions of UT CSOA); Effective March 31, 2007 in Rhode Island; Effective January 17, 2007 in Delaware.
- In 2006, introduced progressed through the legislative process in Colorado, Illinois, Missouri, and Nebraska.
- Study Committee in Wisconsin
- Roadmap for other states to either adopt/amend and/or interpret existing debt adjusting statute

Uniform Debt-Management Services Act

- Regulates debt-management companies by requiring them to register with the state.
- To obtain a certificate of registration, a provider must supply information about itself, obtain insurance against employee dishonesty, and post a surety bond to safeguard any money that it receives from individuals for payment to creditors.

Uniform Debt-Management Services Act

- Regulates interaction with consumers, including steps to be taken before entering into an agreement with an individual, the content of an agreement (including limitations on the fees that may be charged), and provisions concerning the performance and termination of agreements.
- Includes broad prohibitions applicable to debt settlement companies.
- Enforcement both by a state agency and by private individuals, including rule-making authority on the part of the administrator and recovery of minimum, actual and, in appropriate cases, punitive damages in private enforcement actions (e.g., class actions).

UDMSA: Prohibited Acts and Practices

A provider may not, directly or indirectly:

- Misappropriate funds held in trust.
- Take power of attorney that authorizes or settle a debt for more than 50 percent of the principal amount owed a creditor, unless the individual agrees to the settlement after the creditor agrees.
- Exercise the power of attorney after an individual has terminated the agreement.
- Compensate an individual for executing an agreement.
- Compensate a person for referring a prospective customer, if the person making the referral has a financial interest in the outcome, unless neither the provider nor the person making the referral communicates to the prospective customer the identity of the source of the referral.
- Receive a bonus or commission, or other benefit for referring an individual to a person.
- Compensate employees on the basis that includes the number of individuals enrolled into agreements.
- Perform legal services.
- Settle a debt unless, at the time of settlement, the individual receives a certification by the creditor that the payment is in full settlement of the debt.

UDMSA: Prohibited Acts & Practices (cont'd)

A provider in connection with a DMP (including debt settlement plan) may not directly or indirectly:

- Purchase a debt or obligation of the individual.
- Lend money or provide credit to the individual, except as a deferral of a settlement fee at no additional expense to the individual
- Obtain a mortgage or other security interest from any person in connection with the services provided to the individual.
- Except as permitted by federal law, disclose the identity or identifying information of the individual or the identity of the individual's creditors, except to:
 - the administrator, upon proper demand;
 - a creditor of the individual, to the extent necessary to secure the cooperation of the creditor in a plan; or
 - the extent necessary to administer the plan.
- Charge the individual for or provide credit or any other matter (*i.e.*, insurance, coupons for goods or services, membership in a club, access to computers or the Internet) not directly related to debt-management services or educational services concerning personal finance.
- In addition, the UDMSA prohibits providers from receiving compensation for performing certain specified services for a third party and, subject to set criteria, from purchases from affiliates of the provider under certain conditions.

UDMSA: Advertising

- The UDMSA requires providers to make certain disclosures when advertising. The required disclosures include the impact of debt-management services on credit ratings and the likelihood of collection efforts in an easily comprehensible manner. Under the UDMSA, a third party advertiser on behalf of a provider is viewed as an agent, and the provider can be liable if the advertisement fails to comply with these requirements.

UDMSA: Liability for the Acts of Third Parties

- The provisions of the UDMSA impose duties and obligations on providers and on independent contractors, if they fall under the definition of provider, or as a person that caused the provider to violate the UDMSA.

UDMSA: Fee Restrictions

- Minimum education is to be provided free.
- If the provider is a debt settlement company a set-up fee not-to-exceed 4% of the principal amount of the debt in the plan at inception, is allowed, but no more than \$400 may be charged.
- An individual that does not enter into a plan may be charged for educational and counseling services a fee not exceeding \$100 or a greater amount as approved by the administrator.
- A provider that provides both debt-management and debt settlement services may not charge more than one set-up fee (based certain specified criteria) and up to the maximum monthly fee allowed, as specified.
- A debt settlement provider may charge a settlement fee of 30% of the excess of the principal amount of the debt over the amount paid the creditor, but, subject to specified criteria, it must be off set by the setup fee and monthly fees already charged the individual. (Delaware is 15%)

Recently Enacted/Amended State Debt Adjusting Statutes

- Florida
- Iowa
- Mississippi
- Montana
- North Carolina
- Rhode Island
- Oregon
- South Carolina
- Texas
- Utah
- Delaware
- Others

Credit Repair Organizations Act

The Credit Repair Organizations Act became effective on April 1, 1997, and is directed to the credit repair industry.

The term "credit repair organization"—

- (A) means any person who uses any instrumentality of interstate commerce or the mails to sell, provide, or perform (or represent that such person can or will sell, provide, or perform) any service, in return for the payment of money or other valuable consideration, for the express or implied purpose of—
- (i) improving any consumer's credit record, credit history, or credit rating;
or
 - (ii) providing advice or assistance to any consumer with regard to any activity or service described in clause (i).

CROA: Full Disclosure

CROA requires full disclosure regarding consumer rights before any contract for credit repair services is executed. A written statement must be provided and signed by all prospective customers, and must be retained by the credit repair organization for at least two years after the statement is signed.

Consumers must be advised:

- They may dispute inaccurate information in their credit report by contacting the credit bureau directly.
- There is no right to have accurate, current, and verifiable information removed from a credit report unless it is over seven years old. Bankruptcy information can be reported for ten years.
- They have a right to sue a credit repair organization that violates the CROA.
- They have the right to cancel a contract with any credit repair organization for any reason within three business days from the date it was signed.

CROA: Written Disclosure

A written contract is also required and must:

1. specify the terms and conditions of payment, including the total amount of all payments to the credit repair organization or any other person
2. contain a full and detailed description of the services to be performed by the credit repair organization for the consumer, including:
 - (A) all guarantees of performance; and
 - (B) an estimate of the time required for the performance of the services
3. contain the credit repair organization's name and principal business address
4. contain a conspicuous statement in bold face type, in immediate proximity to the space reserved for the consumer's signature on the contract, which reads as follows: "You may cancel this contract without penalty or obligation at any time before midnight of the 3rd business day after the date on which you signed the contract. See the attached notice of cancellation form for an explanation of this right."

CROA: Prohibitions

The statutory scheme provides further protection for consumers with a list of prohibitions. CROA prohibits credit repair organizations, as well as their employees and agents, from:

- misrepresenting the organization's services
- making or enticing consumers to make untrue or misleading statements either to the credit reporting agencies or to the consumer's creditors
- advising consumers to attempt to change their credit identities
- accepting payment or other valuable consideration for their services in advance of fully performing those services.

CROA: Penalties

- CROA includes civil penalties for violations and procedures for administrative enforcement by both the FTC and the states.
- CROA includes a private right of action.

CROA: Waiver of Rights

A consumer cannot waive his rights under the CROA.

- Any waiver of any protection afforded by the CROA is treated as void, and contracts that are not in compliance with the Act's provisions may not be enforced by any federal or state court.

CROA has been applied to...

- **Law Firm** - *Iosello v. Lexington Law Firm*, 2003 U.S. Dist. LEXIS 14591 at *17-19 (N.D. Ill. Aug. 7, 2003)
- **Car Dealership** - *Wojcik v. Courtesy Auto Sales*, 2002 U.S. Dist. LEXIS 22731 at *21-26 (D. Neb. Nov. 25, 2002)
- **Financial services company** that "regularly advertised in local news media that it ... can 'restore your credit'"; *Parker v. 1-800 Bar None, A Financial Corp.*, 2002 U.S. Dist. LEXIS 2139 at *8-14 (N.D. Ill. Feb. 12, 2002)
- **Service to improve the consumer's credit record** - *Bigalke v. Creditrust Corp.*, 162 F. Supp. 2d 996, 997-98 (N.D. Ill. 2001)
- **Debt Collector** - *White v. Financial Credit Corp.*, 2001 U.S. Dist. LEXIS 21486 at *14-18 (N.D. Ill. Dec. 27, 2001), *but see Nielsen v. United Creditors Alliance Corp.*, 1999 U.S. Dist. LEXIS 13267 at *7-9 (N.D. Ill. Aug. 23, 1999)
- **Bank** - *Vance v. National Benefit Ass'n*, , 1999 U.S. Dist. LEXIS 13846 at *9-13 (N.D. Ill. Aug. 26, 1999)
- **Service for Improving Credit Rating** - *In re National Credit Mgmt. Group, L.L.C.*, 21 F. Supp. 2d 424, 457-58 (D.N.J. 1998)(applying the CROA to a credit repair and loan company that "represented that, for a fee, they will provide a service that will assist consumers in improving their credit ratings").

CROA and Debt Settlement Companies?

- In *Plattner v. Edge Solutions, Inc.*, 422 F.Supp.2d 969, 2006 WL 763651 (N.D. Ill. March 22, 2006) the court recognized, that "[w]hether [an apparent debt settlement] company is a credit repair organization under the CROA depends on the representations made [to consumers]." *Plattner*, 2006 WL 763651 at *4.
- *In re National Credit Mgt. Group, LLC*, 21 F.Supp. 2d 424 (D.N.J. 1998), wherein that court, in a case brought by the FTC, agreed with the FTC's position that certain educational and credit monitoring programs of a type offered by the credit counseling agency were governed by the CROA.

State Credit Services Organization Acts (CSOAs)

- $\frac{3}{4}$ of all states have CSOAs
- Broader Applicability
- Bonds
- Few Exemptions
- May have requirement inconsistent with typical debt settlement company business models
- Prohibition on advance payments
- Registration

Federal Trade Commission Act

- The FTC Act [15 U.S.C. §§ 41 *et seq.*] is a statute of more general application than the Credit Repair Organizations Act. It prohibits “unfair or deceptive acts or practices in or affecting commerce.” This general proscription applies to the operations of both credit repair companies and debt settlement companies.
- Credit counseling, debt settlement, credit repair organizations, and debt collectors have all come under the FTC Act enforcement umbrella.

Nine of the Most Important Things a Debt Settlement Company Needs to Know to Stay on the Right Side of the Law

- 1. Unless excluded or exempt, a debt settlement company needs to comply with the law of the debt adjusting statute of residence of its clients.**
- 2. Once licensed/registered, a debt settlement company needs to renew its registration annually and make any of the required ongoing filings and notifications to the state.**
- 3. Debt settlement companies should not ignore correspondence and/or subpoenas from federal or state regulatory agencies.**

Nine of the Most Important Things a Debt Settlement Company Needs to Know to Stay on the Right Side of the Law (*cont'd*)

4. Have a written client agreement with all prescribed disclosures, as well as fees that are set in accordance with applicable state fee restrictions.

5. Keep true and accurate financial records that clearly and accurately reflect all the money it collected, how it was collected, and how and when it was disbursed.

6. Registration/license materials must be accurate, complete and free of material falsifications, misrepresentations and omissions.

Nine of the Most Important Things a Debt Settlement Company Needs to Know to Stay on the Right Side of the Law (*cont'd*)

7. Include any *statutorily required* disclosure statements (including on all solicitations, contracts, marketing materials, and invoices/payment notices it issues) and avoid misrepresentations, omissions and misleading statements.
8. Ensure that its counselors are trained (and certified as *statutorily required*) and that they give *truthful* and *complete* answers about the effect of enrolling in a debt settlement program on a consumer's credit report and score.
9. A debt settlement company and its directors, officers and employees must not engage in any prohibited conduct detailed in the various state debt adjusting statutes, when applicable.

Questions and Discussion

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